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BUSINESS

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Rob Jones

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ABOUT THIS BOOK

This book is written for students following the Pearson Edexcel International Advanced Level (IAL) Business specification. It covers the first year of the International A level qualification as well as the full International AS level.

The book has been carefully structured to match the order of topics in the specification although teaching and learning can take place in any order, both in the classroom and in any independent learning. This book is organised into two units (Unit 1: Marketing and people and Unit 2: Managing business activities), each with five topic areas.

Each topic area is divided into chapters to break the content down into manageable chunks. Each chapter begins by

listing the key learning objectives and includes a getting started activity to introduce the concepts. There is a mix of learning points and activities throughout including global case studies to show a range of businesses within real-life contexts. Checkpoint questions at the end of each chapter help assess understanding of the key learning objectives.

The content for Unit 1 is applicable for Paper 1 (Marketing and people) and the content for Unit 2 is applicable for Paper 2 (Managing business activities). Knowing how to apply learning to both of these papers will be critical for exam success. There are exam-style questions at the end of each chapter to provide opportunity for exam practice. Answers are provided in the online teaching resource pack.

Topic openers

Introduce each of the key topics in the specification.

Learning objectives

Each chapter starts with a list of key assessment objectives.

Specification reference

The specification reference is given at the start of each chapter and in the running header.

MEETING CUSTOMER NEEDS

This section looks at how businesses attempt to meet the needs of customers. It explores the nature of markets, competition in markets and how businesses react to changes in market conditions. It also investigates the ways businesses research markets, including primary and secondary research, different sampling methods and how the research data is used. Finally, the ways in which businesses position their products in different markets, split markets into different segments and differentiate their products from those of rivals are also addressed.



Getting started

An activity to introduce the key concepts in each chapter. Questions are designed to stimulate discussion and use of prior knowledge. These can be tackled as individuals, pairs, groups or the whole class.

SPECIFICATION 1.3.1 1 THE MARKET

LEARNING OBJECTIVES

By the end of this chapter you should be able to understand:

- the characteristics of mass and niche markets (size, market share, brands)
- the impact of dynamic markets, including the effect of online retailing
- how markets adapt to change (growth and innovation, the effect of competition)
- the difference between risk and uncertainty.

GETTING STARTED

Goods and services are sold in markets. However, over time the size and characteristics of markets are likely to change. For example, the market for domestic air travel in China has grown significantly between 1980 and 2016. Figure 1 shows that the number of passengers flying between Chinese airports rose from just 2,568 million in 1980 to 487,960 million in 2016. Rapid growth has been fuelled by growing incomes, increased business traffic, lower air fares and deregulation in the industry. The number of airports is also growing, providing access to an increasing number of potential passengers. In 2015, there were over 200 civil airports in China.

Competition in the market is growing intensely. For example, ten new airlines have arrived in the market since 2013. The three largest airlines in 2015 were China Southern Airlines, China Eastern Airlines and Air China. Three new airlines, Air Gulin, Hongtu Airlines and Jiangxi Air, began operations in 2016.



Calculate the percentage growth in the size of the market for domestic air travel in China between 1980 and 2016. What factors have contributed to the growth in the market? How is competition in the market becoming more intense? What role might the Internet play in this market?

MATHS TIP

It is common in business to express changes in numerical values such as sales, market size, prices or costs in terms of a percentage. The formula required is given by:

$$\text{Difference between the two numbers} \quad \times 100 \\ \text{Original number}$$

For example, if the sales of a business increase from 8,000 units to 8,500 units over a period of time, the percentage change is given by:

$$= \frac{8,500 - 8,000}{8,000} \times 100 = \frac{500}{8,000} \times 100 \\ = 6.25 \text{ per cent}$$

MARKETS AND MARKETING

Businesses make money by selling their goods and services in markets. Historically, markets were places where buyers and sellers would meet to exchange goods. However, today it is possible to trade goods and services without buyers and sellers meeting up. For example, buying cars online, using the telephone, using newspapers, through mail order or on the Internet. Some examples of markets are given below:

- Consumer goods markets – where products such as food, cosmetics and magazines are sold.
- Markets for services – these can include services for individuals, such as hairdressing, or business services, such as auditing.
- The housing market – where people buy, sell and let property.
- Commodity markets – where raw materials, such as oil, copper, wheat and coffee, are traded.
- Financial markets – where currencies and financial products are traded.

Marketing involves a range of activities that help a business sell its products. However, marketing is not just about selling, it involves:

- identifying the needs and wants of consumers
- designing products that meet these needs
- understanding the threat posed by competitors
- telling customers about products
- charging the right price
- persuading customers to buy products
- making products available in convenient locations.

Key subject terms are colour coded within the main text.

ABOUT THIS BOOK

Activity

Each chapter includes activities to embed understanding through case studies and questions.

Skills

Relevant exam questions have been assigned key skills, allowing for a strong focus on particular academic qualities. These transferable skills are highly valued in further study and the workplace.

Thinking bigger

These sections provide opportunity to explore an aspect of business in more detail to deepen understanding.

4 1 THE MARKET

SPECIFICATION 1.3.1 ACTIVITY 1 SKILLS CRITICAL THINKING

CASE STUDY US DRYBAR

The market for hair salons in the USA, as in most countries, is very competitive. However one business, Drybar, has flourished by serving a niche market. Drybar specialises in the provision of affordable, high-quality blowouts. This is when a customer's hair is dried and styled without being cut or coloured. Drybar was set up by Ali Webb, who felt she was paying too much for blowouts in traditional salons. Drybar is set up like a bar where clients can relax, watch TV and have a drink.

The business now has over 70 salons in the USA and Canada and its own product lines which are also sold in stores such as Sephora, Nordstrom and Ulta. Drybar's success is the complete opposite of mass marketing. It involves a small and niche group, sometimes with specific needs. Small firms can often survive by supplying niche markets. They may also be more successful. It is a lot easier to target the needs of the customers directly. Also, if there is no competition it may also be possible to charge premium prices. An example of a business that targets niche markets is Zumiez, which sells products related to extreme sports such as snowboarding. However, a business successfully exploits a niche market it still may attract competition. Niche markets, by their nature, are very small and unable to support many competing firms. If a business is large enough to enter a niche market they may find it easy to overrun a smaller rival. Also, businesses that rely on a single niche market may be vulnerable because they are not spreading their risk. If a business is in their chosen niche, then it is at a disadvantage because they do not have other products or markets as a back-up.

EXAM HINT

In examinations it is helpful to give examples when explaining the meaning of business terms and concepts. Relevant examples support your answer and show that you understand the meaning of the term or concept. It is also good to use images from the material in the question to support your answer. This approach will show your skills in 'application' in your answer.

6 1 THE MARKET

SPECIFICATION 1.3.1 ACTIVITY 2 SKILLS READING

CASE STUDY ONLINE GROCERY SHOPPING

In many countries, online grocery retailing has not quite taken off in the same way that other forms of online retailing have. However, reports suggest that online grocery sales in Australia, for example, may rise from A\$2,200 million in 2015 to A\$8,150 million by 2020. A recent survey found that 39 per cent of Australian shoppers may use online grocery shopping in the near future. The potential increase may be due to busy lifestyles and the greater integration of mobile technology into our lives. Possible reasons for this include, moneysupermarket.com compares financial products and uswitch.com compares energy prices.

A development in online retailing is the increasing popularity of comparison websites. These sites provide shoppers with search engines that can filter and compare products based on price, features and criteria. Most comparison shopping sites compare prices from many different retailers, but do not sell products themselves. They also tend to specialise in particular product groups. For example, trivago.com is used to compare hotel prices around the world and egyptair.com compares flight prices. moneysupermarket.com compares financial products and uswitch.com compares energy prices.

However, some of these sites have been criticised for not being transparent. For example, it was reported in 2014 that consumers were missing out on the best energy deals. This was because comparison sites filter out the tariffs that do not pay commission.

To combat this, the government set up OFID to help consumers reduce their energy bills. They reported that the cheapest energy deals were not presented to customers by the five major price comparison sites. Instead, these sites encourage users to click 'yes' if they want to see tariffs they can switch to 'today' or 'now'. Any deals that do not earn the comparison site commission from the energy companies are filtered out from the search findings.

It is easier to gather personal information from customers so that it can be targeted with other products and offers in the future.

• Selling costs, such as sales staff, rent and other overheads can be avoided. The savings might be enormous and allow online retailers to charge lower prices.

• Marketing costs will also be lower. It is much cheaper, for example, to send a marketing message by email to 1000 customers than it is to send 1000 leaflets to 1000 people.

• Online retailers can reach more customers. A single store in a high street can only attract a limited number of customers. However, a website advertising a 15,000-item product range can have a global reach.

• Online retailing provides greater flexibility. An online retailer can be updated instantly and as frequently as required. For example, it can quickly promote a deal of the day on the home page, without the need for expensive printed display material.

HOW MARKETS CHANGE

The size of markets: The size of some markets can remain quite stable over a period of time. For example,

Exam hint

Tips give practical advice and guidance for exam preparation.

Checkpoint

Questions to check understanding of the key learning points in each chapter. These are NOT exam-style questions.

Exam practice

Exam-style questions are found at the end of each chapter. They are tailored to the Pearson Edexcel specification to allow for practice and development of exam writing technique. They also allow for practice responding to the command words used in the exams.

SPECIFICATION 1.3.1

THE DIFFERENCE BETWEEN RISK AND UNCERTAINTY

One of the challenges when running a business is dealing with risk and uncertainty. Although both risk and uncertainty are likely to pose threats to a business, they are not the same thing.

Risk: Owners take risks when running a business. This means they take actions where the outcomes are unknown. Specifically, they invest resources that could be lost, damaged or destroyed if something goes wrong. This is because they invest their own money to get the business 'up and running' and there is a chance that the business will not succeed. If the worst happens and the business collapses, it is possible that all the money invested by the owner is lost.

In many countries it is reckoned that a very large proportion of new businesses, perhaps as much as 90 per cent, do not survive until they have made their first profit. Once businesses are established, they may

continue to take risks. This is because they often spend money on ventures that may not provide positive results. For example, they may invest in a new product, which fails to sell. In this case, the product is withdrawn, most of the money spent on development and launch will be lost.

In 2014 Amazon, the online retailer, launched a mobile phone called the Amazon Fire Phone. It failed in the market and the price was reduced very quickly from US\$199 to just US\$99. It was reported that Amazon lost US\$170 million as a result.

Uncertainty: Businesses operate are often subject to external influences. This means that events that are completely beyond the control of business can have an impact on the market, which can have financial consequences. For example:

- a superior product
- consumer tastes might change as a result of a new survey
- the government might introduce a new policy or piece of legislation
- some new technology might be invented
- there may be a natural disaster, such as a flood
- the economy might go into recession

Unfortunately, such influences are very difficult to predict.

This means that businesses have to operate all of the time in an uncertain environment.

However, the consequences of uncertainty are not always negative. For example, new technologies can provide new opportunities. The introduction of the Internet has resulted in entrepreneurs finding new business opportunities. Generally though, businesses do not like uncertainty. Decision making becomes more difficult, particularly when investing for the future.

SPECIFICATION 1.3.1

1 THE MARKET

CHECKPOINT

1. What is the difference between a mass market and a niche market?
2. What is a key advantage of selling in a mass market?
3. State two disadvantages of selling in a niche market.
4. How long would a franchisee have to pay franchise fees?
5. State three advantages of giving products brand names.
6. State two advantages of using online retailing.
7. What is meant by a dynamic market?
8. How might the nature of a market change over time?
9. State three reasons why a market might grow.
10. Describe two ways a business might adapt to changes in markets.

SUBJECT VOCABULARY

Brand name: a name, term, sign, symbol, design or any other feature that allows consumers to identify the goods and services of a business and to differentiate them from those of other businesses. Branding is the process of creating a brand.

Credit crunch: a situation in which banks reduce their lending to customers by loaning less money.

E-commerce: the use of electronic systems to sell goods and services.

EV: electric vehicle that can be recharged from an external source of electricity, such as wall sockets, and the electricity needed to recharge the battery pack drives or contributes to driving the vehicle. EVs are also known as electric vehicles.

Liquidation: the act of closing a company by selling the things it owns in order to pay debts. This is often done when a business is set up to sell off its assets before buyers and sellers to communicate and trade in a particular range of goods and services.

Marketing: a management process involved in identifying, anticipating and satisfying consumer requirements profitably.

Market: a place where goods and services are bought and sold.

Market share: the percentage of a particular market that a company holds.

Mass market: a large market, usually within a large market or industry.

Online retailing: or e-tailing: the retailing of goods online.

Payday lending: an amount of money that is lent for a short period of time, usually at a high rate of interest and because the lender has a right to the borrower's wages if the borrower does not make repayments.

10 1 THE MARKET

SPECIFICATION 1.3.1 EXAM PRACTICE

GLOBAL EV MARKET

SKILLS ANALYSIS, INTERPRETATION, REASONING

Growing concerns about the environment, and agreements by many countries in the world to cut carbon emissions, have led to a surge in the use of electric vehicles (EVs) and hybrids. A hybrid vehicle is one that uses two or more power sources. These vehicles are now beginning to grab market share from traditional petrol and diesel models.



Figure 3 Global sales of EVs, 2010 and 2017

Although EVs only have a very small market share at the moment, the sector is developing rapidly. One of the barriers to growth is the uncertainty about supply and infrastructure. This includes the lack of facilities for recharging batteries. However, the cost of batteries for recharging has fallen at least tenfold and the number of available charging stations has increased from 70 in 2010 to 2015. Also, the cost of batteries has fallen by 50 per cent in recent years and renewable sources are now roughly the same cost as fossil fuels in electricity generation.

Many governments around the world have also introduced financial incentives to encourage the purchase of EVs.

- (a) Define market share. (2 marks)
- (b) Explain one reason why the global car market is likely to grow in the next 5 years. (4 marks)
- (c) Suggest one manufacturer might adjust to changes in the market. (8 marks)
- (d) Assess the factors that might affect the growth of the EV market in the future. (10 marks)

EV sales and percentage growth

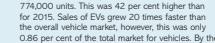


Figure 4 EV sales and growth rates in a selection of regions, 2015 and 2016

ASSESSMENT OVERVIEW

The following tables give an overview of the assessment for this course. You should study this information closely to help ensure that you are fully prepared for this course and know exactly what to expect in each part of the assessment.

PAPER 1	PERCENTAGE OF IAS	PERCENTAGE OF IAL	MARK	TIME	AVAILABILITY	STRUCTURE
MARKETING AND PEOPLE Written exam paper Paper code WBS11/01 Externally set and marked by Pearson Edexcel Single tier of entry Calculators can be used	50%	25%	80	2 hours	January, June and October First assessment: January 2019	There will be three sections, A, B and C. Students must answer all questions. Section A: short- and extended-response questions based on sources (30 marks) Section B: same as Section A but different sources (30 marks) Section C: one 20-mark essay question, based on one or more sources (20 marks)
PAPER 2 MANAGING BUSINESS ACTIVITIES Written exam paper Paper code WBS12/01 Externally set and marked by Pearson Edexcel Single tier of entry	50%	25%	80	2 hours	January, June and October First assessment: June 2019	There will be three sections, A, B and C. Students must answer all questions. Section A: short- and extended-response questions based on sources (30 marks) Section B: same as Section A but different sources (30 marks) Section C: one 20-mark essay question, based on one or more sources (20 marks)

ASSESSMENT OBJECTIVES AND WEIGHTINGS

ASSESSMENT OBJECTIVE	DESCRIPTION	% IN IAS	% IN IA2	% IN IAL
A01	Demonstrate knowledge and understanding of terms, concepts, theories, methods and models	27.5	20	23.8
A02	Apply knowledge and understanding to various business contexts to show how individuals and organisations are affected by and respond to issues	25	22.5	23.8
A03	Analyse business issues, showing an understanding of the causes, costs and consequences for individuals and organisations	27.5	30	28.8
A04	Evaluate evidence to make informed judgements and propose evidence-based solutions to business issues	20	27.5	23.8

Note: Totals have been rounded either up or down.

RELATIONSHIP OF ASSESSMENT OBJECTIVES TO UNITS

UNIT NUMBER	ASSESSMENT OBJECTIVE			
	A01	A02	A03	A04
Unit 1	13.75%	12.5%	13.75%	10%
Unit 2	13.75%	12.5%	13.75%	10%
Total for International Advanced Subsidiary	27.5%	25%	27.5%	20%

Note: Totals have been rounded either up or down.

UNIT NUMBER	ASSESSMENT OBJECTIVE			
	A01	A02	A03	A04
Unit 1	6.9%	6.3%	6.9%	5%
Unit 2	6.9%	6.3%	6.9%	5%
Total for International Advanced Level	13.8%	12.6%	13.8%	10%

RELATIONSHIP OF ASSESSMENT OBJECTIVES TO COMMAND WORDS

COMMAND WORD	NUMBER OF MARKS	MARK SCHEME	ASSESSMENT OBJECTIVES
Define	2	Points based	A01
Calculate	4	Points based	A01, A02, A03
Construct	4	Points based	A01, A02, A03
Explain	4	Points based	A01, A02, A03
Analyse	6	Points based	A01, A02, A03
Discuss	8	Levels based	A01, A02, A03, A04
Assess	10 (Units 1 and 2) 12 (Units 3 and 4)	Levels based	A01, A02, A03, A04
Evaluate	20	Levels based	A01, A02, A03, A04

MEETING CUSTOMER NEEDS

This section looks at how businesses attempt to meet the needs of customers. It explores the nature of markets, competition in markets and how businesses react to changes in market conditions. It also investigates the ways businesses research markets, including primary and secondary research, different sampling methods and how the research data is used. Finally, the ways in which businesses position their products in different markets, split markets into different segments and differentiate their products from those of rivals are also addressed.



1 THE MARKET

LEARNING OBJECTIVES

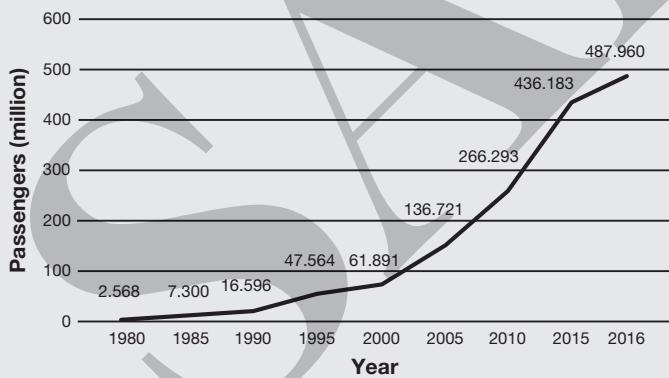
By the end of this chapter you should be able to understand:

- the characteristics of mass and niche markets (size, market share, brands)
- the impact of dynamic markets, including the effect of online retailing
- how markets adapt to change (growth and innovation)
- the effect of competition
- the difference between risk and uncertainty.

GETTING STARTED

Goods and services are sold in markets. However, over time the size and characteristics of markets are likely to change. For example, the market for domestic air travel in China has grown significantly between 1980 and 2016. Figure 1 shows that the number of passengers flying between Chinese airports rose from just 2.568 million in 1980 to 487,960 million in 2016. This rapid growth has been fuelled by growing incomes, increased business traffic, lower airline fares and deregulation in the industry. The number of airports is also growing, providing access to an increasing number of potential passengers. In 2015, there were over 200 civil airports in China.

Competition in the market is growing intensely. For example, ten new airlines have arrived in the market since 2013. The three largest airlines in 2015 were China Southern Airlines, China Eastern Airlines and Air China. Three new airlines, Air Guilin, Hongtu Airlines and Jiangxi Air, began operations in 2016.



▲ Figure 1 Domestic air travel in China, 1985–2016

Calculate the percentage growth in the size of the market for domestic air travel in China between 1980 and 2016. What factors have contributed to the growth in the market? How is competition in the market becoming more intense? What role might the Internet play in this market?

UNIT 1 1.3.1

MATHS TIP

It is common in business to express changes in numerical values such as sales, market size, prices or costs in terms of a percentage. The formula required is given by:

$$= \frac{\text{Difference between the two numbers}}{\text{Original number}} \times 100$$

For example, if the sales of a business increase from 8,000 units to 8,500 units over a period of time, the percentage change is given by:

$$= \frac{8,500 - 8,000}{8,000} \times 100 = \frac{500}{8,000} \times 100 \\ = 6.25 \text{ per cent}$$

MARKETS AND MARKETING

Businesses make money by selling their goods and services in markets. Historically, markets were places where buyers and sellers would meet to exchange goods. However, today it is possible to trade goods and services without buyers and sellers meeting up. For example, trading can be done over the telephone, using newspapers, through mail order or on the Internet. Some examples of markets are given below.

- Consumer goods markets – where products such as food, cosmetics and magazines are sold.
- Markets for services – these can include services for individuals, such as hairdressing, or business services, such as auditing.
- The housing market – where people buy, sell and let property.
- Commodity markets – where raw materials, such as oil, copper, wheat and coffee, are traded.
- Financial markets – where currencies and financial products are traded.

Marketing involves a range of activities that help a business sell its products. However, marketing is not just about selling, it involves:

- identifying the needs and wants of consumers
- designing products that meet these needs
- understanding the threat posed by competitors
- telling customers about products
- charging the right price
- persuading customers to buy products
- making products available in convenient locations.

According to the Chartered Institute of Marketing, 'Marketing is the management process responsible for identifying, anticipating and satisfying customer requirements profitably'.

