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MITSloan MARKETING

15.810
Course Introduction

Marketing Management
Prof. Natalie Mizik

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What is Marketing?

- **Marketing is the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large (AMA 2007)**

- *Marketing is an organizational function and a set of processes for creating, communicating, and delivering value to customers and for managing customer relationships in ways that benefit the organization and its stakeholders (AMA 2004)*

- "Everything starts with the **customer**"
  - Lou Gerstner, CEO of IBM 1993-2002

- "Creating shareholder wealth is not the purpose of the business. It is the reward for creating **customer value**"
  - Tracy and Wiersema in CFO magazine

- "My own biggest mistake in the last 20 years was that sometimes I designed solutions for problems that people didn't yet know they had. That's why some of the things that could've made a difference couldn't find a market"
  - Bill Joy the 'Edison of the Internet'

- To achieve organizational goals by determining the needs and wants of **customers** and delivering the desired benefits more effectively and efficiently than **competitors**

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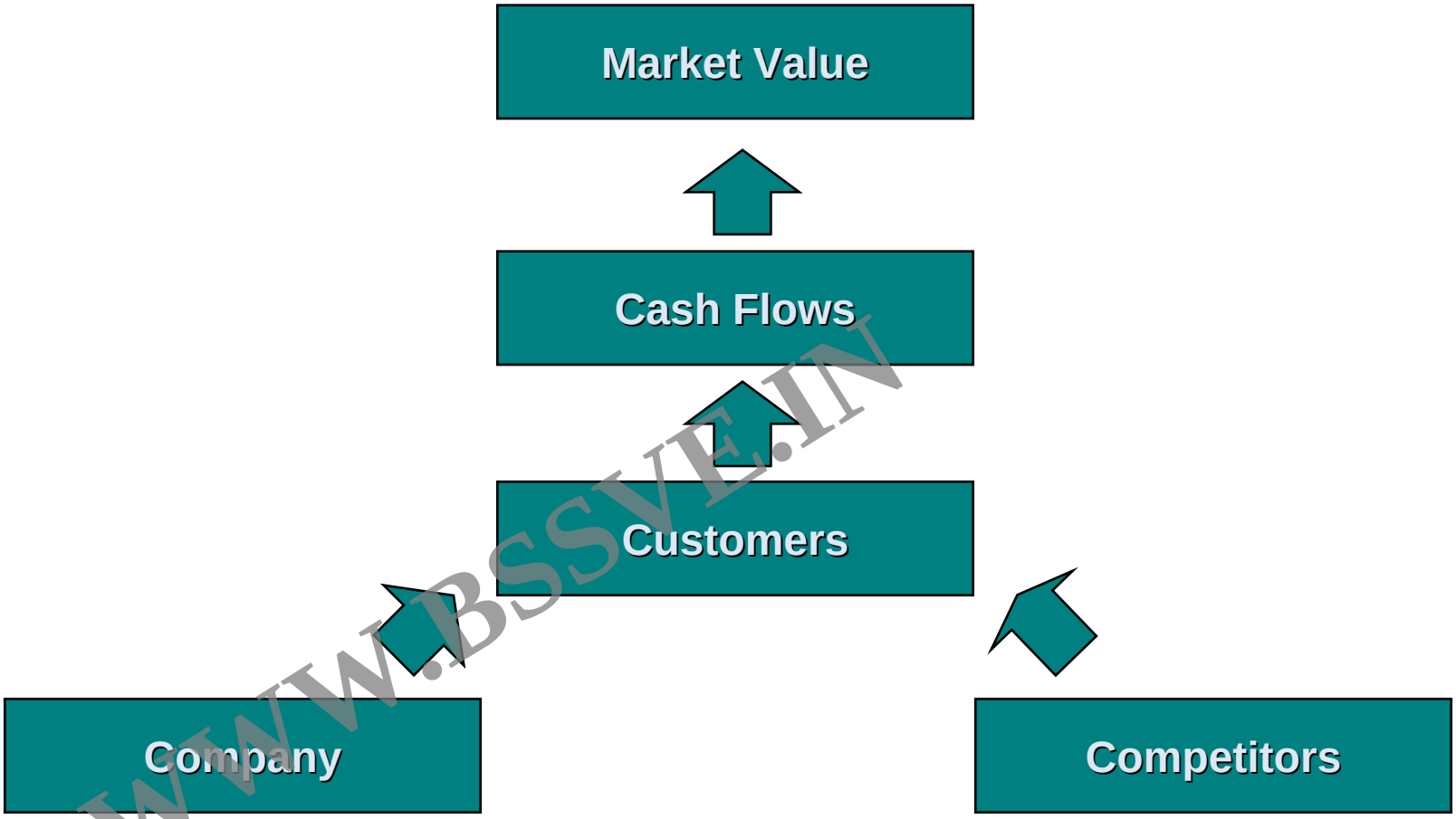
Importance of Marketing



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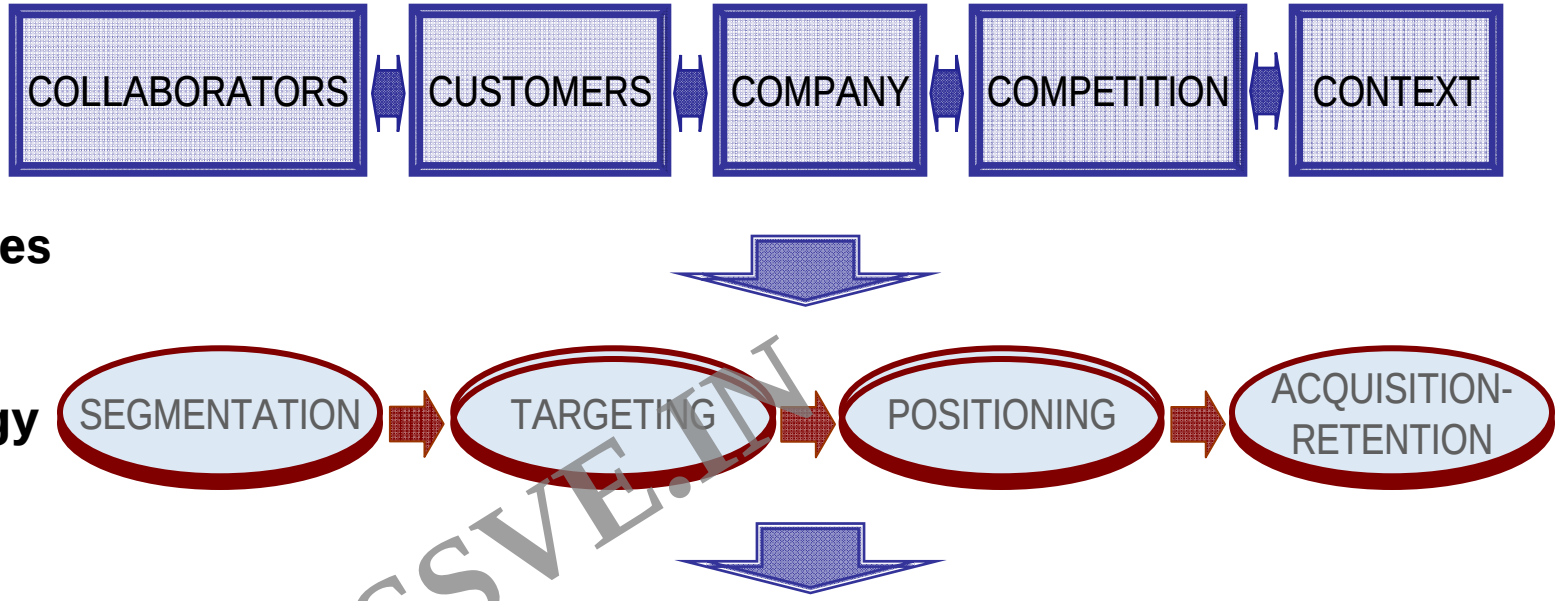
Course Objectives and Structure

I. Situation Analysis: Identify Market Opportunities (5Cs)

II. Set Strategy (STP)

III. Formulate Marketing Programs (4Ps)



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15.810 Course Structure:

I. Analyzing Markets and Identifying Opportunities

Session Date	Topic	Case/Readings	Assignment
1. Sept 8	Introduction and Company Analysis	**Case: Federal Express (B)** Read: "Note on Marketing Strategy" Read: "Basic Quantitative Analysis for Marketing" Read: "Analyzing Marketing Problems and Cases"	
2. Sept 13	Competitive Analysis	**Case: American Airlines (A)** Skim: "Managing the Competition" Read: "How to manage an aggressive competitor"	Marketing Survey due by 7:00 pm
3 Sept 15	Customer Analysis I	Read: "To Understand Your Customers, You Have to Know How they Think" Read: "A Nobel That Bridges Economics and Psychology"	HW Assignment 1
4. Sept 20	Customer Analysis II & III: Value to the Customer and Customer Lifetime Value	Read: "Economic Benefits and Value Creation" Read: "Zero Defections: Quality Comes to Services" Read: "Customers As Assets"	

II. Developing Marketing Strategy

5. Sept 22	Developing Mkt Strategy	**Case: Aqualisa Quartz: Simply a Better Shower**	
6. Sept 27	Segmentation, Targeting and Positioning	Skim: "Segmentation and Targeting Analysis" Skim: "Value Proposition and Positioning"	HW Assignment 2
7. Sept 29	EVC-Based Strategy	**Case: Optical Distortion, Inc.**	
8. Oct 4	STP-based Strategy and **IBS**	**Case: Harrah's Entertainment Inc.** Read: "The Worst of all Bets" Read: "Betting Your Life on It" Read: "Behavioral Addictions"	HW Assignment 3
9. Oct 6	IBS, Social Responsibility and Marketing	**Speaker: Ron Gonen** (Founder and CEO, RecycleBank)	
Oct 11	No class	*Columbus Day holiday*	No class
10. Oct 13	Branding	Read: "How do Brands Create Value?" Read: "How to Better Value Branded Businesses"	
Oct 18-22	SIP	**October 18-22 SIP**	No class
11. Oct 25	Developing Mktg Strategy for Innovation	**Case: Sonance (A)**	Case Write-up due by 10 am

III. Formulating Marketing Programs

Session Date	Topic	Case/Readings	Assignment
12. Oct 27	Product	Read: "Product Development: A Customer-Driven Approach" Read: "First-Mover Disadvantage"	
13. Nov 1	Mktg Products for Multi-Sided Demand Markets	**Case: Massive Inc.** **Speaker: Katherine Hays** (CEO, GenArts, Inc., former COO and CFO of Massive Inc.)	HW Assignment 4
14. Nov 3	Price	**Case: Medicines Co** Read: "Pricing Opportunities" Read: "Ethical Issues in Pricing"	
15. Nov 8	Promotion	Read: "Who Benefits from Price Promotion?" Read: "Marketing Communications and Customer Response" **Speaker: John Gerzema** (CIO, Young&Rubicam)	Final Project Proposal
16. Nov 10	Distribution	**Case: Rohm and Haas (A)** Read: "Aligning Incentives in Marketing Channels"	

IV. Special Topics

17. Nov 15	International Market Entry	**Case: Citibank: Launching the Credit Card in Asia Pacific (A)**	
18. Nov 17	International Branding	**Speaker: Juan J. Alfonso** (Vice President, Marketing & Program Development, ESPN International)	
19. Nov 22	Course Summary	Read: "The Cost of Myopic Management" Read: "Myopic Marketing Management"	
Nov 24	No Class	Thanksgiving	
20. Nov 29	Team Presentations	Read: "Building a Marketing Plan"	
December 1		Final Projects Due	Final Project

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What You Will Learn

What to do

A. Frameworks to develop and evaluate marketing strategy.

1. Analysis (**C**ompany, **C**ompetitors, **C**ustomers, **C**ontext, **C**ollaborators: **5Cs**)
2. **S**egmenting, **T**argeting, **P**ositioning (**STP**)

B. Analytical tools

1. Value of products (**EVC**)
2. Value of customers (**CLV**)
3. Value of brands (brand equity)

C. Marketing assets

1. Customers
2. Brands

How to do it

A. Developing marketing programs (**P**roduct, **P**lace, **P**rice, **P**romotion: **4Ps**)

B. Strategy implementation

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Why it will help you

- **Marketers**—gateway course, basic intro to marketing (take electives!)
- **Entrepreneurs**—framework for identifying and exploiting market opportunities
- **Consultants**—strategic framework and tools to facilitate firm decision-making
- **Financiers**—where cash comes from, alternative approaches to valuation

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15.810 Course Logistics

- In-class requirements
  - Name tents, stable seating
  - Effective participation
  - No laptops or wireless devices – print out your analysis before the class
- Course requirements
  - Four individual Homework assignments
  - One case write-up in groups of 4 (“Sonance” due Session 11)
  - In-class group presentation, Session 20
  - Final group project, Session 20

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Course Special Elements

- Ethics/ Individual, Business & Society
  - Throughout, but an emphasis on
    - Harrah's – privacy issues and marketing to vulnerable audiences

- Bridging Theory and Practice
  - Throughout, but an emphasis on Developing an Integrated Marketing Strategy

    Juan J. Alfonso (VP, ESPN International)

    John Gerzema (CIO, Young&Rubicam)

    Ron Gonen (Founder and CEO, RecycleBank)

    Katherine Hays (CEO, GenArts)

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Customer Analysis I

Session 3

Marketing Management

Prof. Natalie Mizik

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Outline

- How do you think about customers?
- How do customers think?
  - Overview of approaches.
  - Focus on behavioral economics.
    - Useful in understanding many marketing phenomena.
    - Alternative to ‘rational’ and ‘motivational’ approaches.

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The Consumer Quiz

- Asked you to estimate common marketing statistics
- Measured your confidence in these estimates
- **Results?**

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Key Learning

- You are not alone: Executives, MBA students in other schools make similar errors.

- Why do people make these "mistakes"?
  - **False consensus:** believe that the others are more like yourself than they really are
  - **Overconfidence:** people believe that they are right more often than they really are

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How do you prevent this?

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Implications for Marketing:

- You are a member of (at most) one segment
- Possible Solution:
  - Customers *must* provide the data, do not rely just on your intuitions
  - Globally, mktg research is essential
- Overconfidence keeps you from seeing this
- Possible Solution:
  - Diverse teams and involving customer inputs at every stage

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How Customers Think

- A continuum of views:

Rational Approaches	Bounded Rationality	Motivational Approaches
Standard Economic Theory	Behavioral Economics and Behavioral Decision Theory	Freudian and Anthropological Approaches

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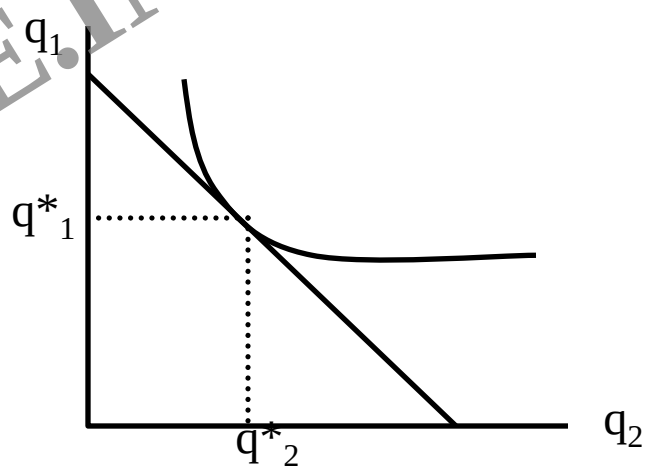
The Standard Economic Theory

- Customers assess options relative to their net worth

- Pick the best option to maximize utility subject to budget constraint



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Motivational Approaches

- People are less than rational, driven by unconscious and uncontrolled motivations
- Best studied by observation
- Examples of motivational approaches
  - For the ladies: Diet Coke (USA)
  - For the fellas: Tuborg beer
  - Fear appeal: Aussie underpants
  - Fear appeal: More Australian underpants (Underdaks)
  - Fear appeal: Philippines anti-smoking

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Behavioral Approaches

- People, because of limited processing capacity, use simplified ways of making decisions

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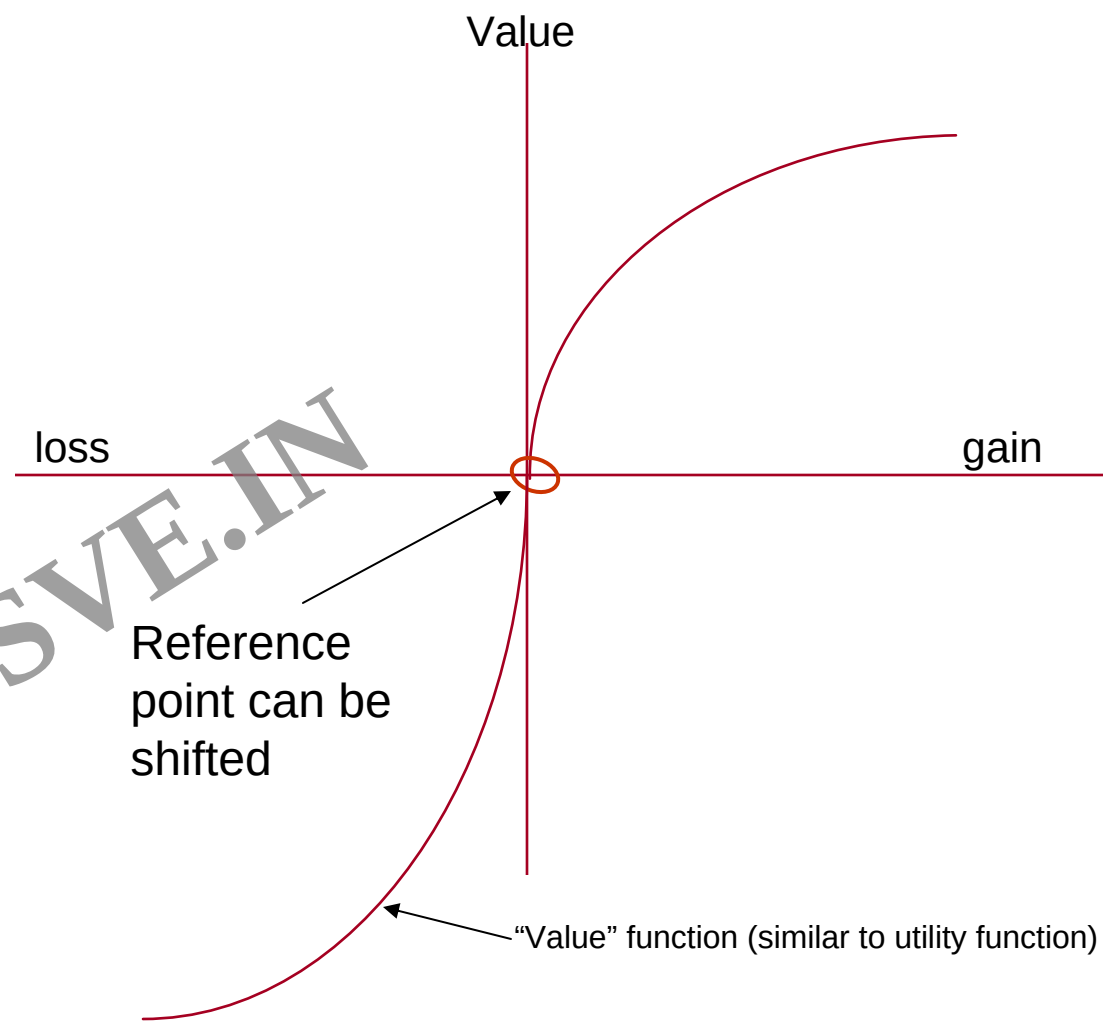
Behavioral Approaches: Prospect Theory

- Value is judged relative to a reference point
- Losses loom larger than gains

(estimates range 2.0-2.5)

- Diminishing sensitivity



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Three concepts from PT

- Reference pricing
- Framing
- Loss aversion

Do these apply to you?

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A beer at the beach…

Reference Price Matters

You are lying on the beach on a hot day. All you have to drink is ice water. For the last hour you have been thinking about how much you would enjoy a nice cold bottle of your favorite brand of beer. A companion gets up to go make a phone call and offers to bring back a beer from the only nearby place where beer is sold, [a fancy resort hotel] [a small, run-down grocery store]. He says that the beer might be expensive and so asks how much you are willing to pay for the beer. He says that he will buy the beer if it costs as much or less than the price you state. But if it costs more than the price you state he will not buy it. You trust your friend and there is no possibility of bargaining with the [bartender] [store owner]. What price do you tell him?

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	Hotel	Store
CBS 2009	9.38	7.40

Cornell MBA's 1985
Store: $1.50
Hotel: $2.65

Your Answers:
$ 7.29
$ 9.21

Different Frames, Same Alternatives.

A large car manufacturer has recently been hit with a number of economic difficulties and it appears as if three plants need to be closed and 6,000 employees laid off. The vice president of production has been exploring alternative ways to avoid this crisis. She has developed two plans:

Gain Frame:

- **PlanA :** This plan will save one of the three plants and 2,000 jobs.
- **Plan B:** This plan has one-third probability of saving all the three plants all 6,000 jobs but has a two-thirds probability of saving no plants and no jobs.

Loss Frame:

- **Plan C:** This plan will result in the loss of two of the three plants and 4,000 jobs
- **Plan D:** This plan has two-thirds probability of resulting in the loss of all of the three plants and all the 6000 jobs, but has one-third probability of losing no plants and no jobs.

Your answers:

Gain	Loss
A: 79%	**C: 67%**
B: 21%	**D: 33%**

	Gain Frame		Loss Frame	
	Plan A	Plan B	Plan C	Plan D
CBS 2009	57	43	50	50

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Two simultaneous choices:

- Choose between:
  - a) A sure gain of $2,400
  - b) A 25 percent chance to gain $10,000 and a 75 percent chance to gain nothing.

And

- Choose between:
  - c) A sure loss of $7,500
  - d) A 75 percent chance to lose $10,000 and a 25 percent chance to lose nothing.

- Your answers:

First choice	Second choice
A: 72%	C: 24%
B: 28%	D: 76%

- **Notice:**
  risk aversion for gains,
  but
  risk seeking for losses.

	Decision 1		Decision 2	
	Plan A	Plan B	Plan C	Plan D
CBS 2009	65	35	20	80

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Applications of Prospect Theory

- Reference Price
- Defaults (Status Quo effects)
- Framing ("Mental Accounting")

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Applications of PT: Reference price

- Price increases hurt more than price decreases help
  - Dannon yogurt
- Impact of the List Price: **40% off !!!**
- Bad behavioral marketing: Teach people a reference price of zero, as did many dot-coms.
- Comparisons in infomercials

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Applications of PT: Rebates

- Rebates are particularly good because at the time of purchase they are seen as a gain, instead of the reduction of a loss (framing effect)
- Yet while they are almost as effective as price cuts in boosting sales, they have 'modest' (20-30%) redemption rates
- What does PT tell us about duration of promotion campaigns?

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Real Estate

- What happens when real estate prices decrease?
  - People are hesitant to realize the loss.
    - Asking prices are too high
    - Sales slow down
  - Economic Theory?
- Evidence:
  - Boston condos, 1990's and mid-2000s
  - Asking prices were 25-35% higher than selling prices
  - Sell more slowly
  - Happens to owners more than investors.

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Applications: Defaults (Status Quo Bias)

- Loss aversion contributes to a tendency to favor stability over change, the status quo is (too) often chosen:
  - Privacy policy on web sites
  - Pension plans
  - Insurance choices and right to sue in NJ (opt-in full tort; 21%) and in PA (opt-out; 75%). Annual savings of $500.

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Applications of PT: Mental Accounting

- Mental accounting is categorization of money and spending. Money mentally coded as gain or loss in a category.
- Mental accounting affects behavior
  - Pay more with credit cards (like not paying)
  - People pay high% interest on credit cards while keeping money in their saving accounts
  - Examples from your own experience?

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Examples of Mental Accounting

What would you do under Scenario I and Scenario II?

Scenario I:

- You are on your way to see a play and have a ticket which cost $40. When you arrive at the theater, you discover that you have lost your ticket. Would you buy another?

Scenario II:

- You are on your way to see a play and are about to purchase a ticket which cost $40. As you step up to the box office, you discover you have $40 less in you pocket than you thought when you left home. Would you still buy the ticket?

- Jackie is shopping with a friend. She need to buy a calculator. The store offers a price of $50. A friend tells her that another store, which is 10 block away is selling the same calculator for $40. Jackie decides to go to the other store. Jane goes to a store to buy a TV. The store offers a price of $500. Jane's friend tells her that another store, which is 10 blocks away, is selling the same TV for $490. Jane decides it is not worth walking 10 blocks for $10 savings.

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Summary

- How do Customer think?
  - Customers think differently (than what standard economic theory predicts), but systematically.
  - They judge value:
    - Relative to a reference level.
    - Losses loom larger than gains.
- How do you think about customers?
  - They are more different than you realize
  - You are overconfident of it

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Does all this matter?

BUSINESS/FINANCIAL DESK | October 10, 2002, Thursday
A Nobel That Bridges Economics and Psychology

By DANIEL ALTMAN (NYT) 1178 words
Late Edition - Final, Section C, Page 1, Column 2
ABSTRACT - Daniel Kahneman of Princeton University and Vernon L Smith of George Mason University are awarded Nobel Memorial Prize in Economic Science; tried to explain idiosyncrasies in people's ways of making decisions, research that has helped incorporate insights from psychology into discipline of economics; photos (M)

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Open questions

- Are customers rational?
- Are companies rational?
- Are markets rational?

"The evidence is mixed: Theory says one thing, the data say another"

Richard Thaler

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For further reading:

- See:
  - Dan Ariely (2010) "Predictably Irrational"
  - Richard H. Thaler and Cass R. Sunstein (2009) "Nudge: Improving Decisions About Health, Wealth, and Happiness"

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Two Sides of Customer Value:

Economic Value to the Customer (EVC)
and
Life Time Value of a Customer (LTV)

Session 4
Marketing Management
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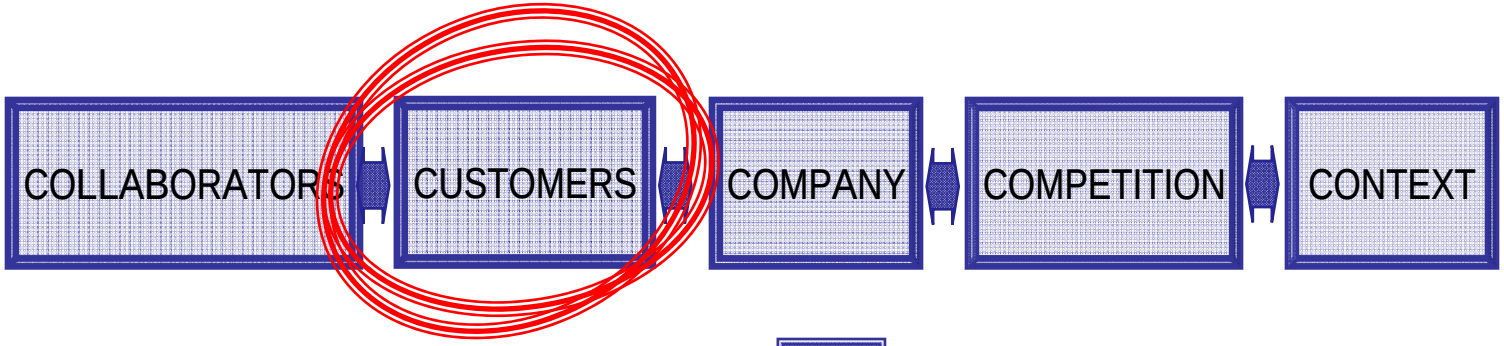
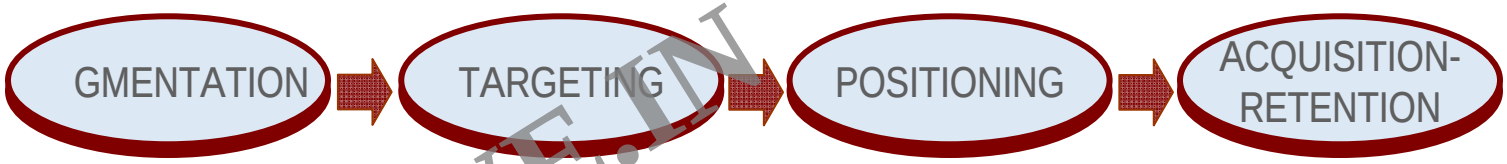
Marketing Management: The Big Picture

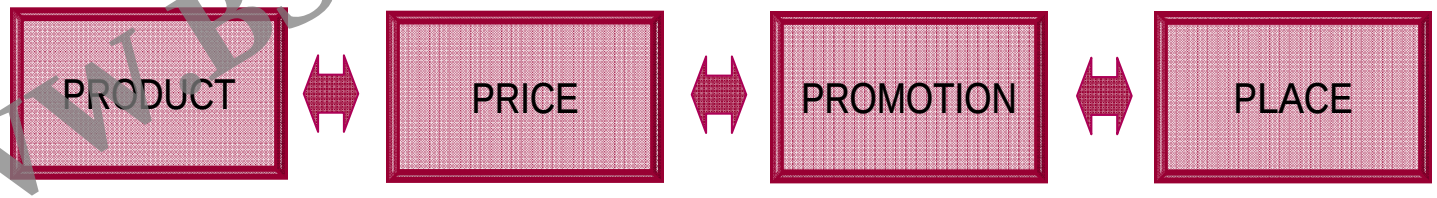
I. Situation Analysis (5Cs)



II. Set Strategy (STP)



III. Formulate Marketing Programs (4Ps)



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Sources of Customer Value

Psychological

Economic **Functional**

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1. Economic Value to Customers

- **EVC** is the total (life-cycle) cost savings from using a new product in place of a current product.