THE CHARACTERISTICS OF MASS MARKETS AND NICHE MARKETS

Some businesses sell their products in a **mass market**. This is when a business sells the same products to all consumers and markets them in the same way. Fast-moving consumer goods, such as crisps, breakfast cereals, computer software and soft drinks, are sold in mass markets. The number of customers in these markets is huge – possibly billions if products are sold globally. This means that businesses can produce large quantities at a lower unit cost by exploiting economies of scale. This might result in higher sales and higher profits. However, there is often a lot of competition in mass markets and therefore businesses may spend a lot of money on marketing. For example, in 2016 Coca-Cola®'s advertising budget was around US\$4000 million.

A **niche market** is a small market segment – a segment that has sometimes gone 'untouched' by larger businesses. Niche marketing is the complete opposite of mass marketing. It involves selling to a small customer group, sometimes with specific needs. Small firms can often survive by supplying niche markets. They may also avoid competition. It is a lot easier to focus on the needs of the customer in a niche market. Also, if there is no competition it may also be possible to charge premium prices. An example of a business that targets niche markets is Zumiez, which sells products related to surfing, skateboarding and snowboarding. However, if a business successfully exploits a niche market it still may attract competition. Niche markets, by their nature, are very small and unable to support many competing firms. As a result, if a large business decides to enter a niche market they may find it easy to overrun a smaller rival. Also, businesses that rely on a single niche market may be vulnerable because they are not spreading their risk. If they lose a grip in their chosen market, they may collapse because they do not have other products or markets as a back-up.

EXAM HINT

In examinations it is helpful to give examples when explaining the meaning of business terms and concepts. Relevant examples support your answer and show that you understand the meaning of the term or concept. It is also important to use information in the case material in the question to support your answer. This approach will show your skills in 'application' in your answer.

ACTIVITY 1

SKILLS

CRITICAL THINKING

CASE STUDY: US DRYBAR

The market for hair salons in the USA, as in most countries, is very competitive. However, one business, Drybar, has flourished by serving a niche market. Drybar specialises in the provision of affordable, high-quality 'blowouts'. This is when a client's hair is washed and blow-dried into style without being cut or coloured. Drybar was set up by Alli Webb, who felt she was paying too much for blowouts in traditional salons. Drybar is set up like a bar where clients can relax, watch a film and get a blowout.

The business now has over 70 salons in the USA and Canada and its own product lines which are also sold in stores such as Sephora, Nordstrom, Ulta and Bloomingdale's. Drybar interacts with its clients using social media. It listens to their stories, provides information and responds to every single tweet, Facebook® post and Yelp review which helps to improve the overall Drybar experience. To encourage customer loyalty, Drybar offers a service called Barfly membership. This entitles each member to:

- two blowouts per month and a free birthday blowout
- a 10 per cent discount on all Drybar products
- the opportunity to keep unused blowouts to use at a later date
- a US\$5 discount off any extra blowouts above the allocated two per month
- flexible membership – it can be suspended or cancelled at anytime.



1. Using this case as an example, explain what is meant by a niche market.
2. Explain one possible disadvantage to a business like Drybar of targeting a niche market.

MARKET SIZE

The size of a market can be estimated or calculated by the total sales of all businesses in the market. Market size is usually estimated in a number of ways.

Value: This is the total amount spent by customers buying products. For example, in 2014 the value of the global fast food market (burgers/sandwiches, chicken, pasta/pizza, Asian/Latin American food, seafood and others) was approximately US\$495,000 million. It was expected to reach approximately US\$645,000 million by 2020.

Volume: This is the physical quantity of products that are produced and sold. For example, in 'Getting started', the market size for domestic air travel in China is measured by the number of passengers carried per year. This was 487,960 million in 2016. Some estimates of volume are based on the number or percentage of users, subscribers or viewers. This is often the case in markets for services, such as the number of mobile phone users, the number of television viewers or the percentage of households with digital television.

Different markets are likely to differ in size. For example, the sale of savoury snacks in 1 year is likely to be much smaller than the sales of footwear in the same year in a country.

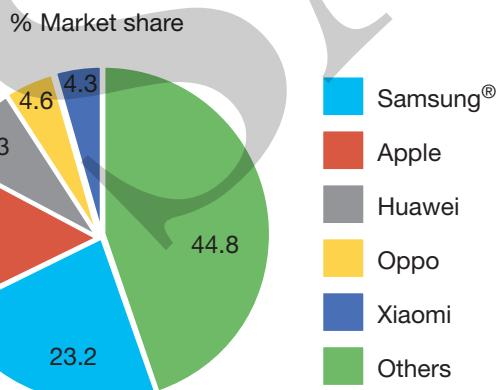
MARKET SHARE

Market share or market penetration is the term used to describe the proportion of a particular market that is held by a business, a product, a brand or a number of businesses or products. Market share is shown as a percentage. The market share of a business can be calculated as:

$$\frac{\text{Sales of a business}}{\text{Total sales in the market}} \times 100\%$$

Why might the measurement of market share be important? It might indicate a business that is a market leader. This could influence other companies to follow the leader or influence the leader to maintain its position. It might influence the strategy or objectives of a business. A business that has a small market share may set a target of increasing its share by 5 per cent over a period of time. It may also be an indication of the success or failure of a business or its strategy.

Figure 2 shows the global market shares of smartphone suppliers. It shows, for example, that Samsung is the market leader with a 23.2 per cent share. It also shows that the top five producers have more than half of the entire market to themselves.



▲ Figure 2 Global market shares of smartphone suppliers, 2016Q1

BRANDS

Many businesses try to establish themselves in markets by giving their products a **brand name**. Products are given brand names to distinguish them from other products in the market. Branding is particularly important in mass markets where lots of products are competing for a share of the market. Examples of common brand names include Google®, BBC, Toyota, Nike® and Apple®. Branding might be used to:

- differentiate the product from those of rivals
- create customer loyalty
- help product recognition
- develop an image
- charge a premium price when the brand becomes strong.

Branding is discussed in more detail in Chapter 10.

DYNAMIC MARKETS

Most markets do not remain the same over time – they tend to be dynamic, which means they are likely to change. They may grow, shrink, fragment, emerge or completely disappear. For example, in the majority of countries there is no longer a market for cassettes. Most people download audio material such as music from the Internet.

Dynamic markets can have a huge impact on businesses. A failure to adapt in a dynamic market can lead to the collapse of a business. For example, when digital photography emerged in the 1980s, Kodak® (the camera company) continued to rely on sales of film cameras. Eventually, the market for these types of cameras collapsed and Kodak went into **liquidation**. Those businesses that can adapt to changes in dynamic markets are more likely to survive in the long term. The changing nature of markets is discussed in more detail later.

ONLINE RETAILING

One of the biggest changes to occur in the marketing of products has been the development of **online retailing** or **e-tailing**. This is a popular branch of **e-commerce** that has emerged along with the development of the Internet. It involves shoppers ordering goods online and taking delivery at home. There are specialist e-tailers such as Amazon® and Alibaba® – retail 'giants' that sell a huge range of goods online. However, many retailers, both large and small, now have online services. Growth in online retailing is rapid and expected to continue into the future. Businesses may enjoy a number of benefits from offering online retail services.

- Retailers can market their goods to people who prefer to shop from home or who find it difficult to get to traditional shops. For example, people who do not enjoy the physical shopping experience, people too busy to go shopping and people with health conditions or disabilities that make physical shopping difficult.

ACTIVITY 2

SKILLS ➤ REASONING

CASE STUDY: ONLINE GROCERY SHOPPING

In many countries, online grocery retailing has not quite taken off in the same way that other forms of online retailing have. However, reports suggest that online grocery sales in Australia, for example, may rise from AUD 2600 million in 2015 to AUD 5800 million by 2020. A recent survey showed that 39 per cent of Australian shoppers may use online grocery shopping in the near future. The potential increase may be due to busier lifestyles and the further integration of mobile technology into our daily lives. People are increasingly becoming 'on-the-go' consumers.

One growing trend in online shopping is the use of click & collect services, where customers buy goods online and then collect them from a store that is convenient for them. As well as launching online grocery services in more stores, click & collect services are likely to increase. Supermarkets have used collect in-store, lockers and drive-thru services in connection with click & collect. One Australian supermarket chain, Coles, is extending online retailing into a further 13 stores in the next year. It also plans to add another 50 click & collect locations in addition to its 100 plus existing points. Woolworths, the other main supermarket chain in Australia, currently offers click & collect at about a quarter of its supermarkets, however, it also plans for more locations, including further drive-thru services.

In 2016, the Australian transport minister announced a new grocery collection trial for train customers. The aim of the scheme was to save people time after their commute home. Sydney Trains is partnering with Woolworths on a 12-month trial on the scheme, launching at Bondi Junction station. If successful, the scheme may be extended across the network.

1. Explain why online grocery retailing is likely to grow in the future.
2. Assess the benefits and drawbacks to supermarkets of online retailing.

**THINKING BIGGER**

A development in online retailing is the increasing popularity of comparison websites. These sites provide shoppers with search engines that can filter and compare products based on price, features and other criteria. Most comparison shopping sites compare prices from many different retailers, but do not sell products themselves. They also tend to specialise in particular product groups. For example, trivago.com is used to compare hotel prices, skyscanner.com compares the prices of flights, moneysupermarket.com compares financial products and uswitch.com compares energy prices.

However, some of these sites have been criticised for not giving the best deals. For example, it was reported in 2014 that consumers were missing out on the best energy deals. This was because comparison sites filter out the tariffs that do not pay commission.

The Big Deal website was set up in 2013 to help consumers reduce their energy bills. They reported that the cheapest energy deals were not presented to customers by the five major price comparison websites. Instead, the sites provide an option to users to click 'yes' if they want to see tariffs they can switch to 'today' or 'now'. Any deals that do not earn the comparison site commission from the energy companies are filtered out from the search findings.

- It is easier to gather personal information from customers so that they can be targeted with other products and offers in the future.
- Selling costs, such as sales staff, rent and other store overheads can be avoided. The savings might be enormous and allow online retailers to charge lower prices.
- Marketing costs will also be lower. It is much cheaper, for example, to send a marketing message by email to 1000 customers than it is to send 1000 newsletters by post.
- Online retailers can reach more customers. A single store in a high street can only attract a limited number of customers. However, a website advertising a 15,000-item product range can have a global reach.
- An online retailer is open 24/7. There are not many stores that can match this level of service.
- Online retailing provides greater flexibility. An online store can be updated instantly and as frequently as is necessary. For example, it is possible to promote a 'deal of the day' on the home page, without the need for expensive printed display material.

HOW MARKETS CHANGE

The size of markets: The size of some markets can remain quite stable over a period of time. For example,

the size of the milk market in the UK probably hasn't changed much for many years. This is because consumption of milk is fairly constant.

However, the majority of markets are likely to grow. For example, *The Future of Global Packaging to 2018* reports that the global packaging market stood at US\$799,000 million in 2012, increasing by 1 per cent over 2011 with sales projected to increase by 3 per cent. Some forecasters reckoned growth to 2018 would reach 4 per cent per year, with sales reaching over US\$1 trillion. Factors driving growth in the packaging market include increasing urbanisation, investment in construction and housing, development of retail chains, and the expanding cosmetics and healthcare sectors in the emerging economies.

Some markets are in decline. For example, dial-up Internet services are gradually being withdrawn in many countries. They are being replaced by the much faster broadband services. Markets often decline because the need for a product ceases to exist. In the case of coal, other fuels, such as oil, gas, nuclear and renewable sources are now preferred by households and industry.

The nature of markets: Many markets are in a state of flux. This means that the structure and nature of the market is subject to constant change. It is also possible for consumer spending patterns to change. For example, significant changes are taking place in Indian markets. Shopping in India has become more social and often involves the whole family. Shopping events occur more frequently and immediate gratification is becoming more important. Traditionally the purchase of a house and a car took priority. However, today more Indian consumers want to buy holidays abroad and many are prepared to spend increasing amounts of money on 'comfort'. Another change is the desire to buy more 'upmarket' brands. Social media is influencing consumer behaviour as people attempt to match the spending habits of their peers.

New markets: While it is possible for some markets to completely disappear, new markets are always developing. One big source of new markets is from the development of 'emerging economies'. These include the BRIC (Brazil, Russia, India and China) countries and other developing nations, such as Mexico, Thailand, Indonesia and some South American countries. New markets also appear when completely new products are launched. In the 1970s no one had a mobile phone. In the 1980s no one had a smartphone. In the 1990s no one had a flat-screen television. In the 2000s few people had e-books. These are all examples of brand-new markets.

INNOVATION AND MARKET GROWTH

Markets can grow over time – some rapidly, some more slowly. Growth in existing markets and new markets may occur for the following reasons.

Economic growth: Global living standards tend to rise over time. This means that the world's population has

more money to spend. As a result businesses can supply more of their output to growing global markets. Also, as people get wealthier they are likely to demand different types of goods. For example, the markets for holidays, electronic goods, cars, air travel, cosmetics, furniture and luxury goods will grow.

Innovation: Businesses can grow their markets through the process of innovation. They can create new wants and needs and meet them with new products. A lot of innovation emerges through technological research and development. The arrival of smartphones, tablets, the Internet, 3D printing, driverless cars, wearable technology and space travel have all created brand-new markets that did not exist before the technological breakthroughs. However, innovation can take other forms. Businesses can use clever marketing techniques to develop new wants. They can supply their products in new locations, for instance, supermarkets offering a click & collect service at stations. New businesses can cash in on the inadequacies of others. For example, since the '**credit crunch**' in 2008, new businesses have been set up to compete with banks. Crowd funding and peer-to-peer websites have started to provide **unsecured loans**. At the moment their market shares are relatively small. But if they prove successful the established banks will have to match these new innovations.

Social changes: Changes in society can have a big impact on markets. For example, the decline in the number of marriages, an increase in the proportion of working women and the growth in the number of one-parent families have increased the market size for childcare and housing.

Changes in legislation: New laws can affect markets. For example, environmental legislation has helped to stimulate growth in renewable energies and 'green goods'. Tighter laws relating to **payday lending** has resulted in many firms leaving the market. A ban on tobacco advertising in some countries might have reduced the market size for cigarettes.

Demographic changes: Changes in the structure of the population can affect the size of markets. In most countries the population is ageing. This will help a lot of markets to grow because populations get bigger. But there will also be an increase in the markets for specialist holidays for the elderly, healthcare, care homes and mobility aids.

ADAPTING TO CHANGE

If businesses do not adapt to market changes, they are likely to lose market share. At worst they could collapse. In 2017 it was reported that Microsoft® was losing market share. In September 2016 Microsoft's key product, Windows® 10, lost 0.46 per cent of its share and again in February 2017 it lost 0.11 per cent. These are not

dramatic changes but could be a cause for concern if they become consistent. To help retain its share Microsoft is adding new features to Windows 10 in a bundle called Creators Update. This will enhance the experience for users, particularly those that use systems for gaming.

Flexibility: Businesses need to be prepared for change. One way is to develop a culture of flexibility within an organisation.

A business might need flexible working practices, machinery and equipment, pricing and staff. This could mean that staff have to be trained in a variety of skills and be prepared to change the tasks they undertake in the workplace. This might help businesses to serve customers more effectively when changes occur. For example, if customers want access to the business during the evening, then staff might have to work shifts. If businesses have flexible operations it will be a lot easier for them to adapt to market changes.

Market research: Businesses must keep in touch with developments in the market. One way to do this is to undertake regular market research. This might be aimed at current customers or potential customers. Firms need to be aware of any changes in customer needs or tastes. Communication with customers and potential customers should be an ongoing process if firms want to keep completely up to date. Market research is discussed in Chapter 2.

Investment: Those businesses that invest in new product development are likely to survive for longer in the market. Although research and development are expensive, a failure to innovate could be costly. A unique new version of a product or a brand could lift sales and help win a larger share of the market. In the car industry, firms spend very large sums of money on product development. BMW has enjoyed a larger slice of the small car market by extending the range of its Minis. Investment might also be needed in training and new flexible machinery.

Continuous improvement in the increasingly competitive environment:

Businesses need to make continual improvements in all aspects of their operations. For example, if they can improve efficiency, costs will be lower and prices can be held or reduced. If customer service is excellent, customers are more likely to return. If new product ideas are encouraged, they may gain a competitive edge. A culture of continuous improvement can help businesses be more adaptable in the market.

Develop a niche: If a market is in decline and a business is unable to diversify, it may survive by serving a niche. A niche strategy is appropriate if groups of loyal customers can be served profitably. For example, Harley-Davidson survived by leaving most of the motorcycle market to the Japanese. They sold highly powerful 'hogs' to a small segment of motorcycle enthusiasts. As a result they became quite profitable and survived. Generally,

if firms cannot adapt quickly to the changing needs of customers, they will lose out to rivals that do adapt.

HOW COMPETITION AFFECTS THE MARKET

Competition is the rivalry that exists between businesses in a market. It would be rare for a business to operate in a market where there was absolutely no competition. The existence of competition will have an impact on both businesses and consumers in the market.

Businesses: Competition puts businesses under some pressure. It means that they have to encourage customers to buy their products in preference to those of rivals. They will use a range of methods to attract customers. These methods include:

- lowering prices
- making their products appear different to those of rivals
- offering better quality products
- using more powerful or attractive advertising or promotions
- offering 'extras', such as high-quality customer service.

All of these methods cost money and generally reduce the amount of profit a business can make. However, businesses have to use such methods in order to survive in the market.

Because competition makes running a business more challenging and reduces the profit potential, owners and managers might try to reduce competition in the market. One way of doing this is to take over their rivals. This might be achieved by purchasing a rival in the market. Alternatively, they might try to create obstacles that make it difficult for others to enter the market. For example, they may spend huge amounts of money on advertising, which potential entrants might struggle to match. It is generally the larger businesses in the market that are able to reduce competition in this way. However, there is a range of legislation that prevents businesses restricting competition using practices that are considered unfair.

Consumers: Consumers will generally benefit from competition in markets. In markets where there are lots of businesses competing with each other, there will be more choice. Most people enjoy having lots of choice because it makes their life more interesting. For example, when people buy a car they can choose from a huge range of different models, styles, colours and endless variations in specifications. Consumers may also enjoy better-quality products and lower prices.

In the absence of competition consumers might be exploited. A business with little or no competition might raise prices and restrict choice. They will lack the incentive to innovate. For example, they are unlikely to invest money to develop new products. Consequently, one of the roles of a government is to ensure that competition exists in markets.

THE DIFFERENCE BETWEEN RISK AND UNCERTAINTY

One of the challenges when running a business is dealing with risk and uncertainty. Although both risk and uncertainty are likely to pose threats to a business, they are not the same.

Risk: Owners take risks when running a business. This means they take actions where the outcomes are unknown. More specifically, they commit resources that could be lost. Initially, they take a risk when setting up a business. This is because they invest their own money to get the business 'up and running' and there is a chance that the business will not succeed. If the worst happens and the business collapses it is possible that all the money invested by the owner is lost.

In many countries it is reckoned that a very large proportion of new businesses, perhaps as much as 90 per cent, do not survive beyond 5 years.

Even when businesses are established, they may continue to take risks. This is because they often spend money on ventures that may not provide positive results. For example, they may invest in a new product, which subsequently fails in the market. If the product is withdrawn, most of the money spent on development and launch will be lost.

In 2014 Amazon, the online retailer, launched a mobile phone called the Amazon Fire Phone. It failed in the market and the price was reduced very quickly from US\$199 to just US\$0.99. It was reported that Amazon lost US\$170 million as a result.

Uncertainty: The markets in which businesses operate are often subject to external influences. This means that events that are completely beyond the control of businesses can have an impact in the market, which can have financial consequences. For example:

- a new competitor might enter the market with a superior product
- consumer tastes might change as a result of a new social trend
- the government might introduce a new policy or piece of legislation
- some new technology might be invented
- there may be a natural disaster, such as a flood
- the economy might go into recession.

Unfortunately, such influences are very difficult to predict. This means that businesses have to operate all of the time in an environment of uncertainty.

However, the consequences of uncertainty are not always negative. For example, new technologies can provide new opportunities. The introduction of the Internet has resulted in an enormous range of new business opportunities. Generally though, businesses do not like uncertainty. Decision making becomes more difficult, particularly when investing for the future.

CHECKPOINT

1. What is the difference between a mass market and a niche market?
2. What is a key advantage of selling in a mass market?
3. State two disadvantages of selling in a niche market.
4. How is market share calculated?
5. State three advantages of giving products brand names.
6. State two advantages to customers of online retailing.
7. What is meant by a dynamic market?
8. How might the nature of a market change over time?
9. State three reasons why a market might grow.
10. Describe two ways a business might adapt to changes in markets.

SUBJECT VOCABULARY

brand name a name, term, sign, symbol, design or any other feature that allows consumers to identify the goods and services of a business and to differentiate them from those of competitors.

credit crunch a time when borrowing money becomes difficult because banks reduce the amount they lend and charge high interest rates.

e-commerce the use of electronic systems to sell goods and services.

EV a motor vehicle that can be recharged from an external source of electricity, such as wall sockets, and the electricity stored in the rechargeable battery packs drives or contributes to drive the wheels. A PEV is an plug-in electric vehicle.

liquidation the act of closing a company by selling the things that belong to it, in order to pay its debts.

market a set of arrangements that allows buyers and sellers to communicate and trade in a particular range of goods and services.

marketing a management process involved in identifying, anticipating and satisfying consumer requirements profitably.

market share the proportion of total sales in a particular market for which one or more businesses or brands are responsible. It is expressed as a percentage and can be calculated by value or volume.

mass market a very large market in which products with mass appeal are targeted.

niche market a smaller market, usually within a large market or industry.

online retailing or e-tailing the retailing of goods online.

payday lending an amount of money that is lent for a short period of time, usually at a high rate of interest and because someone needs money until they get paid again from their job.

unsecured loan a loan where there are no assets to which the lender has a right if the borrower does not make repayments.

EXAM PRACTICE

GLOBAL EV MARKET

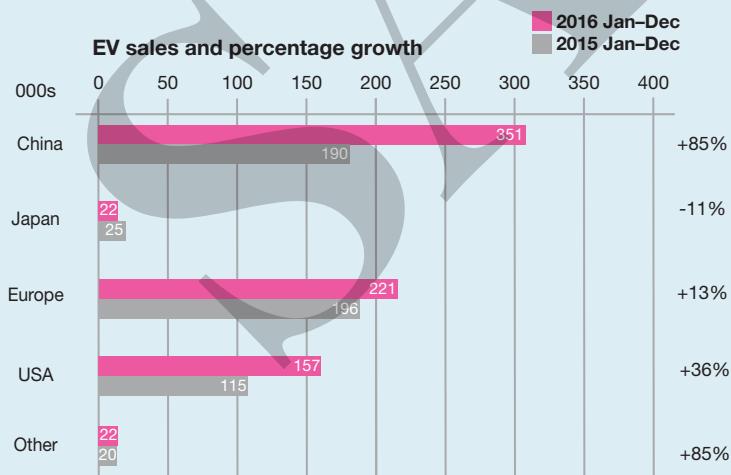
SKILLS ANALYSIS, INTERPRETATION, REASONING

Growing concerns about the environment, and agreements by many countries in the world to cut carbon emissions, have helped to encourage sales of electric vehicles (EVs) and hybrids. A hybrid vehicle is one that uses two or more power sources. These vehicles are now beginning to grab market share from traditional petrol and diesel models.



▲ Figure 3 Global sales of EVs, 2010 and 2017

Figure 3 shows that global sales of EVs in 2016 was 774,000 units. This was 42 per cent higher than for 2015. Sales of EVs grew 20 times faster than the overall vehicle market, however, this was only 0.86 per cent of the total market for vehicles. By the end of 2016, the number of EVs on the road passed 2 million. Of these 61 per cent were pure EVs and 39 per cent were hybrids. As Figure 4 shows, China is currently the most important market. It also plays a leading role in the manufacturing of EVs.



▲ Figure 4 EV sales and growth rates in a selection of regions, 2015 and 2016

Although EVs only have a very small market share at the moment, the sector is developing rapidly. One of the barriers to growth is the uncertainty about supporting infrastructure – stations that provide facilities for recharging batteries. However, locations for charging have increased at least tenfold and the number of available grid-charged models has increased from 70 to 130 since 2013. Also, the cost of batteries has fallen by 50 per cent in recent years and renewable sources are now roughly the same cost as fossil fuels in electricity generation.

Many governments around the world have also introduced financial incentives to encourage the purchase of EVs.

Q

- Define market share. (2 marks)
- Explain one reason why the global car market is likely to grow in the next 5 years. (4 marks)
- Discuss how a car manufacturer might adapt to changes in the market. (8 marks)
- Assess the factors that might affect the growth of the EV market in the future. (10 marks)

2 MARKET RESEARCH

UNIT 1
1.3.1

LEARNING OBJECTIVES

By the end of this chapter you should be able to understand:

- the primary and secondary market research data (qualitative and quantitative) used to identify and anticipate customer needs and wants, quantifying likely demand and gaining insight into consumer behaviour
- methods of primary market research: surveys/questionnaires, focus groups/consumer panels, face-to-face/telephone interviews and product trials/test marketing
- methods of secondary market research: websites/social media, newspapers/magazines/television/radio, reports and databases
- sampling methods: random, quota and stratified.

GETTING STARTED

In 2017, Alok Hossain decided to set up a Bangladeshi takeaway food service in Lagos, Portugal. Before he started trading he gathered information about the market for takeaway food in the town. He spent a lot of time finding out about competitors. He found out about the:

- number and location of takeaway restaurants in Lagos
- menus and prices charged
- opening times
- advertising and promotions used
- additional services offered, such as delivery
- speed of service
- types of customers who bought Bangladeshi food.

The information gathered by Alok was very helpful. For example, he found that one of the main criticisms of current takeaway services was the slow speed of service. When Alok opened Chittagong Paradise his speed of service was a unique selling point.

Why would it have been a mistake for Alok not to carry out market research? Alok used primary or field research, what does this mean? Is market research expensive? What might be the limitations of Alok's research?

MARKET RESEARCH

Market research involves gathering, presenting and analysing information about the marketing and consumption of goods and services. Businesses spend money on market research because it helps to reduce the risk of failure. Products that are well researched are more likely to be successful. Market research data can be used for the following specific purposes.

Identify and anticipate customer needs and wants: Businesses will benefit if they can clarify the specific needs and wants of consumers. In order to design products that are likely to sell, they need to identify as precisely as possible the product features that people desire. For example, a car manufacturer will need to find out which product features are important to potential customers. Examples include:

- body design and style
- colour
- interior design and style
- economy
- ease of maintenance
- how long it will last
- performance (e.g. acceleration and top speed).

The data that market researchers gather need to be as comprehensive as possible so that all the needs and wants are identified. This data will be qualitative. This is explained later in this chapter.

Quantify likely demand: It is important to find out how much of a product a business might expect to sell in a market. This data will be quantitative. This is discussed in detail later in this chapter. One reason for this is to help determine whether or not a particular product is going to be commercially viable. If market research finds that demand is inadequate, a business might cancel the launch of a product. This could save the business a lot of money. This is one of the reasons why businesses carry out research.

Assuming that demand is adequate, a business will need to know how much it should produce. Once demand has been quantified a business can plan production of the product. This means that it can start to organise the resources that will be needed for production and draw up production schedules. For example, it might need to recruit more staff to work in the factory and work with different departments to ensure that the necessary resources can be acquired.

Gain an insight into consumer behaviour: Some market research is aimed at analysing consumer behaviour. Businesses might be more successful if they can identify and understand patterns of consumer behaviour. For example, a holiday company selling package (organised by travel agents) holidays abroad might use market research to find out:

- when consumers book their holidays
- when consumers are most likely to go on holiday
- the number of holidays people take each year
- which methods consumers use to book their holidays, e.g. online or travel agent
- how much money people spend on holiday
- whether customers take out holiday insurance
- how people travel to the airport.

Getting an insight into how people behave will help a business to meet customer needs more effectively. This is qualitative data and might also help them to identify new opportunities. Businesses can use a number of different methods to gather market research data. Some of these methods are explained in detail below.

PRIMARY RESEARCH

Primary research or field research involves collecting primary data. This is information that did not exist before the research began. In other words, it has to be collected by the researcher. It can either be carried out by a business itself or by a market research agency. Because of the high costs of using the services of a market research agency, many small businesses choose to conduct market research themselves.

Most primary information is gathered by asking consumers questions or by monitoring their behaviour. The most accurate way to do this would be to question or observe all consumers of a particular product (known as the population). However, in all but a few instances this would be either impractical to carry out or expensive. It is usual to carry out a survey of a **sample** of people who are thought to be representative of the total market.

METHODS OF PRIMARY RESEARCH

Some of the main methods of gathering data are discussed briefly below.

Questionnaires/surveys: A questionnaire is a list of written questions. They are very common in market research and are used to record the views and opinions of **respondents**. A good questionnaire will have the following elements.

- **Have a balance of open and closed questions.**
- Closed questions allow respondents a limited

range of responses. An example would be 'How many times have you flown with Emirates® this year?'. The answers to closed questions are easier to analyse and represent numerically. Open questions let people say whatever they want. They do not have to choose from a list of responses.

Open questions are best used if there are a large number of possible responses. An example would be 'How would you improve the quality of cabin service provided by Emirates?'.

- **Contain clear and simple questions.** Questions must be clear avoiding the use of jargon, poor grammar and bad spelling.
- **Not contain leading questions.** Leading questions are those that 'suggest' a certain answer. They should be avoided because otherwise the results will be unreliable.
- **Not be too long.** If questionnaires are too long people will not give up their time to answer them. Questionnaires can be used in different situations. Two examples are outlined below.

- **Postal surveys.** Questionnaires are sent to people and they are asked to complete them in their own time. They may be more convenient for people but the vast majority of questionnaires are never returned. This means that resources are wasted.
- **Online surveys.** An increasing number of businesses are using online surveys to gather information from customers. These are likely to be cheap because they avoid printing and postage costs. Some businesses send consumers links to online surveys after they have made a purchase. These allow businesses to gather quick feedback from customers, which might help to identify strengths and weaknesses in their quality of service. Booking.com and Amazon are two examples of companies that use this approach. Also, in some countries, there are online surveys that pay cash to respondents if they complete questionnaires. These are used to gather information for a variety of different businesses.

Focus groups or consumer panels: If a business wants very detailed information from customers it might use **focus groups** or **consumer panels**. A focus group is where a number of customers are invited to attend a discussion organised by market researchers. The group must be representative of the whole population and be prepared to answer detailed questions. This is a relatively cost-effective method of collecting information but the group may be a little small. Consumer panels are similar

to focus groups except that groups of customers are asked for feedback over a period of time. This approach allows businesses to see how consumers react to changes in their products.

Face-to-face/telephone interviews: Businesses may conduct face-to-face interviews in the street. For example, an interviewer might approach pedestrians, ask them a few questions and record the answers on a clipboard. The advantage is that questions can be explained if a respondent is confused. It may be possible to collect more detailed information. However, many people do not like being approached in the street. Another approach is to interview people over the telephone. This is likely to be cheaper than questioning people in the street. Also, people from a wide geographical area can be covered. However, some people do not like being telephoned

by businesses – especially if they have not made an appointment.

Product trials/test marketing: Some businesses use product trials to get feedback from customers. This is where consumers are encouraged to examine, use or test a product before it is launched fully into the market. This enables businesses to make late adjustments to the product, if necessary, based on the feedback they gather. In some cases, consumers might be offered cash for trying out products and providing feedback. A similar approach is called test marketing. This involves selling a new product in a restricted geographical area to test it before a wider launch. After a period of time feedback is gathered from customers. The feedback is used to make modifications to the product before the final launch across the whole market. This reduces the risk of failure.

Advantages	Disadvantages
Data can be collected that directly applies to the issue being researched. Secondary data will be data collected for another purpose.	It can be expensive to collect and may take longer than desk research.
The business that initially collects the data will be the only organisation with access to it. It can be used to gain marketing advantages over rival firms.	The sample taken may not represent the views of all the population.
Secondary data may be unavailable in a certain area.	If the research method is flawed, the findings will also be flawed. For example, a badly worded questionnaire may not provide the data a business requires.

▲ Table 1 Advantages and disadvantages of primary or field research

ACTIVITY 1

SKILLS

ANALYSIS, REASONING

CASE STUDY: ONLINE SURVEYS

Some businesses use online surveys to gather data. This involves providing a link to a questionnaire on a company website and inviting people to complete it. An online questionnaire can be completed quickly and responses can often be analysed immediately. Survey costs are low because there are no printing and posting charges. Online surveys can be interactive and may be fun to complete. They can also be accessed 24/7 and be completed when it is convenient. However, there are problems. The sample of respondents may not be representative. This is because online surveys are only presented to Internet users. The views of others may not be

taken into account even though they may be potential customers.

Some businesses are keen to find out what customers think of their websites. They might use an online survey similar to the one shown in Figure 1.

1. Give one reason why it might be important to find out what people think of a business website.
2. Explain whether an online survey would benefit a company selling to: (a) customers in isolated areas (b) less-developed countries, such as Ethiopia, Bhutan and Haiti.
3. Discuss the advantages and disadvantages of online surveys.

Website survey

Thank you for using our website. We'd like to ask you some questions about your experience so that we can improve.

We would like your feedback about the content on our site. How satisfied are you with the content?

Very dissatisfied Dissatisfied Neutral Satisfied
 Very satisfied

Please tell us how our site compares with similar sites for each of the items below. If you did not experience an item, please select "N/A".

	Much worse	Worse	About the same	Better	Much better	N/A
Overall organisation/navigation	<input type="radio"/> 1	<input type="radio"/> 2	<input type="radio"/> 3	<input type="radio"/> 4	<input type="radio"/> 5	<input type="radio"/> -
Home page content	<input type="radio"/> 1	<input type="radio"/> 2	<input type="radio"/> 3	<input type="radio"/> 4	<input type="radio"/> 5	<input type="radio"/> -
Product information	<input type="radio"/> 1	<input type="radio"/> 2	<input type="radio"/> 3	<input type="radio"/> 4	<input type="radio"/> 5	<input type="radio"/> -
Ease of finding how to contact us	<input type="radio"/> 1	<input type="radio"/> 2	<input type="radio"/> 3	<input type="radio"/> 4	<input type="radio"/> 5	<input type="radio"/> -
Downloading information	<input type="radio"/> 1	<input type="radio"/> 2	<input type="radio"/> 3	<input type="radio"/> 4	<input type="radio"/> 5	<input type="radio"/> -

How likely are you to recommend our site to others?

Definitely not Unlikely Neutral May be likely
 Very likely

What prompted you to visit our site today? Please select all that apply.

Comparison shopping
 Interested in purchasing products/services
 Looking for contact information
 Looking for technical support
 Other, please specify

How did you find our site? Please select all that apply.

Recommended by others
 Link from email our site sent you
 Link from another website
 Link from marketing leaflet
 Search engine results
 Other, please specify

How frequently do you visit our site?

First choice Daily A few times per week
 A few times per month Once per month Less frequently than once per month

The next questions will only be used to group your answers with others like yourself.

Please tell us how you access the Internet. Check all that apply.

Home Cafe
 Work Mobile phone
 College Computer tablet (e.g. iPad(R))
 Library Other, please specify

Please indicate your gender.

Male Female

Please select the category that includes your age.

18-30 31-55 56 or older

Which one of the following ranges includes your total yearly household income before taxes?

up to £28,000 over £28,000
 Prefer not to answer

Submit
Back

▲ Figure 1 An example of a website survey

SECONDARY RESEARCH

Secondary research or desk research involves the collection of secondary data. This is information that already exists in some form. It can be internal data, from records within the business, or external data, from sources outside the business.

METHODS OF SECONDARY RESEARCH

Websites: A business can carry out secondary research by gathering data from the websites of rivals. By analysing the websites of competitors, a wide range of information can be gathered very easily and cheaply. For example, information about prices charged, product ranges, delivery terms, payment terms, store locations, details of special offers and useful links that might provide even more information. A business might also use comparison websites to identify the cheapest suppliers in the market.

Social media: Few businesses can afford to neglect the role social media can play in marketing. An increasing number of businesses make use of social media platforms such as Facebook, Twitter®, YouTube®, blogs and coupon sites. Social media can provide a cost-effective and in-depth tool for gaining insights into a firm's customers, market, brand appearance and other important market research aspects.

For example, most social media platforms offer numerous ways to analyse trends and conduct market research. By simply searching the latest posts and popular terms, it is possible to gain insight into emerging trends and see what customers are talking about in real-time. One example of this is conducting hashtag searches on Twitter. By setting up a few searches with hashtags (#) related to a specific brand, industry or product, instant notifications (alerts) can be received when customers, clients or competitors use key terms.

One of the biggest weaknesses to most marketing research methods is that they are driven by questions. To obtain the proper information, you must first know what to ask. At the same time, simply changing the words of a question can result in drastically different answers. This means that market research is only as good as the questions used. With the broad scope and interactive nature of social media, information is gained through interaction and observation. Instead of leading the discussions, businesses can simply observe or join in as an equal. This can result in a variety of answers and discoveries that might have remained hidden using other research methods.

Table 2 summarises the advantages of using social media for market research.

Broad reach	It can reach millions of people all around the world.
Ability to target	Social media allows specific groups of people to be targeted.
Free or low cost	The use of social media may be free for businesses and paid options are usually cheap.
Personal	It allows communication on a personal basis with individual customers and groups.
Fast	Information can be collected very quickly from large numbers of people.
Easy	High-level IT skills and complex equipment are not needed.

▲ Table 2 The advantages of using social media for market research

Newspapers/magazines: Some businesses may be able to use written information printed in newspapers and magazines as a source of market research data. For example, a small business might use a local newspaper to help assess the strength of competition in a market. This might be done by analysing the small ads placed by rival firms.

Some magazines carry out surveys among their readership, which might be useful. For example, a survey that explores the way readers spend their leisure time might provide useful information for a business operating a fitness centre.

Trade journals, which are publications produced by businesses or industries, can be a major source for marketing data and intelligence for the industries and markets they cover. They regularly publish special issues that may include, for example: industry outlook; year in review; product sales and market shares; buyer's guides; and other statistics.

Television/radio: Programmes broadcast on television and radio may provide useful data for some businesses. For example, documentaries about business, industry, the economy and people's behaviour might be helpful. There may be some specialist channels that can provide very specific information. For example, shopping channels might be used to help analyse the products of competitors. Also, a business might be able to analyse the adverts used on television and radio to help gather information about rival products and marketing methods.

Reports: The reports published by a wide range of organisations might be used to gather secondary data. In many countries the government is likely to publish data that could be used by businesses. For example, statistical reports may be available free of charge to any business and contain information such as the:

- relative sizes of the primary, secondary and tertiary sector
- number of people in different age groups in a country
- income levels in different regions or countries
- spending patterns in different regions or countries
- value of output in different industries
- methods of transport used by people travelling to work.

Organisations, such as the EU, the World Bank, the World Trade Organization and the International Monetary Fund, also publish a wide range of regular reports that can be accessed by businesses.

DATABASES

A **database** allows a great deal of data to be stored. Every business that uses computers will compile and use databases. The information is set up so that it can be updated and recalled when needed. Table 3 shows part of a database of a finance company which gives details about their clients. The collection of common data is called a file. A file consists of a set of related records. In Table 3 all the information on Jane Brown, for example, is a record. The information on each record is listed under headings known as fields, e.g. name, address, age, occupation, income each year. A good database will have the following facilities:

- be user definable (having a function or meaning that can be specified and varied by a user)
- file-searching facility for finding specified information from a file, e.g. identifying all clients with an income over £33,000. It is usually possible to search on more than one criterion, e.g. all females with an income over £33,000

- file-sorting facility for rearranging data in another order, e.g. arranging the file in Table 3 in ascending order of income
- calculations on fields within records for inclusion in reports.

In the world of business and commerce there is actually a market for information held on databases. It is possible to buy banks of information from market researchers who

have compiled databases over the years. Names and addresses of potential customers would be information well worth purchasing if it were legally available. The storage of personal data on a computer in the UK is influenced by the Data Protection Act. Any company or institution wishing to store personal data on a computer system must register with the Data Protection Office. Individuals have a right under the Act to request details of information held on them.

Surname	First name	Address	Town	Age	Occupation	Income p.a.
Adams	John	14 Stanley St	Bristol	39	Bricklayer	£32,000
Appaswamy	Krishen	2 Virginia St	Cardiff	23	Welder	£26,000
Atkins	Robert	25 Liverpool Rd	Cardiff	42	Teacher	£32,000
Biddle	Ron	34 Bedford Rd	Bath	58	Civil servant	£35,000
Brown	Jane	111 Bold St	Newport	25	Solicitor	£41,000

▲ Table 3 An extract from a simple database

Advantages	Disadvantages
It is relatively easy, quick and cheap to collect, especially if the sources that exist are known. This makes it very useful for smaller businesses.	Data is not always in a form that a particular business would want because it has been collected for another purpose. Adapting it may take time and become expensive.
Several sources may be used. This allows the data to be checked and verified.	Data may be out of date and not relevant, especially in fast-changing markets.
Historical data may be used which can show a trend over time.	Researchers must be aware of bias. For example, company reports and accounts may show figures in the best possible light to satisfy shareholders.
It can be used before carrying out primary research, which helps to establish the most useful questions to be asked in questionnaires.	There may have been problems with the research. For example, the footnotes to research may state that the sample used was too small and that the results may be inaccurate as a result.

▲ Table 4 Advantages and disadvantages of secondary or desk research

QUANTITATIVE AND QUALITATIVE RESEARCH

Data collected through desk and field research can be either quantitative or qualitative in nature.

Qualitative research involves the collection of data about attitudes, beliefs and intentions. Focus groups and interviews are common methods used to collect qualitative data. An example of qualitative research could be face-to-face interviews with 100 purchasers (buyers) of new Land Rover Discoveries to find out why they prefer this product to similar four-wheel drive vehicles sold by other car manufacturers. The information collected through qualitative research is usually regarded as being open to a high degree of interpretation.

This means that there are often disagreements within businesses about the significance and importance of qualitative research data.

Quantitative research involves the collection of data that can be measured. In practice this usually means the collection of statistical data such as sales figures and market share. Surveys and the use of government

publications are common methods of collecting quantitative research data. An example of quantitative research would be a survey of four-wheel drive vehicle owners in Bavaria to establish where they live, their ages, occupations, incomes and gender. The information collected through quantitative research is usually regarded as being open to less interpretation than that collected through qualitative research.