- **EVC** = (Total ownership cost of existing product) – (Total ownership cost of new product)

- **Maximum Willingness to Pay** = Total lifecycle savings from new product compared with old product

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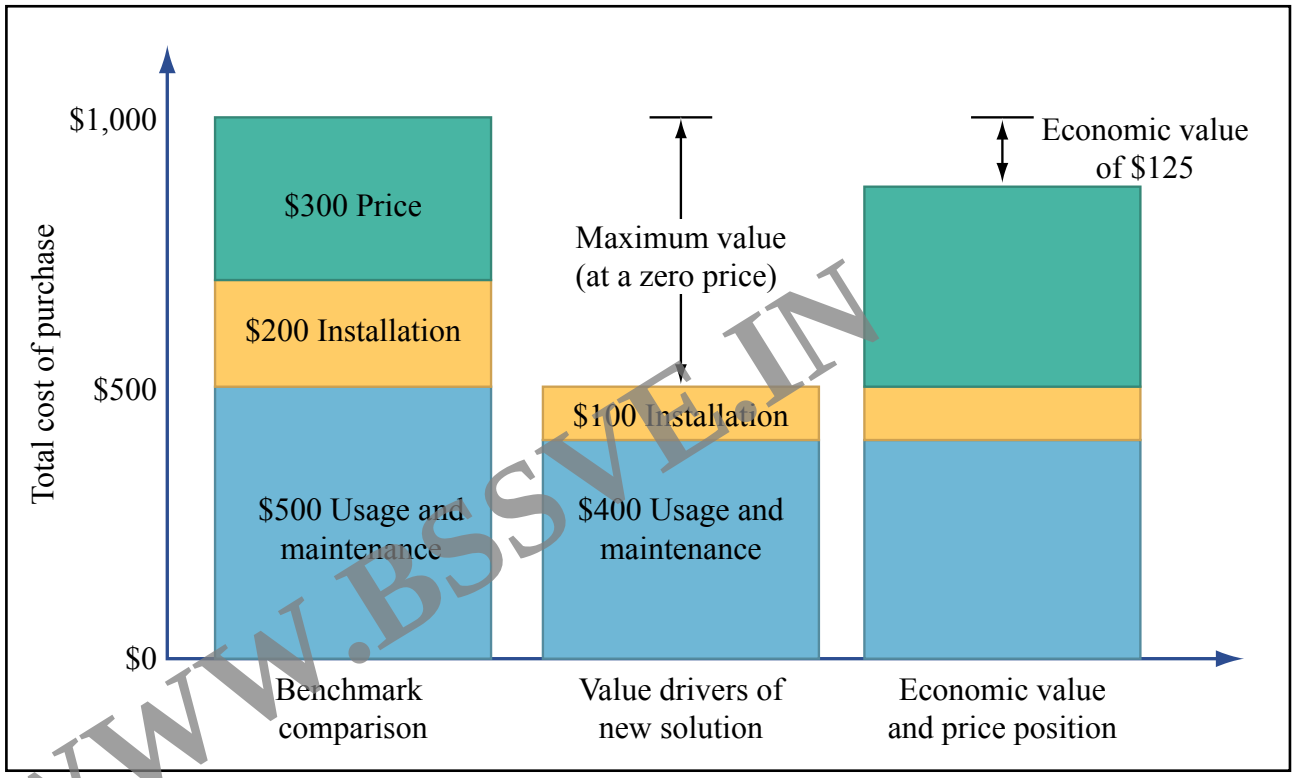
Example: New Telecom Switch



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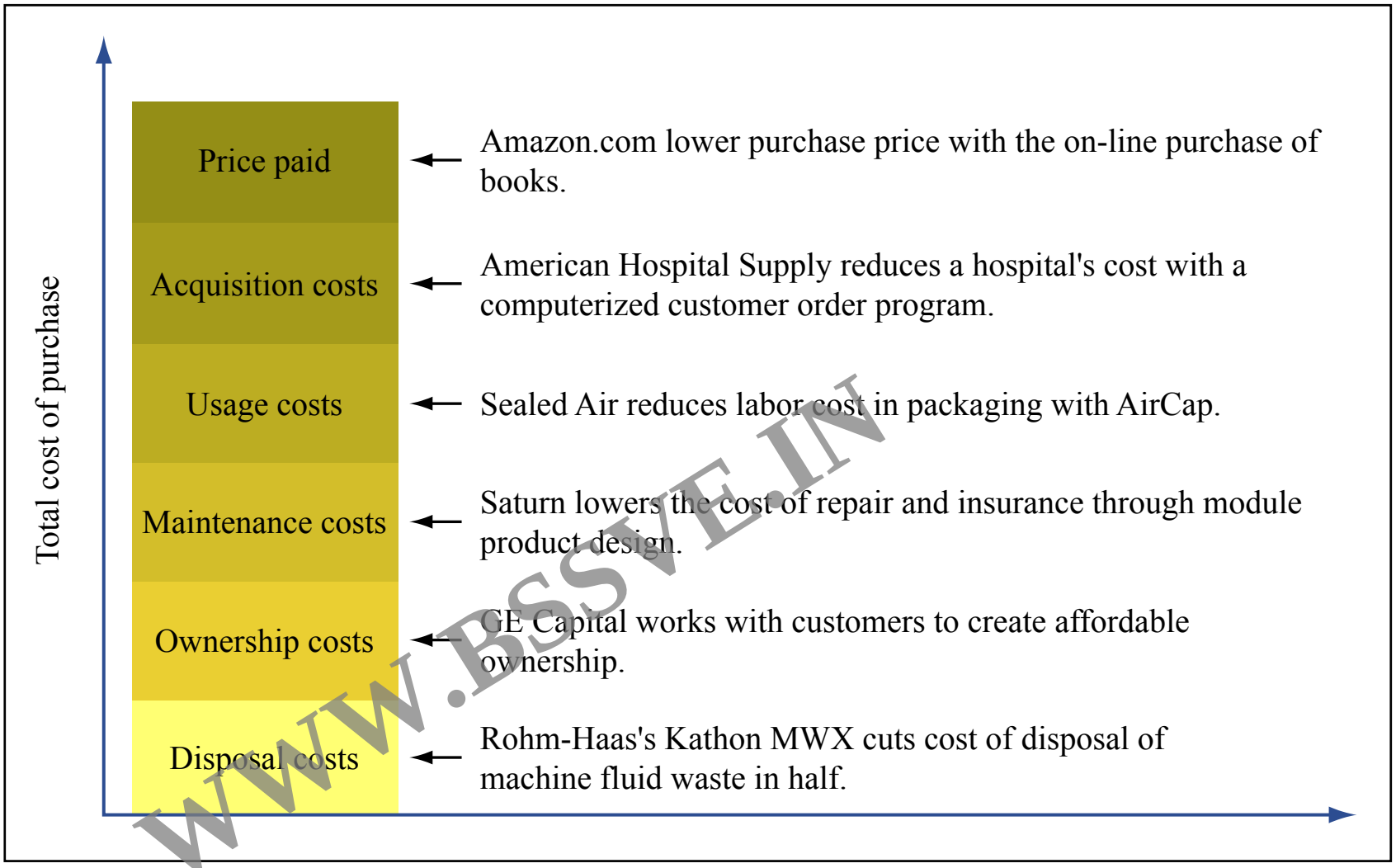
Sources of EVC



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Example

- Lasik
- The Canon and Lexmark printers are the cheapest, or are they?

▲ High scores are best. ▼ Low scores are best. Bold type denotes first place.	Black pages output ▲	Color pages output ▲	Cost per page ▼	Printer cost ▼	Total cost of ownership for 1 year ▼	Total cost of ownership for 3 years ▼
Canon i250 Color BubbleJet	103	387	6¢	**$49.99**	$227.04	$541.13
Canon i350 Color BubbleJet	111	382	6¢	$59.99	$229.69	$529.08
Epson Stylus C84	671	1,410	3¢	$100.00	**$198.00**	**$354.00**
HP Business Inkjet 1100d	**1,326**	**3,378**	**2¢**	$199.99	$271.99	$375.99
HP Deskjet 5150	381	310	8¢	$99.99	$336.62	$769.90
HP Deskjet 5650	456	456	6¢	$149.99	$333.86	$661.61
HP Deskjet 6127	673	902	4¢	$249.99	$380.22	$600.70
Lexmark Z605 Color Jetprinter	173	694	12¢	$50.00	$387.25	$1,021.74
Lexmark Z705 Photo Jetprinter	288	1,127	8¢	$80.00	$296.44	$689.31
RED denotes Editors' Choice.						

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Example

- A new synthetic motor oil is about to be introduced with the primary benefit that it needs to be changed less frequently, specifically once every year regardless of the mileage. Assuming current oils need to be changed every 3,000 miles at a cost of $30 per change (oil at a dollar a quart or a total of $5 per car, labor $20, disposal of oil $5) for an average car. What is the EVC of the new oil to a car driver who drives 15,000 miles per year?

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EVC by Customer

	New Product	Old Product		
		Low Mileage (3,000)	Average Mileage (15,000)	High Mileage (45,000)
Product Price	???	1 x 5 = 5	25	15x 5 = 75
Labor Costs	20	1 x 20 = 20	100	15 x 20 = 300
Other Costs (disposal fee)	5	1x 5 = 5	25	15 x 5 = 75
TOTAL COST	25 + price	30	150	450
EVC		5	125	425
EVC/Quart		1	25	85

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Issues in Using EVC

- Customer differences
  - High vs. low mileage drivers.
- Convincing customers
- Other (fuzzy) benefits ignored
- BUT, EVC can be useful in
  - Pricing
  - Segmentation
  - New product introduction

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What is Customer Lifetime Value (CLV aka LTV)?

- **Customer Lifetime Value**

  is the net present value of all future streams of profits that a customer generates over the life of his/her business with the firm

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Creating or Destroying Value?

"In the United States, top executives **lose their jobs** when their companies sell too little. In Britain, it can happen when their companies **sell too much**."

—The New York Times, March 31, 1993

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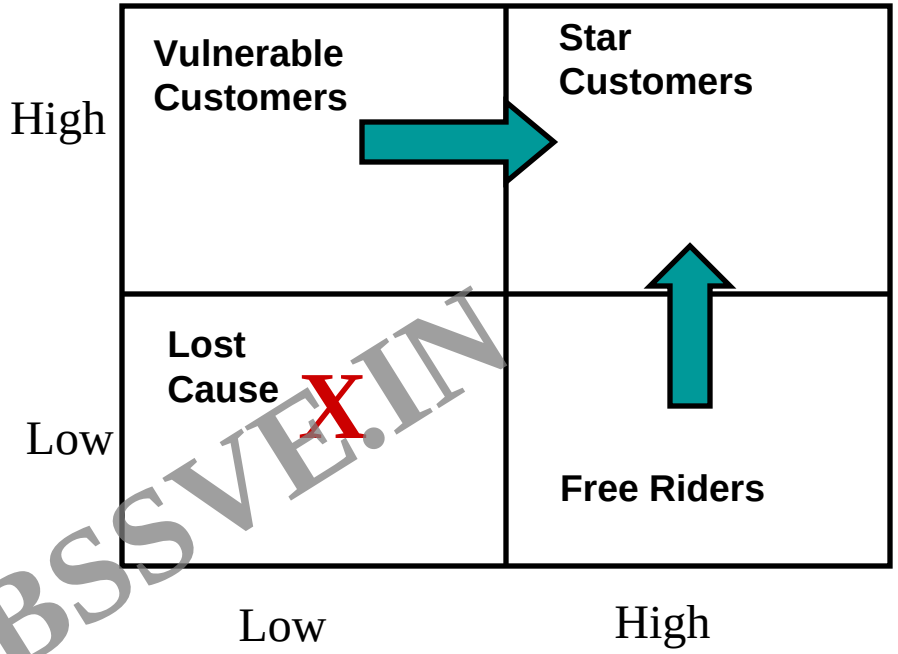
The Two Sides of Customer Value

Appropriating Value

Value of Customers



Value to Customers

Creating Value

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Value of Tennis Club Member

You own a tennis club where the annual membership fee is $300. The average club member spends about $100 dollars a year at the club (in balls, drinks, snacks, etc.). The annual cost of these miscellaneous goods (the balls, drinks, snacks, etc.) to you is $40 per player. On average people who join a tennis club have a playing career of 7 years. Historically, 65% of the members in a given year rejoin the following year. Investing capital at the going rate would earn a return of 8% a year. Based on this information, what is the long-term value of a customer?

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LTV Calculations

	Annual profit	Retention Probability	Expected profit	Discount factor	Expected discounted profit
Assumptions	**Constant**	**r = .65**		**d = .08**	
Year (A)	**(B)**	**(C)**	**(D) = (B) x (C)**	**(E)**	**(F) = (D) x (E)**
0	360	1.00	360.00	1.00	360.00
1	360	0.65	234.00	0.93	216.67
2	360	0.42	152.10	0.86	130.40
3	360	0.27	98.87	0.79	78.48
4	360	0.18	64.26	0.74	47.23
5	360	0.12	41.77	0.68	28.43
6	360	0.08	27.15	0.63	17.11

LTV = 878.32

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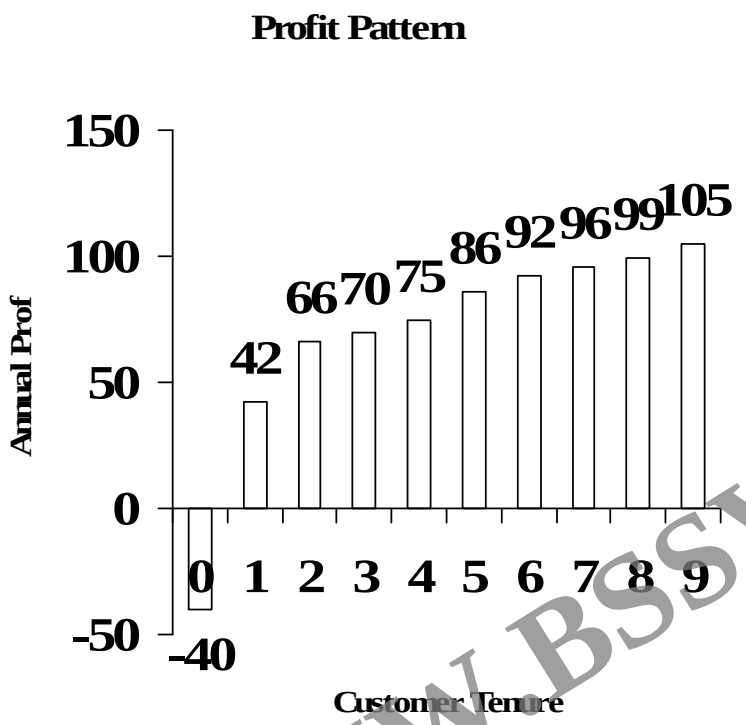
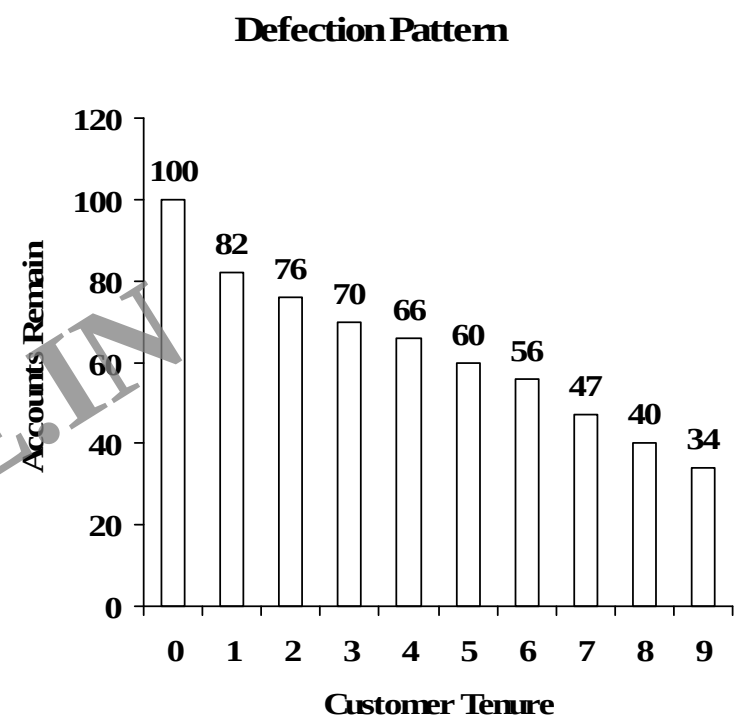
Profit and Defection Patterns
Credit Card Industry





$$CLV = \frac{(\$42)*(.82)}{(1+0.1)} + \frac{(\$66)*(.76)}{(1+0.1)^2} + \ldots \longrightarrow \frac{(m)(r)}{(1+i)} + \frac{(m)(r^2)}{(1+i)^2} + \ldots. - AC$$

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Measuring Customer Value

- Lifetime value of a customer assuming infinite horizon:

$$LV = m\left(\frac{r}{1+i-r}\right) - AC$$

m = margin
i = discount rate
r = retention rate
AC = acquisition cost

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Economics of Customer Acquisition for FedEx

- 140 accounts in advertising industry use 2,285 Courier Paks (CP) per month
- CP price is $12.50 and variable cost is $4.25
- Retention rate = 0.9, discount rate = 12%
- What is the maximum FedEx should be willing to spend to acquire a new account in this industry?

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Margin Multiple

Constant Margins

$$\frac{r}{1+i-r}$$

Retention Rate	Discount Rate			
	10%	12%	14%	16%
60%	1.20	1.15	1.11	1.07
70%	1.75	1.67	1.59	1.52
80%	2.67	2.50	2.35	2.22
90%	4.50	4.09	3.75	3.46

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Margin Multiple

Growth in Margins

$$\frac{r}{1+i-r(1+g)}$$

Retention Rate	Growth Rate				
	0%	2%	4%	6%	8%
60%	1.15	1.18	1.21	1.24	1.27
70%	1.67	1.72	1.79	1.85	1.92
80%	2.50	2.63	2.78	2.94	3.13
90%	4.09	4.46	4.89	5.42	6.08

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Increasing Customer Equity:

Three strategies:

I. Customer acquisition (gain new customers)

II. Customer expansion

III. Customer retention

$$LV = m\left(\frac{r}{1+i-r}\right) - AC$$

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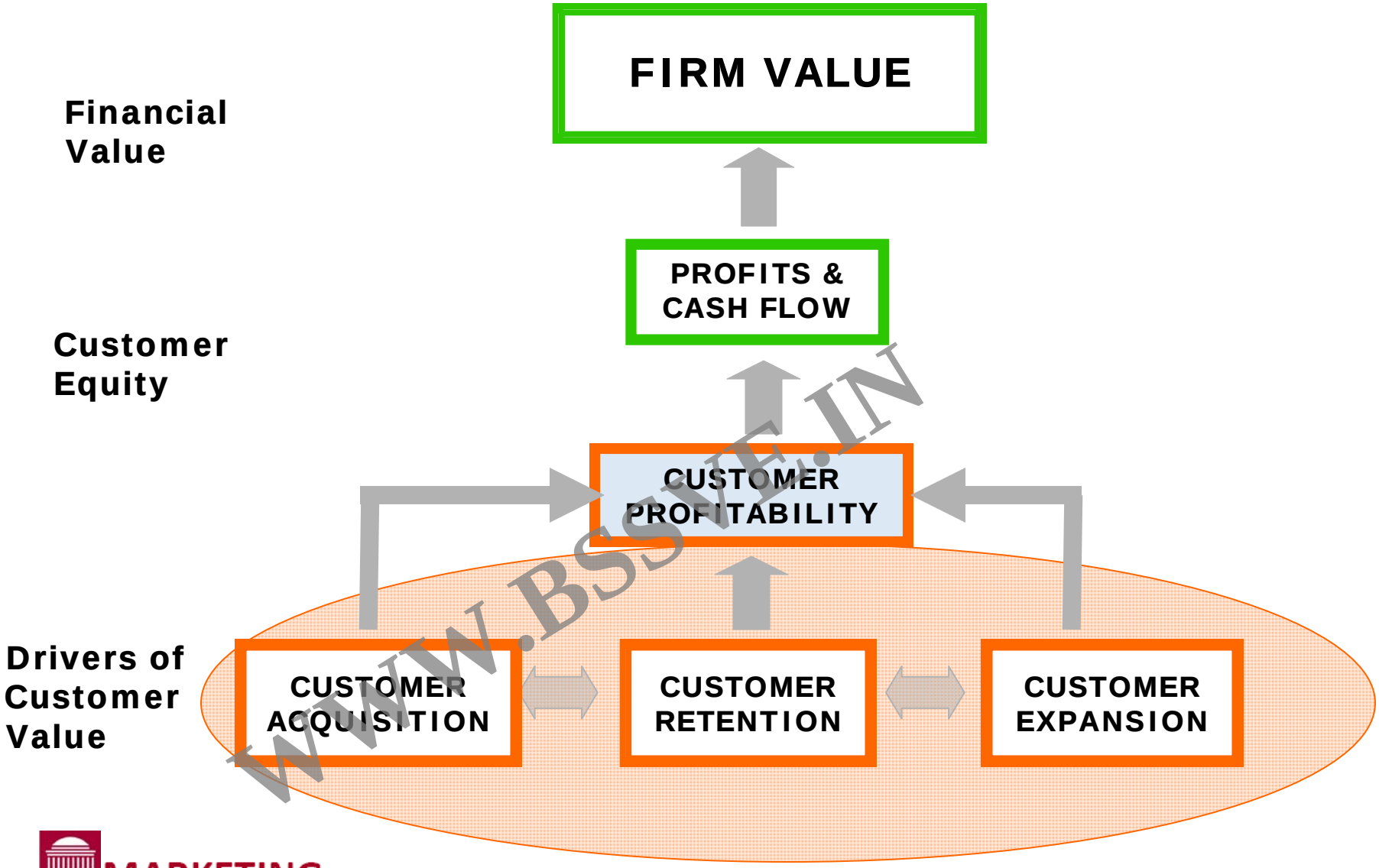
Drivers of CLV



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I. Customer Acquisition Strategies

- Marketing E*Trade
- Affiliations amazon.com
- Merges and Acquisitions AT&T

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Customer Acquisition Costs by Marketing Activity

Activity	Cost per New Customer	Cost per Solicitation
Personal selling	$500	$100.00
Direct mail	$115	$1.50
Telemarketing	$95	$3.30
Web site, e-mail	$30	$0.06

1. Costs are based upon typical industry averages. Response rates are implied.

2. Actual costs vary from business to business depending on the complexity of the sales process.

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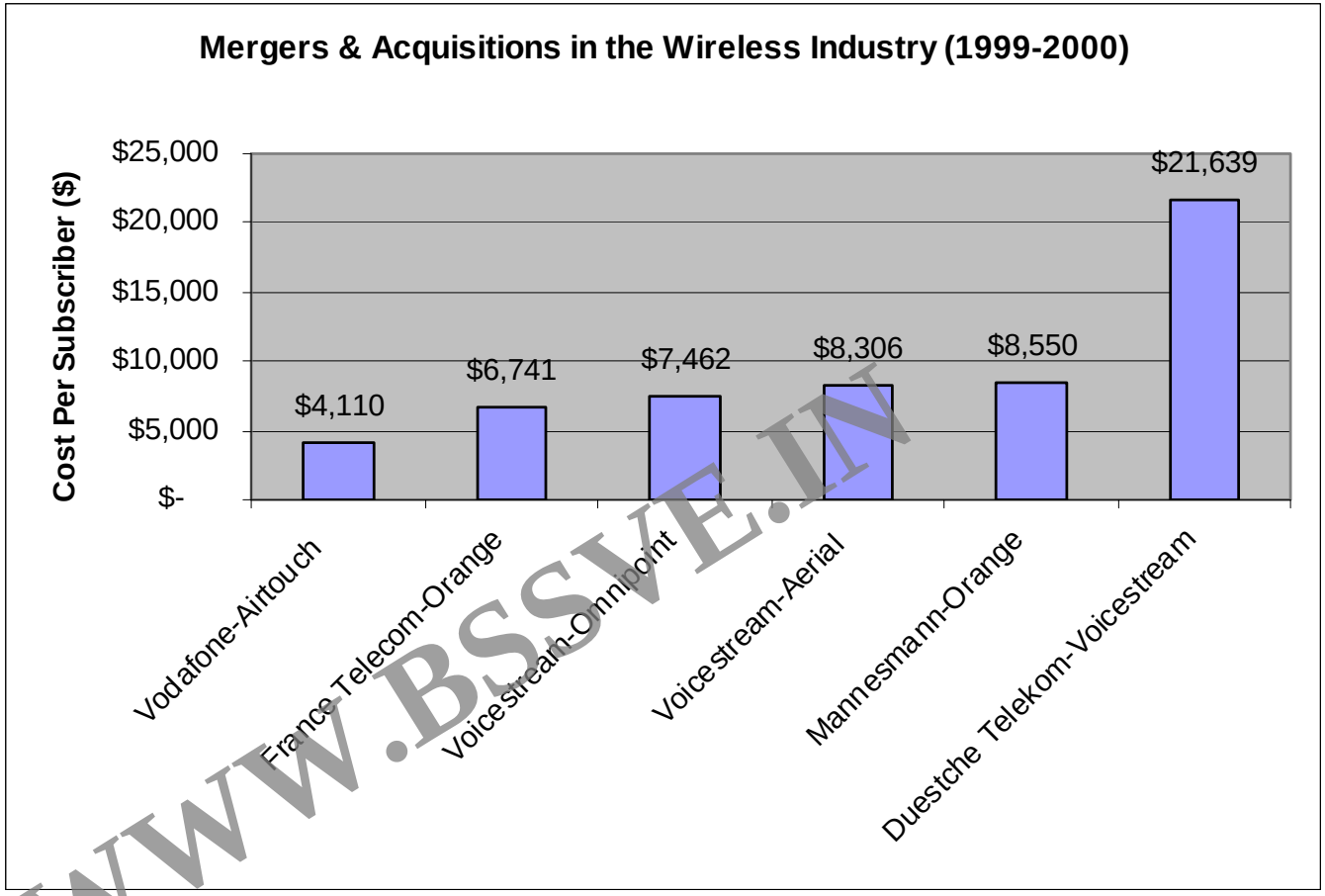
Source: Customer acquisition cost--a key marketing metric. *Justin Zohn*. NPN, National Petroleum News, April 2003.

Mergers & Acquisitions in the Wireless Industry (1999-2000)



Source: Based on data from *The Industry Standard*, Aug 7, 2000 and *Business Week*, August 7, 2000

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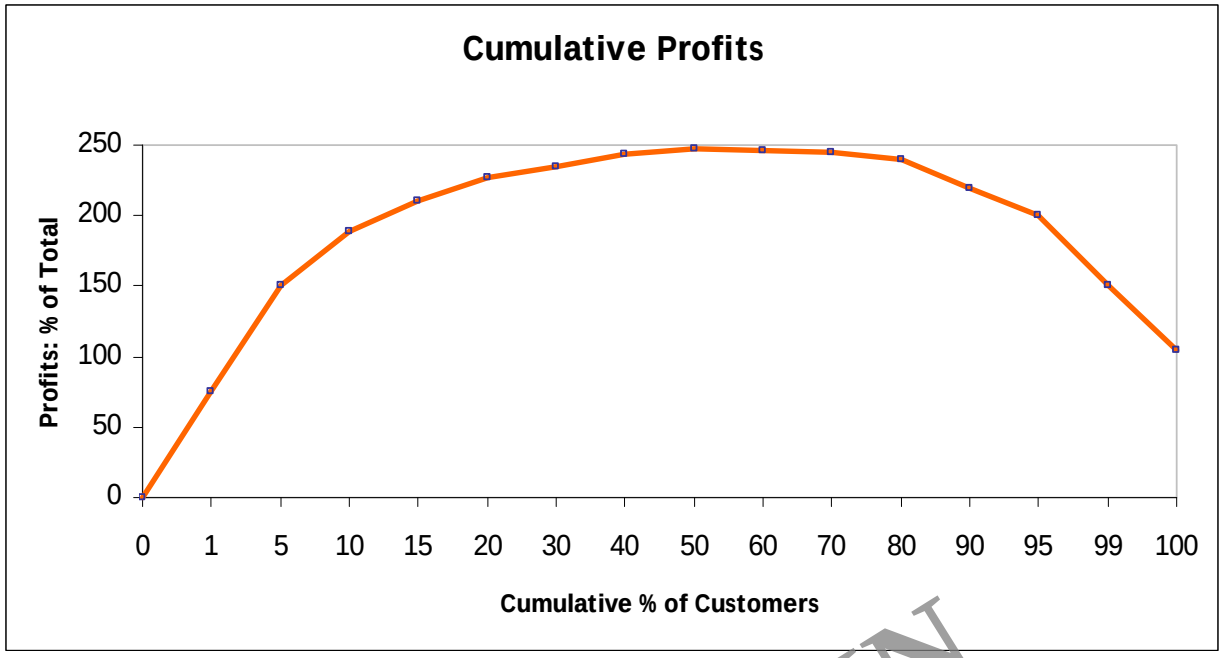
All Customers are Important, but…



…some are More Important than Others

Source: Kanthal (A), HBS Case 9-190-002
Kanthal is a Swedish B2B selling hearing wires

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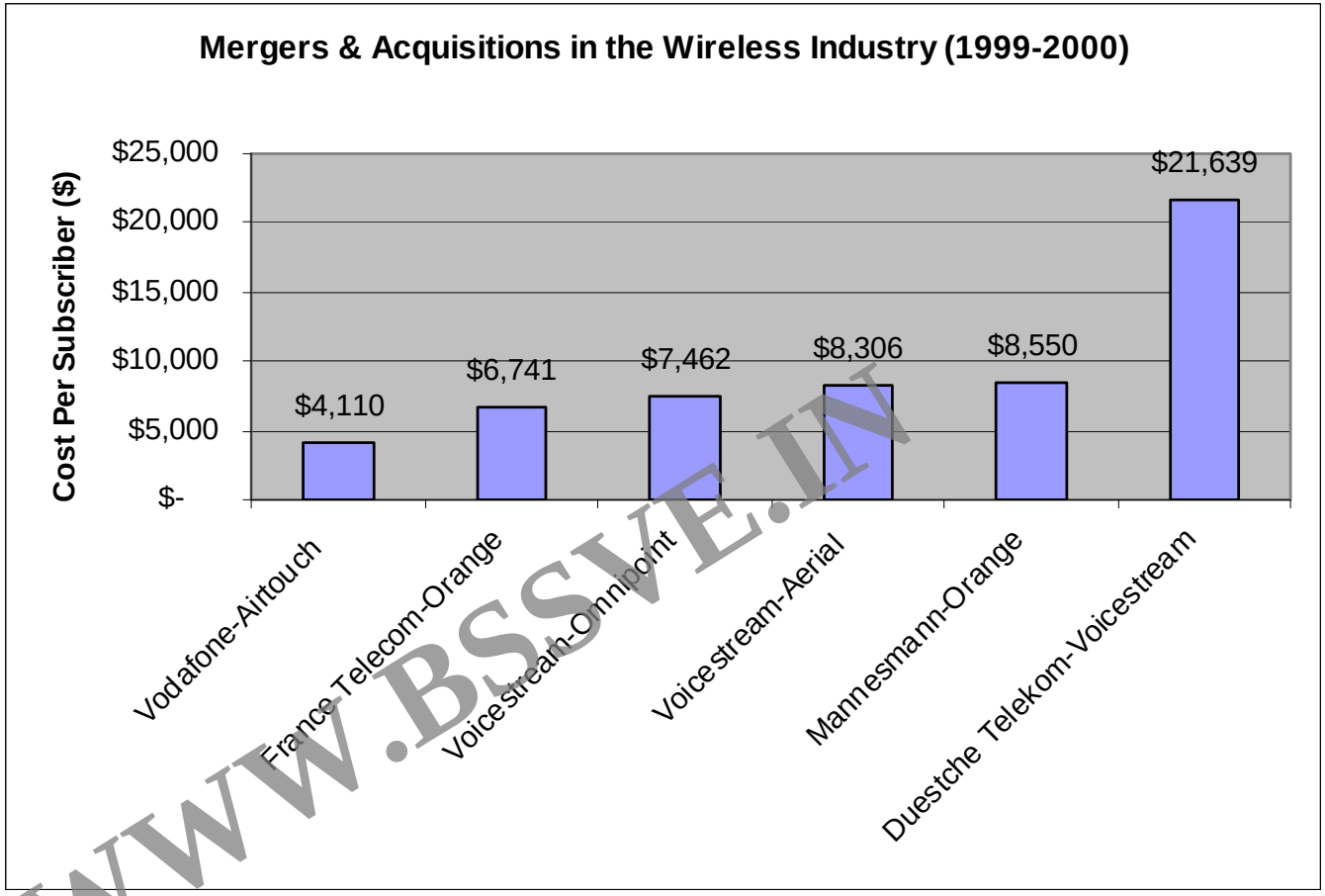
Mergers & Acquisitions in the Wireless Industry (1999-2000)



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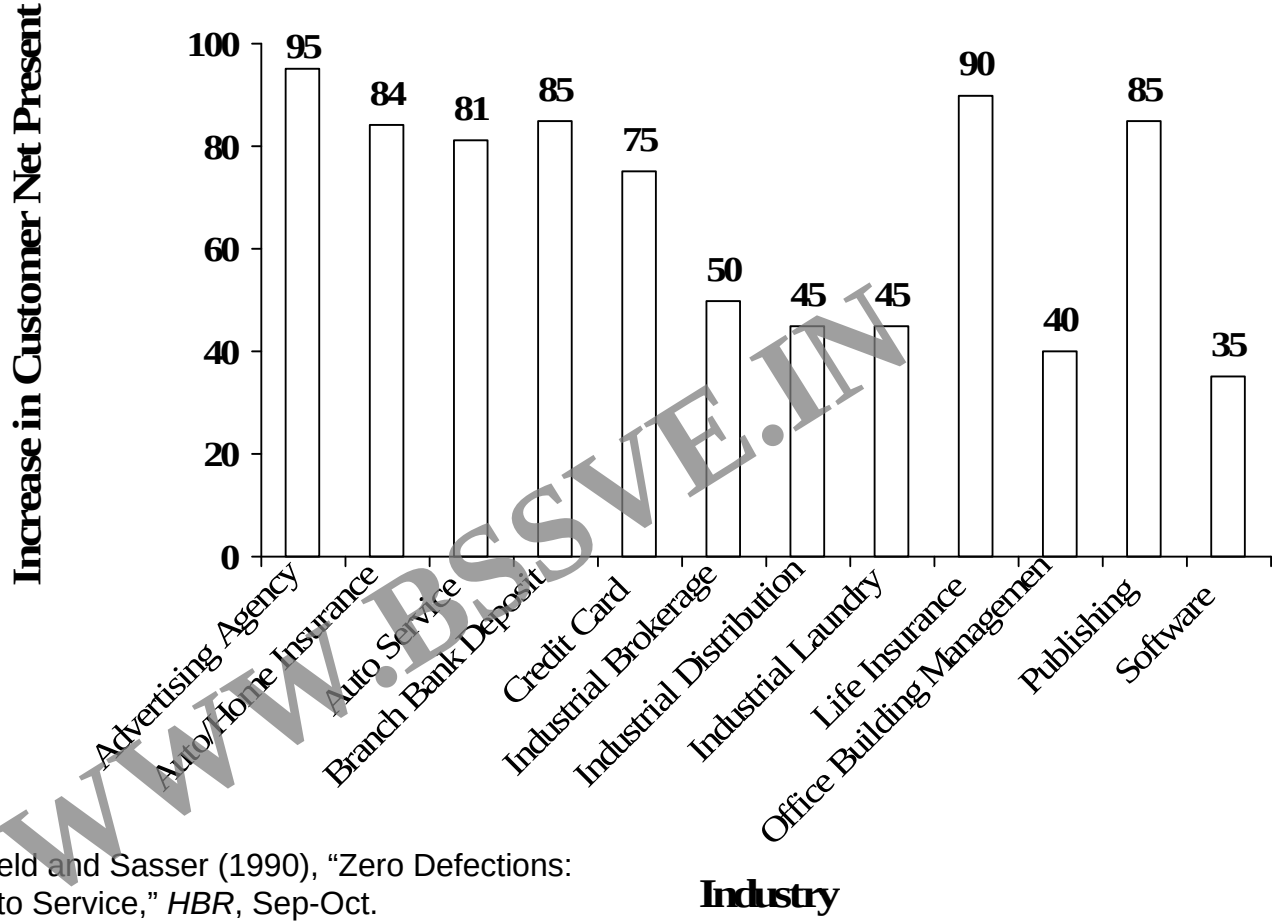
Source: Based on data from *The Industry Standard*, Aug 7, 2000 and *Business Week*, August 7, 2000

Customer Retention

Profit Impact of 5% Increase in Customer Retention



Source: Reichheld and Sasser (1990), "Zero Defections: Quality Comes to Service," *HBR*, Sep-Oct.

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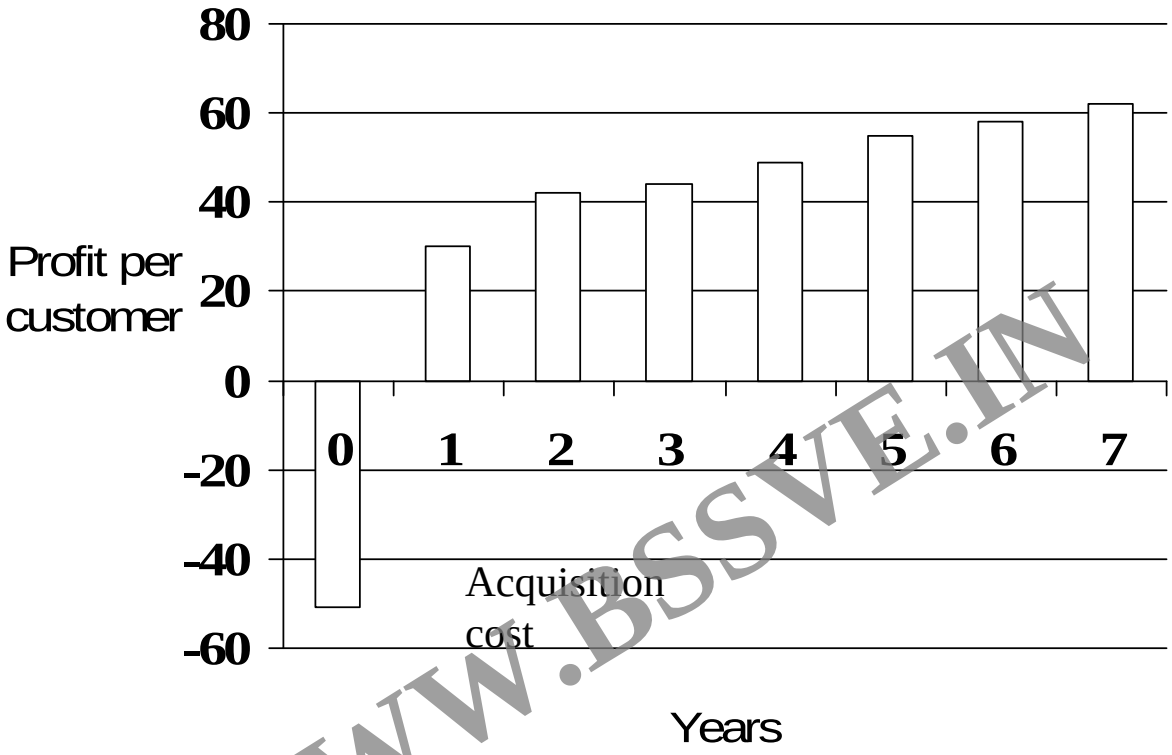
Customer Retention (why think long term?)

Impact on Profit



- Profit from price premium
- Profit from referrals
- Profit from reduced cost
- Profit from increased purchases
- Base profit

Source: Reichheld and Sasser (1990), "Zero Defections: Quality Comes to Service," *HBR*, Sep-Oct.

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Under-investing in Retention

PRIMARY MARKETING GOALS[1] OF U.S. B-TO-B MARKETERS

	2004	2005
Customer acquisition	28.4%	28.4
Driving sales	31.8	26.8
Brand awareness	15.6	17.5
Lead generation	14.2	16.4
Customer retention	7.1	7.7

[1] As a percentage of respondents of more than 300 marketing executives

Source: *BtoB* Magazine, Chicago and eMarketer Inc., New York

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What Drives Retention and Loyalty?

CUSTOMER RETENTION & LOYALTY

Experience

Loyalty Programs

Cross-selling

…

Whiskey Blue Destination Bars
Whatever/Whenever Service

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"Business travelers with a sense of style can't get enough of the W Hotel chain"

– Entrepreneur Magazine

III. Customer Expansion: Strategies to Increase Margin

- Pricing
- Share of Wallet
- Redefining your business
- Cross-Selling

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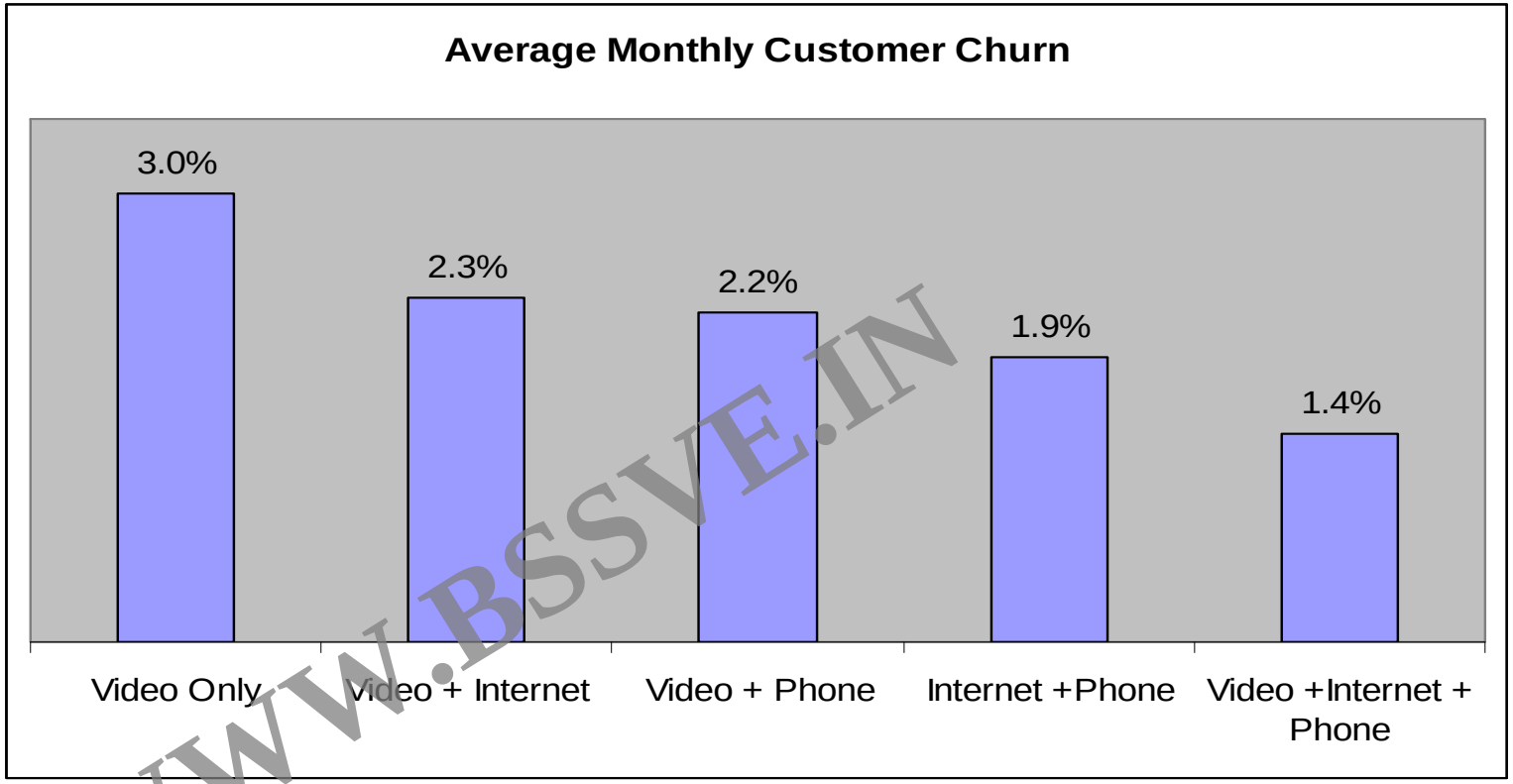
Impact of Cross-Selling at Cox



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Source : www.cox.com

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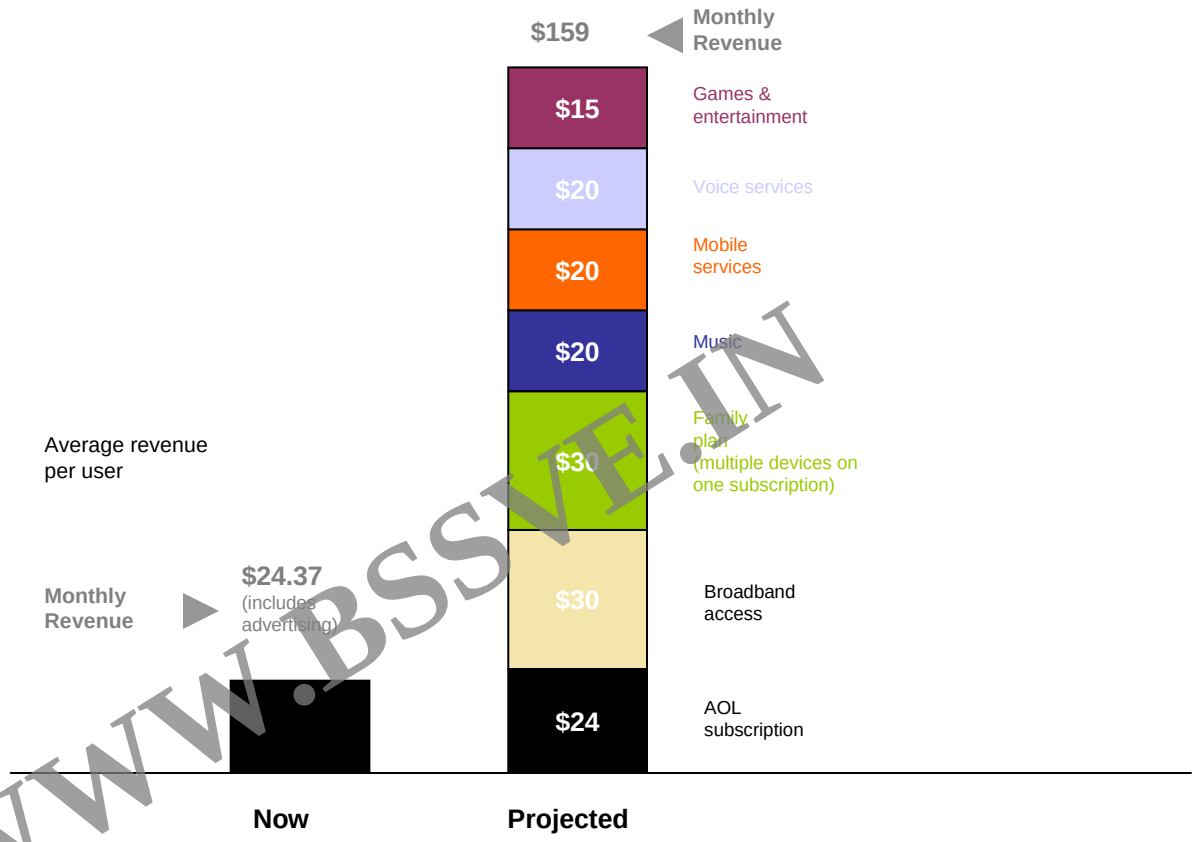
Easier Said Than Done

AOL's Vision or Pipe Dream?



Source: Fortune, Feb 4, 2002

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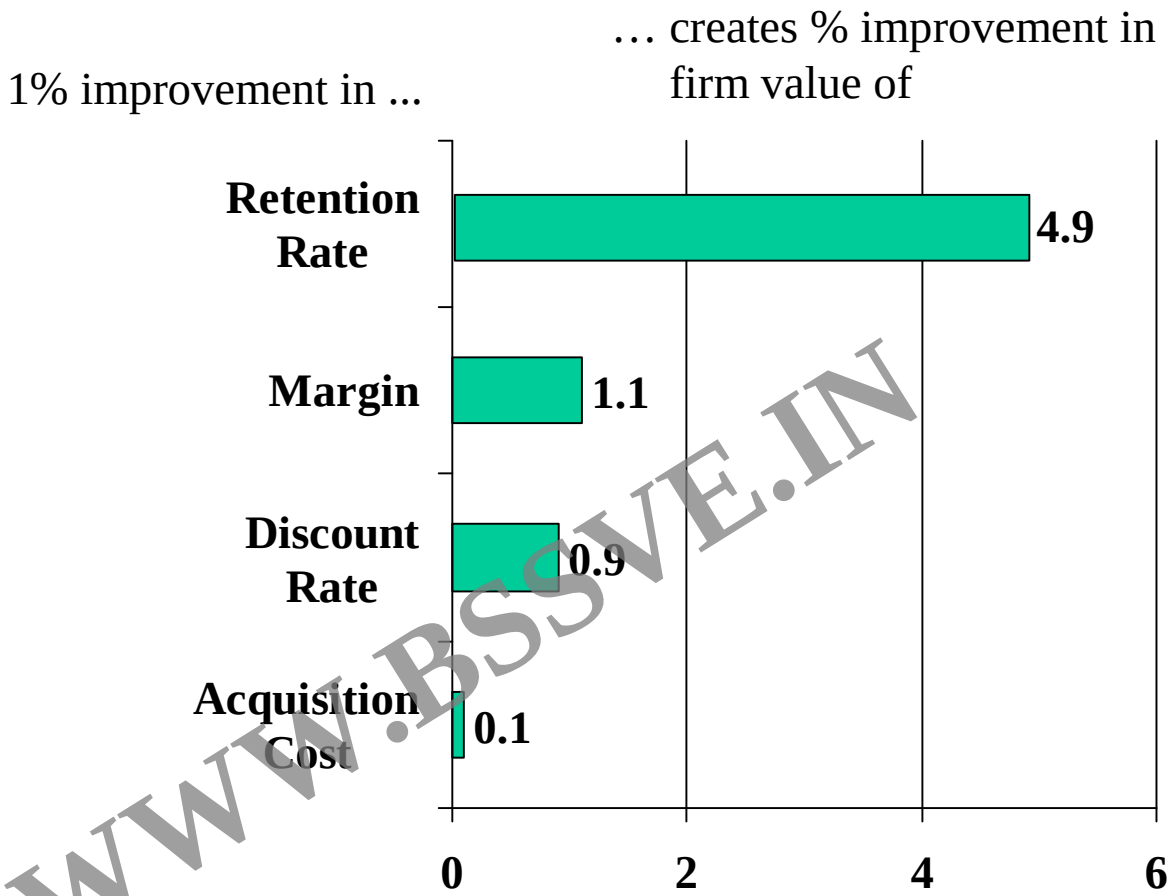
What Drives Firm Value?



Gupta, Sunil, Donald R. Lehmann, and Jennifer Stuart (2004), "Valuing Customers," *Journal of Marketing Research*, February, 7-18.

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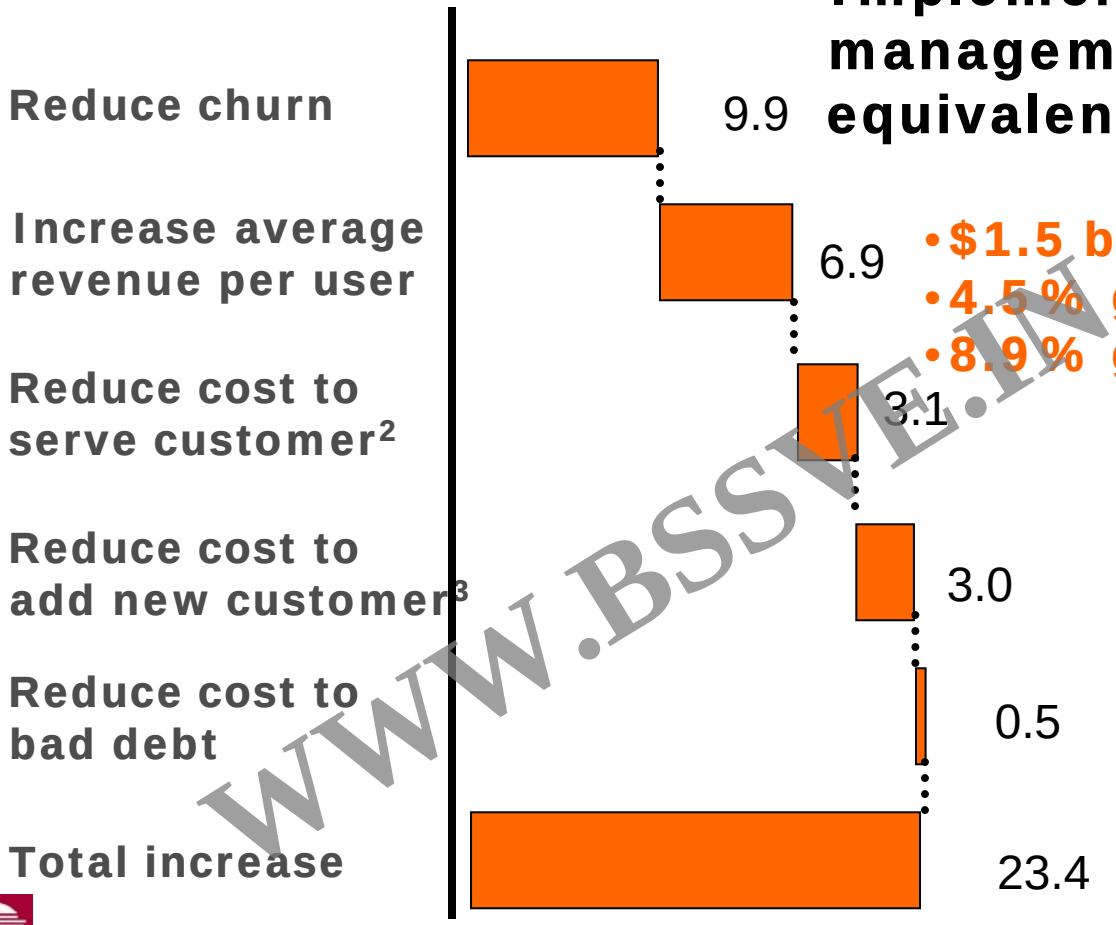
Huge Earnings Potential

Expected increase in earnings before interest, taxes, depreciation, and amortization (EBITDA) for typical US wireless carrier, percent



Implementing customer lifetime management can lead to increase equivalent to:

- **$1.5 billion growt**
- **4.5% growth in E**
- **8.9% growth in re**

PRIMARY MARKETING GOALS[1] OF U.S. B-TO-B MARKETERS

	2004	2005
Customer acquisition	28.4%	28.4
Driving sales	31.8	26.8
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Source: *BtoB* Magazine, Chicago and eMarketer Inc., New York

Source: The McKinsey Quarterly, 2003, Number 4.

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Conclusion

- Customers are assets
- Lifetime value of a customer can be approximated as

$$LV = m\left(\frac{r}{1+i-r}\right) - AC$$

- Three key levers of growth
  - customer acquisition (AC)
  - customer retention (r)
  - customer expansion (m)
- **"Success is getting the right customers … and keeping them."**

Charles Cawley, Founder MBNA

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Appendix: Modeling Customer Value

Time 0	n_0				
1	$n_0 r$	n_1			
2	$n_0 r^2$	$n_1 r$	n_2		
3	$n_0 r^3$	$n_1 r^2$	$n_2 r$	n_3	
4	$n_0 r^4$	$n_1 r^3$	$n_2 r^2$	$n_3 r$	n_4
.	.	.	.	.	.

$$n_0 \sum_{t=0}^{\infty} \frac{m_t r^t}{(1+i)^t} - n_0 c_0$$

$$n_1 \sum_{t=1}^{\infty} \frac{m_{t-1} r^{t-1}}{(1+i)^{t-1}} - n_1 c_1$$

$$\frac{n_1}{(1+i)} \sum_{t=1}^{\infty} \frac{m_{t-1} r^{t-1}}{(1+i)^{t-1}} - \frac{n_1 c_1}{(1+i)}$$

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Value of Customer Base

- In discrete time

$$Value = \sum_{k=0}^{\infty} \frac{n_k}{(1+i)^k} \sum_{t=k}^{\infty} \frac{m_{t-k} r^{t-k}}{(1+i)^{t-k}} - \sum_{k=0}^{\infty} \frac{n_k c_k}{(1+i)^k}$$

- In continuous time

$$Value = \int_{k=0}^{\infty} \int_{t=k}^{\infty} n_k m_{t-k} e^{-ik} e^{-\left(\frac{1+i-r}{r}\right)(t-k)} dt\,dk \quad - \int_{k=0}^{\infty} n_k c_k e^{-ik} dk$$

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Gupta, Sunil, Donald R. Lehmann, and Jennifer Stuart (2004), "Valuing Customers," *Journal of Marketing Research*, February, 7-18.

If you enjoyed Behavioral Econ Lecture last week

this mktg elective is for YOU:

Time is running out!

Consumer Behavior

15.847

Professor Joshua Ackerman

Act NOW!

How do we know what to buy? What information captures our attention? When are we most susceptible to being persuaded? What shapes our decisions?

This class will help you develop a basic understanding of cognition and decision making as they apply to marketing contexts, and become familiar with the major research methods for analyzing consumer behavior

Topics include:

Influence techniques, Self-control, Behavioral decision theory, Nonconscious processing, Cognitive biases, Social consumption

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If you enjoyed LTV Lecture today

this mktg elective is for YOU:

15.840: Customer Analytics Using Probability Models

- Professor Michael Braun.
- Most of what drives customer behavior is unobservable
  - Still, there are regular patterns in activity that managers can exploit, even when we know nothing about specific customers
  - "Probability" lets us incorporate what we know, and **don't know**, about these patterns, in a rigorous, systematic way
- Goal of this class: **mastery** of cutting-edge quantitative methods that enable you to analyze customer data correctly
  - Structured thinking, not wild, assumptions
  - Decision-making under uncertainty: doing it well
  - Build models from the ground up (going "under the hood"), so you understand exactly what's going on.
- Full disclosure: it's hard-core quant.
  - Designed to be accessible to any Sloan MBA who did well in DMD.
  - Still, it's not for everyone. See Prof. Braun if you have questions.

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15.840: Customer Analytics Using Probability Models

- Selection of topics covered
  - Modeling customer lifetimes and customer retention
  - Estimating customer lifetime value
  - Forecasting adoption of new products
  - Modeling repeat purchases
  - Measuring and forecasting media exposures
  - The “80/20” rule: what is it really?
  - Using test marketing data to segment and target customers
  - What was the effect of 9-11 on the online travel industry?
  - “Buy Until Dead” models: will your previous customers ever return?
  - Understanding and exploiting metrics of brand effectiveness (and why most of them are useless)

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15.810 Marketing Management
Fall 2010

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MITSloan MARKETING

Segmentation, Targeting and Positioning

Session 6

Marketing Management

Prof. Natalie Mizik

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Developing Marketing Strategy

Identify Market Opportunities

COLLABORATORS → CUSTOMERS → COMPANY → COMPETITION → CONTEXT

Set Strategy

SEGMENTATION → TARGETING → POSITIONING → ACQUISITION-RETENTION

- Segment the market
- Develop profiles of segments

- Evaluate segment attractiveness
- Select target segments

- Develop positioning concepts for each target segment
- Select, develop, and communicate the chosen concept

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Segmentation

- What is segmentation
- Why segment the market
- Characteristics of a good segmentation
- Bases for segmentation
- Techniques for segmentation
- Examples

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Why Segment

	Hospital A	Hospital B	Total
Died	63	16	79
Survived	2037	784	2821
Total	2100	800	2900
Death Rate	0.03	0.02	0.027

	Hospital A	Hospital B	Total	Hospital A	Hospital B	Total
Died	6	8	14	57	8	65
Survived	594	592	1186	1443	192	1635
Total	600	600	1200	1500	200	1700
Death Rate	0.010	0.013	0.012	0.038	0.040	0.038

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Benefits of Segmentation

To the Firm:

- Identification of valuable customers
- More targeted promotions & marketing comms
- Higher CLV

Sustainable Profit Growth

To the Customer:

- Customized products & services
- Personalized experience
- Increased customer satisfaction

Customer Loyalty & Retention

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Characteristics of Good Segmentation

- Large
- Identifiable
- Distinctive
- Stable
- Actionable / Respond differently

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Bases for Segmentation

Descriptors "Who"	Bases "Why"	Behaviors "What"
Age	**Needs**	**Usage**
Income/	**Preferences**	**Loyalty**
Education	**Decision processes**	**Deal proneness**
Profession	**Lifestyles**	**Responsiveness to marketing mix**
Media Habits	**Strategic importance**	
Industry		
Size		
Location		

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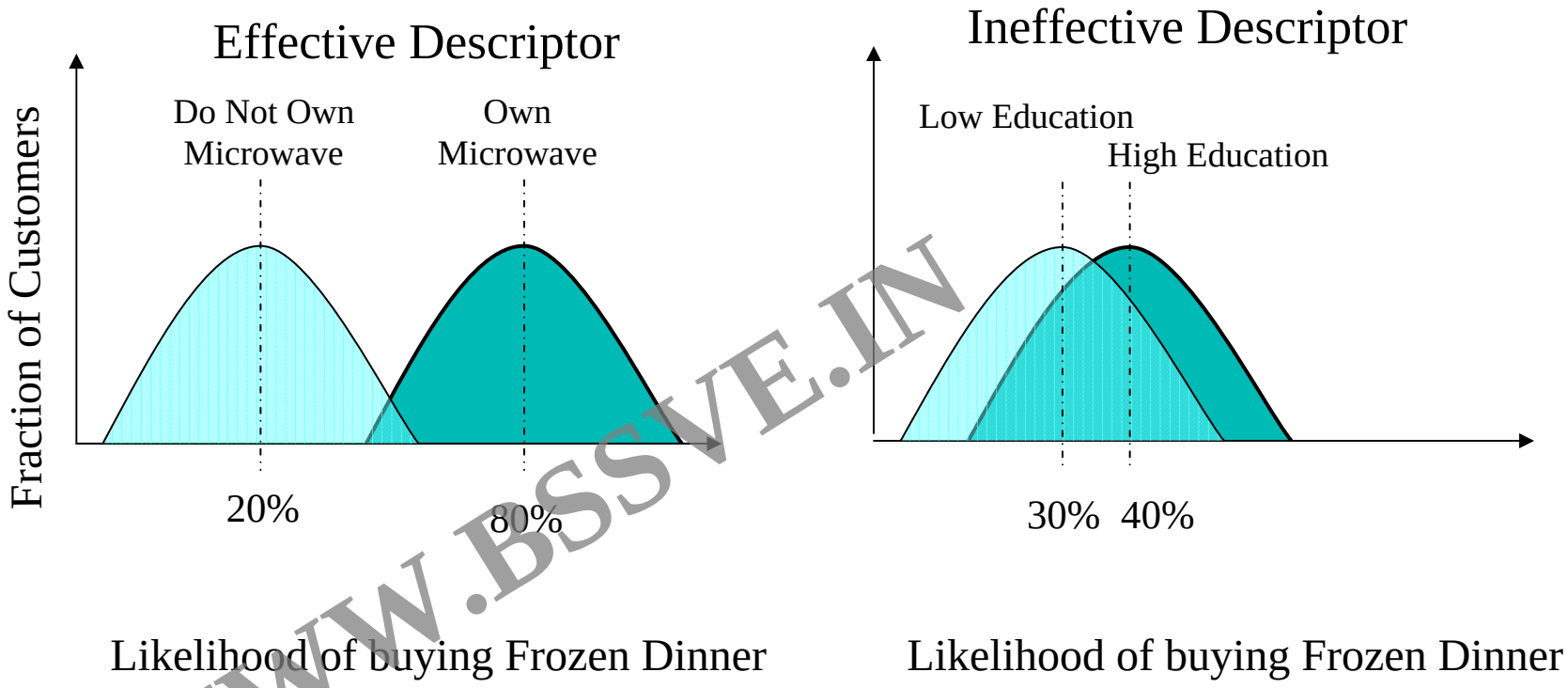
Statistically Speaking



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Dog Food Market

Attribute	SEGMENTS Functionalist	Family Mutt	Baby Substitute	Nutritionist
Demo	Central/South Low income Children	East Low income Children	West High income No children	East/Central High income Urban
Dogs	Several	One, average size	One, small	Several, large
Attitudes	No bother, dog outdoor	Little interest	Attached, dog fragile	High attachment
Feeding behavior	Basic feeders low priced	Heavy usage, biscuits, lots of cans	Soft moist, high priced	Many feedings

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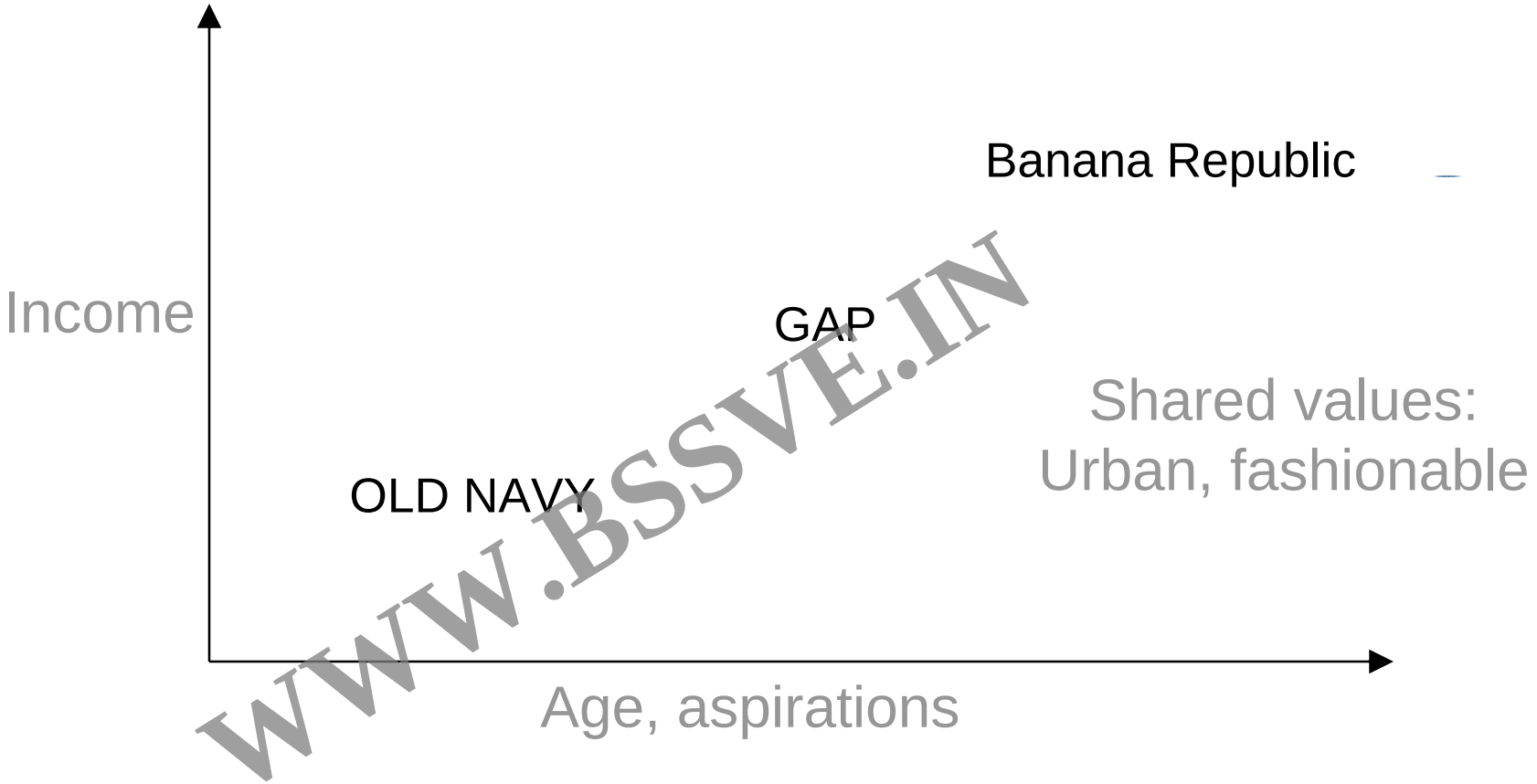
Product Line Segmentation



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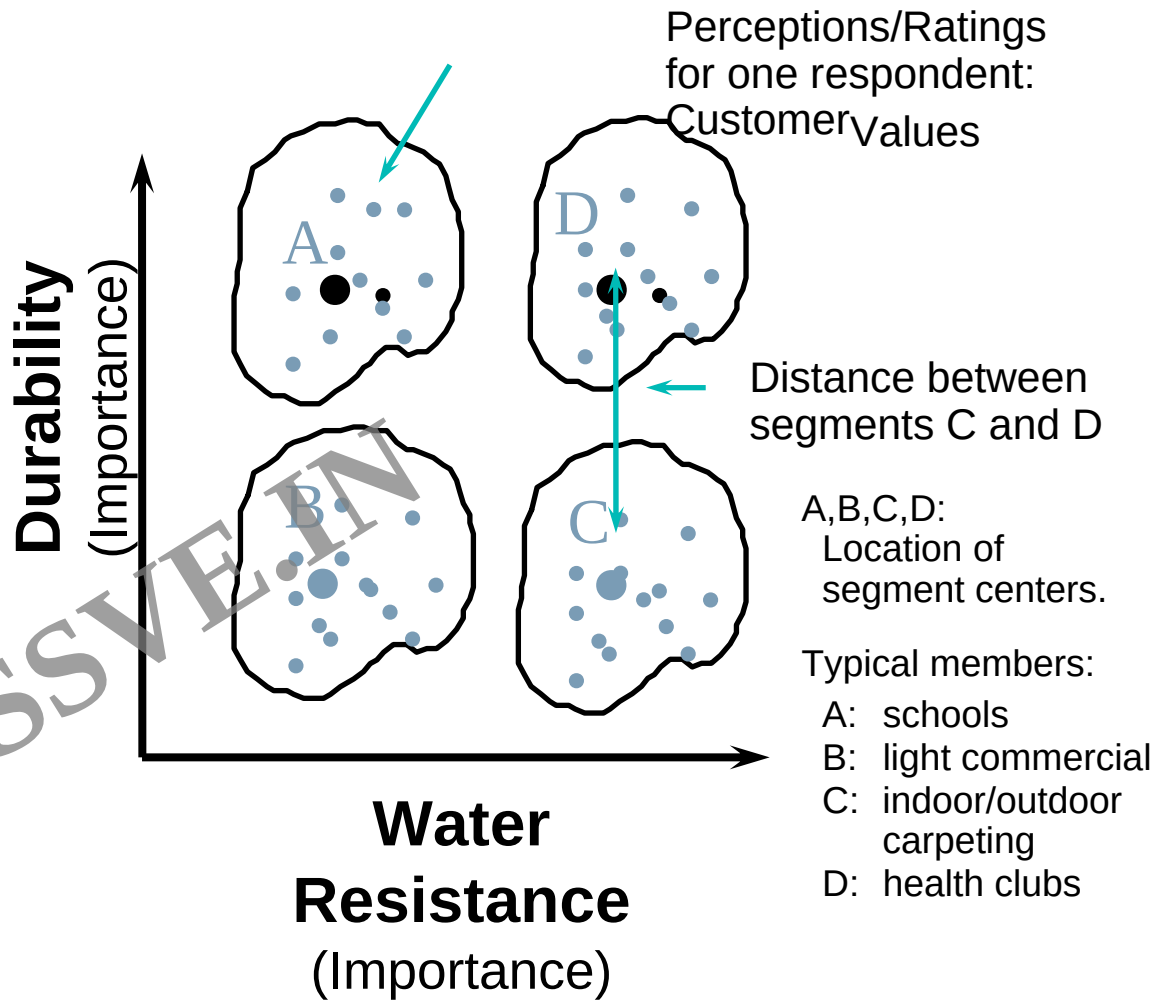
Techniques for Segmentation

Segmentation Methods:

- ❑ Judgment
- ❑ Data-based:
  - •Cluster Analysis
  - •Regression



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Choosing your Target Market(s)

Market Opportunities (Customer):
- Segment Size
- Growth rate/potential

Target Market Selection

Company "Fit"
- With Objectives
- With Competencies
- With Customer Base
- With Resources

Competition:
- Competitors' Strengths
- Competitive Intensity

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Taxonomy at the Pump: Mobil's Five Types of Gasoline Buyers

Road Warriors: Generally higher income middle-aged men who drive 25,000 to 50,000 miles a year…buy premium with a credit card…purchase sandwiches and drinks from the convenience store…will sometimes wash their cars at the carwash.