ACTIVITY 2

SKILLS

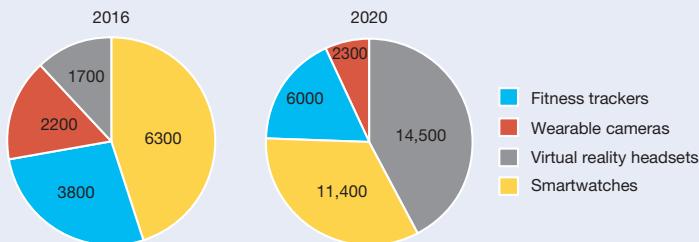
CRITICAL THINKING, ANALYSIS,
INTERPRETATION, INNOVATION

CASE STUDY: TEKKONG AND VIRTUAL REALITY

TekKong, a Chinese technology company based in Hong Kong, has developed a new virtual reality (VR) headset that it hopes to launch in 2018. A VR headset is a device used to deliver VR experiences for three-dimensional (3D) simulations, computer games and other applications, such as movies. They may be used in the development of training methods, engineering design process, business environments and audience

engagement (involvement), such as VR gaming, sports and events. VR headsets are also widely used by medical students when training for surgery. TekKong decided to develop the product after some desk research was carried out in 2016 to assess the size of the market and the strength of the competition.

Figure 2 shows the market sizes for four different types of wearable technology in 2016 and 2020. According to online research, 2016 saw significant fragmentation in the VR hardware market, with many new devices and platforms launching. Appearing alongside Google Cardboard were new platforms Google Daydream, Samsung Gear VR, Oculus Rift, PlayStation® VR and Steam® VR.



▲ Figure 2 Market sizes of four types of wearable technology (US\$ million), 2016 and 2020 (estimated)

1. Define desk research.
2. Figure 2 is an example of quantitative data.
 - (a) What does this mean?
 - (b) Describe **one** advantage of gathering quantitative data.
3. Based on the data in Figure 2, discuss **one** possible reason why TekKong decided to develop a VR headset.

SAMPLING METHODS

Ideally, when carrying out a survey, information could be gathered from every single member in the **target population**. The target population includes all those people whose views a business wants to explore. The target population may be individual consumers, households or other businesses, for example. However, this may take too long and cost too much money. To overcome this problem businesses collect information from a **sample** of people in the population. A sample is a much smaller group. However, it is important that the behaviour and views of the sample are representative of all those in the population.

The sample size will affect the accuracy of the information gathered. Large samples will be more representative of the population and therefore more useful to a business. However, using larger samples is more expensive so there is a trade-off between cost and the level of accuracy required. It might be argued that

a sample size of at least 10 per cent of the population would be needed for a survey to be meaningful.

There are different types of sample and sampling methods that can be used by a business carrying out primary research.

Random sampling: **Random sampling** gives each member of a group an equal chance of being chosen. In other words, the sample is selected at random, rather like picking numbers out of a hat. Today computers can be used to produce a random list of numbers, which are then used as the basis for selecting a sample. However, it assumes that all members of the group are exactly the same, which is not always the case. A small sample chosen this way may not have the characteristics of the population. Therefore, a very large sample would have to be taken to ensure that it was representative. It would also be expensive for a business to draw up a list of the whole population and then to contact and interview them.

Quota sampling: **Quota sampling** involves the target population being segmented into a number of groups that share specific characteristics. These may be based on the age and gender of the population, for example. Interviewers are then given targets for the number of people out of each segment who they must interview. For example, an interviewer may be asked to interview 10 males between the ages of 18 and 25, or 15 females aged between 45 and 60. Once the target has been reached, no more people from that group are interviewed. The main advantage of this sampling method is that it is more cost effective than other methods. It is also useful where the proportions of the different groups within the population are known. However, results from quota sampling are not statistically representative of the population and are not chosen randomly.

Stratified sampling: This method of sampling is also random. However, unlike the method described above, **stratified sampling** is where the sample is divided into segments or strata based on previous knowledge about how the population is divided up. For example, a business may be interested in how employment status affected the demand for a food product. It might divide the population into different income groups, such as higher managerial and professional occupations, small employers and self-employed workers. A random sample could then be chosen from each of these groups, making sure that there were the same proportions of the sample in each category as in the population as a whole. Therefore, in this example, if the population had 10 per cent of small employers, the sample must also have 10 per cent. Stratified sampling is a popular method because it makes the sample more representative of the whole group.

ACTIVITY 3**SKILLS**CRITICAL THINKING, REASONING,
COMMUNICATION**CASE STUDY: BASEL INTERNATIONAL**

Basel International is a multinational pharmaceutical company based in Basel, Switzerland. In 2017, 74 per cent of the company's products were aimed at the male market. The board of directors felt that this was a weakness and therefore commissioned a market research agency to carry out a worldwide study into female health. The board planned to use the results to identify gaps in the market for future product development.

The agency set about conducting a two-phase survey. In the first phase, 20,000 interviews were conducted with target respondents in 20 different countries. The agency used a combination of telephone and online surveys to gather information. In the second phase, 5 per cent of the initial respondents were chosen at random for a second interview. These interviews were conducted over the telephone and a greater proportion of open questions were used.

The research methods used meant that the same questions were put to all respondents and answers were collected in the same manner.



Random sampling is used by the market research agency in this case.

1. (a) Define random sampling.
 (b) Why are samples used in market research?
 (c) Describe **one** disadvantage of using random sampling.
2. On behalf of Basel International, information was gathered from 20,000 females in 20 different countries. Suggest why it interviewed (a) females only;
 (b) respondents in 20 different countries rather than one country only and (c) 20,000 people rather than 1000 or 1 million.
3. (a) What is the difference between open and closed questions in a survey?
 (b) Describe one advantage to Basel International of using open questions.

CHECKPOINT

1. How might market research reduce the risk in business?
2. State three advantages of primary research.
3. What is desk research?
4. State four sources of data for secondary research.
5. What is meant by quantitative market research?
6. Why might qualitative data be open to different interpretations?
7. How might a business use social media to conduct market research?
8. Give three advantages of using online surveys.
9. How might a business use databases for market research?
10. What is the difference between a random sample and a quota sample?

SUBJECT VOCABULARY

consumer panels groups of customers are asked for feedback about products over a period of time.

database an organised collection of data stored electronically with instant access, searching and sorting facilities.

focus groups a number of customers are invited to attend a discussion about a product run by market researchers.

market research the collection, presentation and analysis of information relating to the marketing and consumption of goods and services.

primary research or field research the gathering of 'new' information that does not already exist.

qualitative research the collection of data about attitudes, beliefs and intentions.

quantitative research the collection of data that can be quantified.

quota sampling respondents are selected in a non-random manner in the same proportion as they exist in the whole population.

random sampling respondents are selected for interview at random.

respondents people or organisations that answer questions in a survey.

sample a small group of people that must represent a proportion of a total market when carrying out market research.

secondary research or desk research the collection of data that is already in existence.

stratified sampling a method of quota sampling in which respondents are chosen at random.

target population the total number of consumers in a given group.

EXAM PRACTICE

MARKET RESEARCH ON 'CLICK & COLLECT' ORDERS

SKILLS

ANALYSIS, INTERPRETATION, CRITICAL THINKING,
REASONING, INNOVATION

Mintel is the world's leading market intelligence agency. It provides a wide range of services in the field of market research. For example, it carries out primary research, analyses market data and market trends, and produces specialist market research reports for its clients. Some of Mintel's reports can be purchased online and can cost up to £2500. The research data below about click & collect orders was gathered by Mintel in 2014.

- Click & collect orders made up 15 per cent of all Internet retail sales of goods in 2014. The collection rate was much higher for non-grocery orders than groceries.
- In 2014, online retail sales were expected to contribute up to 11.6 per cent of all retail sales. This means, in turn, that click & collect orders would make up 1.7 per cent of all retail sales in 2014.
- The survey estimated that in 2015, 17 per cent of all Internet retail sales (or 2.2 per cent of all retail sales) would be collected by customers. In September 2014, Transport for London reported that it had processed 10,000 orders at its click & collect stations in the first 10 months of operation.
- Thirty-five per cent of UK consumers had used click & collect services in the previous year and 64 per cent said that they shopped online more now because retailers offer click & collect services. Furthermore, 58 per cent said that click & collect encouraged them to visit stores more frequently.
- Sixty per cent of UK consumers only used click & collect for smaller items that were easy to carry, but 53 per cent said they would like drive-through points that offered click & collect for a number of retailers – suggesting opportunities to extend click & collect to heavier or bulkier items.



- New click-and-collect fashion facilities are likely to drive up online sales. In the survey, 80 per cent of consumers agreed that when shopping online it is difficult to tell if clothes will fit – consumers aged under 35 see this as the main issue.
- Fifty per cent of consumers (rising to 57 per cent of women) said the annoyance of returning goods through the post was one of the main barriers to buying clothes online. Thirty-one per cent of consumers preferred to be able to return their online order to an actual store – and 23 per cent of UK consumers said that an option to deliver to a store to try on before purchasing would encourage them to buy from one online retailer over another.

Source: adapted from www.mintel.com

Q

- (a) Define primary research. **(2 marks)**
- (b) Explain one benefit of using qualitative market research. **(4 marks)**
- (c) Explain one way in which the data in the Mintel report might be used by retailers. **(4 marks)**
- (d) Assess the usefulness of market research data, like the above information, to retailers. **(10 marks)**

3 MARKET POSITIONING

LEARNING OBJECTIVES

By the end of this chapter you should be able to understand:

- product and market orientation
- market mapping
- market segmentation
- competitive advantage of a product or service
- the purpose of product differentiation
- adding value to products/services.

GETTING STARTED

The market for automobiles is very competitive. Consider the market for the cars below.



To what extent are the two cars the same or different? What might be the target markets for these two products? How might the manufacturers differentiate the two products? How might one of the manufacturers try to gain a competitive edge over their rival?

PRODUCT AND MARKET ORIENTATION

Some businesses are said to be relatively **product orientated** or **market orientated**.

Product orientation: Many businesses in the past, and some today, could be described as product orientated. This means that the business focuses on the production process and the product itself. It puts most of its effort into developing and making products that it believes consumers want and which will sell well.

In the past, businesses producing radios and televisions could be said to have been relatively product

orientated. It was their novelty and the technical 'wonder' of the product that sold them. There were few companies to compete against each other, and there was a growing domestic market. There were also few overseas competitors. The product sold itself. Some industries today are still said to be product orientated.

The machine-tool industry, which produces machines used in the production of other goods, has to produce a final product that exactly matches a technical specification. However, because of increased competition, such firms are being forced to take consumers' needs into account. The technical specification to which a machine-tool business produces might be influenced by what customers want, for example.

Product-orientated businesses thus place their emphasis on developing a technically sound product, producing that product and then selling it. Contact with the consumer comes largely at this final stage. There will always be a place for product orientation. A great deal of pure research, for example, with no regard to consumers' needs, still takes place in industry, as it does in the development of pharmaceuticals.

Market orientation: A business that is market orientated is one that continually identifies, reviews and analyses consumers' needs. It is led by the market. A business is much more likely to be engaged in effective marketing if it is market orientated. Henry Ford was one of the first industrialists to adopt a market-orientated approach. When the Ford Motor Company produced the Model T, it did not just design a car, produce it as cheaply as possible, and then try to sell it to the public. Instead, in advance of production, Ford identified the price at which he believed he could sell large numbers of Model Ts. His starting point was the market and the Model T became one of the first 'mass-market' products.

This illustrates the market-orientated approach – consumers are central to a firm's decision making. Sony is one of many modern businesses that has taken a market-orientated approach. The iPhone® 6 by Apple is an example of a product being developed in response to the wishes of consumers.

A more market-orientated business may have several advantages over one which is more product orientated.

- It can respond more quickly to changes in the market because of its use of market information.
- It will be in a stronger position to meet the challenge of new competition entering the market.
- It will be more able to anticipate market changes.
- It will be more confident that the launch of a new product will be a success.

What effect will taking a market-orientated approach have on a business? It must:

- consult the consumer continuously (market research)
- design the product according to the wishes of the consumer
- produce the product in the quantities that consumers want to buy
- distribute the product according to the buying habits and delivery requirements of the consumer
- set the price of the product at a level that the consumer is prepared to pay.

The business must produce the right product at the right price and in the right place, and it must let the consumer know that it is available. This is known as the marketing mix. The adoption of a market-orientated approach will not always guarantee success. The failure rate for new products, even when launched by high-profile companies, is high. In grocery it is reckoned that the failure rate is between 80 and 94 per cent. One recent example of failure was Kellogg's® Breakfast Mates. This was a box containing cereal, milk (that did not need refrigeration) and a spoon. One reason why it failed was because people do not normally like to eat cereal without cold milk. Also, the adverts for Breakfast Mates showed the product being eaten by children while their parents were asleep. Unfortunately though, the packaging was not child friendly. Whether a business places great emphasis on the product or on the market will depend on a number of factors.

The nature of the product: Where a firm operates in an industry at the edge of new innovation, such as biotechnology, pharmaceuticals or electronics, it must innovate to survive. Although a firm may try to anticipate consumer demand, research is often 'pure' research, i.e. the researcher does not have a specific end product in mind.

Policy decisions: A business will have certain objectives. When these are set in terms of technical quality or safety, the emphasis is likely to be on production. When objectives are set in terms of market share or turnover, the emphasis is likely to be on marketing.

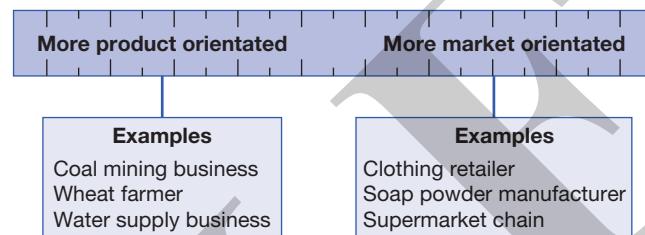
The views of those in control: An accountant or a managing director may place emphasis on factors such as cash flow and profit forecasts, a production engineer may give technical quality control and research a high priority and a marketing person may be particularly concerned with market research and consumer relations.

The nature and size of the market: If production costs are very high, then a company is likely to be market orientated. Only by being so can a company ensure it meets consumers' needs and avoid unsold goods and possible losses.

The degree of competition: A company faced with a lack of competition may devote fewer resources to research with little concern about a loss of market share.

Businesses in competitive markets are likely to spend more on marketing for fear of losing their share of the market.

The distinction between product and market orientation can be seen as a spectrum, as in Figure 1. Most businesses are somewhere along the spectrum. For example, supermarkets may be more market orientated and a copper mining company more product orientated.



▲ Figure 1 Product versus market orientation

ACTIVITY 1

SKILLS

ANALYSIS, INTERPRETATION,
CRITICAL THINKING, REASONING

CASE STUDY: SUN PHARMACEUTICAL INDUSTRIES

Sun Pharmaceutical Industries is the largest pharmaceuticals company in India. It focuses on three important areas of healthcare: cardiovascular and metabolic disease (CVMD); oncology; and respiratory, inflammation and autoimmunity (RIA).

The company employs over 50,000 people worldwide and manufactures products in 45 sites in many different countries. It is committed to ensuring a reliable supply of medicines where and when they are needed. In 2016, its total sales revenue was Rs 282,697 million.

Sun Pharmaceuticals has around 2000 research scientists working in several R&D centres around the world. Most centres are equipped with up-to-date technologies specifically designed for research. Their scientists have expertise in developing generics, difficult-to-make highly technical products, active pharmaceutical ingredients, novel drug delivery systems and new chemical entities. Figure 2 shows the amount of money Sun Pharmaceuticals has invested in R&D since 2011.



▲ Figure 2 Sun Pharmaceuticals R&D expenditure (spending), 2011–16



- Comment on the pattern of R&D expenditure shown in Figure 2.
- Explain one benefit to Sun Pharmaceuticals of being product orientated.
- To what extent is Sun Pharmaceuticals product orientated?

MARKET POSITIONING

Market positioning is concerned with the perceptions consumers have about products. To simplify the choice from a vast range of products, consumers categorise them according to a range of factors. Such factors include the quality, status and value for money of products. It is the categories into which consumers place products that define their 'position'.

Consumers often position a business's products in relation to those of its competitors. This can be in the form of 'pecking order' or product ladder. Firms will plan marketing activities to shape consumer perceptions and therefore achieve a desired position. Some approaches that a business might use to position its products are outlined below.

- The benefits offered by the product.** For example, in the automobile market, some manufacturers emphasise safety, others the quality of work and style, and yet more value for money.
- The unique selling point.** The **unique selling point** or **unique selling proposition (USP)** of the product. This is the key aspect of the product or service that sets it apart from those of competitors. For example, some shampoos claim to remove flaky skin.
- The characteristics/qualities of the product.** This is a common method used to position products. For example, the slogan 'M&Ms melt in your mouth, not in your hand' emphasises clearly a quality of this sweet.
- The origin of the product.** In the market for cheese, the names of many products are derived from where they were originally manufactured.

Examples might be Lancashire, Port Salut, Edam, Gorgonzola and Camembert.

- The classification name of the product.** The name of a product may be used to position a product in the market. This positioning strategy tends to take a leadership position in the overall market. Statements with the general message of 'we are the best in our field' are common. For example, Beanz Meanz Heinz.

As markets change in response to shifting consumer demand, some businesses find they need to **reposition** their products. This usually involves changing their target market, the features of the product or the image of the product that distinguishes it from those of rivals. For example, cleaning products originally designed for washing babies' nappies faced a sharp fall in demand when throwaway nappies were introduced. However, some companies successfully repositioned their brand for a new use – being an ideal washing powder for tough stains.

MARKET MAPPING

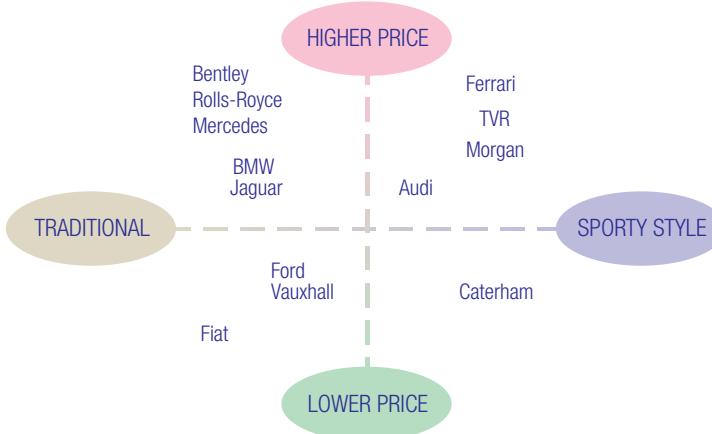
The positioning of a brand is influenced by customer perceptions rather than by those of businesses. For example, a business may feel its brand is a high-quality, upmarket product. But if customers see it as low quality and downmarket, it is their views that will influence sales.

So, if a business wants to find out where its brand is positioned in the market, it might carry out market research. This will help it to understand how customers see the brand in relation to others in the market.

A business may also wish to launch a new brand. Having decided the target market, market research might show what characteristics the brand must have to succeed in that market. It could reveal the price that customers are prepared to pay. It could also suggest what sort of promotional support will be needed. For example, will a national television advertising campaign be used? Will promotion to retailers be a better strategy?

The results of market research can be displayed on **market or perceptual maps** (sometimes also called positioning maps). An example is shown in Figure 3. This illustrates a perceptual map for a sample of motor cars.

The use of market maps can have its limitations. For example, perceptual maps are two dimensional, which means that only two product qualities can be analysed on the same map. They can also be more relevant for individual brands, and less helpful for a corporate brand image. The information needed to plot the maps can be expensive to obtain, requiring the use of primary market research. There may also be a difference between consumers' perception of the brand's benefits and the actual benefits.



▲ Figure 3 A perceptual map for cars

Finally, perceptual maps need not come from a detailed study. There are also intuitive maps (also called judgemental maps or consensus maps) that are created by marketers based on their understanding of their industry. Management uses its best judgement. It is not certain how valuable this type of map is. Often they just give the appearance of reliability to management's preconceptions (presumptions).

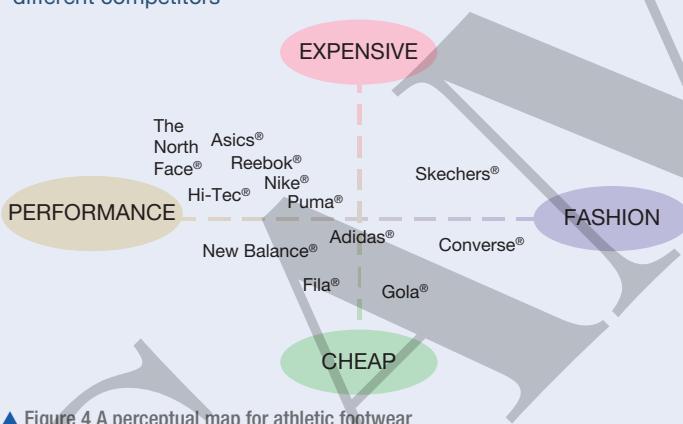
ACTIVITY 2

SKILLS

ANALYSIS, CRITICAL THINKING,
INTERPRETATION

CASE STUDY: ATHLETIC FOOTWEAR

A perceptual map provides a visual picture of how customers see different competitors



▲ Figure 4 A perceptual map for athletic footwear

Figure 4 shows a perceptual map for athletic footwear.