16% of buyers

True Blues: Usually men and women with moderate to high incomes who are loyal to a brand and sometimes to a particular station..frequently buy premium gasoline and pay in cash

16% of buyers

Generation F3: (for fuel, food and fast): Upwardly mobile men and women - half under 25 years of age- who are constantly on the go…drive a lot and snack heavily from the convenience store

27% of buyers

Homebodies: Usually housewives who shuttle their children around during the day and use whatever gasoline station is based in town or along their route of travel.

21% of buyers

Price Shoppers: Generally aren't loyal to either a brand or a particular station, and rarely buy the premium line…frequently on tight budgets…efforts to woo them have been the base of marketing strategies for years.

20% of buyers

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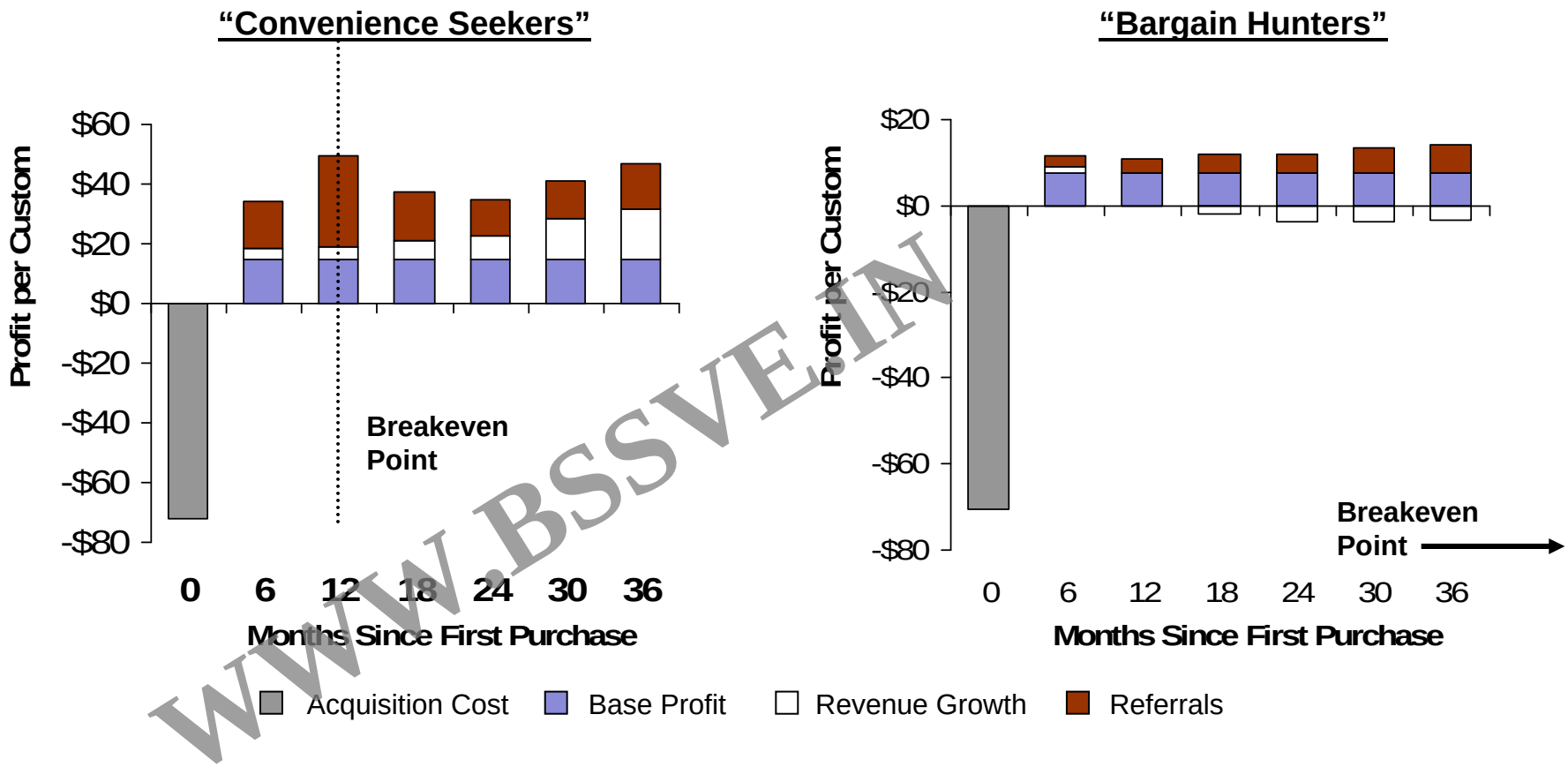
Selecting segments based on segment profitability



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Source: Bain/Mainspring Online Retailing Survey (Groceries, n=297), Oct 99.

Early Pregnancy Tests

Q: Are there differences in consumer needs in this market? What are they?

Q: What are the descriptors of these segments?

Q: What is the best positioning in these segments?

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How is the packaging and positioning different? What customer values are the products appealing to?

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Product Differentiation & Positioning

- "There is no such thing as a commodity"

- Differentiation can be achieved on
  - product attributes
  - service factors
  - Image

- Positioning: the image created in the minds of target consumers

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Positioning statement

- To customers who are (target summary)
- Our product offers (state what the product does from the consumers' point of view)
- Relative to (competitive alternatives)

"For World Wide Web users who enjoy books, Amazon.com is a retail bookseller that provides instant access to over 1.1 million books. Unlike traditional book retailers, Amazon.com provides a combination of extraordinary convenience, low prices, and comprehensive selection."

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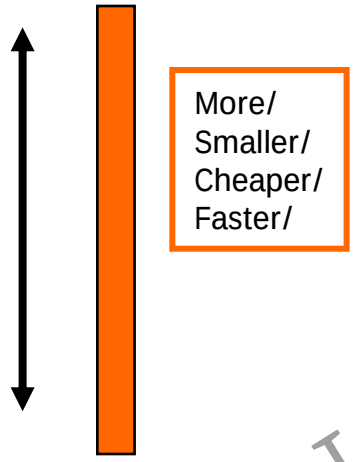
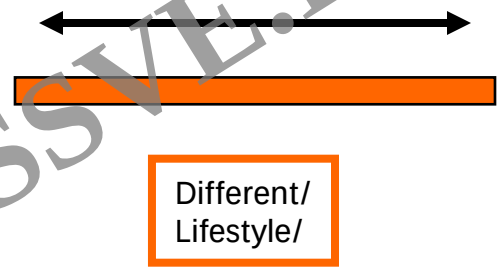
Positioning strategies

Vertical positioning



Horizontal positioning



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Vertical positioning

The Razor Battle

Schick Quattro

Image courtesy of Rene Schwietzke on Flickr.

Gillette Mach 3 Turbo

Gillette Trac II

Image courtesy of Maskington San Francisco on Flickr.

Gillette ups the ante, unveils 5-blade razor

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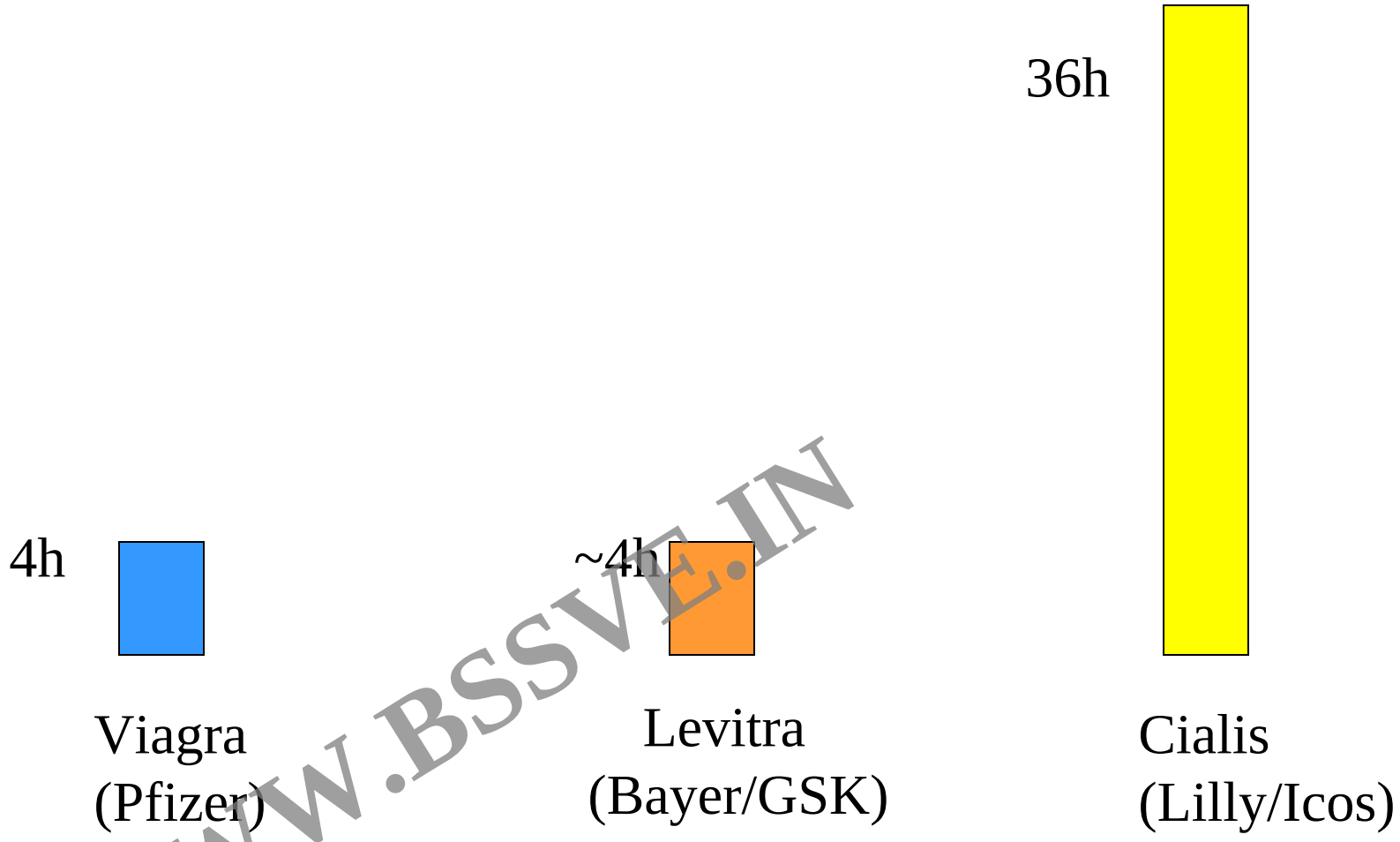
Positioning the ED drugs



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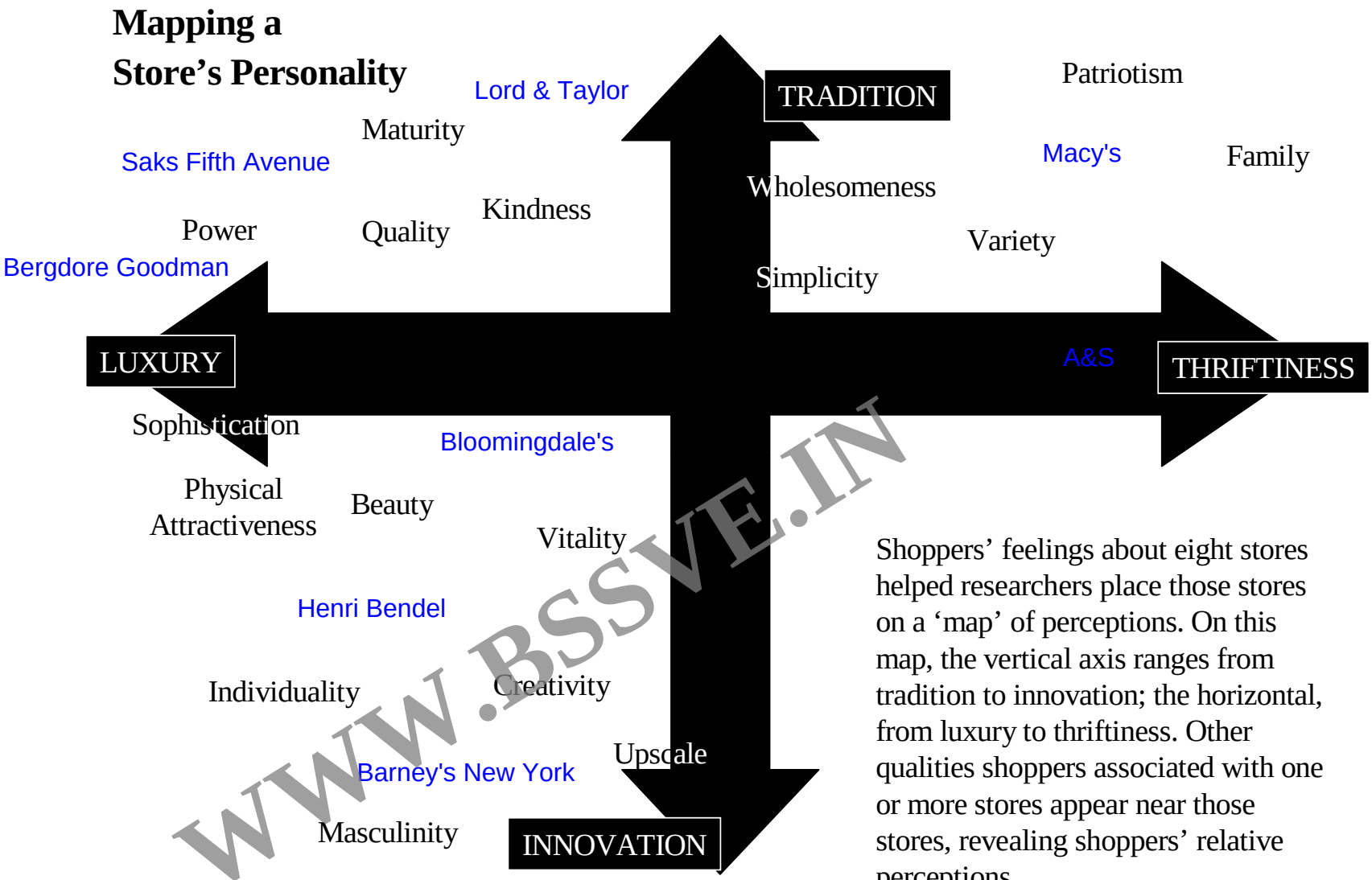
Example of a Perceptual Map:



Shoppers' feelings about eight stores helped researchers place those stores on a 'map' of perceptions. On this map, the vertical axis ranges from tradition to innovation; the horizontal, from luxury to thriftiness. Other qualities shoppers associated with one or more stores appear near those stores, revealing shoppers' relative perceptions.

Source: BBDO

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Developing a Positioning Strategy: Guiding Questions

- Which positions are of greatest value to our target customers, given their needs?
- Which of these positions are "taken," and which positions are relatively free of competition?
- Which of the available positions fits best with our objectives and our distinctive capabilities, *i.e., can we back up the chosen positioning by demonstrable product attributes or benefits?*
- Can we "change the rules" of the game by discovering new critical points of differentiation?
- Are all our positioning messages consistent?

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Conclusion: STP as Marketing Strategy

- Segmentation
  - Identify segmentation bases and segment the market
  - Develop profile of resulting segments
- Targeting
  - Evaluate attractiveness of each segment based on 3Cs
  - Select target segments
- Positioning
  - Use perceptual map to identify current positions
  - Identify positioning concepts for each target segment
  - Select, develop, and communicate the chosen concept

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An Afterward:

- What about personalization? And mass customization?
  - Information technology lowers the cost of
    - Gathering information about consumers
    - Changing the product
  - But there is still the trade-off:
    - Finer, smaller segments are expensive
    - Must produce increase in loyalty, satisfaction, and ultimately profits

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Listening to the Customer 15.821 H1

- Understand strengths and weakness of the most important qualitative research methods
- Learn how to get quick customer input, skipping the market research middleman
- Do a Voice of the Customer project
- For everyone (marketing, product development, consulting..)

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Strategic Market Measurement 15.822 H2

- Learn how to create, interpret and analyze a market research survey
- Emphasis on market structure and segmentation
- Hands-on conjoint and cluster analysis
- For consulting, market research careers
- 15.821 NOT a prerequisite

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Fall 2010

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Branding: Functional and Psychological Value

Session 9

Marketing Management

Prof. Natalie Mizik

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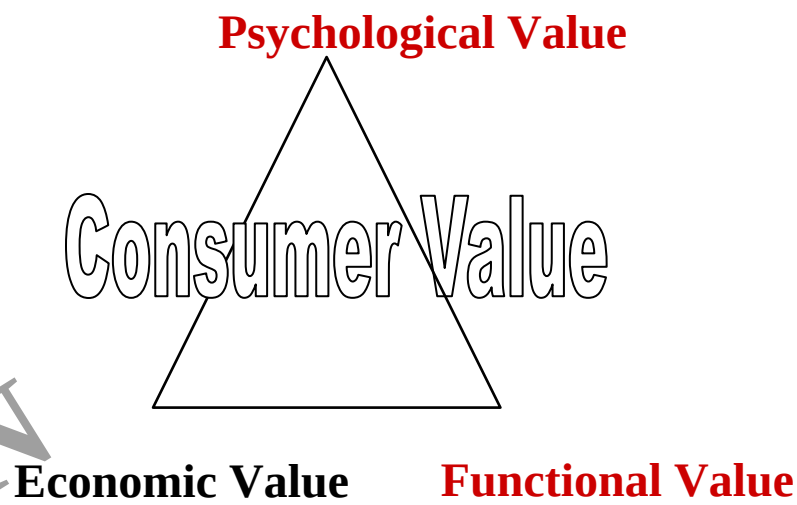
•"Our company's name and trademarks are by far our most valuable assets."

•Johnson and Johnson Corporate Management

Outline

Functional Value
- The multi-attribute model
- Conjoint Analysis



Psychological Value: Branding
- What is a brand?
- How do you extend a strong brand?
- How do you place a value on a brand?

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Functional Value: Multi-Attribute Model

your product

$$\text{Preference}_k = \Sigma\, b_{ik}\, e_i$$

perception that your brand possesses the attribute

importance of each attribute

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Products have Psychological Value

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What is a Brand?

- . . . A name, term, sign, symbol, or design, or a combination of them intended to identify the goods and services of one seller or group of sellers and to differentiate them from those of competition.
- . . . A promise that a firm makes to its customers.

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Importance of Brands

- ***"What's in a name? That which we call a rose by any other name would smell as sweet."***

  - *William Shakespeare*

- "Shakespeare was wrong. A rose by any other name would not smell as sweet ... which is why the single most important decision in marketing of perfume is the name.

  - *Al Ries and Jack Trout,* Marketing Warfare

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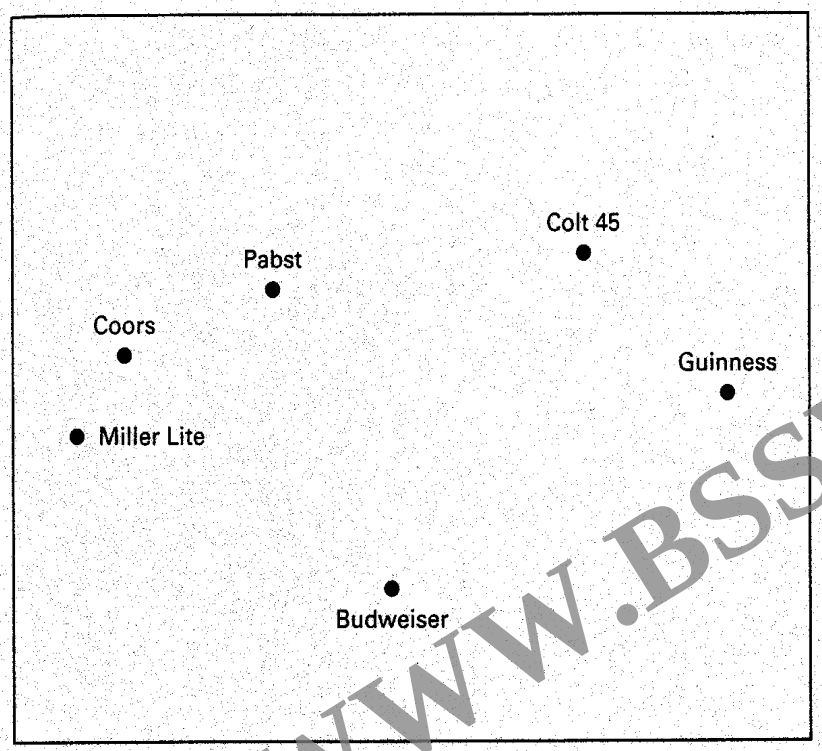
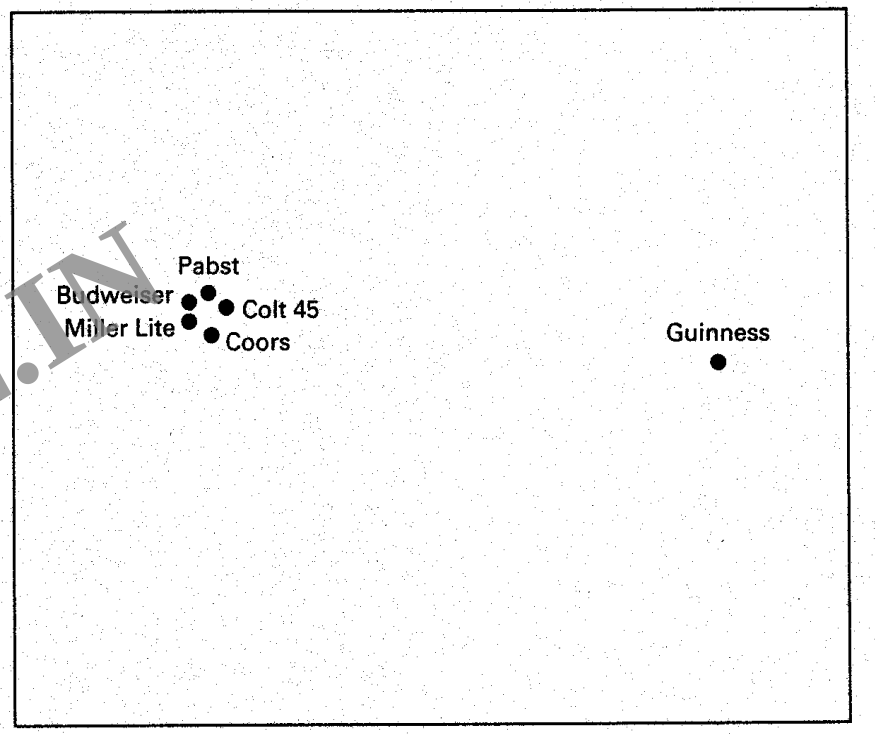
Importance of Brands:

Brands impact how we experience products



A. Taste Perceptions of Six Beer Brands When the Drinker Knows What He Is Drinking



B. Taste Perceptions of Six Beer Brands When the Drinker Does **Not** Know What He Is Drinking

FIGURE 2–2 Results of "Blind" Beer Taste Tests

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Power of Brands: Brand Equity = Financial Power

- **Consumer based**
  - Loyalty, reduced price sensitivity
- **Product market based**
  - Product differentiation
  - Price premium over unbranded alternatives
  - Barriers to competition
  - Ability to extend brand name to other categories
  - Leverage in distribution channels
- **Financial market based**
  - Willingness of firms to pay for established brands
  - Cost of "creating" a new brand
  - Value from licensing
- Half of market value of Fortune 250 is in intangible assets

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Brand Salience:
Brand Name, Awareness and Associations

- Awareness ⇨ Familiarity ⇨ Attitude
- Inhibits recall of competing products
- Stays in consumer memory for a long time
- Names, symbols and slogans create associations which aid memory

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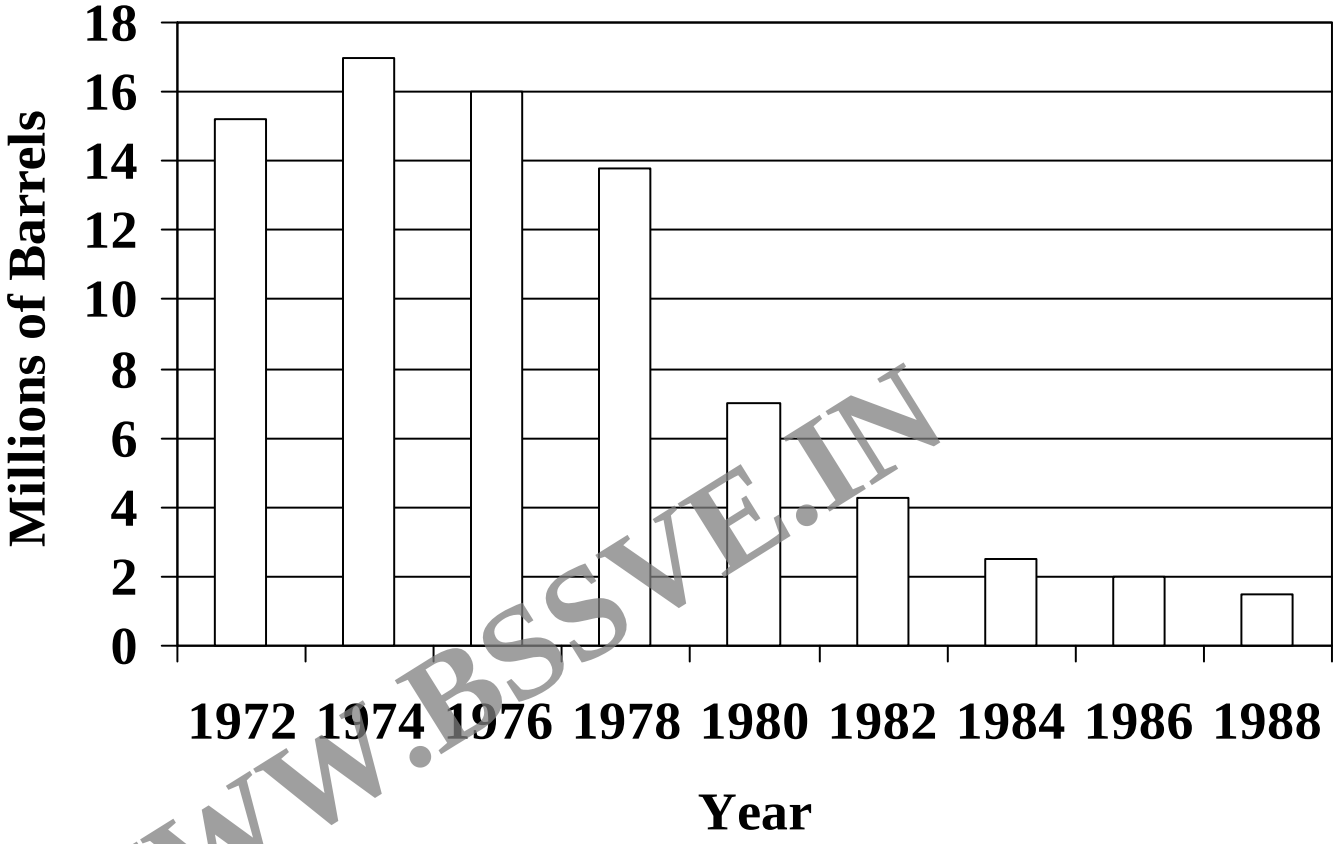
Managing Brand Equity: Schlitz Beer Sales



Source: David Aaker (1991), *Managing Brand Equity*

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Building Brand Equity

. . . Response to a product due to brand name over and above other aspects of the product offering.

- **Having it is good (we know this), but how do you build it (we don't know this so well)?**

Geo Prizm & Toyota Corolla are "twin cars"
Both are manufactured in the same factory in Fremont California. The Toyota costs $400 more and sales are 5 times higher for the Corolla. Toyota earns 108M dollars more than GM.