- How might a Taiwanese sports shoe manufacturer use the map in Figure 4?
- Describe **one** drawback of the Taiwanese sports shoe manufacturer using the perceptual map in Figure 4.
- Assess the position of The North Face brand compared to that of Adidas using the perceptual map in Figure 4.

THINKING BIGGER

From time to time there may be a need to reposition an entire company, rather than just a product line. Reasons for repositioning an entire company might be to deal with a damaged image, to differentiate the company from rivals, to clarify the company's position, to create more business opportunities or to increase the value of the company. In 2015, Kia®, the South Korean car manufacturer used an advertising campaign involving television, print, digital and social media in an effort to reposition its brand. Historically, Kia had a reputation for 'affordable cars'. However, according to Kia, the new campaign had a 'premium feel'. It was designed to emphasise Kia's quality, reliability, design and technology and therefore repositioning it as a 'value brand'. Using the word premium in the adverts suggests that Kia's new brand won't be all about price.

Repositioning a company is an enormous task. It involves more than a marketing challenge. It requires making hard decisions about how a market is shifting and how a firm's competitors will react. Often these decisions must be made without the benefit of sufficient information. Positioning is also difficult to measure because customer perception of a product may not have been tested using quantitative techniques.

MARKET SEGMENTATION

Markets can be divided into different sections or **market segments**. Each segment is made up of consumers that have similar needs. Businesses recognise this and target particular market segments with their products.

- Some businesses concentrate on producing one product for one particular segment, for example, luxury cars targeted at a very wealthy market segment in the car market.
- Some businesses produce a range of different products and target them at several different segments.
- Some businesses aim their products at nearly all consumers. For example, large food manufacturers are likely to target their brands at everyone.

However, by dividing markets into segments businesses can more easily supply products that meet customers' needs.

GEOGRAPHIC AND DEMOGRAPHIC SEGMENTATION

Geographic segmentation: Different customer groups are likely to have different needs depending on where they live. For example, groups living in hot climates, such as Australia or South Africa, will have different needs to groups living in mild climates such as Denmark. There might also be differences between groups living in different parts of the same country. For example, in India different regions have slightly different tastes in food.

Demographic segmentation: It is common for businesses to divide markets according to age, gender, income, social class, ethnicity or religion of the population.

- **Age.** Young children, teenagers, young adults and the over 65s are all likely to have different needs because of their different ages. Many products are targeted to different consumer groups based on age. For example, clothes are produced in different styles for people in different age groups.
- **Gender.** Men and women are likely to be targeted by businesses with different products. For example, producers of clothes, cars, magazines, bathroom products and drinks target different products to different genders.
- **Income.** Incomes in most countries vary considerably. As a result businesses target products at certain income groups. For example, luxury watchmakers target products at very high-income groups. In contrast, low-cost supermarket chains target lower-income groups.
- **Social class.** Businesses pay a lot of attention to different **socio-economic groups**. Such groups are usually based on occupations. An example of a commonly used measure of social class is shown in Table 1. It is compiled by the Institute of Practitioners in Advertising (IPA), in the UK, and divides social class into six categories. These can be used by businesses to target products.
- **Ethnicity.** Many countries in the world are becoming more cosmopolitan. This means that people from different ethnic groups are likely to live in the same country. This is important for businesses because different ethnic groups are likely to have different needs and tastes due to their different cultures. For example, in Canada, where there are over 200 different ethnic groups, Chinese consumers are likely to spend more than other ethnic groups on leather goods, furniture, appliances and electronic equipment.
- **Religion.** Different religious groups can display different tastes. For example, Muslims do not eat pork. In the US the market for kosher (Jewish) food is thought to be worth \$100 billion.

Social grade	Social status	Head of household occupation	Percentage of UK population (approx)
A	Upper middle	Higher managerial, administrative or professional – doctors, lawyers and company directors	4
B	Middle class	Intermediate managerial, administrative or professional – teachers, nurses and managers	12
C1	Lower middle class	Supervisory or clerical and junior managerial, administrative or professional – shop assistants, clerks and police constables	22
C2	Skilled working class	Skilled manual workers – carpenters, plumbers, cooks and train drivers	33
D	Working class	Semi-skilled and unskilled manual workers – fitters, window cleaners and storekeepers	19
E	The poor	State pensioners or widows, casual or lower-grade workers, or long-term unemployed	10

▲ Table 1 Socio-economic groups

PSYCHOGRAPHIC SEGMENTATION

Geographic and demographic segmentation have limitations. For example, there is a wide variety of spending patterns among females aged 16–18 living in Mombasa, Kenya. Yet people in this consumer group share the same gender, age and location. An alternative way of grouping customers is through psychographic segmentation. This groups customers according to their attitudes, opinions and lifestyles.

- Sports products may be aimed at those who are interested in ‘extreme’ sports such as snowboarding.
- Chocolate manufacturers have identified two categories of chocolate eaters. ‘Depressive’ chocolate lovers eat chocolate to unwind, mainly during the evening. ‘Energetic’ chocolate eaters eat chocolate as a fast food and live life at a fast pace.
- People’s attitudes to life may also be used to segment the market. Some pension funds are geared towards those who only want investments in ‘ethical’ (morally acceptable) businesses.
- Clothes may be geared at those who are interested in ‘retro’ fashions from earlier decades.
- Travel companies target holidays at families with younger children.
- Many newspapers are often targeted at readers with particular political views.

One of the drawbacks of psychographic segmentation is that it can be difficult for businesses to collect data

about the beliefs, attitudes and lifestyles of consumers. In order to do this they may require the help of specialist businesses.

BEHAVIOURAL SEGMENTATION

Behavioural segmentation attempts to segment markets according to how consumers relate to a product. There are a number of different methods of behavioural segmentation.

Usage rate: This is when consumers are categorised according to the quantity and frequency of their purchases. One example of this is British Airways, which established an 'Executive Club' to encourage and develop the custom of regular business travellers.

Loyalty: Consumers can be categorised according to their product loyalty.

Time and date of consumption: Consumers often consume particular products at particular times and dates. Businesses can take advantage of this in order to improve their marketing. So, for example, manufacturers of breakfast cereals, while recognising that their product will be primarily consumed in the morning, encourage consumers also to consume their products in the evening. Similarly, many restaurants seek to encourage different groups of consumers. For example, they often have deals for students or lunchtime deals for local offices.

Like other segmentation methods, a drawback of behavioural segmentation is that on its own it may fail to adequately capture a target market for a business. For this reason, in many cases a business might employ a variety of the segmentation methods explained above. So, for example, a manufacturer of luxury apartments may be interested in segments that included single men or women with no children, in the 30–40 age range, with high incomes that fall into social class AB. Because of the likely exceptional nature of such a purchase, behavioural segmentation would be less important in this instance.

BENEFITS OF MARKET SEGMENTATION

Generally a business is more able to meet the needs of different customer groups if the market is segmented. Some specific advantages include the following.

- Businesses that produce different products for different market segments can increase revenue. For example, airlines charge first-class passengers many times more than they charge economy passengers for the same flight. This helps to increase revenue from the flight.
- Customers may be more loyal to a business that provides products that are tailored specifically to them.
- Businesses can avoid wasting promotional resources by not targeting products at customers that do not want them.

- Some businesses can market a wider range of goods to different customer groups. For example, many car manufacturers have several different models, each of which is targeted at a different segment.

COMPETITIVE ADVANTAGE OF A PRODUCT OR SERVICE

A business is likely to be more successful if it can gain a **competitive advantage** in the marketplace. Competitive advantage is a set of unique features of a company and its products that are perceived by customers as significant and superior to the competition. For example, a product may save time, save money, make money, improve health, taste better, be more convenient or offer more comfort. A business can develop a competitive advantage in a number of ways.

Product design: If a firm can develop a product that has superior design, this might appeal to a significant proportion of a market. A business may emphasise a specific design feature to differentiate its product from those of its rivals and gain a competitive advantage. It could stress the superior functionality of the product – it might be ergonomically (very efficiently) designed, for example. Alternatively a design might focus on the aesthetics (look and feel) of a product. This approach may be used by jewellery producers. Product design is discussed in Chapter 10.

Product quality: Offering high-quality products is a common way of gaining a competitive edge in a market. The main advantage of this approach is that a premium price (higher than usual) can be charged. However, costs may be higher if superior raw materials are required along with higher standards of quality. Rolex®, the Swiss watchmaker, for instance, has a reputation for high-quality handmade wristwatches.

Promotion: Effective promotion using creative advertising, for example, might give a firm a competitive edge (advantage). The use of persuasive advertising may be capable of changing consumer perceptions so that they are more inclined to buy the product. For example, the use of television adverts for products that claim to reduce pain may be perceived as persuasive.

Customer service: Some businesses pay less attention to the product itself and rely on high-quality customer service to gain a competitive edge. For example, Enterprise, the car hire firm, delivers and collects cars from a chosen customer location (e.g. at home) to encourage sales.

Delivery times: Some customers demand fast delivery of products. Where speed of delivery is important, a prompt service will be a way of gaining an advantage. An example might be a components supplier in the car industry that can guarantee to deliver just-in-time (see Chapter 39).

Economies of scale: Firms that can produce efficiently at low cost can afford to charge a lower price and therefore gain a competitive advantage by being a cost leader in their market. Larger firms are likely to be better placed to exploit this advantage.

Flexibility: Some customers appreciate a flexible service. For example, firms that supply other businesses may win a bigger market share if they can change designs or specifications while production is in progress. Or if they can speed up production to meet a more urgent delivery time.

Ethical stance: It might be possible to gain a competitive edge by adopting a particular ethical position. For example, Fairtrade aims to deal ethically and fairly with the producers of the commodity being sold. A furniture maker might attract environmentally aware consumers if it ethically sources its raw materials. It could do this by avoiding the use of wood from trees that are threatened with extinction.

Focusing on a particular market segment: For example, a gym could gain a competitive advantage by focusing on an audience not typically catered for by gyms and fitness clubs such as the over-60s or parents with young children.

THE PURPOSE OF PRODUCT DIFFERENTIATION

Product differentiation is used by businesses to gain a competitive edge over their rivals. In highly competitive markets, where lots of firms produce similar products, firms will try to make their product unique in some way so that it stands out from the pack. This involves supplying goods and services that have different features or physical qualities. The differences in products may be real – the products look different, or have different technical specifications or have different capabilities or performance levels. Energizer®, for example, claims that its AA lithium batteries have a longer life than any other AA batteries. Or, in contrast, the differences may be perceived – consumers believe there is a difference even if there is not one, or it is not a significant one. Consumers attach a value to products in their own minds based on information that they receive – a sophisticated persuasive advertising campaign, for example. Attractive packaging might also be used to create a perceived difference.

The purpose of product differentiation may include the following.

Flexible pricing: If a business can demonstrate clear physical differences between their products and those of rivals, it may be able to charge higher prices. In the case of perceived differences, consumers sometimes

attach a value to a product that may be priced well above the costs of production. For example, perceived value is often used with perfumes. Perfumes are frequently associated with a glamorous celebrity in order to create a sense of mystery and perception of luxury. Or, they may be the subject of sophisticated and expensive advertising campaigns to create a strong image for the perfume. Consumers may not realise that production costs for perfumes are relatively low. As a result, perfume manufacturers can often charge high prices.

Recognition: One of the main purposes of product differentiation is to gain recognition in the marketplace. Consumers often find products more appealing if they stand out from the pack. Sweets tend to be packaged in attractive and colourful wrappings so that consumers are drawn to them. Also, some consumers 'like to be different' and will naturally be drawn to products that are clearly different from those of rivals.

Extend product range: If businesses can differentiate products they may be able to serve more than one market segment in the same industry. For example, cruise ships offer different standards of cabin accommodation to consumers with different levels of spending power. They also offer different destinations, different length cruises and different on-board facilities. In the biscuits market, producers supply a very wide range of different products in an effort to appeal to different tastes and to compete aggressively with rivals.

Brand development: A business that can differentiate its product successfully for a long period of time can develop a strong brand. The Coca-Cola® Company, with its distinctive formula, has built one of the strongest brands in the world as a result of initial product differentiation. Over the years the brand has been supported by constant advertising and other forms of promotion to stay at the top. But it all started with successful product differentiation.

Overcome competition: Generally, a business will differentiate its products to try and win market share from their rivals. By creating real or perceived differences businesses can attract new customers and win larger market shares. With an increase in scale a business might also be able to lower costs and raise profits.

ADDING VALUE TO PRODUCTS AND SERVICES

In highly competitive markets a business may try to **add value** to its product. This means that the business provides 'extra' features for the customer that go beyond their standard expectations. For example, a carpet retailer might offer to fit a customer's new carpet free of charge. This extra free service is a means of adding

value for the customer. Businesses can add value to their products and services in a number of ways. Some examples are outlined below.

- **Bundling.** A business might be able to add value by putting together a 'package' of benefits or services that make up the whole product. For example, in the holiday industry tour operators may offer flights, accommodation, transfers, insurance, childcare facilities and excursions all for one price. The product may also be presented in such a way that suggests that some of the services, such as insurance and excursions, are free in the package. This will help to add value for consumers.
- **Customer service.** Staff that come into direct contact with customers can play a very big role in adding value. Well-presented, friendly, thoughtful and professional staff create a good image and make customers feel at ease. Staff with a good knowledge of the products that they are selling, and the willingness to 'go out of their way' to help customers are likely to be a source of added value. After-sales service can also be an important feature of added value. Customers may be happier buying from a business that operates a helpdesk, makes follow-up calls or offers a free maintenance service.
- **Speed of response to customers.** This is linked to customer service. A lot of people do not like waiting – this might include queuing at checkouts, waiting for appointments and waiting for deliveries. A business can add value by reducing waiting times or eliminating them completely. For example, airlines allow first-class passengers to leave the plane first. A customer might choose a particular dry-cleaning service because it can return garments within 4 hours.
- **Packaging.** The packaging of products can add value. Many businesses make an effort to present products in attractive wrappings. For some products, such as jewellery for example, a business might offer to gift-wrap a product. In agriculture many farms add value by packing produce, such as vegetables, in specific bags for supermarkets.
- **Frequent buyer offers.** It might be possible to add value by rewarding customers for repeated purchases. Regular customers are offered benefits such as a more valuable service, better pricing and free products. For example, many regular travellers collect air miles, which can be used to get free flights.
- **Customisation.** Customising products might involve placing a customer's logo or brand on the product, or simply using customised wrapping to distinguish a product from those of competitors. It could also

involve changing or adapting product designs to suit the needs of individual customers.

Adding value can generate a number of benefits for a business.

- It may be possible for a business to charge a higher price. However, businesses may want to disguise higher prices so that the value-added element appears to be free. Some tour operators do this by giving free holiday insurance when a package is purchased.
- Adding value can be used to differentiate a product and gain a competitive edge. For example, some customers may prefer to shop with retailers that offer high-quality customer service.
- Adding value may help a business protect itself from competitors charging lower prices in a bid to steal customers.
- A business might focus more closely on its target market segment by adding value, for example by meeting the needs of customers more effectively.

ACTIVITY 3

SKILLS → ANALYSIS

CASE STUDY: EMIRATES

In common with many airlines, Emirates offers three distinct services on most of its long-distance flights. For example, on 3 May 2017, a one-way flight from Dubai to Sydney was showing the following services:

Economy	AED 5205
Business class	AED 15,515
First class	AED 20,165



1. Describe the different customer groups targeted by Emirates in this example.
2. Discuss how Emirates might benefit from this method of market segmentation.

EXAM HINT

When discussing a concept, such as added value in this chapter, it is not necessary to remember all of the different methods. You only need to remember one or two. However, you must be able to explain them in detail and perhaps give an example.

CHECKPOINT

1. State two benefits that a market-orientated business might enjoy.
2. What is meant by behavioural segmentation?
3. State two benefits of market segmentation.
4. State three ways a business might position its products.
5. Perceptual maps are two dimensional. What does this mean?
6. Why might a business choose to reposition the whole organisation?
7. State three ways a business might try to gain a competitive advantage in the market.
8. What is a USP?
9. State two reasons why a business should differentiate its product.
10. What is meant by adding value?
11. State three ways a business might add value to products.

SUBJECT VOCABULARY

adding value offering extra features when selling a product, such as high-quality customer service, which helps to exceed customer expectations.

competitive advantage an advantage that enables a business to perform better than its rivals in the market.

market maps or perceptual maps typically a two-dimensional diagram that shows two of the qualities or characteristics of a brand and those of rival brands in the market.

market orientated an approach to business which places the needs of consumers at the centre of the decision-making process.

market positioning the view consumers have about the quality, value for money and image of a product in relation to those of competitors.

market segments parts of a whole market where a particular customer group has similar characteristics.

product differentiation an attempt by a business to distinguish its product from those of competitors.

product orientated an approach to business which places the emphasis upon the production process and the product itself.

reposition change the view consumers have about a product by altering some of its characteristics.

socio-economic groups divisions of people according to social class.

unique selling point (or proposition) the aspect or feature of a product that clearly distinguishes it from its rivals.

EXAM PRACTICE

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SKILLS ANALYSIS, INTERPRETATION,
CRITICAL THINKING

Harley-Davidson is a high-profile US motorcycle manufacturer. It was established in 1903 and developed a good reputation for its advanced technology and classic design. For many years the company enjoyed a number of advantages over its competitors. For example, the brand was steeped in US history. Also, Harley-Davidson motorcycles were used by the US Army in both world wars. The brand had a distinctive image. It was associated with a powerful, brave and rebellious man and an adventurous lifestyle that was attractive to a significant number of males aged between 25 and 35.

However, eventually strong competition emerged in the market, particularly from Japan, and Harley-Davidson nearly went bankrupt on more than one occasion. The company faced a number of problems.

- Competitors' motorcycles were often more reliable than Harley-Davidsons.
- A number of quality Japanese brands entered the market.
- The Harley-Davidson brand became associated with biker gangs, such as the Hells Angels.
- Harley-Davidsons were eventually perceived as old-fashioned.

To resolve these problems the company attempted to reposition the Harley-Davidson. The motorcycles failed to meet the quality standards that the customers demanded. The products were also not appealing to the younger market segments. Harley-Davidson decided to channel resources from marketing into improving the quality and reliability of their products. Once these quality and

technical issues were resolved the company began to grow again. It is now positioned at the premium (high-priced) end of the market.

Harley-Davidson uses psychographic segmentation to cater to the changing needs of consumers. This is mainly because the motorcycle is a lifestyle brand. Customers choose a Harley-Davidson over rival bikes because they love to buy and ride premium motorcycles. The distinct and innovative design has helped Harley-Davidson break into new and emerging markets across the world.

Harley-Davidson is now enjoying success by differentiating its products clearly from those of rivals. It has developed a competitive advantage by offering its customers a wide range of different products and a high level of customisation from the handle and the stand to the overall looks. This also includes the motorcycle accessories riders can wear. The company has also developed a specific culture for Harley-Davidson bikers through its Harley Owners Group. This owners' club holds regular meetings where Harley owners from different regions can get together and enjoy a lifestyle of passionate bikers.

Q

- (a) (i) Define market positioning. **(2 marks)**
- (ii) Explain why Harley-Davidson felt the need to reposition its brand. **(4 marks)**
- (b) Define psychographic segmentation. Use the example in this case to support your answer. **(2 marks)**
- (c) Explain one way in which Harley-Davidson has developed a competitive advantage. **(4 marks)**
- (d) Assess the importance to Harley-Davidson of product differentiation in this case. **(10 marks)**



THE MARKET

This section focuses on the forces of demand and supply in markets. It looks at the factors that influence demand, such as consumer incomes and the prices of substitutes and complementary goods. It also examines the factors that influence supply, such as production costs, indirect taxes and government subsidies. The section looks at how prices are determined in markets by the interaction of supply and demand. It also explores the responsiveness of demand to both changes in prices and incomes. This is called price elasticity of demand and income elasticity of demand.



4 DEMAND

UNIT 1
1.3.2

LEARNING OBJECTIVES

By the end of this chapter you should be able to understand:

- factors leading to a change in demand:
 - changes in the prices of substitutes and complementary goods
 - changes in consumer incomes
 - fashions, tastes and preferences
 - marketing, advertising and branding
 - demographics
 - external shocks
 - seasonality.

GETTING STARTED

What might happen to sales of these products if there was a recession in the economy? What might happen to sales of these products if free Wi-Fi was more widely available? What other factors might encourage more people to buy these products?



DEMAND

Demand is the amount of a product that consumers are willing and able to purchase at any given price. Demand is concerned with what consumers are actually able to buy (what they can afford to and would buy), rather than what they would like to buy. So, for example, we could say that the demand for cars in the Australian market at an average price of AUD 20,000 might be 90,000 a year.

Table 1 shows a demand schedule for button mushrooms. These figures can be used to draw a **demand curve** as in Figure 1. In practice, demand curves are not a straight line, but are usually drawn in this way for simplicity.

The curve shows the quantity of a product or service that will be demanded at any given price. As with nearly all demand curves, it slopes downwards from left to right. This is because the quantity demanded is likely to be higher at lower prices and lower at higher prices – *ceteris paribus* (assuming no other things change). In Table 1 more button mushrooms are bought at a price of £0.50 than at a price of £2.50.