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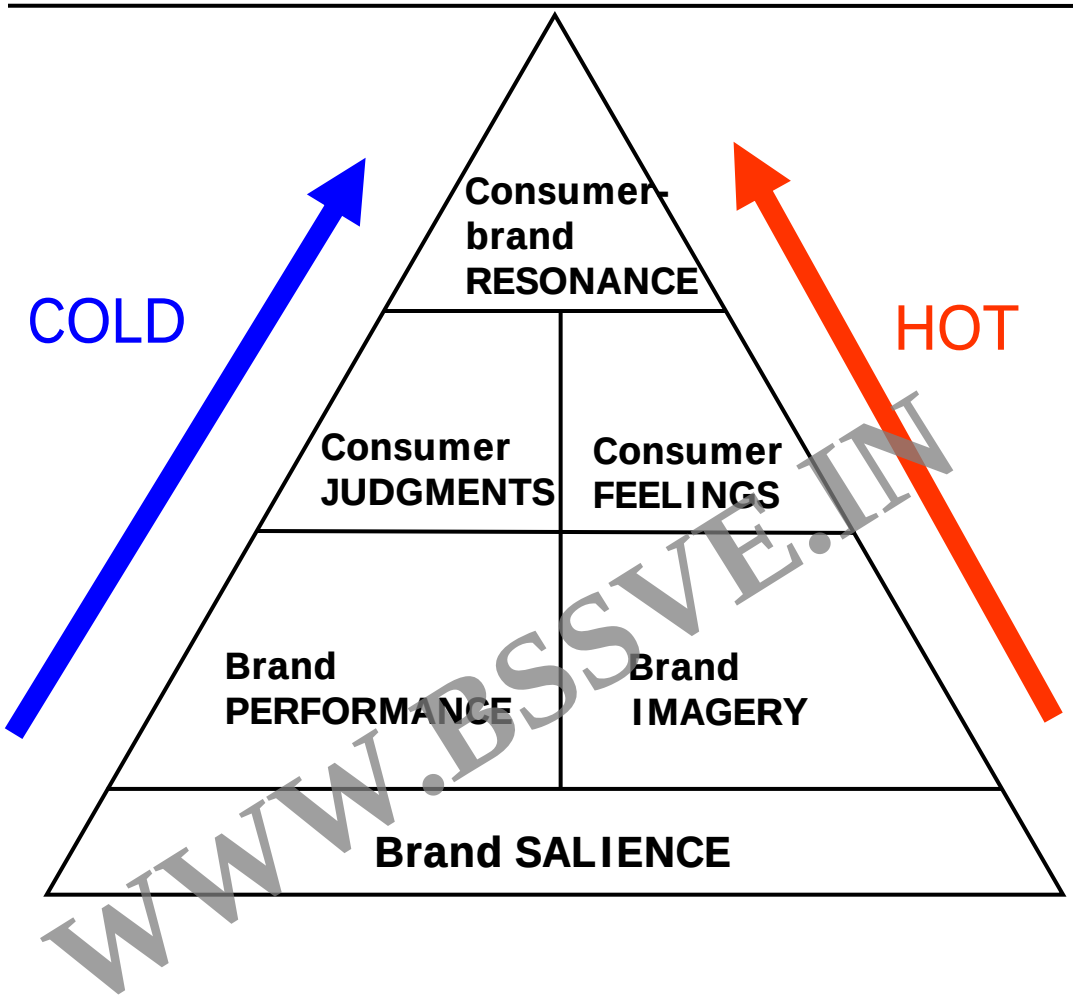
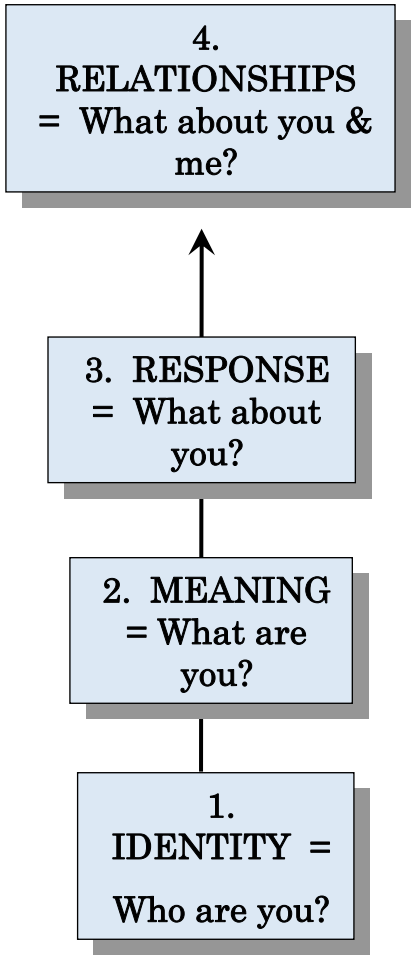
Core Brand Values Pyramid





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by Kevin Keller
MARKETING

Prof. Natalie Mizik – 2010 MIT 15.810

EXAMPLE: (COLD path of pyramid) Building utilitarian associations with a brand

- Cadillac transforming image via performance
  - From Car and Driver Review:
    - "With a folding hardtop that completely disappears at the touch of a button, the XLR presents a sleek and clean profile"
    - "Under the XLR's hood lies its most significant major mechanical distinction – the 4.6 liter Northstar V-8...upgraded in a variety of ways for improved performance, emissions, and fuel economy"
  - New ad strategy is to move from heritage—classic Caddies morphing into models—to performance (engineering and speed)
- Benefits to revitalizing the Cadillac brand
  - Average age of buyers has dropped
  - Resale values are rising

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EXAMPLE: (HOT path of pyramid) Building Imagery and Feelings to a Brand

- MasterCard and the Priceless Campaign
  - Visa and American Express were targeting high end
  - Yet – there was an increase in purchasing power of "Middle Class" Americans.
  - THEME: "Living the good life…was not the accumulation of material things, but the sharing of meaningful moments with loved ones and close friends."
  - CATCH PHRASE: "There are some things money can't buy. For everything else there's MasterCard."
  - BENEFITS:
    - Global Reach: Variations in 96 countries / 45 languages
    - Accepted at more locations around the world than any other card
    - # of Cards in US: MasterCard 319 Mil > Visa (270 Mil)

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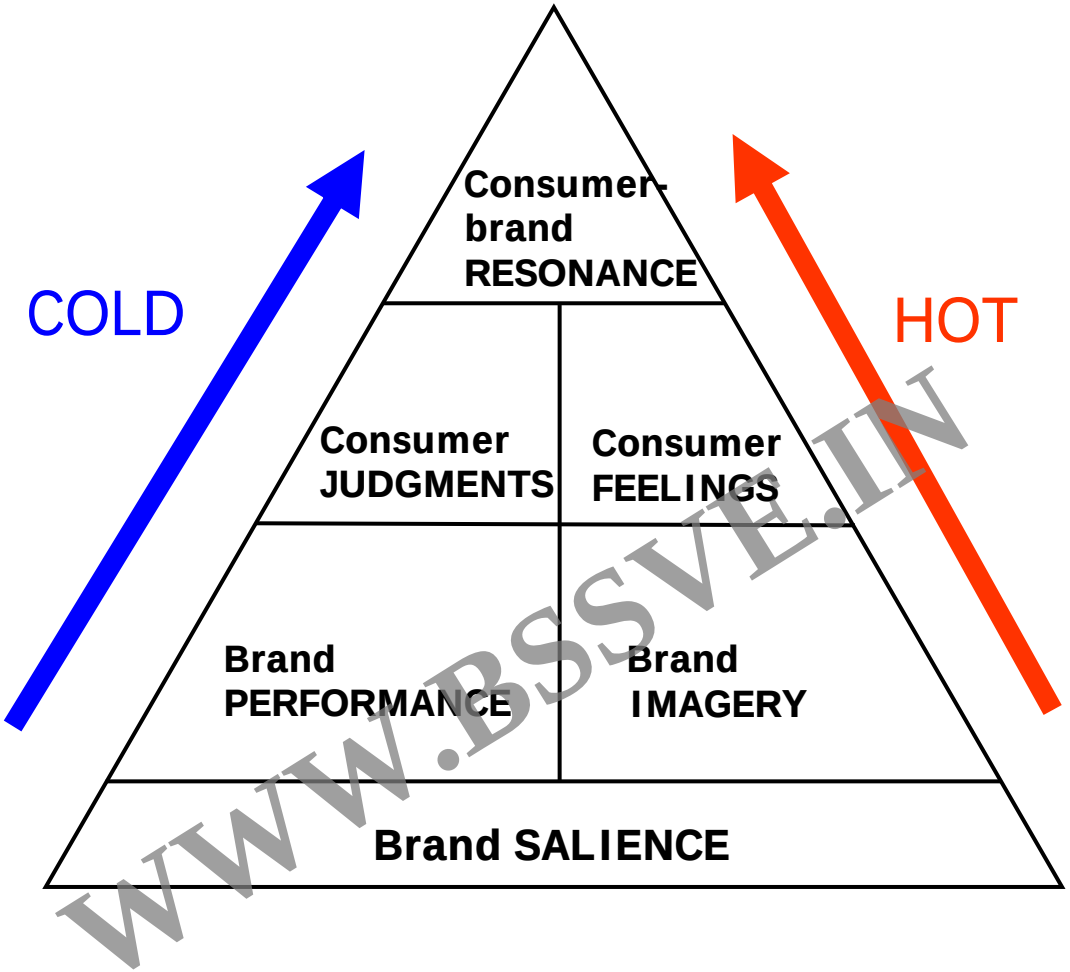
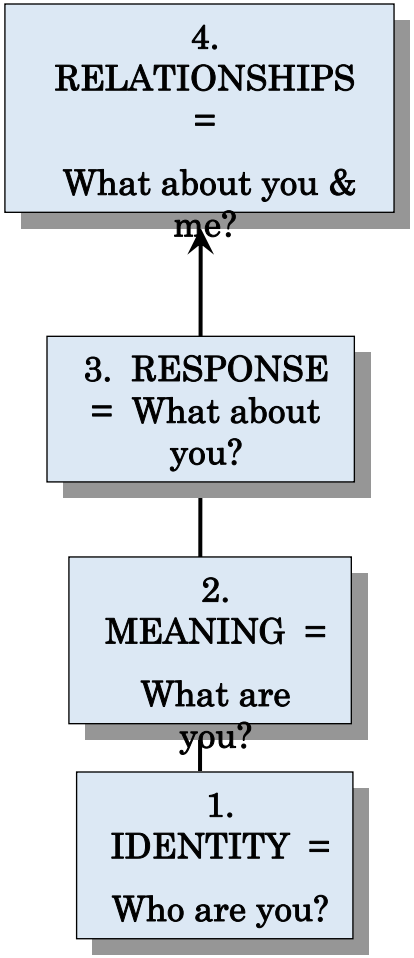
Reminder: where we are





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Resonance: Brand Communities

- 3 core components of a community

  Shared consciousness : members feel they sort of know each other
  - "Who else drives Broncos: Guys like myself and guys who like engines..."

  Rituals and traditions: way in which meaning of community is reproduced
  - "If you drove a Saab, whenever you passed someone else driving a Saab on the road, you beeped or flashed your lights."

  Sense of moral responsibility: sense of duty to community as a whole
  - "we see another Saab on the road, we pull over and help, no matter what it is"

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Brand Extension

Brand Name	Product Category: Existing	Product Category: New
Existing	Line Extension	Brand Extension
New	Multibrands	New Brands

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Extending a brand name may . . .

- Provide a point of differentiation
  - e.g., Weight Watchers
- Aid in gaining awareness (less expensively)
  - e.g., Hershey pudding,
  - Starbucks ice cream, instant
- Aid in communication of complex idea
- Induce trial/reduce risk
- Increase favorability of evaluation

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House of Brands vs. Branded House: Example of "Umbrella" Branding

- What company sells:
  - Airline travel
  - Credit cards
  - Cola
  - Vodka
  - Wedding coordination services
  - Movies (theatre)

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Brands are Important and Powerful,

but

The trouble with Brand Equity is that it has no consistent meaning…. No one knows how to measure it…

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Brand Valuation:

There are three main brand consultancies (among many) producing annual brand rankings:

Interbrand "Best Global Brands"

Published in *Business Week* in September

(since 2010 published in WSJ)

Millward Brown "Top 100 Lists"

Published in the Financial Times in April

Brand Finance "The World's 500 Most Valuable Brands"

Published on their website in April

Interbrand and Millward Brown use the earnings split approach; Brand Finance uses relief from royalty

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Highly Divergent Estimates of Brand Value

Brand	IB BV 09	Brand	MB BV 09	Brand	BF BV 09
Coca-Cola	68,734	Google	100,039	Wal-Mart	40,616
IBM	60,211	Microsoft	76,249	Coca-Cola	32,728
Microsoft	56,647	Coca-Cola	67,625	IBM	31,530
GE	47,777	IBM	66,622	Microsoft	30,882
Nokia	34,864	McDonald's	66,575	Google	29,261
McDonald's	32,275	Apple	63,113	GE	26,654
Google	31,980	China Mobile	61,283	HSBC	25,364
Toyota	31,330	GE	59,793	Vodafone	24,647
Intel	30,636	Vodafone	53,727	Hewlett-Packard	23,837
Disney	28,447	Marlboro	49,460	Toyota	21,995
Hewlett-Packard	24,096	Wal-Mart	41,803	Bank of America	21,017
Mercedes	23,867	ICBC	38,056	McDonald's	20,003
Gillette	22,841	Nokia	35,163	Nokia	19,889
Cisco Systems	22,030	Toyota	29,907	AT&T	19,850
BMW	21,671	UPS	27,842	Verizon Wireless	18,854
Louis Vuitton	21,120	Blackberry	27,478	China Mobile	17,196
Marlboro	19,010	Hewlett-Packard	26,745	Orange	16,799
Honda	17,803	BMW	23,948	Disney	16,750
Samsung	17,518	SAP	23,615	Budweiser	16,692
Apple	15,443	Disney	23,110	Tesco	16,408

Source: Type 2 Consulting

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No Agreement on the Direction of Change

Brand	09 vs 08 I'BRAND	09 vs 08 M BROWN	09 vs 08 B FINANCE	Sign change conistent?
Coca-Cola	3%	16%	-28%	NO
Microsoft	-4%	8%	-31%	NO
Google	25%	16%	-32%	NO
IBM	2%	20%	-17%	NO
GE	-10%	-16%	-26%	YES
McDonald's	4%	34%	-8%	NO
Apple	13%	14%	-37%	NO
Nokia	-3%	-20%	-40%	YES
Toyota	-8%	-15%	-16%	YES
Hewlett-Packard	2%	-9%	-30%	NO
Disney	-3%	-3%	-15%	YES
Intel	-2%	4%	-45%	NO
BMW	-7%	-15%	-21%	YES
HSBC	-20%	3%	-28%	NO
Gillette	3%	6%	-75%	NO
UPS	-8%	18%	-20%	NO
Cisco Systems	3%	-25%	-40%	NO
Mercedes	-7%	-14%	-51%	YES
Oracle	-1%	-6%	17%	NO
Pepsi	3%	-3%	-38%	NO

Source: Type 2 Consulting

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Measuring Brand Value: Customer Based-Approaches

- Indirect approaches
  - Brand awareness and association measures
- Direct approaches
  - "Brand blind" experiments
  - Willingness to pay
  - Conjoint analysis

Brand	Price Premium $
IBM	295
Compaq	232
Apple	195
Dell	92
HP	76

Source: McKinsey & Company, 1995

$$U_{IBM} = BE_{IBM} + a_1 speed + a_2 memory + \ldots$$

$$U_{Base-Brand} = a_1 speed + a_2 memory + \ldots$$

$$BE_{IBM} = U_{IBM} - U_{Base-Brand}$$

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Measuring Brand Value: Accounting and Financial Market-Based Approaches

- "Goodwill" in balance sheet
- Acquisition cost - Tangible assets
- Cost of launching new, successful brand
- Earnings split method
- Stock Market Response to change in Brand quality/ awareness/ perceptions/ etc. measures

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Brand Value and Market Value

Do brand perceptions affect capital market valuation?

- Data: 2000-2006 (perceived brand **Differentiation, Relevance, Esteem, Knowledge, Energy**)
- Method: Regression-based model
- Results: brand perceptions data significantly improves enterprise valuation accuracy: % improvement in mean absolute forecast error by sector

(1)	industrial	17.4%
(2)	finance	7.6%
(3)	retail, apparel	2.4%
(4)	high-tech	7.0%
(5)	nondurables	9.3%
(6)	durables	30.2%
(7)	travel, transport	15.7%

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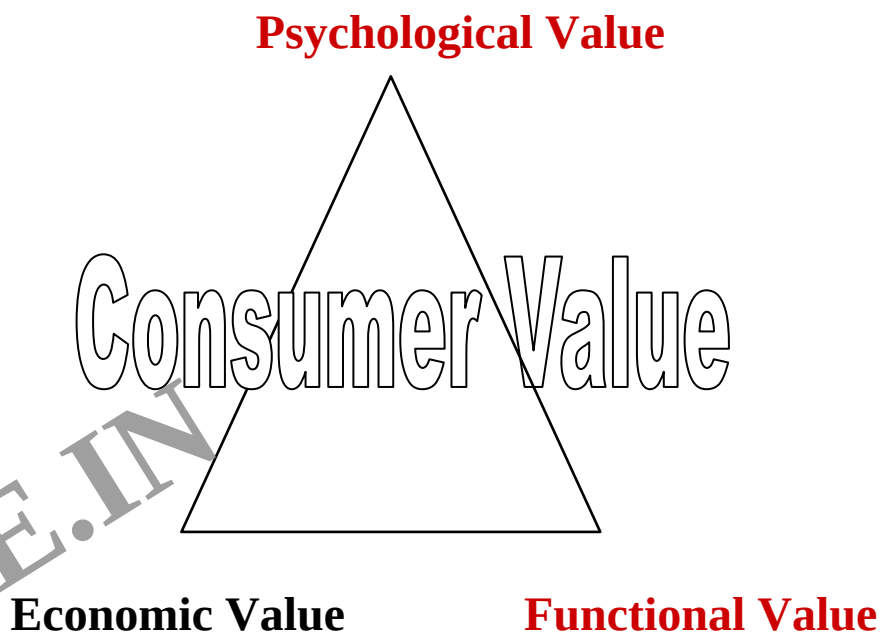
Mizik, Natalie and Robert Jacobson (2009), "Valuing Branded Businesses," ***Journal of Marketing***, 73 (6), 137-153
Mizik, Natalie and Robert Jacobson (2008), "The Financial Value Impact of Perceptual Brand Attributes," ***Journal of Marketing Research***, 45 (1), 15-32

Conclusion

- Functional value
  - multiattruibute model
  - conjoint analysis
- Brand are valuable assets
- Key elements of customer state-of-mind brand value:
  - awareness
  - perceptions
  - associations
- Measuring brand value is possible, though more refinements are needed
- Brands value needs to be managed and enhanced



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15.846: Branding

- **This course will provide you with the tools to manage brands in unpredictable markets.**
  - Cases from a variety of industries.
  - Examine brands at various stages in the life cycle (from start-up, to mature, and in-between).
  - Quantitative and qualitative methods.
  - Relevant to novices and experienced brand managers, people interested careers in Brand Management, Consulting, Media, Advertising*, Entrepreneurs, and anyone who has ever purchased a branded item.

**Sorry, you will not be trained to be the next Don Draper.*

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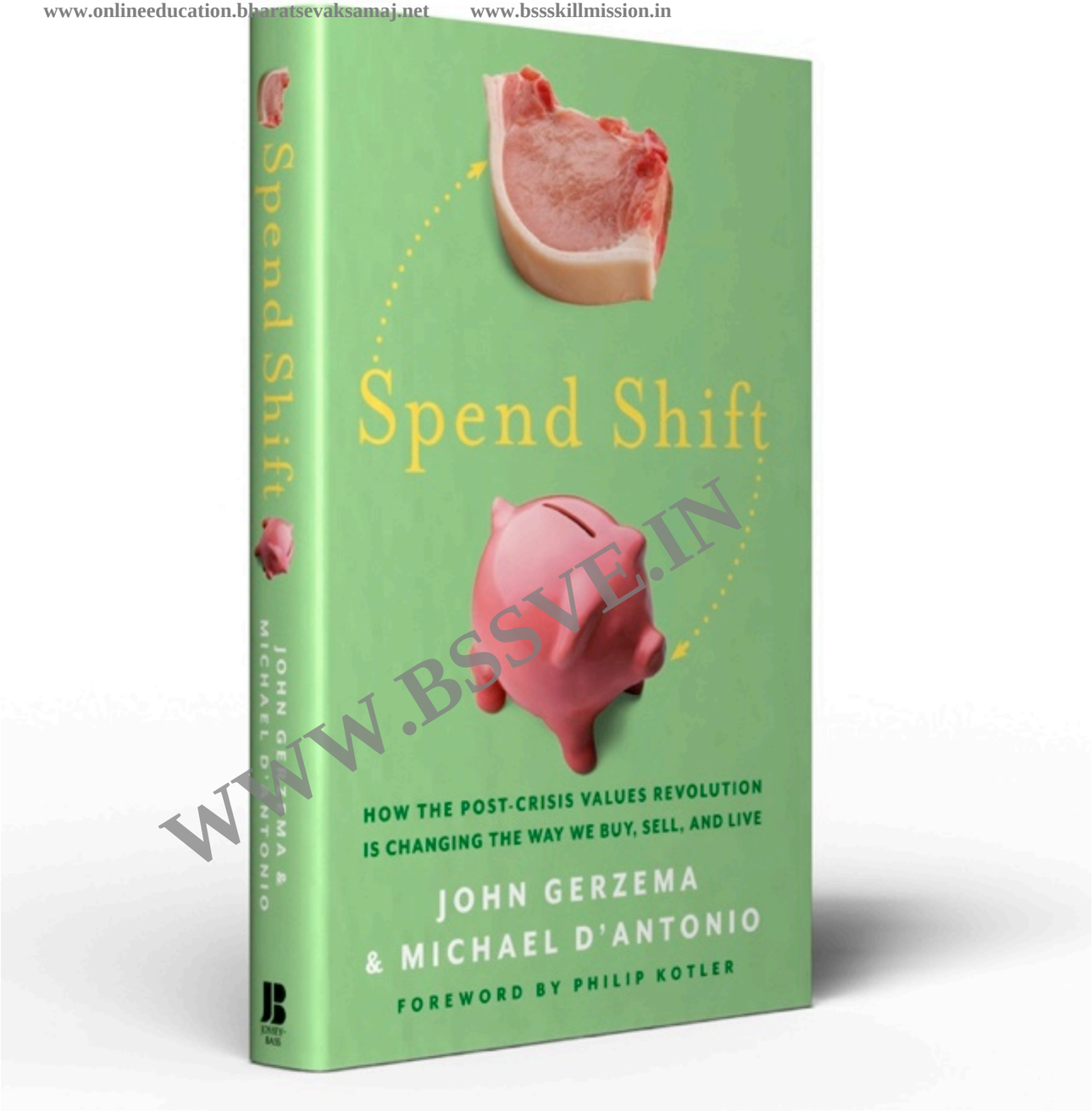

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WE EXAMINED 18 YEARS OF DATA FROM BRAND ASSET VALUATOR®

WORLD'S LARGEST DATABASE OF BRANDS

50,000 BRANDS

QUARTERLY U.S. PANEL OF 16,000 RESPONDENTS

OVER 800,000 CONSUMERS

275 STUDIES ACROSS 51 COUNTRIES

$ 130 MILLION INVESTED

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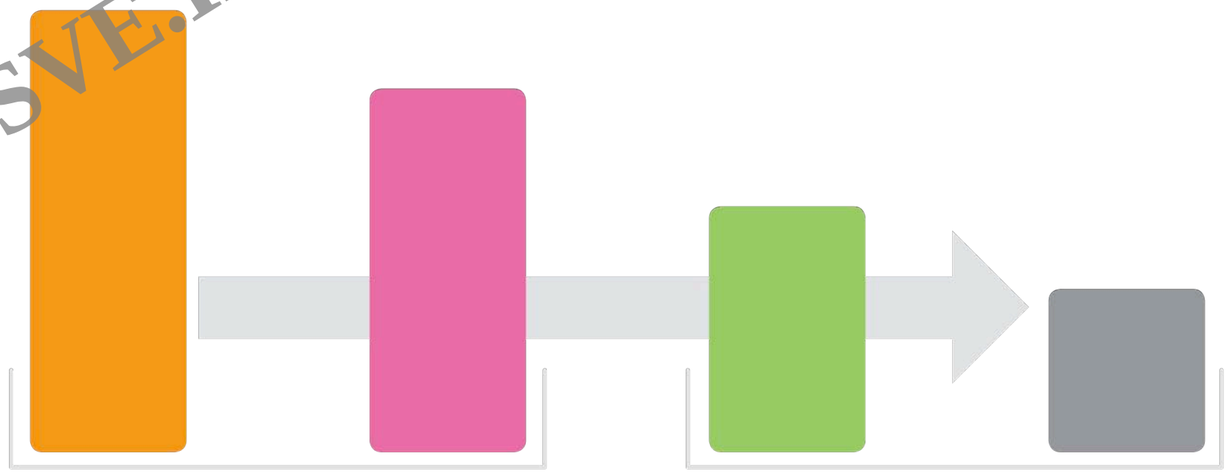
FOUR PILLARS ASSESS BRAND HEALTH, MOMENTUM AND COMPETITIVE ADVANTAGE

ENERGIZED DIFFERENTIATION
A brand's unique meaning, with motion and direction
Relates to margins & cultural currency

RELEVANCE
How appropriate the brand is to you
Relates to Consideration & Trial

ESTEEM
How you regard the brand
Relates to Loyalty

KNOWLEDGE
An intimate understanding of the brand
Relates to brand Saliency



BRAND STRENGTH
Leading Indicator
Future Growth Value

BRAND STATURE
Lagging Indicator
Current Operating Value

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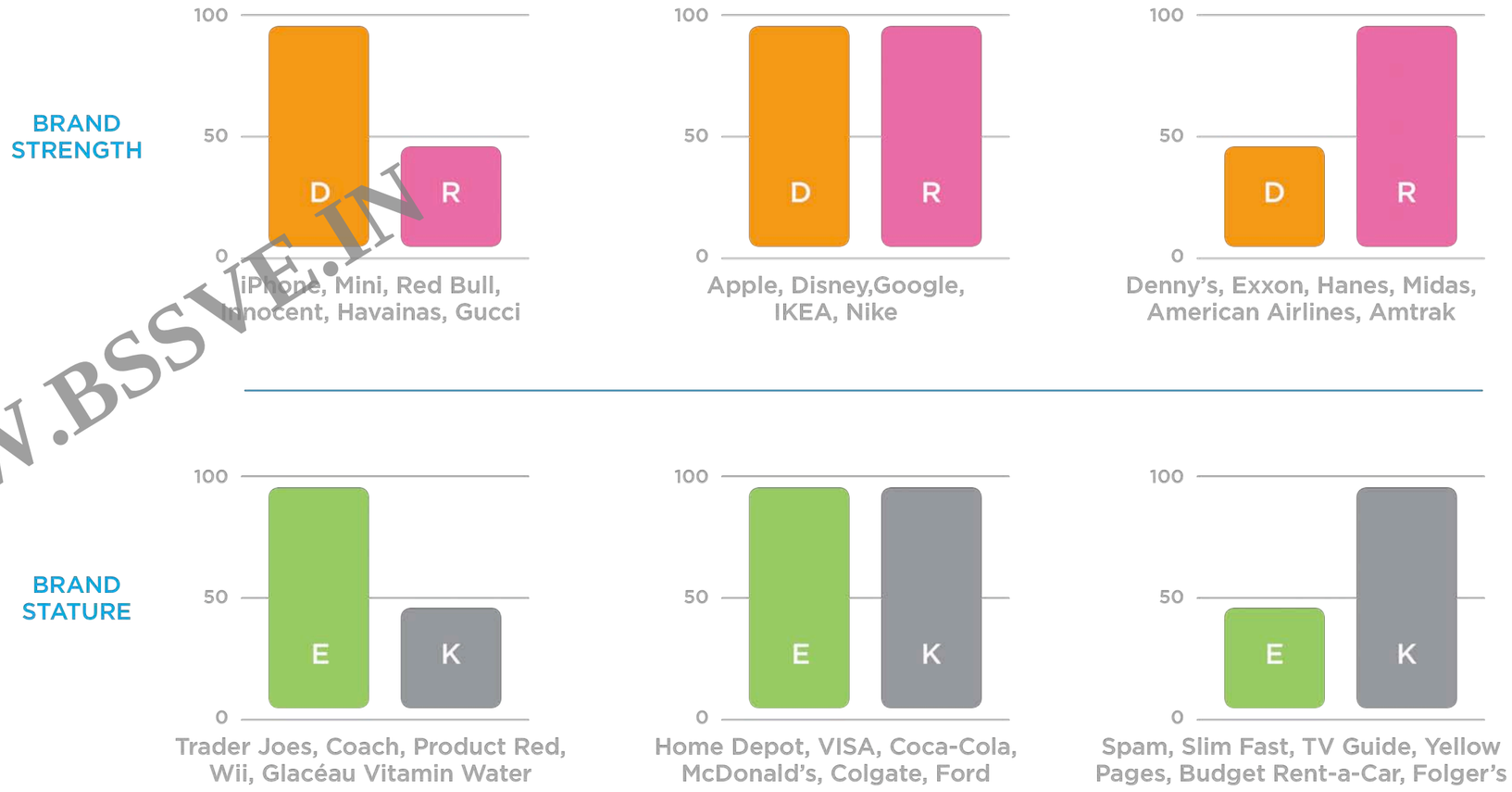
THE RELATIONSHIP BETWEEN EACH PILLAR TELLS A DIFFERENT STORY IN THE BRAND'S DEVELOPMENT



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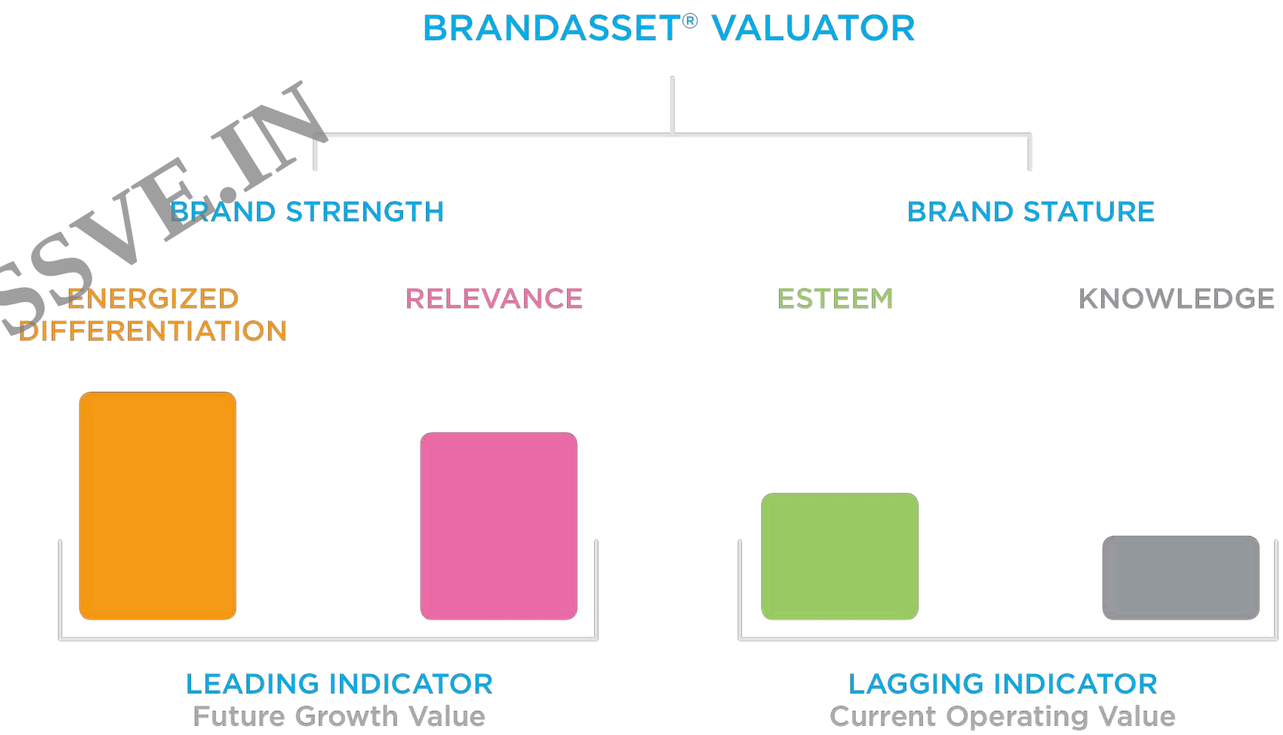
BRAND STRENGTH IS THE FIRST LEVEL OF MEASUREMENT IN ASSESSING A BRAND'S HEALTH



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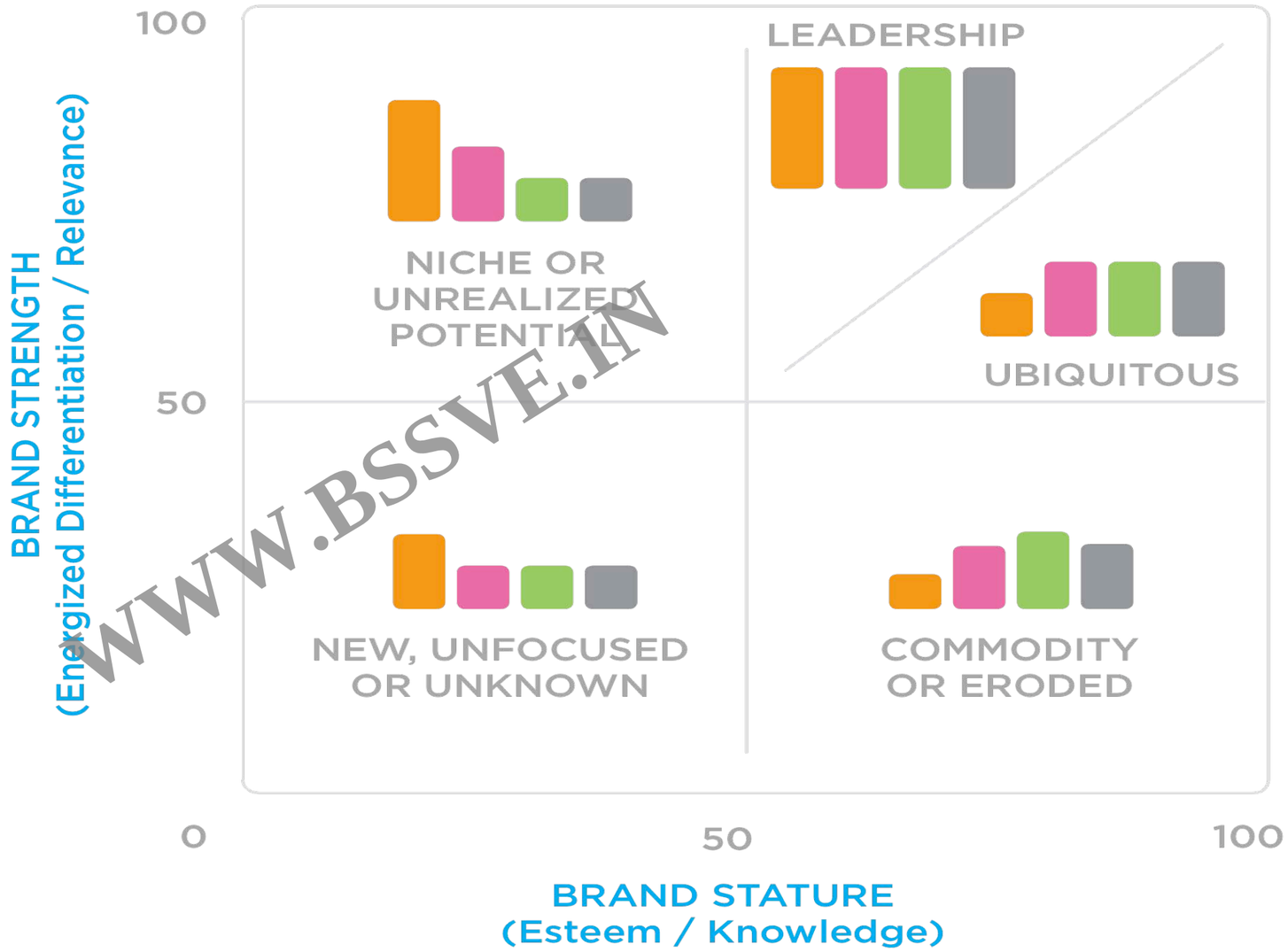
THE BAV POWERGRID



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TO SUPPLEMENT OUR DATA, WE TRAVELED ACROSS AMERICA

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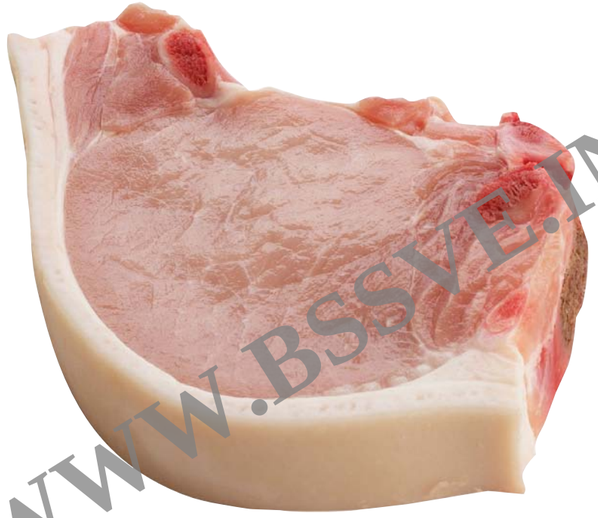
WE ARE MOVING FROM MINDLESS TO MINDFUL CONSUMPTION



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THE SPEND SHIFT IS THE MAJORITY OF AMERICA

THE SPEND SHIFT IS A CONSUMER LED MOVEMENT TO PROMOTE VALUES THROUGH THE POWER OF CONSUMPTION

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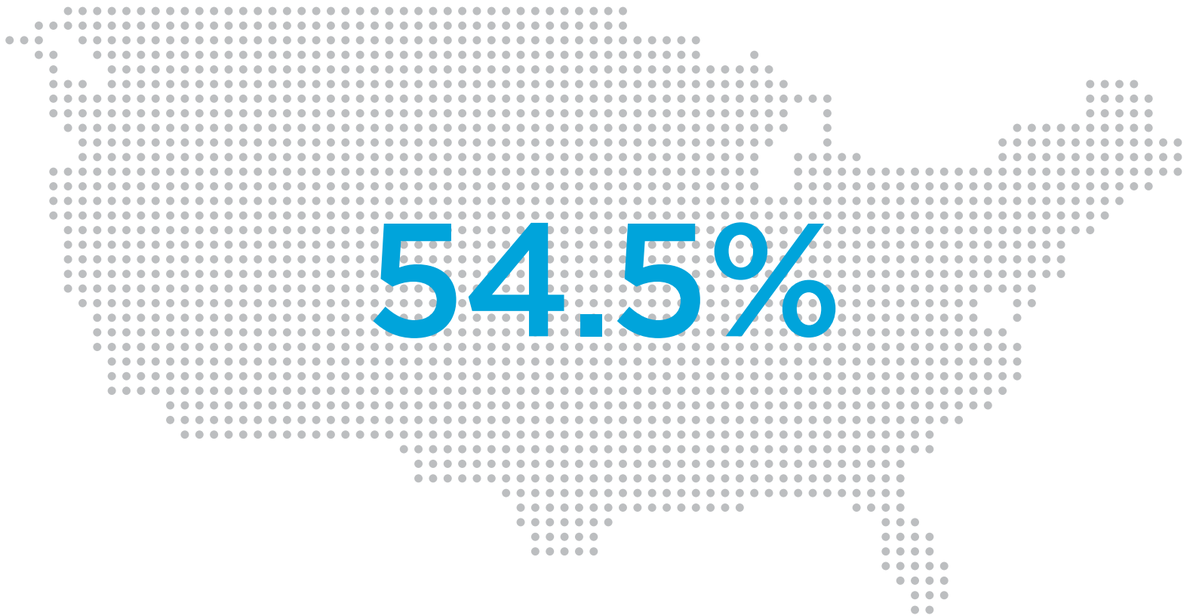

113.4 MILLION PEOPLE

9 Total US population estimate age 22+ / 208 million people Another 126.6% exhibit similar beliefs and behaviors (55.4 Million people)

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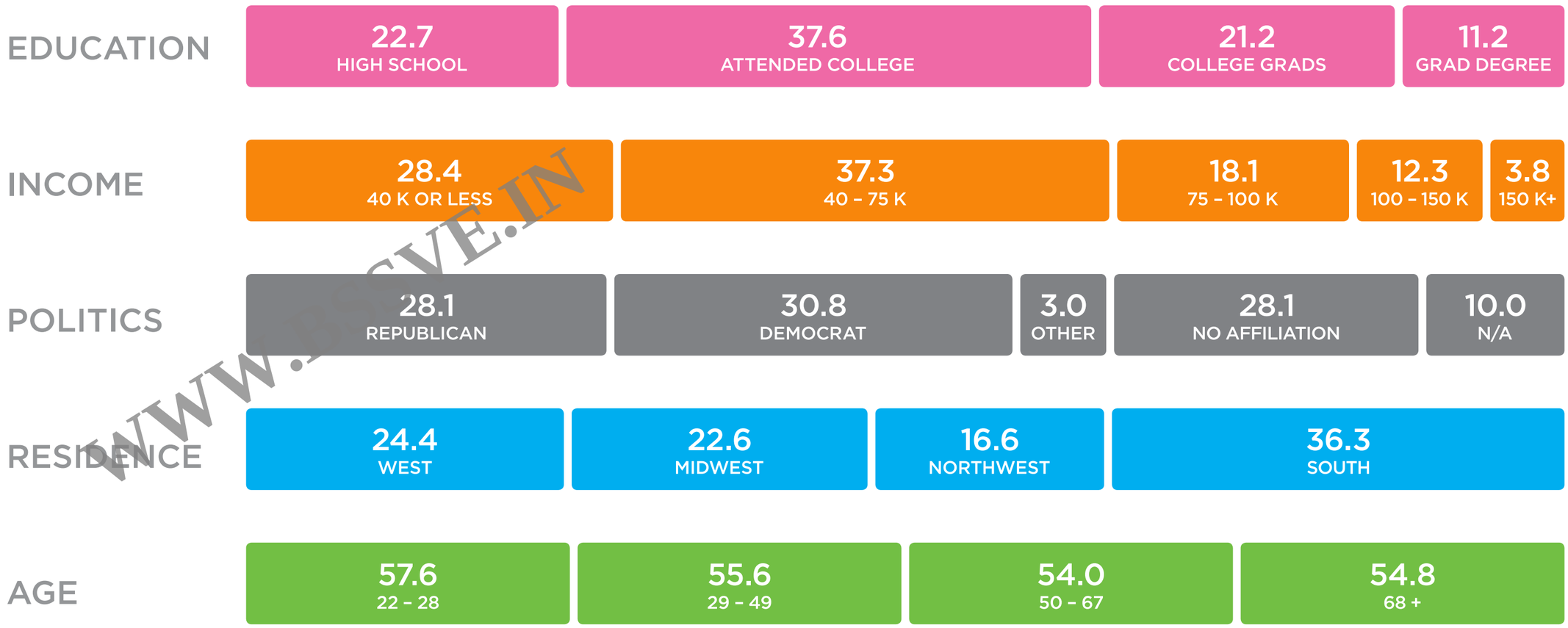
THE SPEND SHIFT SUGGESTS WE'RE MORE ALIKE THAN DIFFERENT



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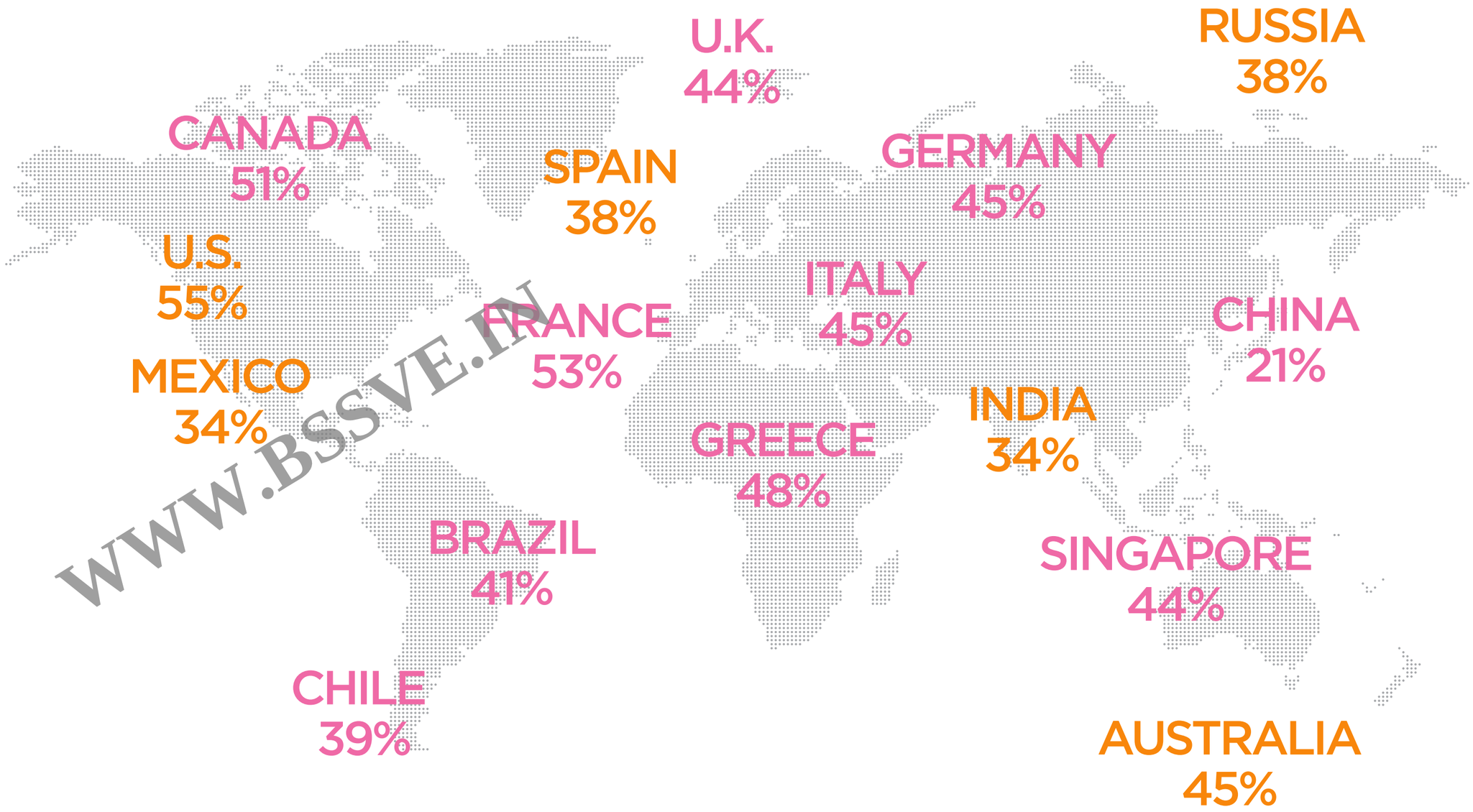
SPEND SHIFTERS THROUGHOUT THE WORLD



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Source: BrandAsset ® Valuator' international values segmentation
— 4-C's (Cross-Cultural-Consumer-Characterization)

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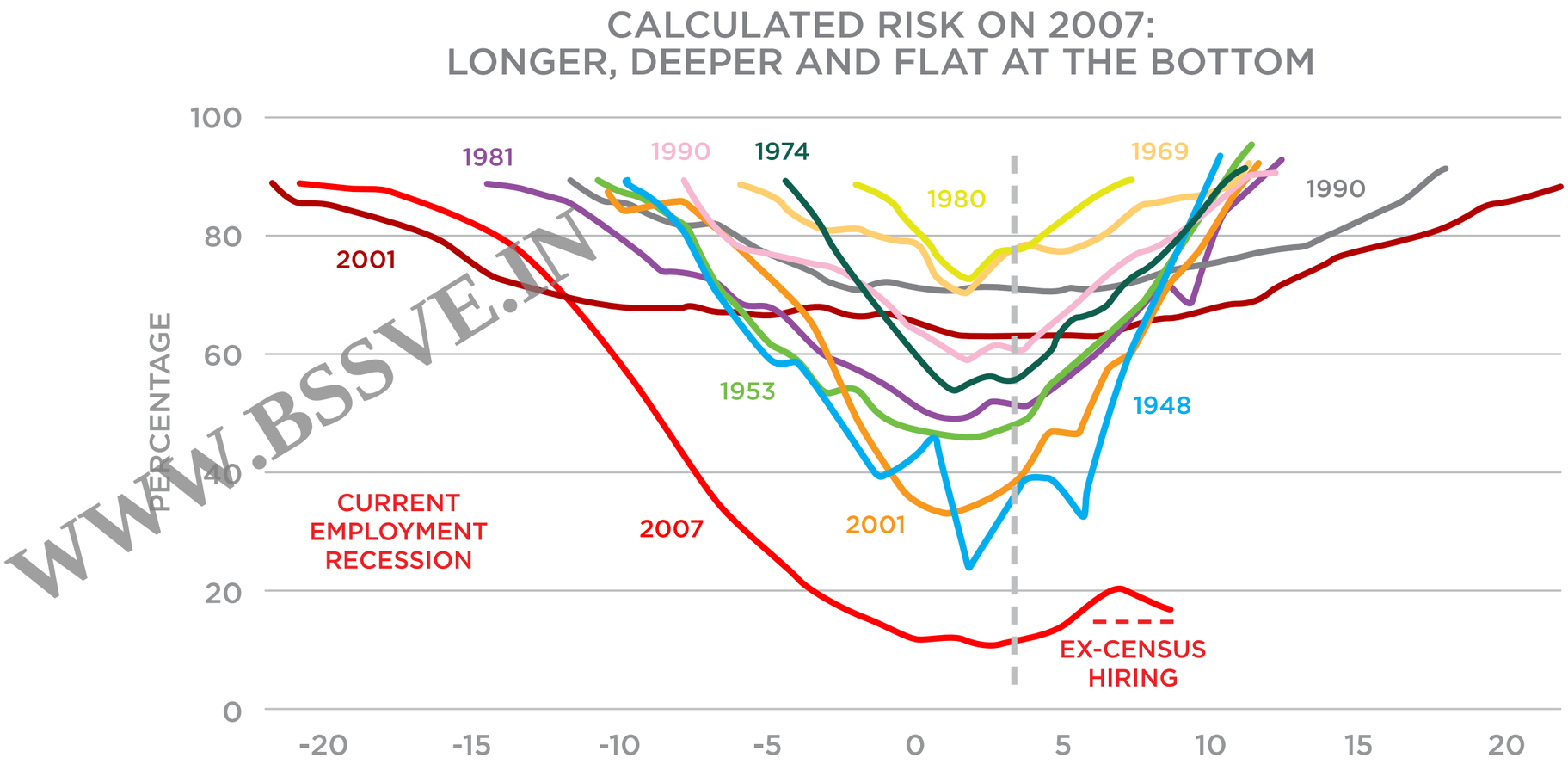
FOR 80% OF AMERICANS, THIS IS A RECESSION LIKE NO OTHER



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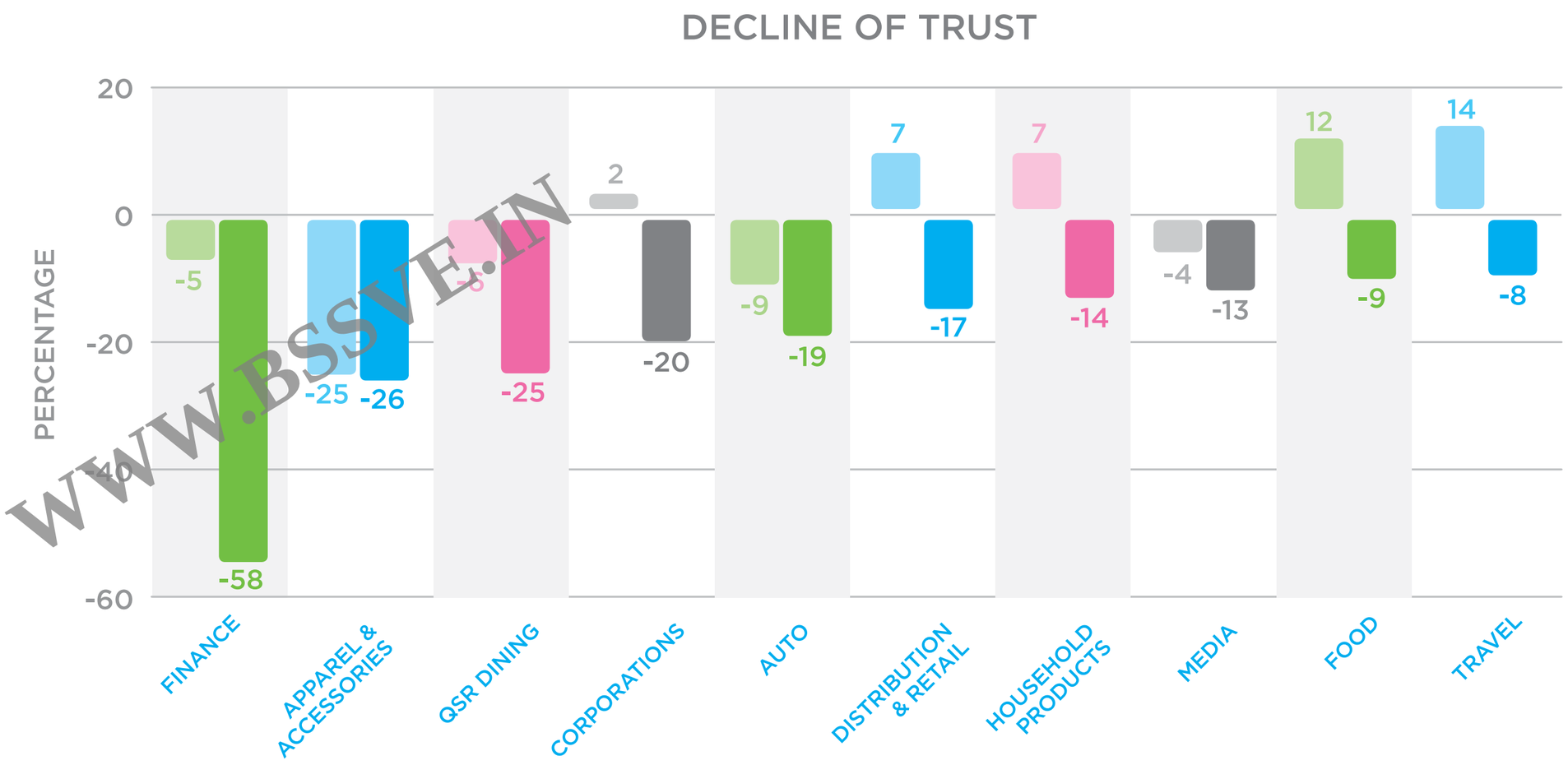
TRUST DECLINE ACROSS INDUSTRIES 2005 TO 2010



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NEW PRIORITIES IN EXPECTATIONS FOR COMPANIES AND BRANDS

5 ATTRIBUTES THAT MATTERED MORE IN THE PAST

MYSTERIOUS -40%

CONFIDENT -31%

SENSUOUS -12%

TRENDY -11%

GLAMOROUS -10%

(TOP LOSERS IN CORRELATION TO ENERGIZED DIFFERENTIATION 2005 VS. 2009 FH)

5 ATTRIBUTES THAT MATTER MORE NOW

KIND +391%

HIGH QUALITY +124%

FRIENDLY +79%

SOCIALLY RESPONSIBLE +63%

LEADER +40%

(TOP GAINERS IN CORRELATION TO ENERGIZED DIFFERENTIATION 2005 VS. 2009 FH)

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THE ROLE OF CONSUMERISM IN THE AMERICAN DREAM IS CHANGING

"I FIND THE MORE I HAVE THE MORE I WANT."

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AND THE ECONOMIC PAIN HAS LEAD US TO RECONSIDER OUR VALUES AND OUR PRIORITIES

"MONEY IS THE BEST MEASURE OF SUCCESS."

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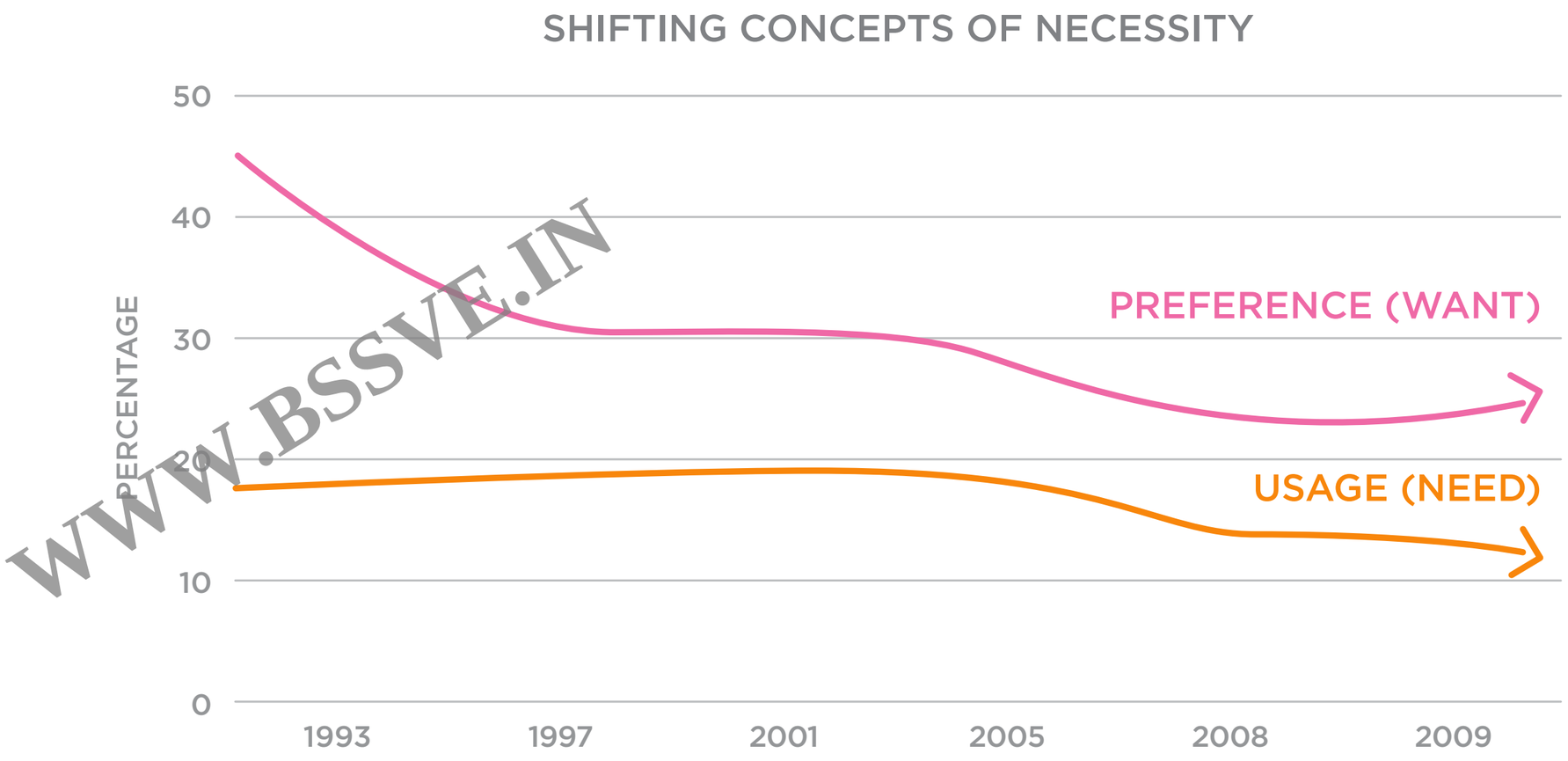
OUR SHIFTING CONCEPTS OF NECESSITY



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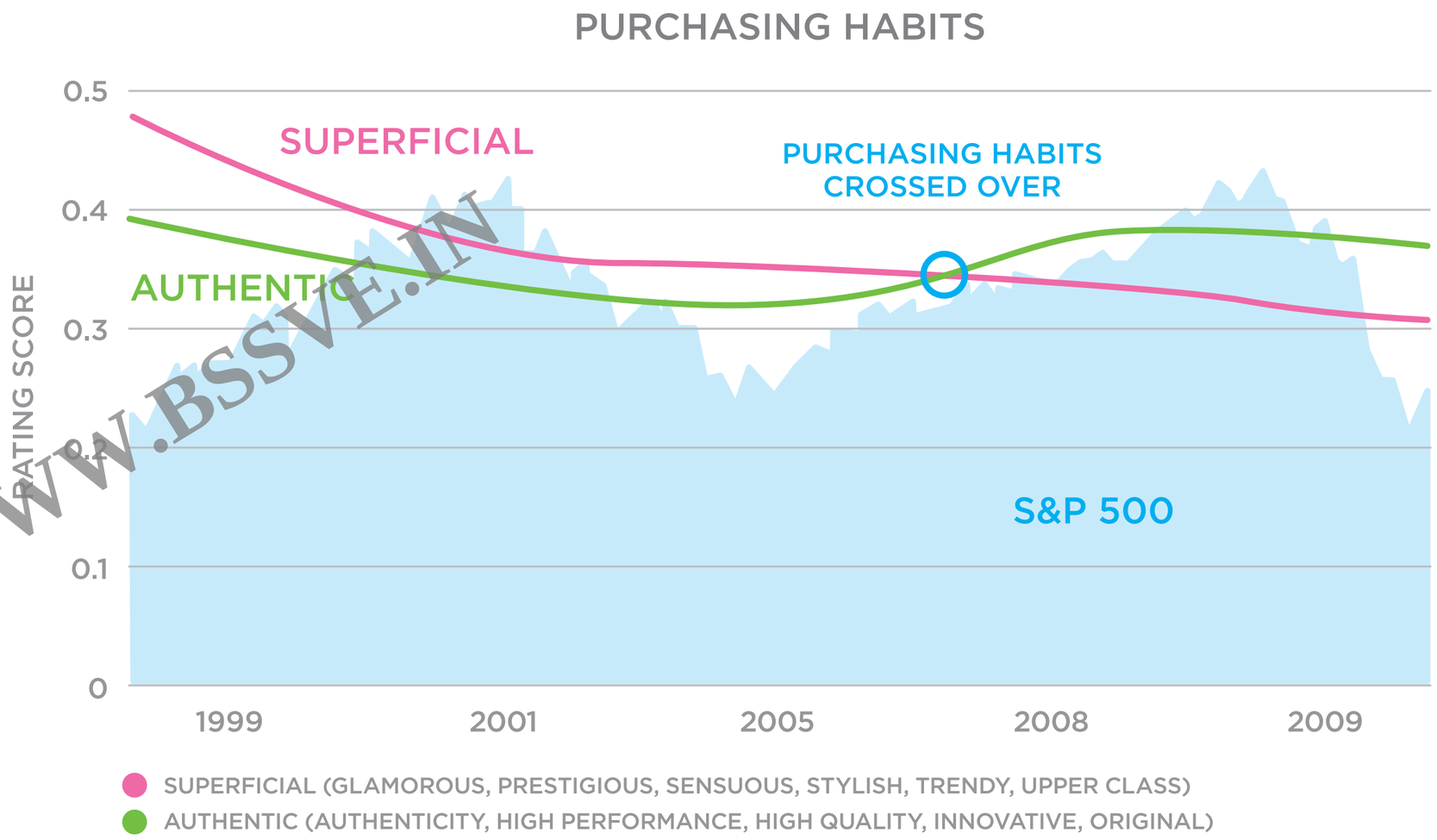
PEOPLE WERE ADJUSTING THEIR LIFESTYLES EVEN BEFORE THE CRISIS HIT



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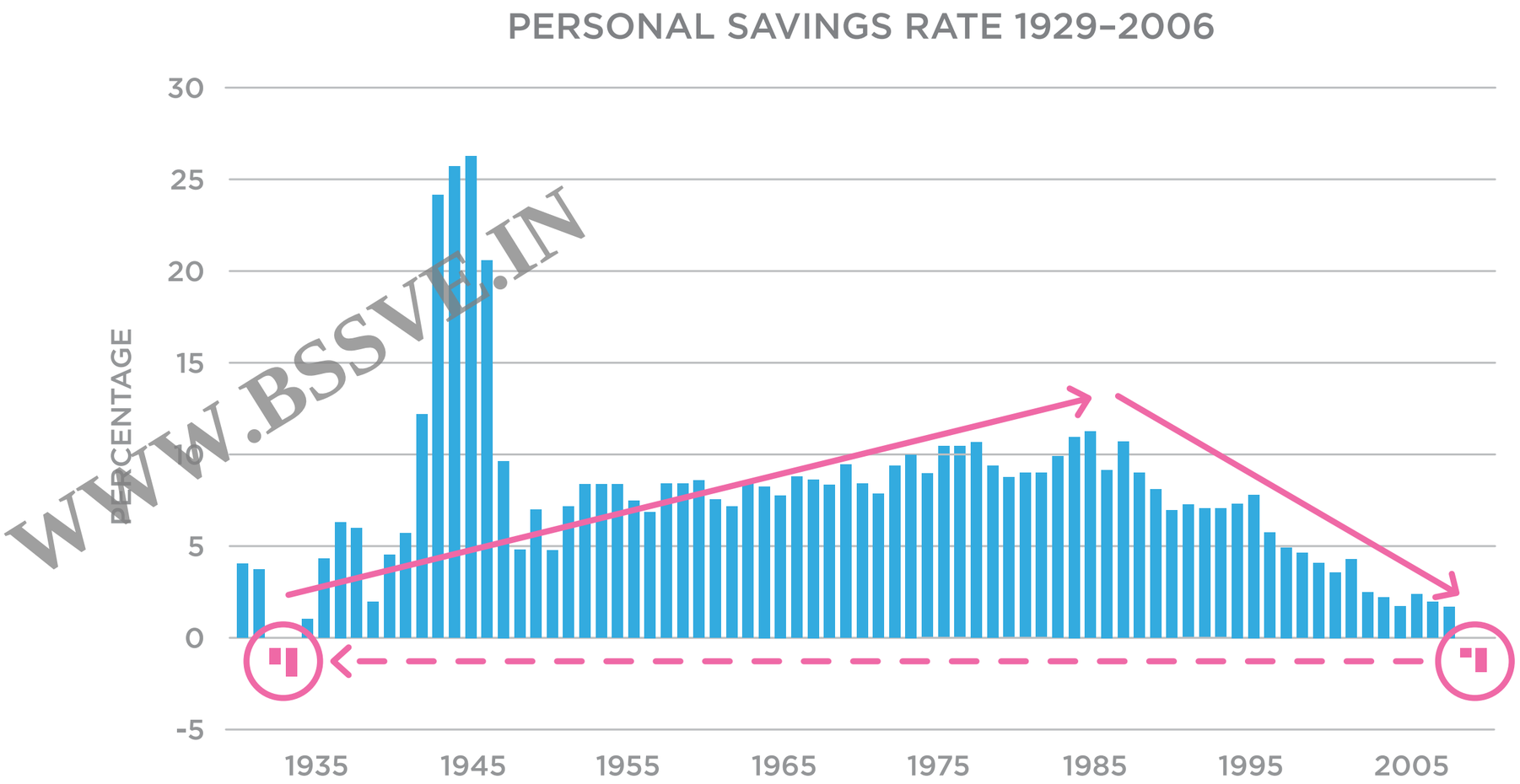
THIS IS NOT A 'NEW NORMAL', BUT A RETURN TO NORMAL



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Source: Board of Governors of the Federal Reserve System

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SPEND SHIFT NO. 1
THE NEW AMERICAN FRONTIER

OPTIMISM | RESILIENCY | OPPORTUNITY

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PEOPLE ARE MORE HOPEFUL AND OPPORTUNISTIC

"SINCE THE RECESSION I'M ACTUALLY MORE CAPABLE OF STARTING MY OWN BUSINESS."