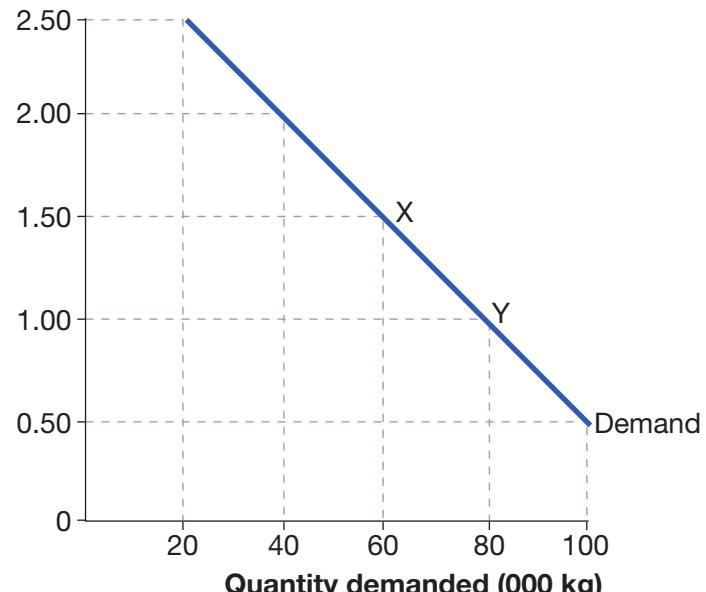
A change in the price of a product or service will lead to a change in the quantity demanded. This is shown on the demand curve as a movement along (up or down) the curve. In Figure 1, a fall in price from £1.50 to £1, for example, will result in a movement along the curve from point X to point Y.

This will result in a rise in the quantity demanded from 60,000 to 80,000 kg. The demand curve itself has not moved from its original position. Price changes only lead to an extension (rise) or contraction (fall) in the quantity demanded.

Price per kg (£)	Quantity demanded (000 kg)
0.50	100
1.00	80
1.50	60
2.00	40
2.50	20

▲ Table 1 The demand schedule for button mushrooms

Price (£)



▲ Figure 1 The demand curve for button mushrooms

MATHS TIP

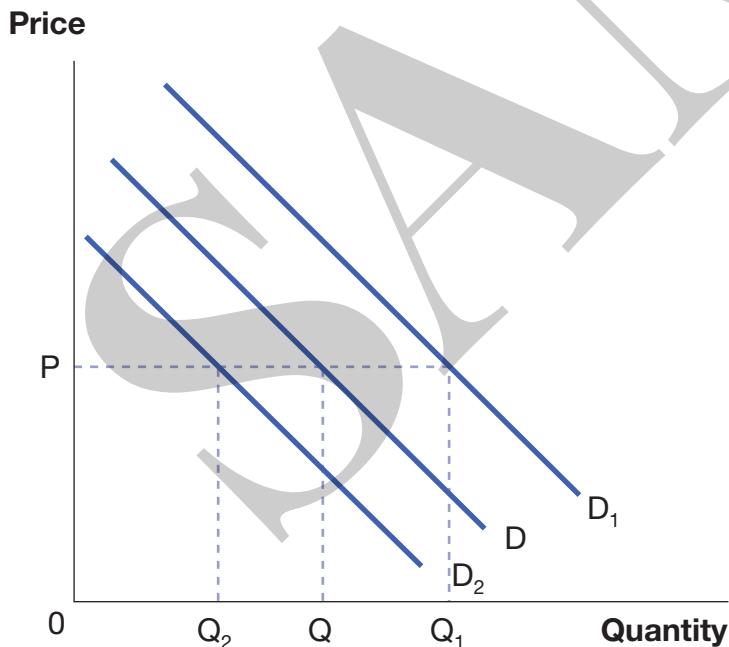
When a demand curve slopes down from left to right, this reflects the **inverse** relationship between price and quantity demanded. When the price goes up, the quantity demanded goes down. When the price goes down, the quantity demanded goes up.



FACTORS LEADING TO A CHANGE IN DEMAND

The price of a product has a significant influence on its demand. For most goods and services higher prices will tend to reduce demand and lower prices will tend to raise demand. However, there are several other factors that can lead to a change in demand. Changes in these factors, which are outlined below, will actually shift the demand curve. This is different from a price change, which results in a movement along the demand curve.

Prices of substitutes: Many goods sold by businesses have a **substitute**. For example, a consumer buying a can of Coca-Cola might have considered other brands such as Pepsi-Cola® or a supermarket 'own label'. Most consumers would consider these as good substitutes. The price of substitutes will affect demand. If the price of a substitute product falls, the quantity demanded of the substitute rises. As a result the demand for the product would fall. If a product has a lot of close substitutes then the prices of these will affect demand significantly. In Figure 2, the line labelled D represents the demand for skiing holidays in the Netherlands.



▲ Figure 2 Dutch demand for skiing holidays

A decrease in the price of a substitute, such as 'winter sun holidays', may reduce the demand for skiing holidays. This would result in a shift from D to D₂ in Figure 2.

Prices of complements: Consumers sometimes purchase certain goods together. This is because the two goods are used together. For example, consumers of cornflakes will also buy milk and people who buy cars will also buy car insurance. In these examples milk and cornflakes and cars and car insurance are **complementary goods**. Demand for such products is likely to be affected by the price of complementary goods. For example, a reduction in the price of skiing accessories may encourage more people to try skiing. This would be shown by a shift from D to D₁ in Figure 2.

Changes in consumer incomes: The amount of money that people earn will influence the amount and types of goods that they buy. Generally, when income rises, demand for goods will also rise. For example, if

ACTIVITY 1

SKILLS

ANALYSIS, INTERPRETATION

CASE STUDY: DIESEL PRICES AND ELECTRICALLY POWERED VEHICLES

Although there has been a growing interest in electrically powered (and similar) vehicles in recent years, the numbers sold globally are still very small. In 2016, electric vehicles only captured 0.86 per cent of the global market. Most cars are still powered by petrol or diesel. Many drivers prefer diesel cars because they are more economical. Figure 3 shows movements in diesel prices in the UAE between May 2016 and May 2017.



▲ Figure 3 UAE diesel price, May 2016–May 2017

- Calculate the percentage change in the UAE diesel price between May 2016 and May 2017.
- What is meant by a complementary good?
- Explain how the pattern of prices in Figure 3 might affect the demand for (a) diesel-powered cars and (b) public transport in the UAE.

wages and salaries go up people may decide to spend more money going out to restaurants, they may take an extra holiday or they may buy a new car. These are all **normal goods** – goods for which demand will rise when income rises. Most goods in the economy are normal goods; however, a minority are **inferior goods**. This means that demand for them will actually fall when incomes rise. Supermarket 'own-label' brands or public transport can be examples of inferior goods. For example, consumers who generally buy supermarket own-label detergent may switch to a more expensive brand, such as Persil® when their incomes rise. Therefore demand for the supermarket own-label brand will fall.

In Figure 2, if consumer incomes rise, the demand for skiing holidays would also probably rise causing a shift in the demand curve from D to D₁.

Fashions, tastes and preferences: Over a period of time, demand patterns change because of changes in consumer tastes and fashion. For example, the growth in demand for four-wheel drive cars in many countries is not because an increasing number of people need to drive off-road but because increasing numbers of drivers find them appealing. The clothes industry in particular is influenced strongly by changes in fashion. In many countries there are buying seasons for clothes – many clothes items bought in one season would not be in demand in later seasons because they will have gone out of fashion.

In recent years there has been a surge in the demand for coffee in India, traditionally a tea-drinking nation. This has been driven largely by the growth in a café culture in the country. Cafés are particularly appealing to young people. A coffee house is not only a place to buy different types of coffee, but also a much-needed urban space. A café offers a neutral meeting place that allows youngsters to get together in a comfortable environment that is neither a home nor a workplace.

Marketing, advertising and branding: Businesses try to influence demand for their products through advertising and other forms of promotion. If goods are heavily advertised demand for them is likely to increase. This helps to explain the huge amounts of money that some businesses are prepared to spend on advertising. For example, Procter & Gamble, the giant US multinational, spent US\$7243 million on global advertising in 2016.

Businesses also use branding to influence demand. By giving products a name, term, symbol or any other sign, to distinguish them from those of competitors, businesses can develop brand recognition and increase sales. They do this by investing heavily in positioning, promoting and advertising to make the brand strong. Branding is discussed in Chapter 11. In Figure 2,

if businesses selling skiing holidays increase spending on advertising and branding, demand will probably increase from D to D₁.

Demographics: As population grows there will be an increase in demand for nearly all goods and services. However, demand is also affected by the structure of the population as well as its size.

- The age distribution of a population is the numbers of people that fall into different age groups. For example, in many countries there has been growth in the number of people aged over 60. This will have an effect on demand patterns. For example, as the population gets older there will be more demand for goods such as retirement homes, specialist holidays for the elderly and healthcare. In Figure 2, if there was an increase in the 18 to 40 age group, there might be an increase in the demand for skiing holidays. This would shift the demand curve from D to D₁.
- There are slightly more women than men overall in many countries. In the older age groups the number of women compared to men increases. Consequently, the gender distribution of the population is likely to affect demand patterns. For example, there will be a greater demand for women's clothes than men's clothes.
- Geographical distribution can also affect demand. Increasingly, in most developed and developing countries more and more people live in urban areas. As a result demand for schools and hospitals in these areas, for example, will be higher than in rural areas.
- Other factors can affect the structure of the population, such as the nature of households. For example, in some parts of the world there has been a growth in the number of one-person households. This trend increases the demand for single accommodation. Many countries have ethnic groups in their population structure. If these ethnic groups grow in size there is also likely to be an increase in demand for products associated with their culture. Also, there are likely to be changes in the size and structure of populations over time. For example, if the birth rate or immigration rises they will increase the size and structure of the population. For many years the population of Australia has grown rapidly. Immigration has contributed significantly to this growth. In 2017, Australia had a population of around 24 million and about one-quarter of these people were from overseas. As a consequence many businesses have been established to serve this large body of immigrants. For example, there are huge numbers of ethnic restaurants in many of Australia's towns and cities.

External shocks: Factors beyond the control of businesses can have an impact on the demand for products. Some key examples are outlined below.

- **Competition.** If a strong new competitor enters the market for the first time, demand is likely to fall for the original firm's product. For example, it is possible that Sky may be negatively affected following BT winning the right to broadcast Barclays Premier League football for the first time in 2014.
- **Government.** A government can influence demand in a number of ways. Raising taxes, for instance, could decrease demand for many products because spending power would be restricted. New laws can affect demand. For example, legal measures designed to increase competition in the market for gas and electricity might result in a fall in demand for the existing operators in the market.
- **Economic climate.** If the economy is growing, demand for most goods and services will tend to rise. In contrast, during a recession, demand for non-essential goods such as skiing holidays is likely to fall. This would be represented by a shift from D to D_2 in Figure 2.
- **Social and environmental factors.** Demand for some goods might be affected by changes in society. For example, there has been a huge increase in demand for social media. New social websites have emerged as a major means of communication. This has helped to increase the demand for mobile phones, apps, tablets, smartphones and related services. Concerns about global warming have changed consumers' attitudes towards goods and services that raise carbon emissions. For example, there has been a significant increase in demand for electric cars and hybrids (cars which run on both petrol and electricity).

Seasonality: Some goods and services have seasonal demand. This means that demand rises at particular times of the year. For example, in the many countries with a mild climate demand for garden furniture rises in late spring when the weather starts to improve. Similarly, demand for warm clothing, such as coats and wool jumpers, rises in the late autumn when the weather turns colder. Demand is also influenced by calendar events, such as Christmas, Easter, Ramadan, the Chinese New Year, Diwali in India, Thanksgiving Day in the USA, Mother's Day, St Valentine's Day and Halloween.

EXAM HINT

When drawing demand curves to help illustrate answers in examinations, it is acceptable to draw straight lines. Remember the price is always on the vertical axis and quantity on the horizontal axis.

CHECKPOINT

1. What is the relationship between price and the quantity demanded?
2. Give two examples of goods that are close substitutes.
3. If the price of a product rises what will happen to demand for a complementary good?
4. What might happen to the demand for furniture if incomes fall?
5. If a business increases its spending on advertising, how will this affect the position of the demand curve?
6. How might demand be affected by a change in the structure of the population caused by an increase in immigration?
7. Give three examples of external shocks that might affect demand.
8. What might affect the demand for ice cream?

SUBJECT VOCABULARY

complementary goods goods that are purchased together because they are consumed together.

demand the quantity of a product bought at a given price over a given period of time.

demand curve a line drawn on a graph that shows how much of a product will be bought at different prices.

inferior goods goods for which demand will fall if income rises or rise if income falls.

normal goods goods for which demand will rise if income rises or fall if income falls.

substitute (goods) goods that can be bought as an alternative to others, but perform the same function.

EXAM PRACTICE

GLOBAL CARE GROUP

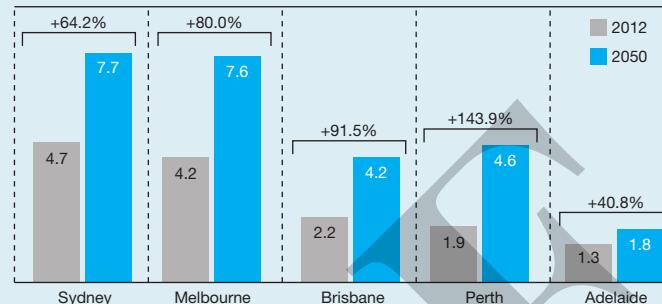
SKILLS ANALYSIS
INTERPRETATION

Global Care Group is an Australian not-for-profit organisation that has been caring for elderly and disabled people for over 20 years. The organisation is run by a voluntary, elected board of management, members of which are selected based on their commitment and achievements in the aged-care sector. The organisation focuses on providing premium care and not maximising (prioritising) profit.

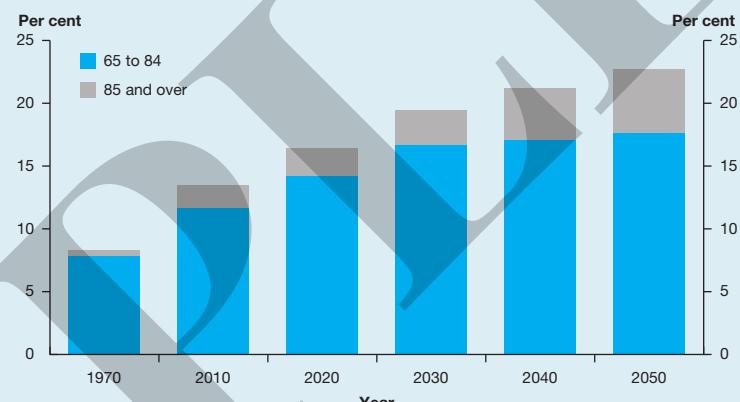
Global Care's first move into the sector was in 1991 when it opened Morrison Lodge Midland. However, the group now offers a wide range of care services for the elderly including retirement living, day care and community care in the Wheatbelt and Midland region in Western Australia. Morrison Lodge can accommodate over 70 residents and has purpose-built facilities to cater for a variety of elderly people with different needs. Close to the lodge there is a day care centre, Hamersley House, and independent living village, Struckman Mews. Together, these centres create a comfortable community where friendships are formed and people can get access to high-quality care services.

Global Care Group also operate two other centres – Balladong Lodge and Balladong Country Estate in York. These centres offer high-quality living environments for the elderly in a peaceful country setting. Here, residents can enjoy independence and freedom in the knowledge that care services are immediately available if needed.

More recently, Global Care Group bought some land next to the Northam Country Club in Northam. This will be used to create a new retirement village for the elderly, called Northam Country Estate. Houses in the village will be custom built and residents will have access to the country club facilities, a shared vegetable garden, golf course and many interactive activities. The idea is that residents will live independently but share a similar lifestyle with like-minded people.



▲ Figure 4 Expected city populations in Australia in 2050 (million)



▲ Figure 5 The proportion of the population that is 65 or older in Australia, 1970–2050

Q

- Draw a diagram showing the likely effect on the demand for Global Care Group's services in the future. **(4 marks)**
- Discuss how the information shown in Figures 4 and 5 might affect demand patterns in Australia. **(8 marks)**
- Assess the impact that external factors might have on the demand for services supplied by companies like Global Care Group. **(10 marks)**

5 SUPPLY

LEARNING OBJECTIVES

By the end of this chapter you should be able to understand:

- factors leading to a change in supply:
 - changes in the costs of production
 - introduction of new technology
 - indirect taxes
 - government subsidies
 - external shocks.

GETTING STARTED

At the beginning of 2017 it was reported in New Zealand that there was a shortage of houses. Based on estimates by the ANZ Bank, at least another 60,000 houses were needed to meet the needs of the population. It was also reported that the shortage was increasing by another 40 houses every single day. In October 2016, the government said it would help to increase the supply of housing by generating an extra 30,000 houses. However, immediately after this promise in November and December, the number of approvals for new houses fell by 9.6 per cent and 7.2 per cent, respectively.

The shortage in the supply of houses is causing house prices and rents to rise sharply and for many people housing is becoming unaffordable. The housing shortages are being caused by growing immigration and inadequate supply. The supply of new houses, particularly in Auckland, is being restricted by a lack of suitable land and an overworked building industry, which has been described as badly managed, disordered and dishonest. Some of the production costs associated with construction, such as land and labour are also high.

Give **two** reasons why the supply of houses in New Zealand is inadequate. How might the government encourage the construction industry to build more houses? Why do prices rise when supply is inadequate? Is it possible to increase the supply of houses quickly? Explain your answer.

SUPPLY

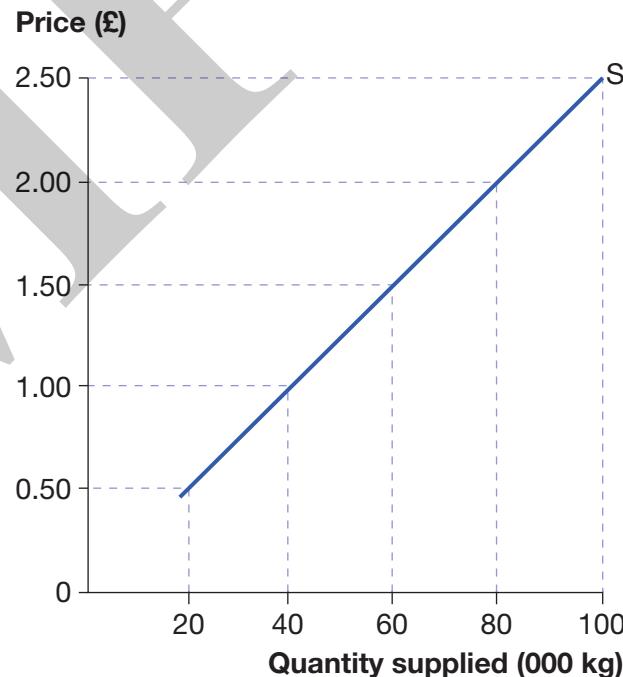
Supply is the amount of a product that suppliers will offer to the market at a given price. The higher the price of a particular product or service, the more that will be offered to the market. For example, the amount of button mushrooms supplied to a market in any given week may be as shown in Table 1.

These figures have been drawn on a graph in Figure 1, which shows the **supply curve** for button mushrooms. The supply curve slopes up from left to right. This is because at higher prices a greater quantity will be supplied to the market and at lower prices less will be supplied.

A change in price will cause a movement either up or down the supply curve. The curve will not change its position assuming that all other factors remain the same. There are a number of other factors that may affect supply other than price. Changes in these factors will cause the whole supply curve to shift.

Price per kg (£)	Quantity supplied (000 kg)
0.50	20
1.00	40
1.50	60
2.00	80
2.50	100

▲ Table 1 The supply schedule for button mushrooms



▲ Figure 1 The supply curve for button mushrooms

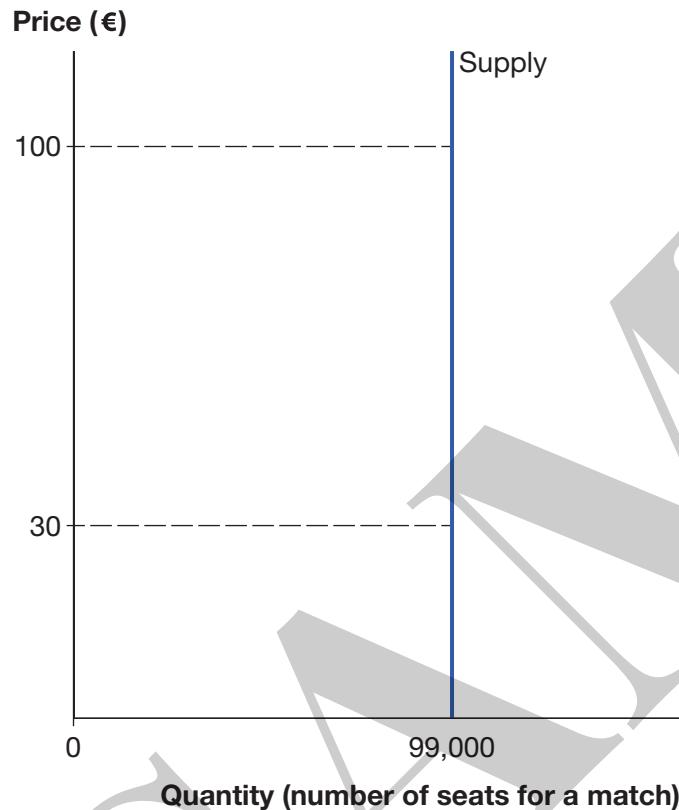
MATHS TIP



Most supply curves slope up from left to right, like the one in Figure 1. This reflects the direct relationship that exists between the price of the product and the quantity supplied. It shows that when price goes up, the quantity supplied also goes up. When the price goes down, the quantity supplied goes down.