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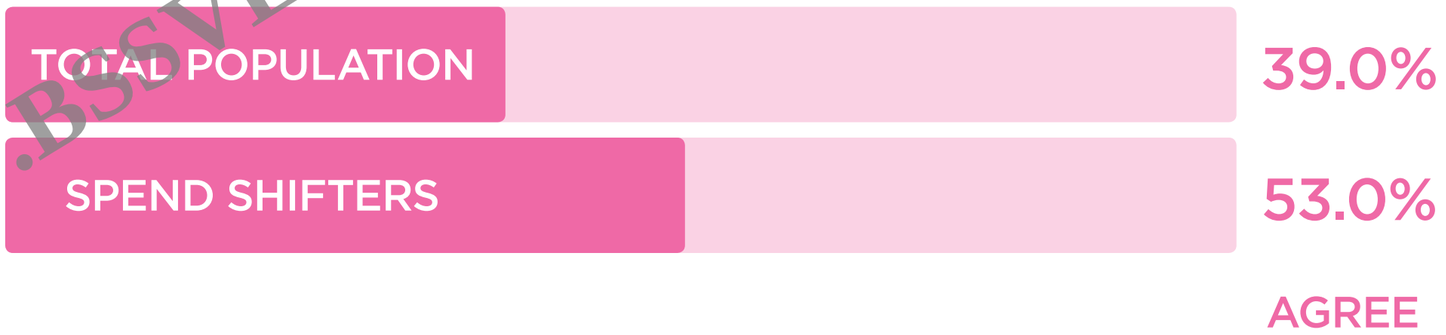
AND MANY ARE MOVING FROM INDUSTRIAL TO INDUSTRIOUS THINKING

"THERE IS A GREATER OPPORTUNITY FOR INDIVIDUAL BUSINESSES TO COMPETE WITH LARGE COMPANIES THAN THERE USED TO BE."



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TORYA BLANCHARD OWNER: GOOD GIRLS GO TO PARIS DETROIT

With low cost loans from the non-profit University Cultural Center Association, Torya Blanchard opened a tiny crepe restaurant to share her love of all things French with her hometown, Detroit. Serving low-cost but high quality meals Good Girls Go to Paris quickly became profitable. The shop also provides jobs and a light of hope in a city where shuttered shops outnumber those that are occupied.

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Charles Sorel opened his little French bistro, Le Petite Zinc, after moving with his family from Brooklyn to Detroit. He had been successful with his cafe in Brooklyn and wanted to try his hand in this new environment. This welcoming little eatery — something like a family kitchen where the coffeepot is always on — makes for the perfect start-up business in any community, especially one that is short of comforts. Le Petite Zinc offers, besides delicious French cuisine, cheer and optimism to its patrons.

CHARLES SOREL OWNER/RACONTEUR: LE PETIT ZINC DETROIT

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PATRICK CROUCH PROGRAM MANAGER: EARTHWORKS FARMS DETROIT

Patrick Crouch of Earthworks Farms has helped turn vacant blocks into productive farms producing everything from salad greens to jarred preserves. Earthworks not only feeds people in an area where grocery stores are scarce, it is helping to change the character of devastated neighborhoods, and raise inner-city employment. Crouch, who is sponsored by local Capuchin monks, teaches other city farmers which crops yield the greatest profit. He says a handful of properties now under cultivation will soon be profitable without any further assistance.

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Paul Savage, CEO of Nextek Power Systems is a pioneer in developing and providing direct current (DC) electrical equipment which provides a substantial increase in the flexibility, reliability, and efficiency of energy systems in buildings. By rekindling Thomas Edison's original creation, a DC system can be scaled to cover one building or several city blocks, providing the lowest-cost off-the-grid light and power. Savage calls it simply "organic energy that's made in Detroit".

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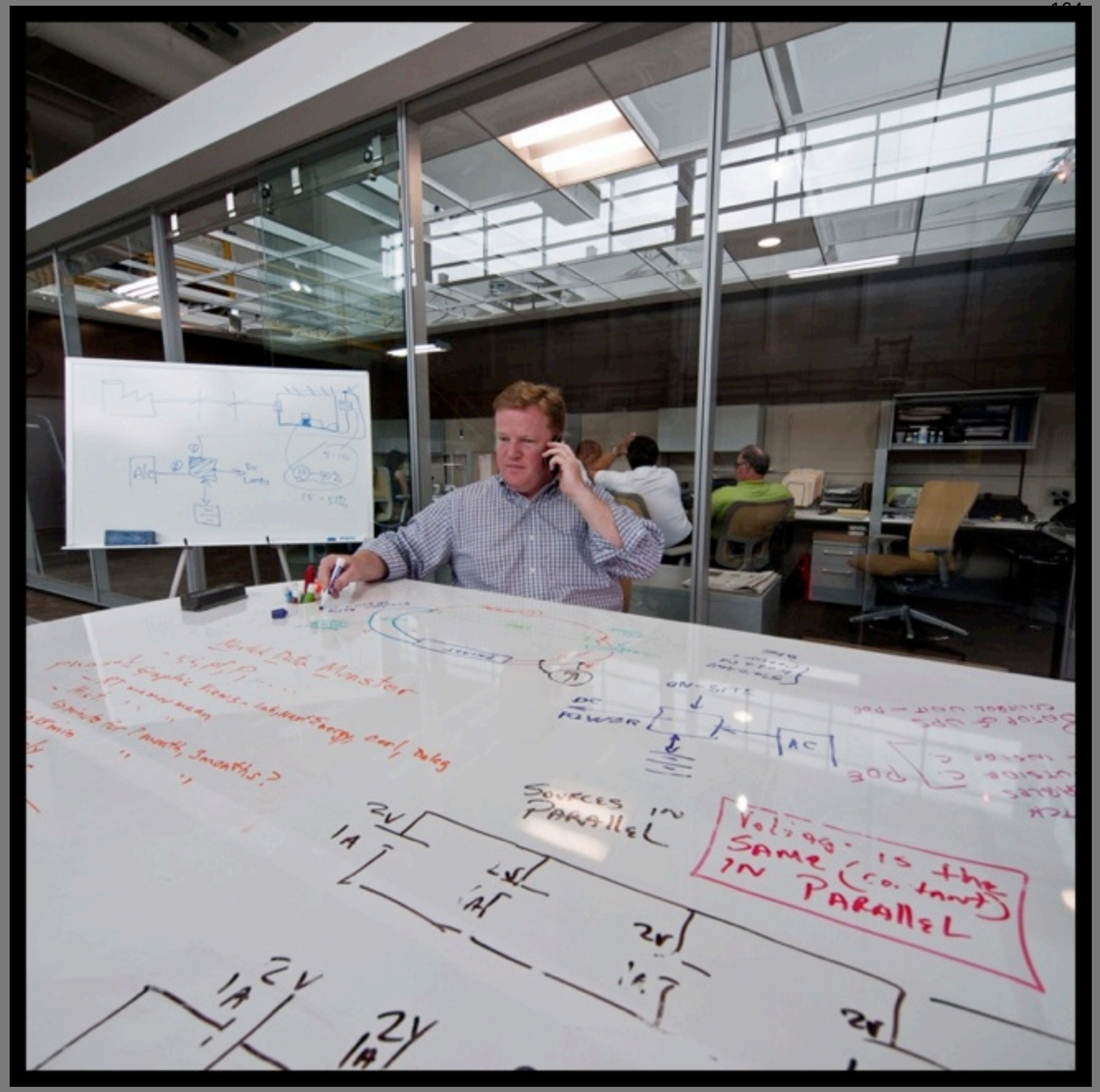
PAUL SAVAGE CEO/RENEWABLE ENERGY PUSHER: NEXTEK POWER SYSTEMS DETROIT



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SPEND SHIFT NO. 2
DON'T FENCE ME IN

RETOOLING | EDUCATION | BETTERMENT

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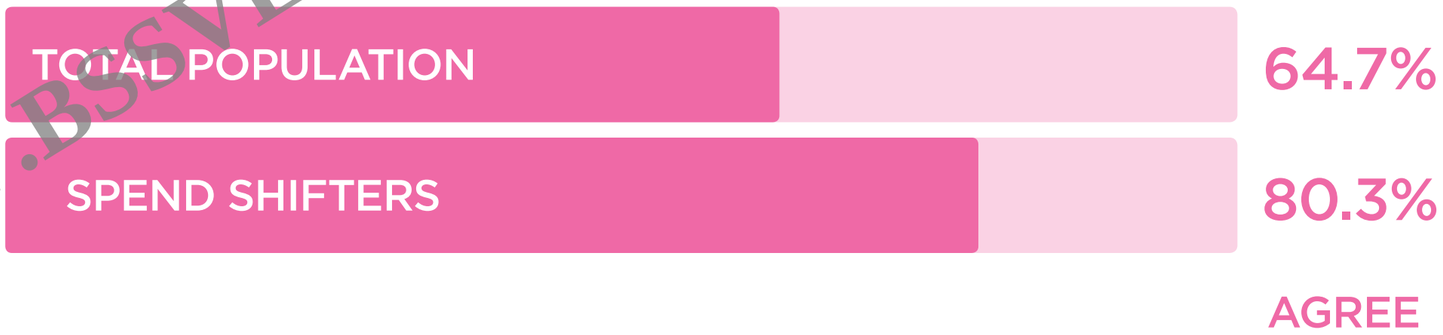
PEOPLE ARE MORE SELF-RELIANT AND RESOURCEFUL

"SINCE THE RECESSION I AM INTERESTED IN LEARNING NEW SKILLS, SO I CAN DO MORE MYSELF AND RELY LESS ON OTHERS."



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PEOPLE ARE IN-SOURCING AS WELL AS 'UN-CONSUMING'

"THESE DAYS, I FEEL MORE IN CONTROL WHEN I DO THINGS MYSELF INSTEAD OF RELYING ON OTHERS TO DO THEM FOR ME."

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LESLIE HALLECK FOUNDER: NORTH HAVEN FARMS DALLAS

Leslie Halleck was one of the first in her neighborhood to start raising chickens in her backyard. This shift from consumption to production in households across America is part of a more self-reliant lifestyle, where thousands of people across the country have started to produce their own eggs for safety and profit. Halleck went one step further, creating a business to train and supply the growing number of locals who raise birds and collect eggs every day.
Her first Saturday class drew over one hundred people. With the parking lot overfilled, cars spilled onto the shoulder.

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As Dallas librarian Miriam Rodriguez confirms, public libraries have become training centers for those who need to brush-up on skills, conduct a job search, or get free instruction in English as a second language. Miriam created a series of networking seminars, job-retraining and continuing education programs. Once thought to be roadkill from the internet, Library use reached record levels during the recession as people sought education and community. Today sixty-eight percent of Americans now have a library card, the highest percentage ever.

MIRIAM RODRIGUEZ LIBRARIAN: PUBLIC LIBRARY DALLAS

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The Senior Editor of *Make* magazine, a bible for do-it-yourselfers, Phil Torrone partnered with Limor Fried to create Adafruit Industries, which sells kits and parts for original open source hardware electronics projects out of a small loft in lower Manhattan. As more Americans became interested in learning new skills, Adafruit-sponsored 'MakerFaires' are an on-line social forum where Millennial-aged electronics enthusiasts are mentored by retired engineers from NASA and Boeing. Technology and social media forums like these are helping to make generational divides are quietly disappear.

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PHIL TORRONE & LIMOR FRIED FOUNDERS: ADAFRUIT INDUSTRIES NEW YORK CITY

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ROB KALIN FOUNDER: ETSY BROOKLYN

In 2005, Rob Kalin and his partners in Brooklyn created an online place where any artisan in the world could display work and sell to any buyer in the world. Today Etsy has 300,000 vendors, many of whom started new small businesses selling crafts after being laid-off during the recession. Etsy's site is visited by millions of shoppers every month. Revenues come from the twenty-cent fee charged to list an item on the site and a sales commission of three and a half percent. Etsy recently raised money to value it's handcrafted goods marketplace at $300 million, adding nearly $200 million in equity value in two years.

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SPEND SHIFT NO. 3
THE BADGE OF AWESOMENESS

NIMBLENESS | ADAPTABILITY | THRIFT

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PEOPLE EQUATE HAPPINESS AND FREEDOM WITH NEEDING LESS

"SINCE THE RECESSION, I REALIZE HOW MANY POSSESSIONS I HAVE DOES NOT HAVE MUCH TO DO WITH HOW HAPPY I AM."

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FIXED COSTS AND OVERHEAD ARE 'THE ENEMY'

"SINCE THE RECESSION I REALIZE I AM HAPPIER WITH A SIMPLER, MORE DOWN-TO-EARTH LIFESTYLE."

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Maura McCarthy and partners buck the downturn in real estate by offering energy-efficient, low-cost homes built with “green” materials. The breakthrough which makes this possible is a unique hinge-based design that lets Blu Homes literally fold a building into a package so small it can fit into a standard shipping container and be transported anywhere in the world. These “anti-McMansions” suit America’s growing appetite for nimbleness and flexibility. Each home has adaptable floor plans so an owner can grow into one over time.

MAURA McCARTHY
CO-FOUNDER:
BLU HOMES
WALTHAM, MA

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To build trust with their loyal fans who had been hit hard by the recession, The San Francisco Giants developed a “dynamic pricing” model on the belief that not all games are created equal. A weekend battle with a pennant contender or a long time rival like the Dodgers is worth more to a fan than a mid-week night game involving a cellar-dwelling opponent. With this in mind ticket prices were scaled according to demand. “Dynamic pricing,” is not a new concept, says Russ Stanley, who is in charge of client relations for the Giants. “I think the Romans did it at the Coliseum, setting prices according to the quality of the lion.”

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RUSS STANLEY
VP TICKET SALES:
SF GIANTS
SAN FRANCISCO

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MIKE COURTNEY & GARY WATSON FAITH-GUIDED COMMUNITY ACTIVISTS DALLAS

In Dallas, Texas two former high-flying business consultants responded to layoffs with a combination of Christian charity and old fashioned thrift. Mike Courtney and Gary Watson formed a mutual support system to keep themselves going as freelancers but also devoted themselves to serving others through foundations and church groups that help struggling families manage their budgets and cope with foreclosures and lost income.

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SPEND SHIFT NO. 4
BLOCK PARTY CAPITALISM

CHARACTER | AUTHENTICITY | LOCALITY

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PEOPLE ARE SEEKING OUT THE LOCAL AND THE ARTISANAL

"I AM WILLING TO PAY A PREMIUM FOR PRODUCTS/SERVICES FROM COMPANIES THAT CONTRIBUTE TO MY LOCAL COMMUNITY."

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WHILE MANY INCREASINGLY TURN AWAY FROM BRAND NAMES

"I PREFER TO BUY NAME BRANDS."

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Co-founder Lynn Jurich and her partner Ed Fenster solved the basic problem in rooftop solar energy — upfront cost — by offering homeowners fixed leases on all the equipment they need to get off the grid. Her San Francisco firm, SunRun, gives homeowners guaranteed fixed energy costs for thirty years along with free maintenance with little or no initial investment. The customer signs a long-term agreement which sets a fixed cost for power. If the house is sold, the contract passes on to the next owner. At the end of the term the owner can renew it, buy the system outright, or have it removed. SunRun's customer base has increased by over four hundred percent in 2010 and has raised nearly $100 million in financing.

LYNN JURICH
CO-FOUNDER
AND PRESIDENT:
SUN RUN INC.
SAN FRANCISCO

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TOM LEVIN
OWNER: TOM'S TOYS AND A SUPPORTER OF BERKSHARES CURRENCY GREAT BARRINGTON, MA

In Western Massachusetts locals have created their own currency called Berkshares (named after the Berkshire Mountains) to help local retailers, restaurants and service people survive competition from national chains that were moving into small mountain towns. Thirteen bank branches, along with many businesses in the community, agreed to exchange dollars and local artists designed the Berkshares as elegant bills, in denominations from one to fifty. Tom Levin accepts them at Tom Toys, a shop that offers what chain stores do not: carefully selected stock from a worldwide network of craftspeople and quality manufacturers.

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Steve Northam, having completed 22 years of marine service, settled in Fallbrook, California where he devoted much of his time to the study of energy self sufficiency. Ultimately he ended up cashing out his investments and put the cash into money saving home improvements including the SunRun solar power system. He saves about $500 a month because he was able to embrace these innovative technologies.

STEVE NORTHAM VIETNAM VETERAN AND SOLAR POWER ENTHUSIAST FALLBROOK, CA

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JON NORTON CITY MANAGER AND RECYCLEBANK ENTHUSIAST EVERETT, MA

Some public/private partnerships are actually working to make life better in the post recession economy. A prime example is the recycling boom made possible by the technology and business model of a new start-up called RecycleBank. Using truck-mounted scales and bins with electronic identification tags, the company weighs the paper, glass, and metal left on the curb by individual households and rewards them with shopping discounts. Everett city recycling manager Jon Norton reports a big increase in recycling, a dramatic drop in landfill expenses, and a savings of more than $1 million per year for local taxpayers. RecycleBank, meanwhile, is expanding its business across the country and recently entered the market in Great Britain.

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SPEND SHIFT NO. 5
AN ARMY OF DAVIDS

COMMUNITY | COOPERATION | AMPLIFICATION

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A GROWING TREND TOWARD 'COOPERATIVE CONSUMERISM'

"I BELIEVE MY FRIENDS AND I CAN CHANGE BEHAVIOR BY SUPPORTING COMPANIES THAT DO THE RIGHT THING."

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ALTHOUGH PEOPLE FEEL LESS RICH, THEY ARE 'VOTING' WITH THEIR PURSESTRINGS

"I MAKE A POINT TO BUY BRANDS FROM COMPANIES WHOSE VALUES ARE SIMILAR TO MY OWN."

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ANDREW MASON FOUNDER: GROUPON CHICAGO

Groupon, the group discounting phenomena mobilizes the masses with daily deals on products, services and even meals. The discounts are unlocked when a threshold number of people agree to pay for the coupon or “groupon”. When that threshold is crossed, the coupon is activated for all those that have agreed to the offer. Founded in 2008 by Andrew Mason, Groupon has grown so fast that it now serves forty cities, claims 1.5 million members and was recently hailed as the fastest company to reach $500 million in sales in the history of business.

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In the “real time web,” information technology is providing tools for transparency, relationship-building, and responsiveness to create lasting and profitable relationships with customers. At the center of this trend is Chartbeat, a Betaworks start-up based in the old meatpacking district in Manhattan where Tony Haile helps thousands of clients track what content is most relevant for which audience, allowing publishers and businesses to understand the meaning behind their web traffic. This knowledge is so valuable that Tony and team recently raised $3 million to expand the scale of their business.

TONY HAILE
GENERAL MANAGER: BETAWORKS’ CHARTBEAT
NEW YORK CITY

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SCOTT MONTY & BOB THIBODEAU HEAD OF SOCIAL MEDIA FORD MOTOR CO. AND OWNER OF FAMILY DEALERSHIP DETROIT

Although a smokestack company like Ford is not where you would expect to find a nimble response to crisis, Scott Monty (left) moved the company toward openness and transparency. His goal was to start conversations with anyone who cared to speak to Ford. The Fiesta Movement on Twitter required that Ford actually allow people to talk about the car in a way that was “unedited, uncensored, unscripted,” said Monty. New products and not taking Government bailout money have also helped lift sales at Robert Thibodeau’s dealership.

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TOP VALUES BRANDS VS. ALL OTHER BRANDS

	REGULAR USAGE VS. ALL OTHER BRANDS	TOP PREFERENCE VS. ALL OTHER BRANDS
TOP ARMY OF DAVIDS BRANDS	2.26 x GREATER	2.42 x GREATER
TOP INDESTRUCTIBLE SPIRIT BRANDS	1.91	1.79
TOP IT'S WHAT COUNTS ON THE INSIDE	2.47	2.55
TOP LIQUID LIFE BRANDS	3.12	2.95
TOP RETOOLING BRANDS	3.34	2.96
TOP SIMPLE BRANDS	3.07	2.08
TOP TRUSTWORTHY BRANDS	3.58	3.15
AVERAGE SPENDSHIFT VALUES BRAND	2.82 x GREATER	2.56 x GREATER

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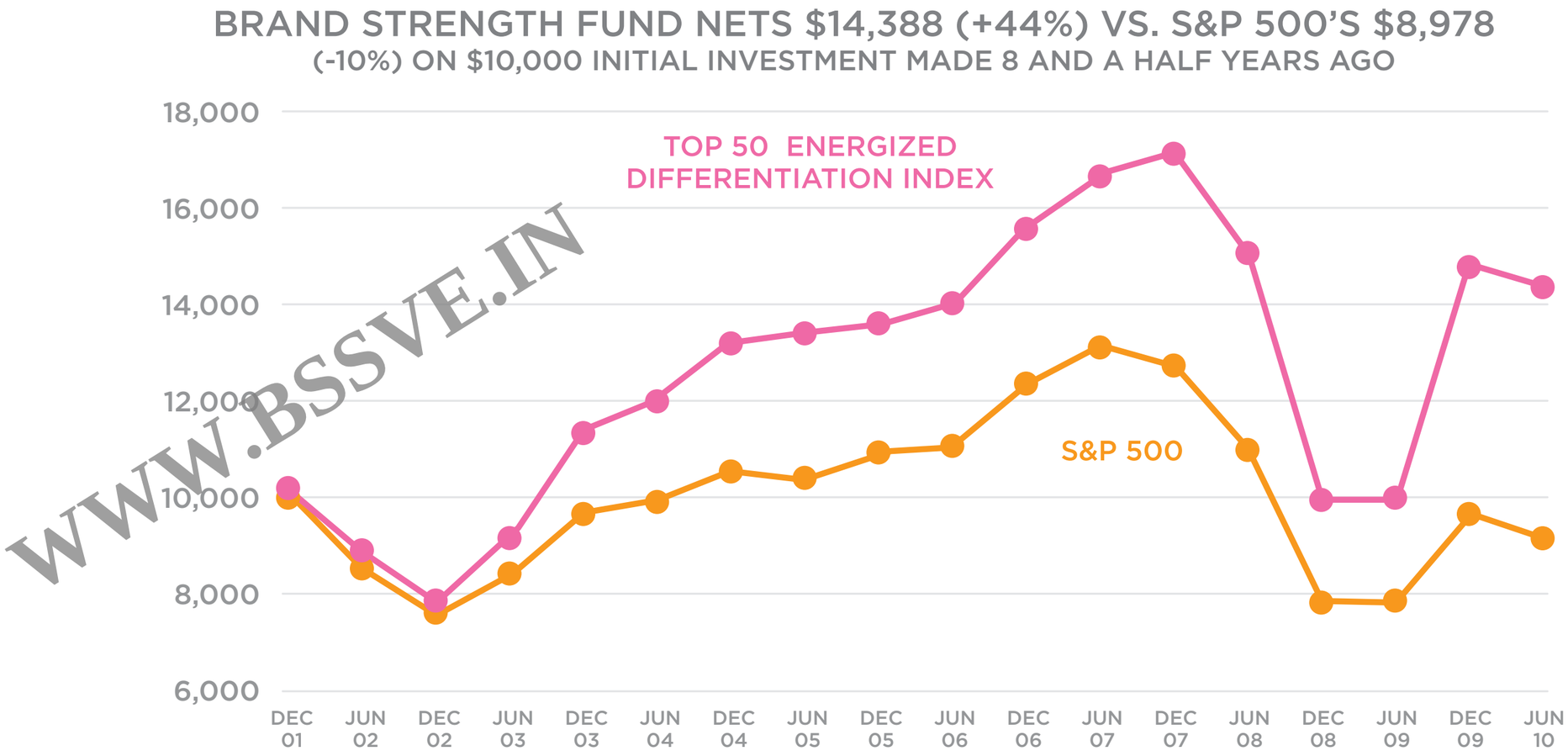
VALUES-LED COMPANIES OUTPERFORM THE STREET



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THERE ARE NO LONGER CONSUMERS, ONLY CUSTOMERS

Photo from Thomas Hawk

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AMERICA IS AN EMERGING MARKET FOR VALUES-LED INNOVATION

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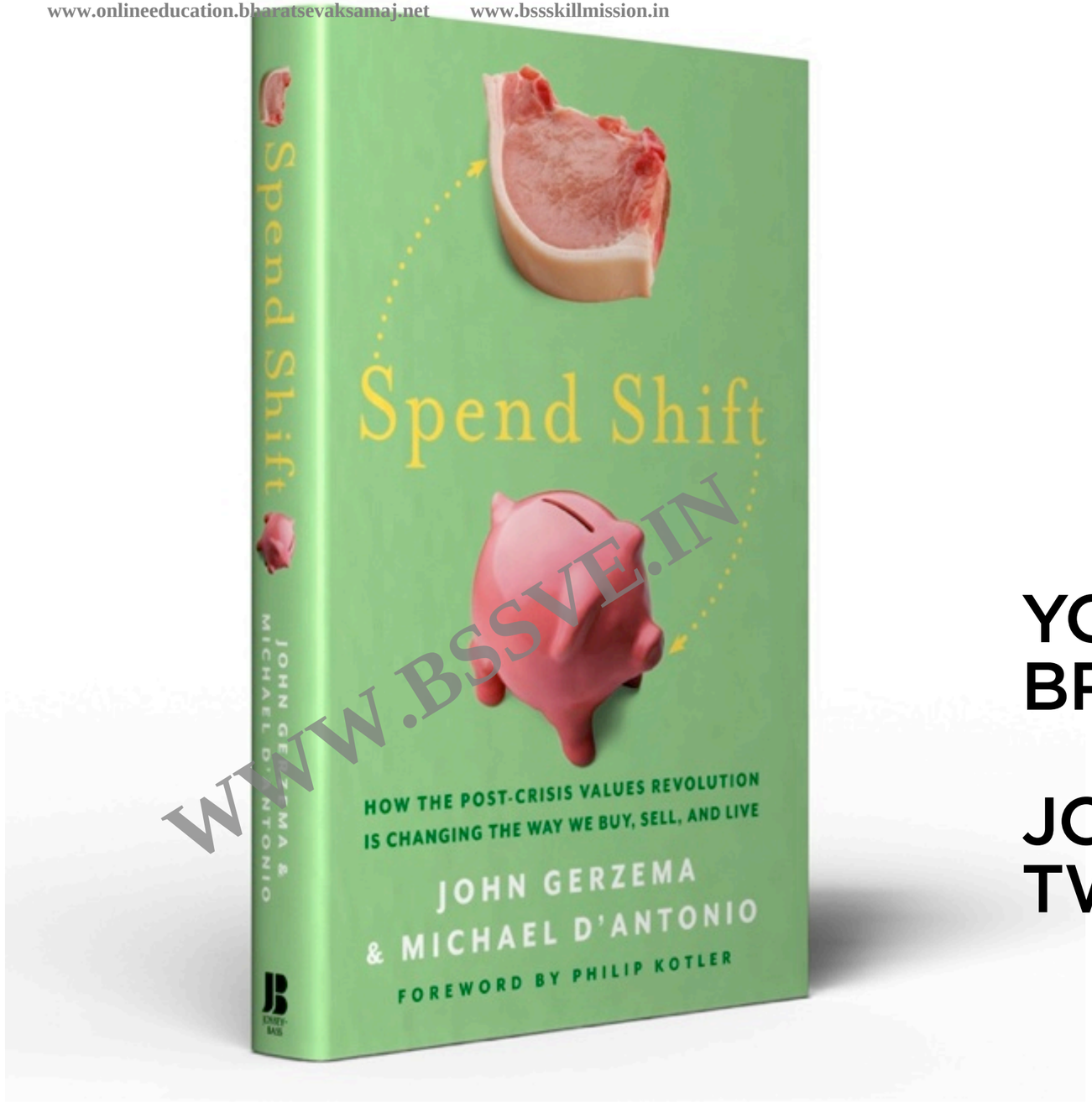

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MITSloan MARKETING

New Products

Session 12
Marketing Management
Prof. Natalie Mizik

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Agenda

- What is a New Product?
- Why do firms introduce new products?
- Why do some good product ideas go bad?
- What factors affect customers' adoption of new products?
- Creativity in NPD

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New to the World?

Total
Total Fresh Stripe
2 in 1 toothpaste & mouthwash
Sparkling White
Sensation Whitening
Sensitive Maximum Strength
Tartar Control
Tartar Control Plus Whitening
Baking Soda & Peroxide Whitening
Tartar Control with Baking Soda & Peroxide
Cavity Protection
Star Wars
Barbie toothpaste
Looney Tunes toothpaste
My First Colgate Toothpaste with Barney

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Only about 5 - 10% of new products are truly new

Types of New Products

FIRM \ MARKET	L	M	H
Newness			
L *Not Very New*	**Cost Reductions** 11%		**Repositionings** 7%
M *Moderately New*		**Product Line Extensions** 26%	
H *Very New*	**New Product Lines** 20%		**New to the World** 10%

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Why Do Firms Introduce New Products?