THINKING BIGGER

In some circumstances the supply of a product or service may be fixed. If this is the case the supply curve will be vertical. Supply will be fixed if it is impossible for sellers to increase supply even when prices rise. The supply at venues such as cinemas, theatres and sports stadiums may be fixed. For example, the Camp Nou Stadium, home of FC Barcelona, currently holds 99,000 spectators. Even if the price of tickets were increased from €30 to, say, €100 no more seats could be supplied. However, there are plans to increase capacity to 105,000 in the near future. If this expansion goes ahead then supply will be fixed at the new level of 105,000 (see Figure 2).



▲ Figure 2 Fixed supply – the capacity of the Camp Nou Stadium

FACTORS LEADING TO A CHANGE IN SUPPLY

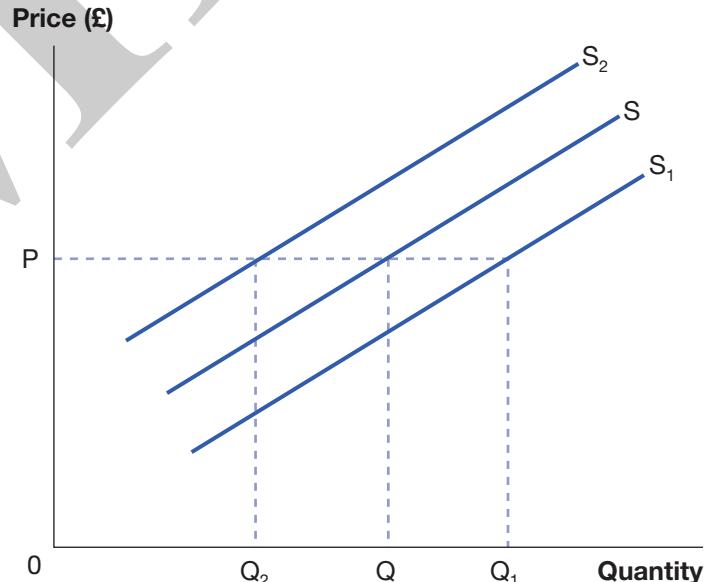
The main determinant of supply is price. For most goods and services, when the market price rises suppliers are willing to supply more. This is because they are likely to make more profit at higher prices. However, a number of other factors can lead to a change in supply. Changes in these factors, which are outlined below, will actually shift the supply curve. This is different from a price change, which results in a movement along the supply curve.

Changes in the costs of production: The supply of any product is influenced by the costs of production, such

as wages, raw materials, energy, rent and machinery. If production costs rise, sellers are likely to reduce supply. This is because their profits will be reduced. For example, in 2013, Tata Chemicals shut its soda ash factory at Winnington in Northwich, UK. This factory had supplied soda ash for industries such as glass and soapmaking since 1874. The factory closed because it was being impacted by rising gas prices.

A rise in costs will cause the supply curve to shift to the left. This is shown in Figure 3. When costs rise, the whole supply curve will shift to the left, from S to S_2 . At a price of P the quantity supplied in the market falls from Q to Q_2 . If costs fall, supply will increase because production becomes more profitable. As a result the supply curve will shift to the right. This shows that more is supplied at every price. In Figure 3 the new supply curve would be S_1 , and the amount supplied at P will rise from Q to Q_1 .

The availability of resources will also affect supply. If there is a shortage in some of the factors of production, such as land, labour, raw materials or capital, it will make it difficult for producers to supply the market. For example, in some countries such as Germany, the USA and the Netherlands, there are shortages of skilled labour. In 2016, it was reported that shortages of workers with IT skills was worrying businesses, industry associations and government departments in Germany and the Netherlands. Germany had 43,000 vacancies for IT specialists while the Netherlands need at least another 15,000.



▲ Figure 3 Shifts in the supply curve

Introduction of new technology: As new technology becomes available many businesses will start to use it in their production processes. New technology is usually more efficient than older technology and will help to lower production costs, encouraging firms to offer more for sale. For example, Agricool, a French business, has

developed technology that allows strawberries to be grown in containers. It grows fruit on the vertical surfaces of containers and each one can produce more than 4000 strawberries. The system also uses 90 per cent less water, renewable electricity and it aims to optimise the growing conditions, such as nutrition levels, watering and LED lighting. The air absorbed from outside is also cleaned to reduce air pollution inside the container.

ACTIVITY 1

SKILLS

ANALYSIS, CRITICAL THINKING,
PERSONAL AND SOCIAL RESPONSIBILITY

CASE STUDY: FARMBOTS



According to farmers and governments around the world, farming might be changed by the increasing number of 'farmbots' (farming machines) used in agriculture. The development of the machines aims to raise efficiency and complete complex tasks that have not been possible with the large-scale agricultural machinery of the past. For example, a 'lettuce bot' (shown in the photograph) can remove unwanted plants from the base of young lettuce plants. A 'farmbot' can look after vines, moving through the vineyards. Other bots are under development to remotely check crops for their growth, how dry they are and signs of disease. Drone technology (the use of aircraft controlled from a distance) is also being adapted for use on farms. For example, in South America, drones are being used for the supervision of animals and to monitor crops, and in Japan smaller models are designed to spray insect poison on crops.

However, there are doubts about how likely it is that new robot technology will become successful. Emma Hockridge, head of policy at the Soil Association, UK, has said: 'The potential use of robots on farms has been discussed for years, but we haven't yet seen anything practical close to reaching the market.'

While the prospect of replacing seasonal workers with robots may be attractive for farm bosses looking to integrate into bigger units, farm workers may be less keen. Even fans of the technology think that it will probably be decades before farmbots are used

commercially. The head of engineering at Harper Adams University, UK, Professor Simon Blackmore, said that his vision was for 'farming with robots in 2050', by which time he believes this should be practical.

Source: Based on UK farming conference hears how 'farmbots' will bring efficiencies and benefits and an end to back-breaking tasks. <https://www.theguardian.com/environment/2014/jan/09/robots-farm-future>

1. Explain one impact that the introduction of farmbots might have on agriculture.
2. Draw a diagram and analyse the effect that the introduction of farmbots might have on the supply of food.

The company reckons it can produce 120 times more fruit than on the same size of a piece of farmland.

The introduction of new technology will shift the supply curve to the right, from S to S_1 in Figure 3. The amount supplied in the market at price P will rise from Q to Q_1 .

Indirect taxes: Indirect taxes are taxes imposed by the government on spending. Value added tax (VAT) and excise duties, such as those placed on petrol and tobacco, are examples of indirect taxes. Such taxes have an effect on supply. When they are imposed or increased, the supply curve will shift to the left, from S to S_2 in Figure 3. This is because indirect taxes represent a cost to firms. If indirect taxes are reduced, the supply curve will shift to the right, from S to S_1 in Figure 3. This is because costs are lower and firms will be encouraged to supply more in the market.

Following the introduction of an indirect tax, the burden is likely to be shared between the consumer and the producer. The size of the price increase faced by consumers will depend largely on the price elasticity of demand (this is discussed in Chapter 7). If an indirect tax is imposed and demand is relatively inelastic, the consumer will have to pay more of the tax.

In recent years a number of governments have increased VAT to raise money to help cut debt. For example, Greece increased VAT to 24 per cent in June 2016. Greece originally raised its standard VAT rate twice in 2010, from 19 per cent to 23 per cent.

Government subsidies: Sometimes the government may give money to businesses in the form of a grant. This is called a **subsidy**. Subsidies may be given to firms to try and encourage them to produce a particular product. For example, in common with many countries around the world, the government in Estonia has given fairly generous subsidies to the producers of renewable energies. Estonia reached its 2020 EU target of 25 per cent of renewable energy in gross final energy consumption early in 2011. This was helped by

government subsidies for biomass (organic matter used for fuel) and wind power generation and the extensive use of biomass (for heating).

If the government grants a subsidy on a product the effect is to increase its supply. This is because subsidies help to reduce production costs. As a result the supply curve will shift to the right, from S to S_1 in Figure 3.

External shocks: Factors beyond the control of businesses can have an impact on the supply of products. Some examples are outlined below.

- **World events.** Global events can have an impact on the supply of some products. For example, in recent years, some areas of the Middle East have experienced political instability. Consequently, when the situation becomes hostile, supplies of oil are threatened and the price rises. This is because a significant proportion of the global oil supply comes from this region.

In 2008, the global financial crisis led to a 'credit crunch'. This meant that many firms were unable to borrow the money they needed to trade and invest for the future. As a result some businesses collapsed and others were unable to grow.

- **Weather.** The supply of agricultural products in particular can be affected by the weather. Good growing conditions will result in high crop production and increased supply. However, bad weather, such as a long period without rain, can reduce crop production severely and cause shortages. In 2014, there were larger than usual crops of wheat in Europe and the Black Sea region due to favourable growing conditions. The increase in the global supply of wheat helped to reduce prices.

Bad weather, such as snow storms, can disrupt the supply of many goods in the short term, for instance by restricting the distribution of goods due to closed roads, railway lines and airports.

- **Government.** Government economic policies can have an impact on supply. For example, if central banks increase interest rates (in order to meet a government inflation target), this could increase business costs for firms with debt. Borrowing to invest might also be discouraged.

Government laws can have an impact on supply. For example, if the government passes laws to make a particular market more competitive, then supply in that market is likely to increase as new entrants join the market.

- **Price of related goods.** In some markets supply can be affected by price changes of related goods. For example, if a farmer producing mainly potatoes sees that the price of carrots and cabbage are rising

in the marketplace, their response might be to grow more carrots and cabbage next season instead of potatoes. As a consequence the supply of potatoes could fall.

EXAM HINT

When answering questions relating to the supply of goods and services, it can be helpful to consider the short term and long term. For example, in the long term the supply of most goods and services can be increased. This is because firms can adapt to changes in market conditions – by expanding production if necessary. However, in the short term firms may not be able to increase supply even if they wanted to. Farmers cannot increase supply until the following year because it takes time to grow produce. Manufacturers may be operating at full capacity and it could take some time to build more plants. Making distinctions between the short term and the long term is useful when showing your skills in evaluation.

CHECKPOINT

1. Describe the relationship between price and the quantity supplied in a market.
2. What is fixed supply?
3. What might happen to the supply of laptop computers if wages of production workers rose significantly?
4. How might a fall in gold prices affect the supply of gold wedding rings?
5. What impact does the introduction of new technology have on the supply of goods and services?
6. What would happen to the supply curve for gardening services if VAT was increased?
7. Why is the supply of a product or service likely to increase if the government grants producers a subsidy?
8. How can government legislation affect supply?
9. State two external shocks that might affect the global supply of rice.

SUBJECT VOCABULARY

subsidy a grant given to producers, usually to encourage production of a certain product.

supply the amount of a product that suppliers make available to the market at any given price in a given period of time.

supply curve a line drawn on a graph that shows how much of a product sellers are willing to supply at different prices.

EXAM PRACTICE

GLOBAL OIL SUPPLY

SKILLS ANALYSIS, INTERPRETATION,
REASONING, CRITICAL THINKING

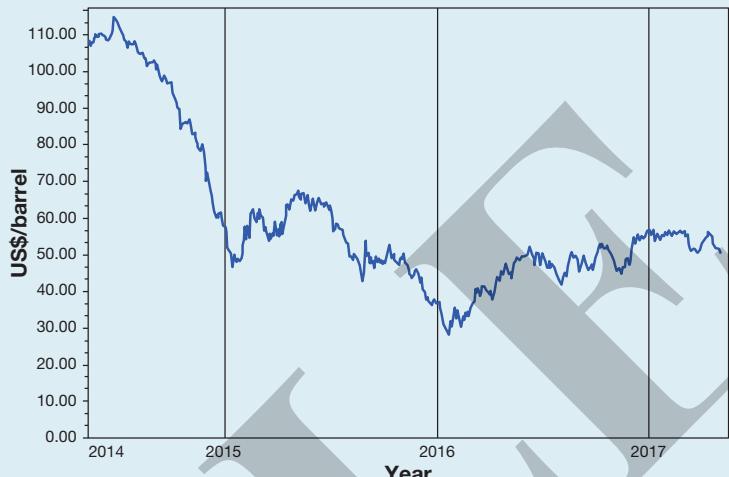
In 2014/15, the global price of oil fell quite sharply. Figure 4 shows that it fell from over US\$100 in 2014 to under US\$30 for a period in 2016. Although the price has recovered since 2016, at US\$50 it is still only one-half of what it was in 2014.

The fall in the price was caused to a significant extent by a global increase in supply. One of the reasons for this was because OPEC (a global cartel of major oil-producing countries including Saudi Arabia, Qatar, Iraq, Venezuela, Algeria, Nigeria, UAE and several others) failed to cut the production of oil, which led to oversupply. In the past, members of OPEC have been able to form agreements that restrict oil production and therefore limit global supply. This has driven up the price. More recently such agreements have not been made. OPEC members supply around 80 per cent of the world's oil.

Supply has also increased because Iran, a major world producer, has been allowed to sell more oil in the market. Iran was subject to sanctions from world powers that prevented it from selling oil. However, the sanctions were lifted recently when Iran reduced its development of nuclear facilities.

The supply of oil has also increased due to the discovery of new sources. In recent years the USA has started to extract oil from shale (a type of rock) using a process called fracking. For example, in 2017 the Energy Information Administration reported that crude (raw) oil storage in the USA rose to 8.2 million barrels (containers) from the previous week – four times higher than expected. US oil production is now growing at around 9.1 million barrels a day, the highest level in more than a year. Another state, Russia, has also been steadily supplying more oil to the market for around 20 years.

Finally, the fall in the price of oil may not have been caused entirely by an increase in supply. Global demand for oil has also weakened. The financial crisis, which started a world recession in 2008, reduced demand and the decrease in the growth of the Chinese economy in recent years also had an impact.



▲ Figure 4 Global oil price, 2014–17



Q

- Define supply. (2 marks)
- Explain the possible effects of the fall in the price of oil on (i) oil exploration companies and (ii) haulage contractors (transportation companies). (4 marks)
- Draw a diagram to show the effect on the supply of oil when new technology in the oil industry is adopted. (4 marks)
- Assess the possible factors that have increased the global supply of oil in recent years. (10 marks)

In recent years new technology in oil production such as tracer technology (used to measure flows in reservoirs and assess the economic viability of oil wells) has helped to reduce costs.

6 MARKETS

UNIT 1
1.3.2

LEARNING OBJECTIVES

By the end of this chapter you should be able to understand:

- the interaction of demand and supply
- how to draw and interpret demand and supply diagrams to show the causes and consequences of changes in demand and supply.

GETTING STARTED

The prices of some goods change slowly over time; others are more volatile. For example, the prices of some fresh produce rose sharply at the beginning of 2017 due to poor growing conditions in Spain and Italy. The supply of products like lettuces, aubergines, tomatoes and peppers was limited and prices rose by between 25 and 40 per cent. One supplier said that a combination of poor growing conditions had been created by flooding, cold weather and poor light levels. The price of flowers can increase greatly in the few days before Mother's Day. On Christmas Day and New Year's Eve it is common for taxi drivers to double their prices. In general, prices are determined by the interaction of demand and supply.

What market factor do you think has the most influence on the price of fresh produce such as lettuces and peppers? Why does the price of flowers rise by so much in the run up to Mother's Day? Why can't taxi drivers double their prices all year round?

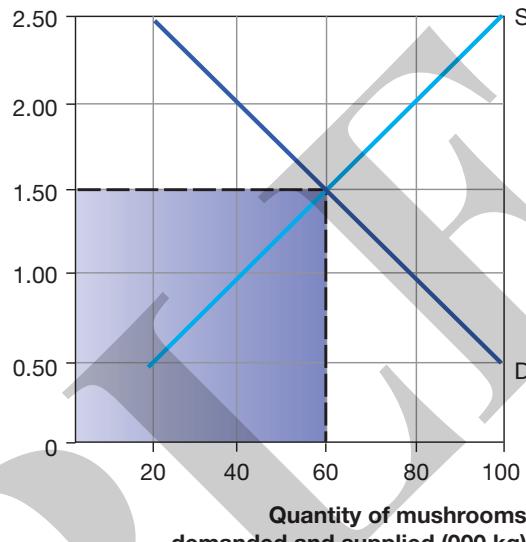
THE INTERACTION OF DEMAND AND SUPPLY

In any market the price is set where the wishes of consumers are matched exactly with those of producers. This price, called the **equilibrium price**, is where supply and demand are equal. The way in which the forces of supply and demand determine prices in a market can be shown graphically. Figure 1 shows the supply and demand curves for mushrooms. Here the equilibrium price is £1.50. At this price consumers want to buy 60,000 kg and producers want to sell 60,000 kg. There is no other price where this happens. For example, if the price were £2, sellers would want to supply 80,000 kg. However, at this price, buyers only demand 40,000 kg because the price is too high.

The equilibrium price is also known as the **market clearing price**. This is because the amount supplied in the market is completely bought up by consumers. There are no buyers left without goods and there are no sellers left with unsold stock. The market is cleared.

Figure 1 also shows the **total revenue or total expenditure** at the equilibrium price. Total revenue is the

Price (£)



▲ Figure 1 The demand for and supply of mushrooms

ACTIVITY 1

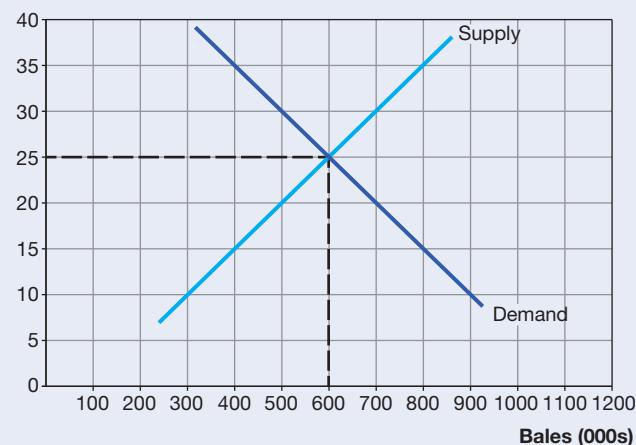
SKILLS

INTERPRETATION, PROBLEM SOLVING

CASE STUDY: FEEDING LIVESTOCK

During the summer months, particularly in countries with mild climates, livestock, such as cows and horses, are left in fields and eat grass. However, in the winter many of them are housed under cover and need to be fed. The market for large, round hay bales (a kind of livestock feed) is represented by the supply and demand curves shown in Figure 2.

Price (€)



▲ Figure 2 The market for large, round hay bales

1. State the equilibrium price and quantity.
2. Using this diagram, explain what is meant by equilibrium price.
3. What is the value of total revenue at the equilibrium price?

amount of money generated from the sale of output. It is calculated by multiplying price and quantity.

$$\text{Total revenue (TR)} = \text{Price (P)} \times \text{Quantity (Q)}$$

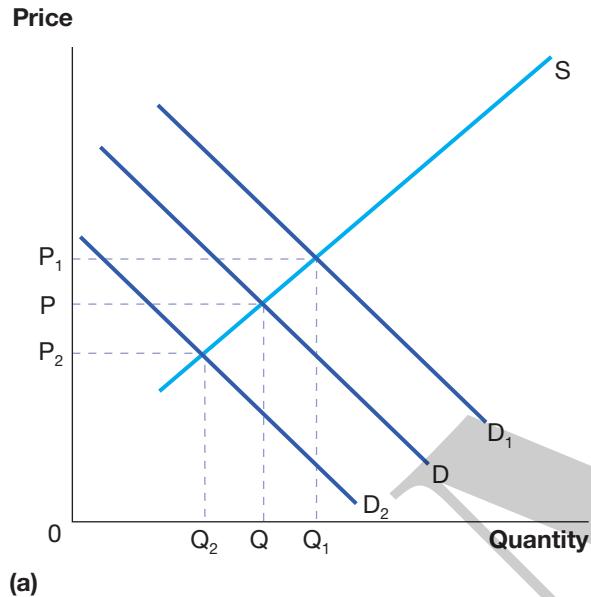
In Figure 1, total revenue at the equilibrium price of £1.50 is:

$$TR = P \times Q = £1.50 \times 60,000 = £90,000$$

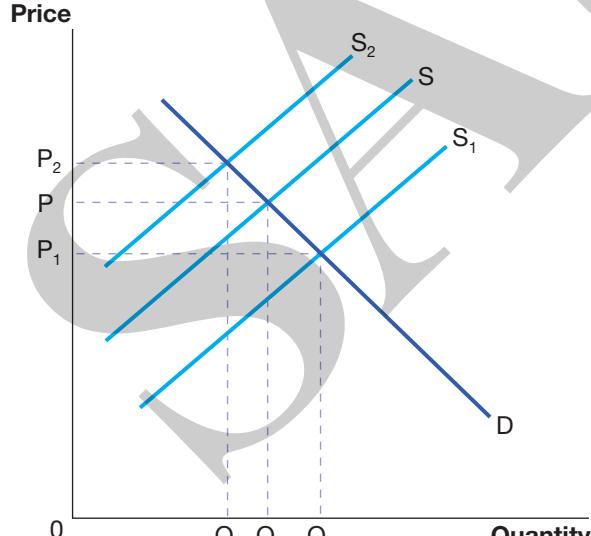
There are many different factors that can cause a change in supply or demand. When such changes occur the supply and demand curves will shift. As a result there will be a change in the equilibrium price.