- Support additional usage
- Better meet needs of slightly different sub-segments through differentiation
- Address needs of potential emerging segments
- Encourage variety seeking
- Enhance sales of current products

CUSTOMER

- Counter encroachment by alternative products
- Control shelf space

COMPETITION

- Alter brand image
- Replacing and improving mature products is a key success factor for a firm

COMPANY

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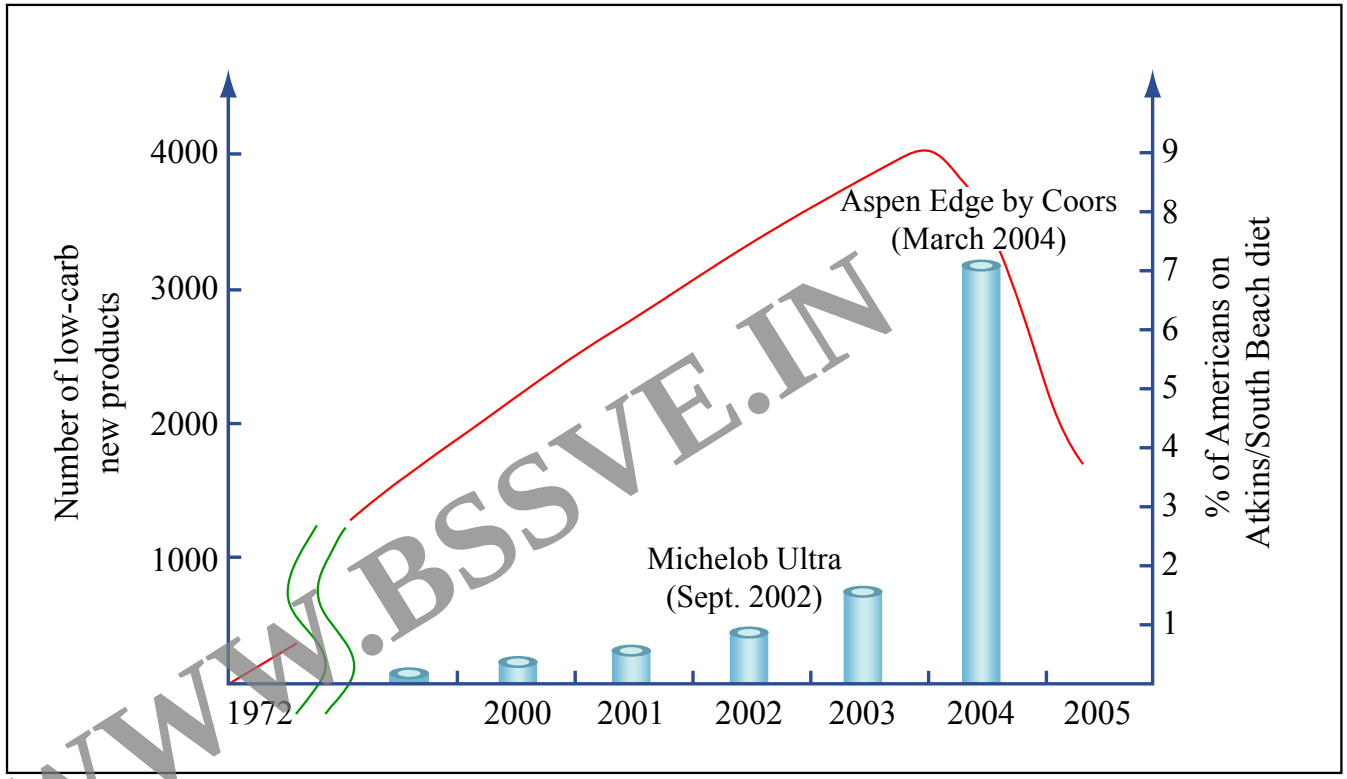
The low-carb trend



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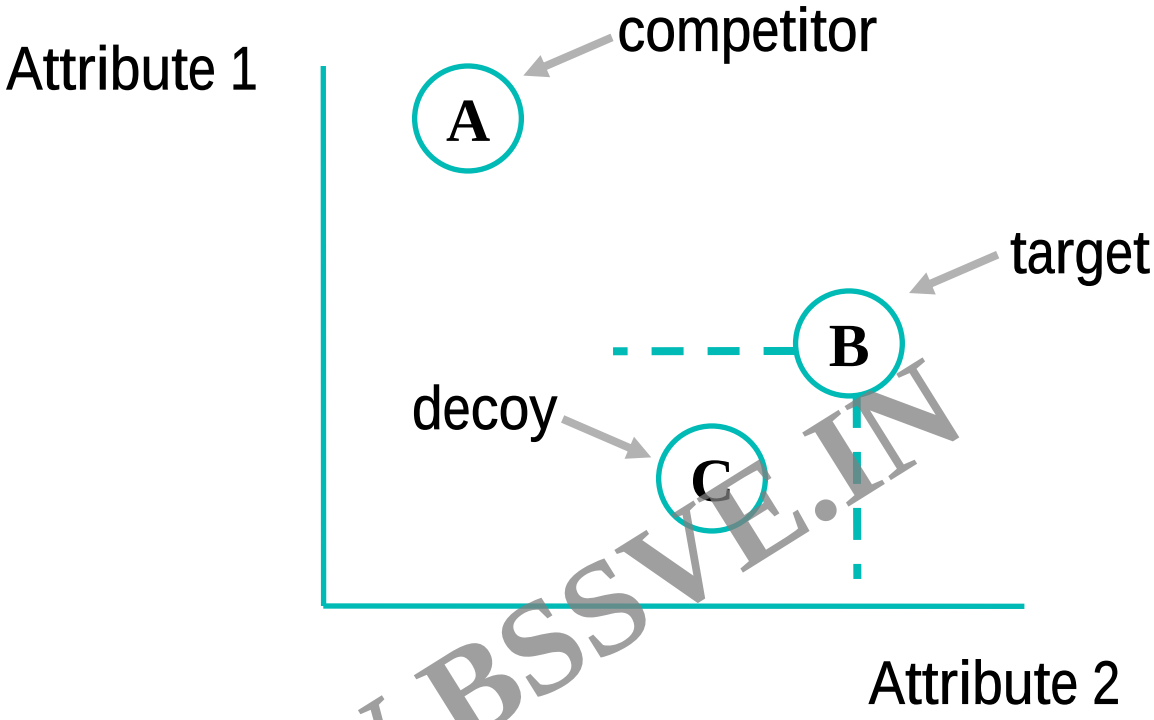
Enhance Sales of Current Products Asymmetric Dominance Effect



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Adding a dominated alternative can increase the probability of choosing the dominating alternative. (Huber, Payne and Puto 1982)

At the Movies…

Compromise Effect

The share of a product is enhanced when it is the intermediate option in the choice set and is diminished when it is an extreme option. (Simonson 1989)

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Why do Products Fail?

Project Newprod: A study of over 200 industrial products

- "Better mousetrap nobody wanted" -- 28% of failures
- "Me-too product meeting competitive brick wall" -- 24%
- "Technical dog product" -- 15%
- "Competitive one-upmanship" -- 13%
- "The price crunch" -- 15%
- "Environmental ignorance" -- 7%

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Source: Cooper and Calantone (1979).

Problems with Product Quality or Product Attributes

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Why Good Ideas Go Bad?

Problems with Product Quality or Product Attributes

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Problems with Distribution (Place)

Problems with Promotion

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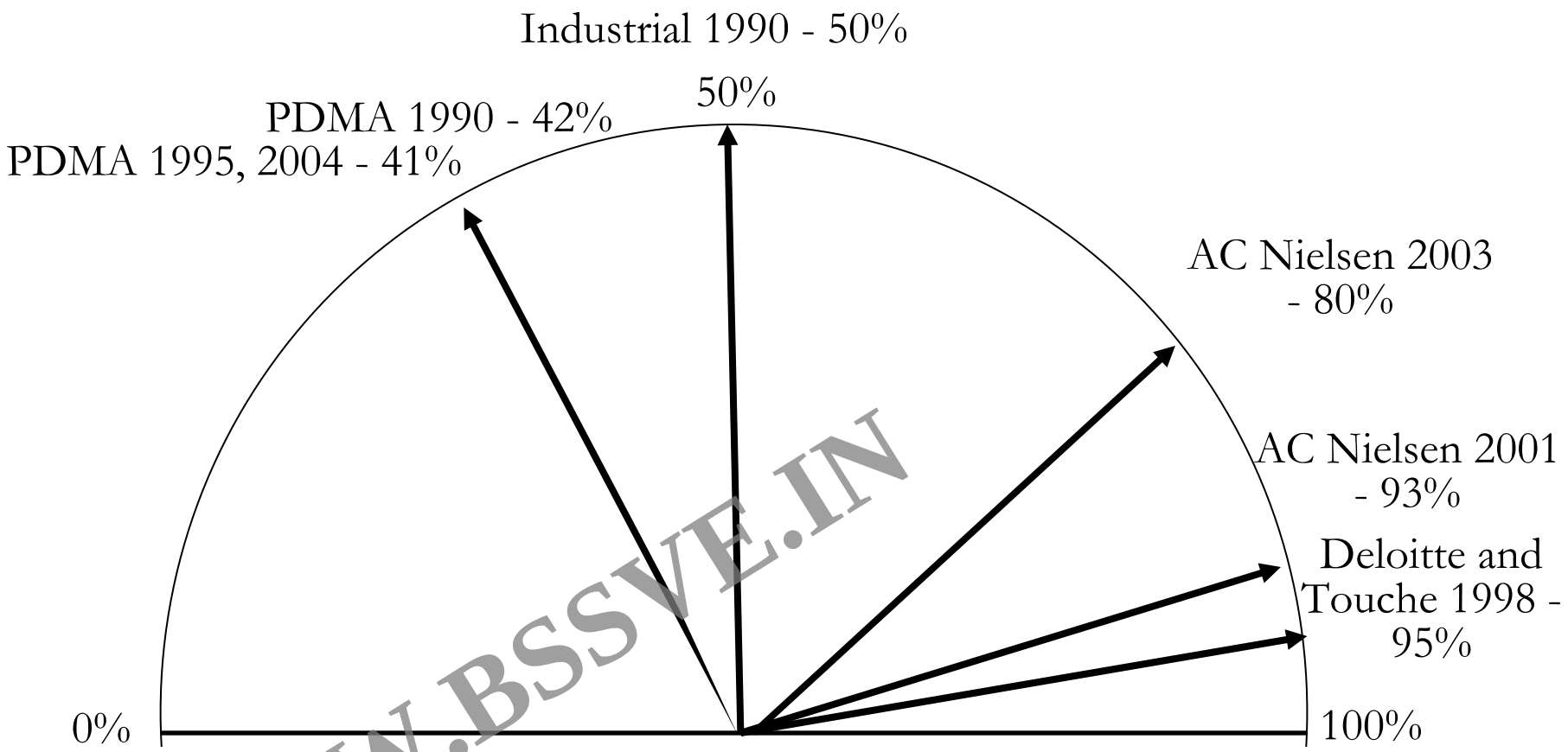
What percentage of new products fail?



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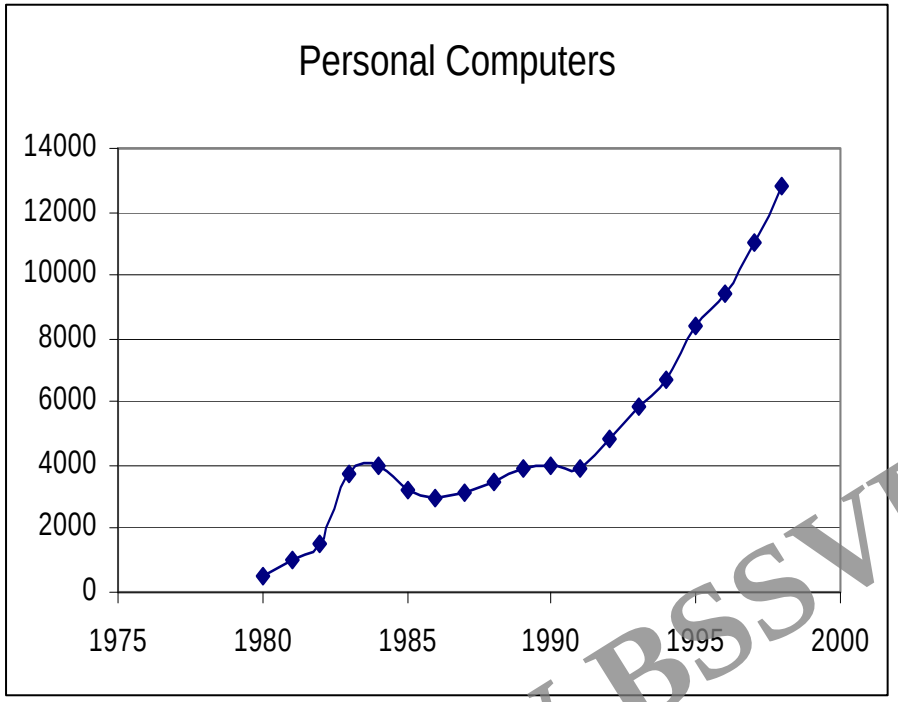
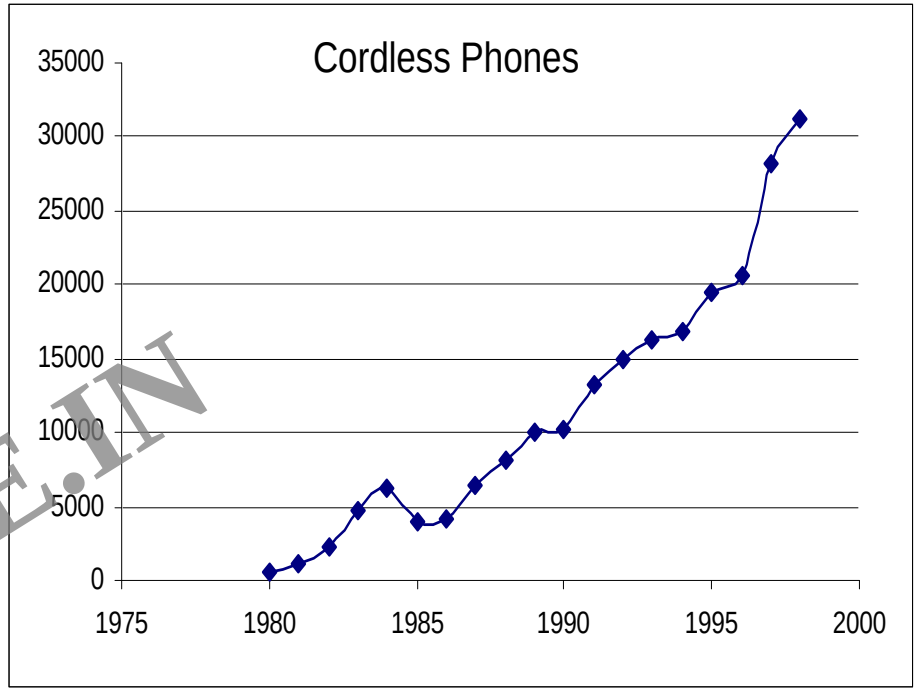
S-Shaped Diffusion Curve of New Products





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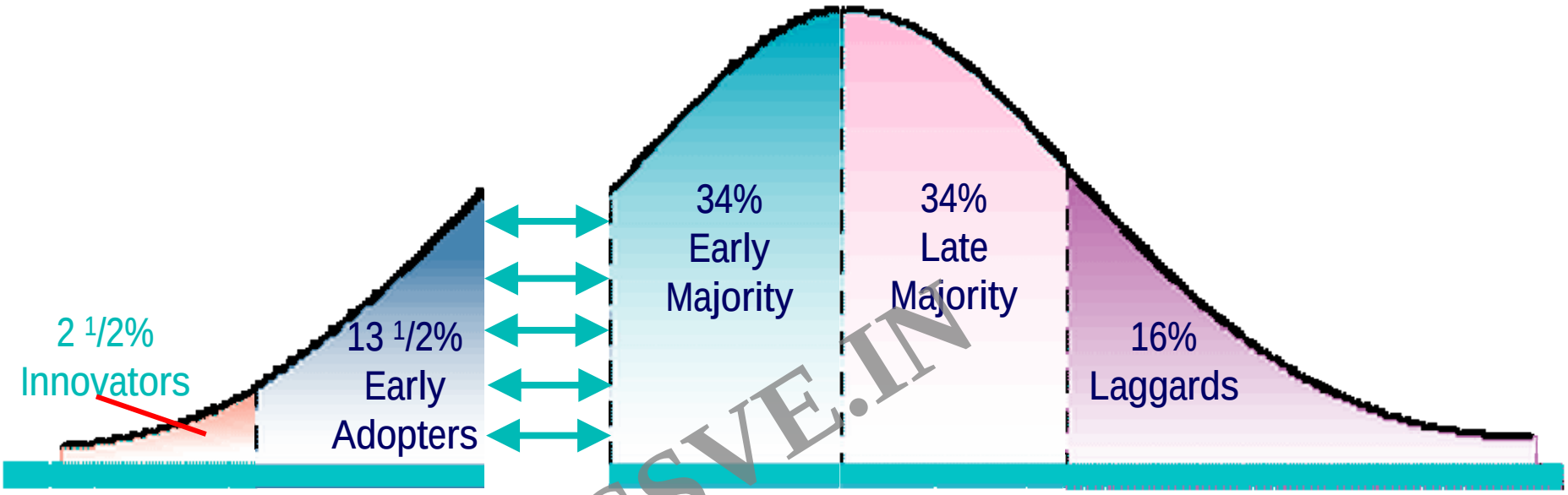
Product Life Cycle and the Chasm



Time of adoption for innovations

Reference: Geoffrey A. Moore (1991), Crossing the Chasm, HarperBusiness.

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Factors Affecting Customer Adoption

- **A**dvantage
- **C**ompatibility
- **C**omplexity
- **O**bservability
- **R**isk
- **D**ivisibility

"Apple iPod Grabs 82% US Retail Market Share"

Oct 12, 2004 (The Register)

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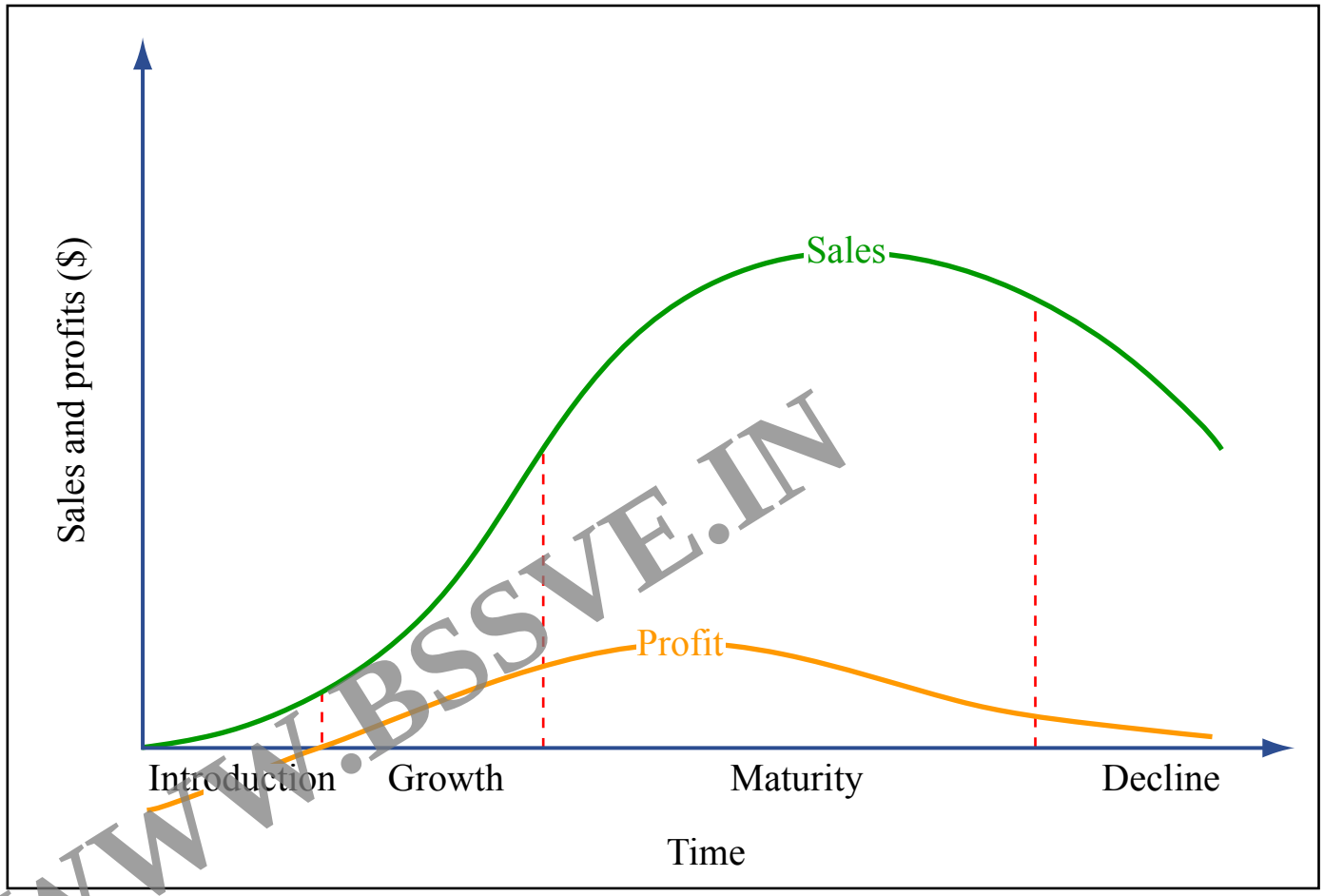
Strategy: Product Life Cycle



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Main Takeaways: New Products

- Why do firms introduce new products?
  - Think of the 5Cs...
- Why do some good product ideas go bad?
  - Think of the 4Ps...
- What factors affect customers' adoption of new products?
  - Think of ACCORD!

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HW # 4: Why has No One thought about THIS yet?

Due: Session 13

Describe a product (or service), which does not exist on the market today, but would benefit consumers, and has potential for commercialization.

- Who are your potential consumers (i.e., your target market)?
- What benefit/value does your product provide to the consumers?
- What is the best way to inform consumers, promote & advertise it?
- What should your price be? Why?
- How do you propose to distribute your product?
- What do you think are the major challenges/ possible problems with bringing this product to the market?

(1-2 page max)

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Creativity in NPD

... an Alternative View

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MARKETING

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A Typical NPD Process

Decreasing uncertainty

Opportunity Identification:

Market definition, Idea Generation

↓

Screening

↓

Concept tests

↓

Design: Customer needs, Product positioning, Segmentation, Sales forecasting, Engineering, Marketing mix.

↓

Testing: Product tests, Market tests, Pretest and Pre-launch forecasting, Tests marketing.

↓

Introduction: Launch planning, Tracking the launch.

Increased expenditures

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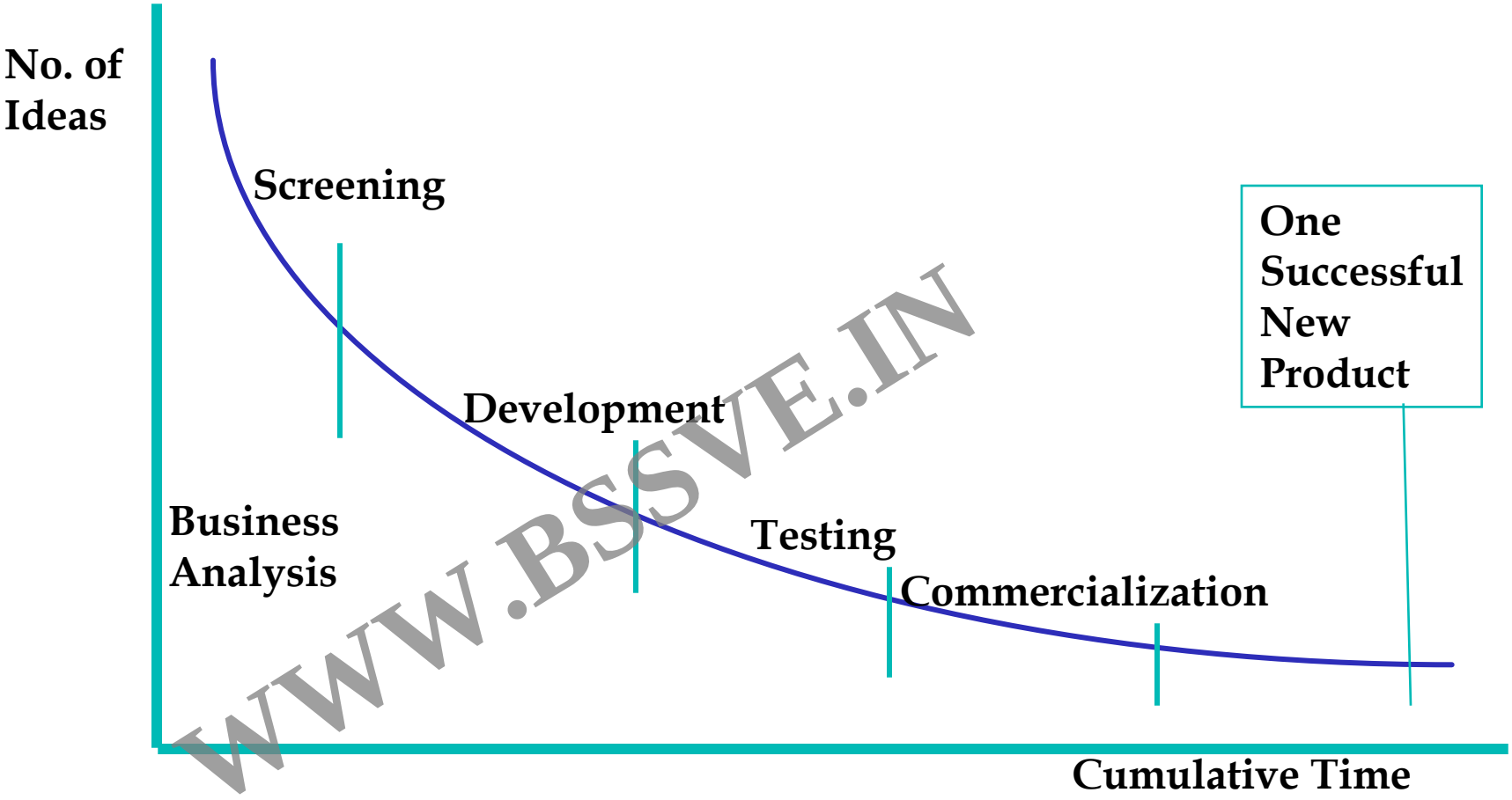
Source: Hauser and Urban, "New Product Development"

A Mortality Curve of New Product Ideas



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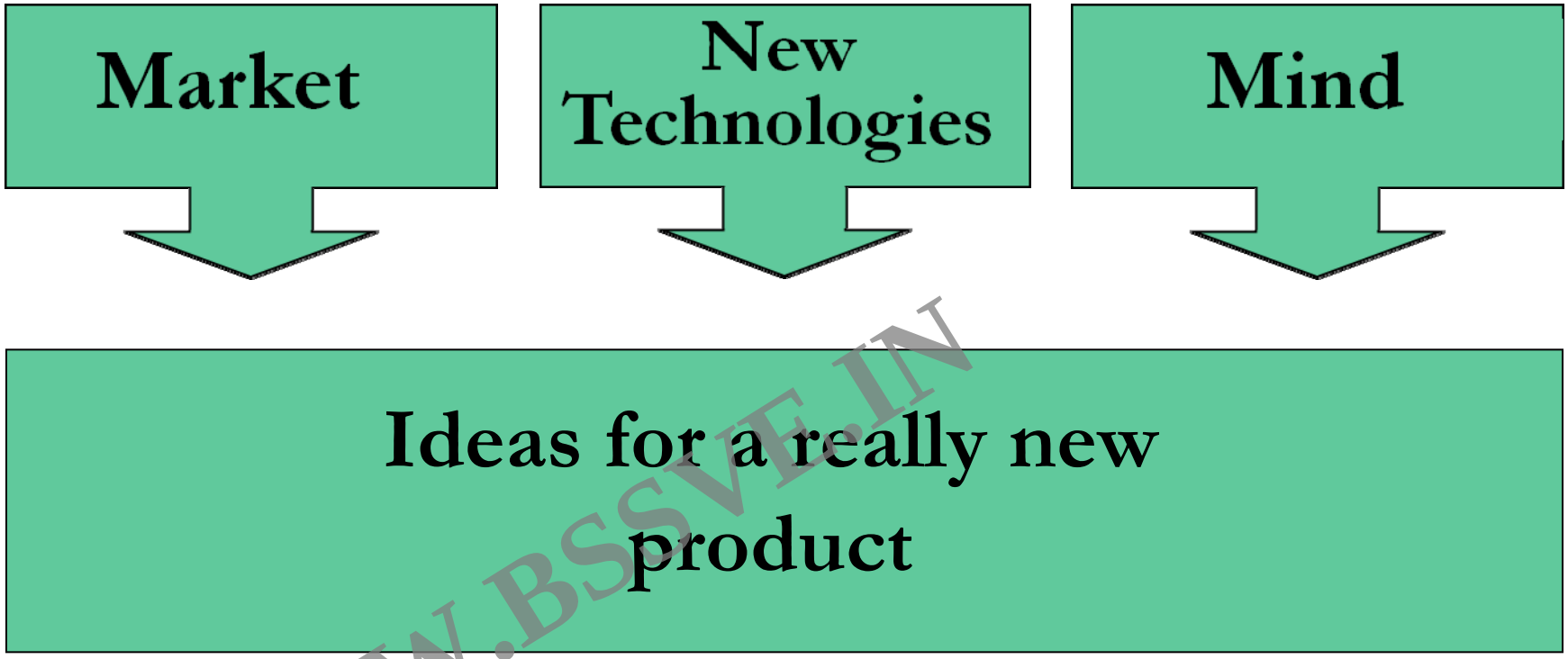
The Prevailing Paradigm on sources for creative ideas



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Customers

- **"If I had asked the public what they wanted, they would have asked for a faster horse"** *Henry Ford*
- **I don't know who discovered the sea, but it sure wasn't a fish.** *an old Arab saying*

Experts

"In order to get a C in this course, the idea has to be feasible"

Yale econ professor on Fred Smith' paper outlining FedEx idea

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November 15, 1876: Expert committee's response to Hubbard & Bell's telephone patent application

"Technically, we do not see that this device will be ever capable of sending recognizable speech over a distance of several miles…"

"The idea is idiotic on the face of it. Furthermore, why would any person want to use this ungainly and impractical device when he can send a messenger to the telegraph office and have a clear written message sent to any large city in the United States?"

"Mr. G.G. Hubbard's fanciful predictions, while they sound rosy, are based on wild-eyed imagination and lack of understanding of the technical and economic facts of the situation, and a posture of ignoring the obvious limitations of his device, which is hardly more than a toy."

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The market cannot indicate a need, if it is not aware that such a need exists

If we wish to find a creative, surprising new product - there is no point to look for it in the market

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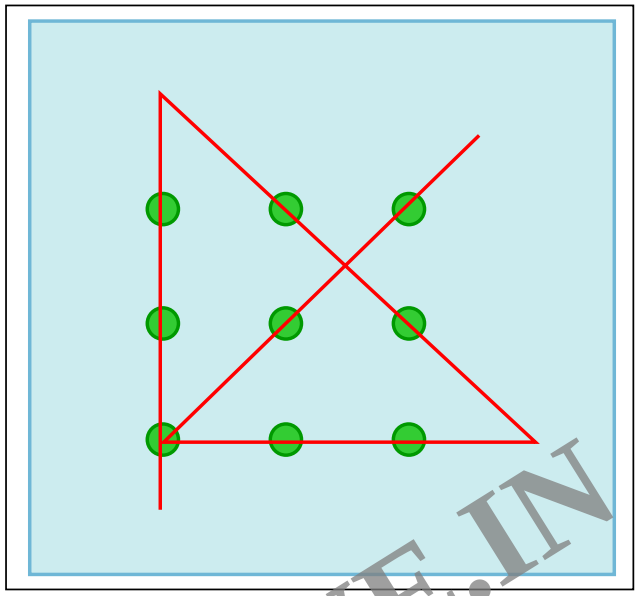
The Famous "Getting out of the box" Puzzle



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- In the 70's only 20% solved this riddle
- In a replication (1989), participants have received further instructions: "In order to solve the riddle intersections of lines out of the imaginary square should be created." Only 25% solved it with instructions

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The Close(d) World Principle

Thinking **Inside** the Box

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Preschoolians Shoes

Young children can not tell us that their shoes are too tight and the age old method of pressing on toes does not work. Preschoolers curl their toes when their toes are pressed on, making it seem that shoes are larger than they are. A study conducted by the Glasgow Caledonian University reveals that 83 percent of preschoolers are wearing shoes that are too small. This problem might seem minor, but unfortunately, tight shoes lead to foot problems later in life.

A breakthrough invention by Preschoolians allows a parent to make sure shoes are never too tight. Preschoolians shoes look like ordinary children's footwear except for one thing: they have see-through bottoms to help ensure proper fit. Like the rest of the sole, the viewing window is made of durable polyvinyl acetate, and the parts are heat fused to prevent cracks or splits.

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Beware of the Bizarre

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How large is the market potential for this cup?

"Creativity" Science Is Rather Young

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15.828 Design and Marketing New Products

- New product development may be the greatest source of profitability in the next 10 years as growth returns to the world's economy. Innovation earns extra profits and ROI by filling new customer needs with products that command premium margins. However the process of new product development is fraught with risk.
- In this course we study the process of design and marketing new products and how new analytic methods can reduce risk and improve innovation. We organize our learning around the basic steps of development: 1. opportunity identification, 2. product design, 3. testing, 4. launch and life cycle management. We study the process in the context of large, startups, consumer, and industrial companies.
- In addition to lectures and guest speakers, the course uses an intensive project on designing an alternative fuel vehicle. The problem is how to design and market a car people "need" (low emissions and high efficiency), but may not "want" (most buyers want large size and power). The obvious solution is to build and economy car, but this market is small (Prius sells 150,000 of over 10 million autos sold in the USA and most people do not buy it because it is "green", but because it gives better mileage). Your problem is to build an alternative fuel vehicle (hybrid plug in, all electric, or hydrogen) that people will buy at a premium price. Teams will define an entry strategy (type of fuel and car type – SUV, sports car, sedan, economy, truck, etc), design a vehicle (target segment, brand, product positioning, specs, price dealers, etc), test it with consumers (real concept test will be done during the course), and develop a launch plan (advertising, selling/distribution, price, etc) Your goal is to repr esent Ford, GM, or Toyota and build a line of green cars that create a business of 500,000 vehic les by 2017 and of one million vehicles a year by 2022. You are given assumptions that make this feasible, but this is a deep dive into new product design and marketing. Do not take this course unless you want an intensive active learning project course. Each team will meet with Professor Urban each week.

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