CHANGES IN DEMAND

If demand increases, price will rise. This is because producers react to rising consumer demand by putting up their prices. They can do this because customers want the product in higher numbers. In Figure 3(a), an increase in demand for a product is shown by a shift in the



(a)



(b)

▲ Figure 3 The effect on equilibrium price of a change in demand and supply

demand curve to the right, from D to D₁. This changes the equilibrium price because supply and demand are now equal at a different point. The price is forced up from P to P₁ and the amount sold in the market has gone up from Q to Q₁.

ACTIVITY 2

SKILLS

INTERPRETATION

CASE STUDY: COLD QUEENSLAND

In 2015, an unusual weather system hit eastern Australia. A very cold spell saw temperatures drop sharply. As a result, in Queensland, the demand for gas-fired outdoor heaters rose as shown in Figure 4. In particular, restaurant and café owners invested in the heaters so that customers could continue their practice of dining and drinking outside.



▲ Figure 4 The market for gas-fired heaters in Queensland, Australia



1. Explain the shift in the demand curve from D to D₁.
2. What has happened to the equilibrium price and quantity as a result of the shift in demand?

If demand were to fall, the opposite would happen. This is because producers are forced to lower their prices. Otherwise they would be left with too much unsold stock. They are forced to do this because customers are wanting much less of the product. The demand curve would shift to the left from D to D_2 and the price would fall to P_2 . The amount traded in the market would fall from Q to Q_2 .

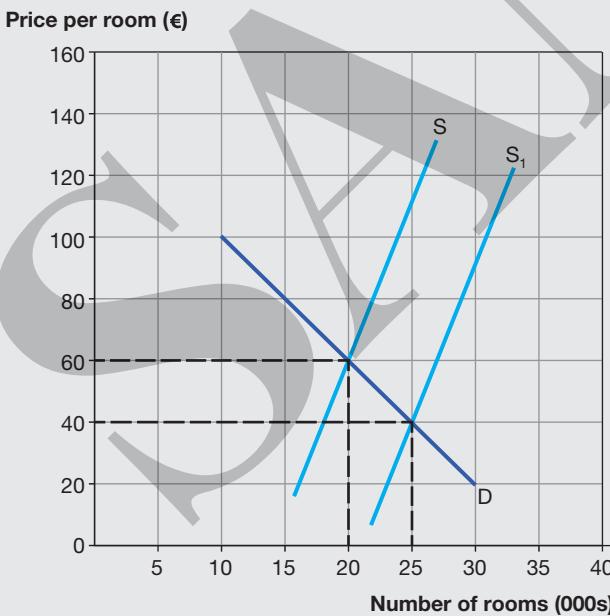
CHANGES IN SUPPLY

A change in supply will also affect equilibrium price. For example, if supply increases the price will fall. In Figure 3(b), an increase in supply for the product is shown by a shift in the supply curve to the right, from S to S_1 . This changes equilibrium price because supply and demand are now equal at a different point. The price is forced down from P to P_1 and the amount sold on the market has gone up from Q to Q_1 . If supply were to fall, the opposite would happen. The supply curve would shift to the left from S to S_2 , price would rise from P to P_2 and the amount traded in the market would fall from Q to Q_2 .

WORKED EXAMPLE

Figure 5 shows the market for accommodation in a Spanish city. The equilibrium price per room is currently €60. What might happen to the price of rooms if some new hotels open up?

The arrival of new hotels in the city would increase the supply of rooms available. This would shift the supply curve to the right from S to S_1 . As a result the equilibrium price per room is forced down from €60 to €40. The equilibrium number of rooms let rises from 20,000 to 25,000.



▲ Figure 5 The market for accommodation in a Spanish city

CHANGES IN DEMAND AND SUPPLY TOGETHER

It is possible for both demand and supply to change at the same time in a market. For example, demand might increase and supply decrease at the same time. This is shown in Figure 6. The original equilibrium price is P where S = D. The increase in demand is represented by a shift to the right from D to D_1 . The decrease in supply is represented by a shift to the left from S to S_1 . The new equilibrium price, where $D_1 = S_1$, is P_1 . The price is higher and the amount sold in the market has fallen from Q to Q_1 .

Note that it would be possible to redraw the diagram to show that, although the price will be higher, the quantity sold could also be higher. To do this it would be necessary to make the increase in demand greater than the decrease in supply. When there is a change in both demand and supply, it is not possible to show exactly what will happen to price and quantity unless it is known precisely by how much supply and demand shift.

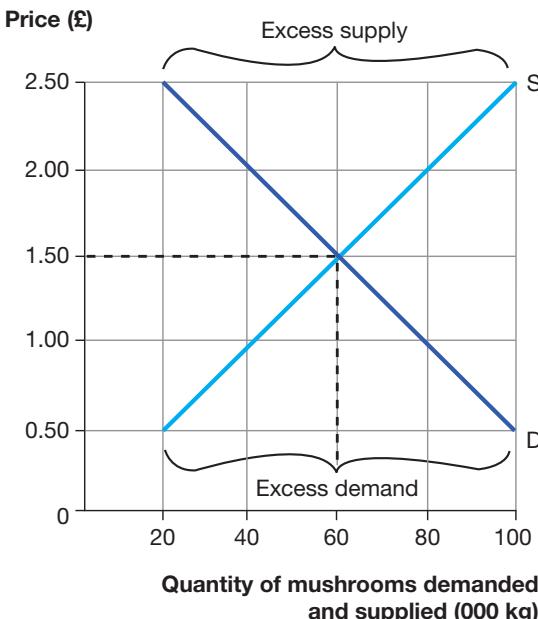


▲ Figure 6 A change in demand and supply

DISEQUILIBRIUM IN THE MARKET

If the price in a particular market is not set at the point where supply and demand are equal, there will be disequilibrium in the market. Two situations might occur.

Excess demand: If the price charged in a market is below the equilibrium price, demand and supply will not be equal. In Figure 7 the equilibrium price for button mushrooms is £1.50. At this price, supply and demand are both 60,000 kg. However, if the price is set lower, say at £0.50 per kg, the market is not in equilibrium. At this lower price demand is 100,000 kg and supply is only 20,000 kg. There is **excess demand**, which means there is a shortage of goods in the market. In this case there is a shortage of 80,000 kg (100,000 – 20,000).



▲ Figure 7 The excess demand for and excess supply of button mushrooms

Excess supply: If the price charged is set above the equilibrium price, again, demand and supply are not equal. In Figure 7, if the price is set higher, say at £2.50, demand is only 20,000 kg while supply is 100,000 kg. This time there is **excess supply**, which means that goods would remain unsold. In this case, the quantity of unsold goods is 80,000 kg ($100,000 - 20,000$).

EXAM HINT

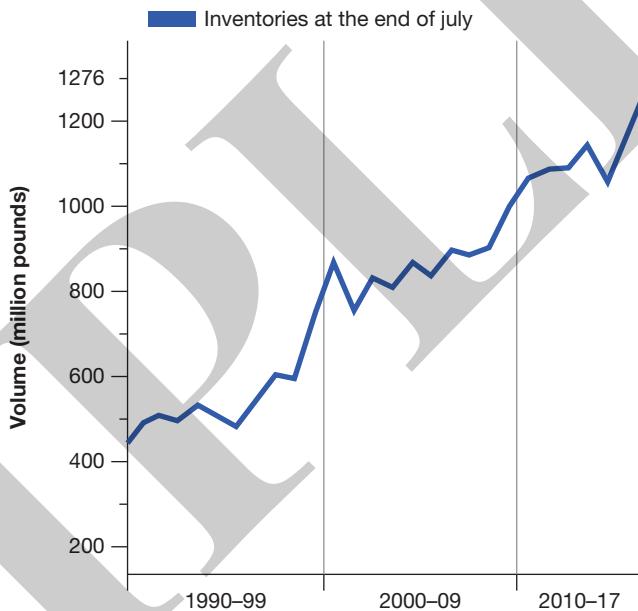
When drawing supply and demand curves you need to remember that demand curves always slope down from left to right and supply curves slope up from left to right (unless supply is fixed). You also need to remember to label the axes correctly. Marks may be awarded in examinations for labelling axes correctly and showing clearly the units measured.

CHECKPOINT

- How are the prices of goods and services determined?
- What is equilibrium price?
- What will happen to the equilibrium price if there is a fall in demand?
- What will happen to the equilibrium price if there is a fall in supply?
- What is meant by fixed supply?
- What would cause excess demand in a market?
- What will happen to the equilibrium price if there is both an increase in demand and a fall in supply?

THINKING BIGGER

In 2016, there was a massive quantity of unsold cheese in the USA. The cheese 'mountain', as these food surpluses are sometimes called, is an example of excess supply. In recent years the supply of cheese has been greater than demand. As a result, stocks in the USA have built up to over 1200 million pounds (544,311 tonnes). This is shown in Figure 8. Increased milk stocks, growing dairy imports from Europe and a change in consumption patterns have all contributed to the market disequilibrium.



▲ Figure 8 The US cheese 'mountain', 1999–2017

To help reduce the excess supply the US Department of Agriculture is planning to buy US\$20 million of cheese and distribute it to food banks nationwide. This will help boost farmer's revenues and stem their losses. However, dairy industry representatives were hoping that the government would buy as much as US\$150 million of cheese.

SUBJECT VOCABULARY

- equilibrium price or market clearing price** the price where supply and demand are equal.
excess demand the position where demand is greater than supply at a given price and there are shortages in the market.
excess supply the position where supply is greater than demand at a given price and there are unsold goods in the market.
total revenue or total expenditure the amount of revenue generated from the sale of goods calculated by multiplying price by quantity in a given period of time.

EXAM PRACTICE

THE MARKET FOR ELECTRICITY IN KENYA

SKILLS

ANALYSIS, INTERPRETATION,
CRITICAL THINKING

Government officials in Kenya have been struggling to match the demand for electricity in the country with supply. A few years ago the Kenyan government began an ambitious plan to connect an increasing proportion of its population to the electricity network. In 2013, only 27 per cent of the population was connected. However, 4 years later, this had risen to 55 per cent and by 2020 the government hopes to achieve 'universal access', where 95 per cent of Kenyan households will have a supply. This is impressive when you consider it took the USA 33 years to achieve universal access. Access to electricity is very important in African states such as Kenya. It helps to improve educational standards, employment levels and agricultural productivity.

The government planned to increase power capacity from 1600 MW (mega-watts) in 2013 to 6600 MW in 3 years. However, demand for electricity has not grown by as much as it was predicted to do so by the government. In 2017, maximum power demand was 1620 MW. According to the Kenyan government this was expected to grow to 4755 MW by 2020. Some of the increase in demand was expected to come from the development of the Kenyan railway system when it became fully operational. Growth in the manufacturing sector and possible exports of electricity to neighbouring African nations were also predicted. However, after a German consultant was employed to estimate the nation's total demand, the reality was somewhat different. The government had clearly overestimated future demand. According to the consultant, which surveyed manufacturers and other large power users, Kenya's

maximum power demand will grow 72 per cent to 2259 MW by 2020 from the current 1620 MW.

Unfortunately, the manufacturing sector, the biggest user of electricity in Kenya, has performed poorly in recent years. A number of larger companies such as tyre maker Sameer, battery maker Eveready® and confectionery producer Cadbury®, have actually ceased production in Kenya. The sector has declined by an average of 10 per cent per annum in the last 10 years or so. Demand from domestic producers is still quite low despite the improvements in electricity access. Also, exports of electricity have not met expectations. This option has been held back by the lack of low-capacity transmission lines.

In order to better balance the demand for, and supply of, electricity the government has cancelled some of the new power generation projects. For example, plans have been dropped to construct a 700 MW natural gas power plant near Mombasa. Also, electricity retailer Kenya Power has expressed an interest in developing a street lighting programme across the country.

Q

- Explain how prices are determined in markets. **(4 marks)**
- Using a demand and supply diagram, illustrate the impact on the market for electricity in Kenya resulting from the increase in capacity funded by the government. **(4 marks)**
- There is currently an excess supply of electricity in Kenya.
 - Use a demand and supply diagram to show what is meant by excess supply. **(4 marks)**
 - Explain how this excess supply has occurred. **(4 marks)**
- Evaluate whether or not the excess supply of electricity will continue in Kenya. **(20 marks)**



7 PRICE ELASTICITY OF DEMAND (PED)

LEARNING OBJECTIVES

By the end of this chapter you should be able to:

- calculate price elasticity of demand
- interpret numerical values of price elasticity of demand
- understand the factors influencing price elasticity of demand
- understand the significance of price elasticity of demand to businesses in terms of implications of pricing
- calculate and interpret the relationship between price elasticity of demand and total revenue.

GETTING STARTED

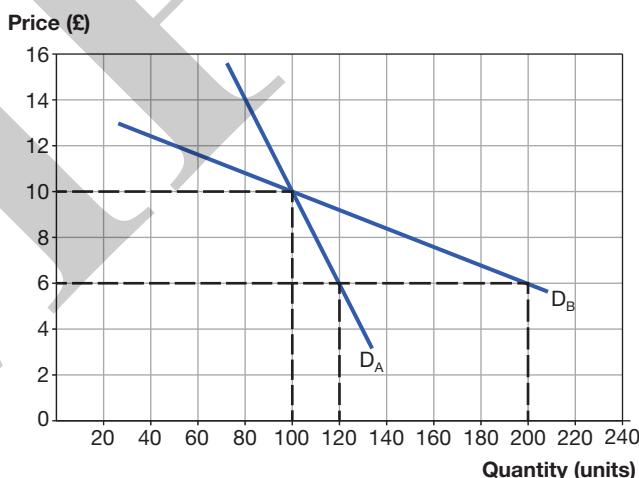
The Abbasi brothers run a traditional Pakistani tea stall in Islamabad. The business has been in the family for 65 years and is located in a busy city centre street. It has served the family well, generating several thousand rupees profit each week. However, in the last 18 months the business has struggled due to the emerging 'coffee scene' in the city. Café chains, such as Coffee Republic and Gloria Jeans Coffees, have opened branches in Islamabad and the Abbasi brothers have seen sales and revenue fall. In order to restore revenue levels they decided to increase their prices from Rs 10 to Rs 12 per cup. As a result sales fell from 3200 to 2400 cups per week.

Calculate the total revenue the business earned (price \times quantity sold) before the increase in price. Now calculate the revenue it earned after it increased price. Was the price increase a wise move for the business? Do you think the same would happen to any business that raised its price by 20 per cent?



WHAT IS PRICE ELASTICITY OF DEMAND?

For some goods a price change will result in a large change in demand and for others a smaller change. Figure 1 helps to illustrate this. Two demand curves (D_A and D_B) are shown with different slopes representing two different products: A and B. The demand curve for product A is steep and the demand curve for product B is flatter. At a price of £10, demand for both products is 100 units. However, when the price falls to £6 demand increases by different amounts for each product. Demand for product A only increases slightly to 120 units. But for product B demand increases a lot more to 200 units. Demand for product B is more **responsive** to the price change. This relationship that exists between the responsiveness of demand and a change in price is called **price elasticity of demand**.



▲ Figure 1 The effect of a price change on the demand for products A and B

PRICE INELASTIC DEMAND

In Figure 1, for product A, the price change resulted in a less than proportionate change in demand. This means that the change in demand was not as big as the change in price. Price fell by 40 per cent (from £10 to £6) but demand only increased by 20 per cent (from 100 units to 120 units). When this happens economists say that the product has **price inelastic demand** or that demand is price inelastic. A minority of goods, such as petrol, have price inelastic demand.

PRICE ELASTIC DEMAND

In Figure 1, for product B, the price change resulted in a more than proportionate change in demand. This means that the change in demand was greater than the change

in price. Price fell by 40 per cent (from £10 to £6) while demand increased by 100 per cent (from 100 units to 200 units). When this happens economists say that the product has **price elastic demand** or that demand is price elastic. Goods with elastic demand are more responsive to price changes. Most goods have price elastic demand.

CALCULATION OF PRICE ELASTICITY OF DEMAND

It is possible to calculate the price elasticity of demand of a product using the formula shown below.

$$\text{Price elasticity} = \frac{\text{Percentage change in quantity demanded of demand}}{\text{Percentage change in price}}$$

MATHS TIP

In the formula for elasticity calculation you need to work out percentage changes. The method below can be used.

Percentage change =

$$= \frac{\text{Difference between the two numbers}}{\text{Original number}} \times 100$$

The percentage change in the quantity demanded for product A is:

Percentage change =

$$= \frac{(120 - 100)}{100} \times 100 = \frac{20}{100} \times 100 = 20\%$$

WORKED EXAMPLE

For product A in Figure 1, the price elasticity of demand would be:

$$= \frac{20\%}{-40\%} = -0.5$$

For product B in Figure 1, the price elasticity of demand would be:

$$= \frac{100\%}{-40\%} = -2.5$$

MATHS TIP

There is a minus number in the calculation above because the price fell by 40 per cent (from £10 to £6). Since the price change was negative a minus sign must be shown. Whenever price or demand falls in the calculation, it is proper, and may be helpful, to show the minus sign.



INTERPRETATION OF NUMERICAL VALUES OF PRICE ELASTICITY OF DEMAND

The values calculated above show whether demand is price elastic or price inelastic.

- If the value of price elasticity is less than 1 (i.e. a fraction, such as 1/2, or a decimal, such as 0.5), demand is said to be price inelastic. Demand for product A in Figure 1 is price inelastic because price elasticity is -0.5.
- If the value of price elasticity is greater than 1, demand is said to be price elastic. Demand for product B in Figure 1 is price elastic because price elasticity is -2.5.
- Note that the minus sign is not used to determine whether goods are price elastic or price inelastic. It is enough to focus on the numerical value.

ACTIVITY 1

SKILLS → INTERPRETATION

CASE STUDY: CARBONATED DRINKS IN MEXICO



Mexicans consume more carbonated drinks, such as Coca-Cola or lemonade, per person than any other nation in the world. In 2016, one Mexican drinks company, Agrios, sold 2 million cans of Agioslimón at a price of MXN 10. In 2017, Agios reduced the price of Agioslimón to try and win a larger share of the very competitive market. The price was reduced to MXN 8 and sales rose to 2.6 million cans.

- Calculate the price elasticity of demand for Agioslimón.
- State whether demand is price elastic or price inelastic.

THE FACTORS INFLUENCING PRICE ELASTICITY OF DEMAND

The value of price elasticity of demand for a product is mainly determined by the ease with which customers can switch to other similar substitute products. A number of factors are likely to determine this.

- **Time.** Price elasticity of demand tends to fall the longer the time period. This is mainly because consumers and businesses are more likely to turn to substitutes in the long term. For example, the demand for fuel oil is highly price inelastic in the short term. If the price of petrol goes up 20 per cent in a week, the fall in quantity demanded is likely to be only a few per cent. This is because car owners have to use their cars to get to work or to go shopping. But over a 10-year period, car owners will tend to buy more fuel-efficient cars. Businesses that use oil to heat their properties may start to use gas. Homeowners with oil-fired central heating systems might look for ways to stop heat escaping their houses to cut running costs or change to gas-powered heating systems. As a result, demand for oil in the long run is likely to be price elastic.
- **Competition for the same product.** Some businesses face highly price elastic demand for their products. This is because they are in very competitive markets, where their product is either identical (i.e. a perfect substitute) or little different from those produced by other businesses. Farmers, for example, when selling wheat or potatoes are in this position. If they push their prices above the market price, they will not be able to sell their crop. Customers will simply buy elsewhere at the lower market price.
- **Branding.** Some products are branded. The stronger the branding, the less substitutes are acceptable to customers. For example, many buyers of Kellogg's Corn Flakes do not see supermarket own-label brands as good substitutes for Kellogg's. They will often pay 50 per cent more to buy Kellogg's rather than another brand. Successful branding therefore reduces the price elasticity of demand for the product.
- **The proportion of income spent on a product.** For inexpensive products, where the proportion of a consumer's income spent on the transaction is very small, demand is likely to be price inelastic. For example, if the price of a box of matches rises by 20 per cent from £0.10 to £0.12, the fall in demand is likely to be a lot less than 20 per cent because the amounts of money involved are 'trivial'. In contrast, the demand for products where the proportion of a consumer's income spent on the transaction is much larger is likely to be price elastic. For example, if the price of a car rises by 20 per cent from £20,000

to £24,000, there is likely to be a more than proportionate fall in demand (i.e. greater than 20 per cent). This is because the increase in price of £4000 is likely to stop a significant number of consumers from purchasing the product. £4000 will represent a large proportion of many consumer's incomes.

- **Product types vs the product of an individual business.** Most products are made and sold by a number of different businesses. Petrol, for example, is processed and sold by companies such as Shell, Esso and Total. The major supermarkets also sell petrol, which they have bought from independent producers. The demand for petrol is price inelastic in the short term. But the demand for Shell petrol or Esso petrol is price elastic. This is because petrol has no real substitutes in the short term. But Esso petrol is a very good substitute for Shell petrol. In general, a product category like petrol, carpets or haircuts has a much lower price elasticity of demand than products within that category made by individual businesses.

However strong the branding and however little the competition that an individual product faces, it is still likely that a business will sell at a price where demand is price elastic. To understand why, consider a product which has price inelastic demand. As explained above, raising the price of the product would increase sales revenue. It would also reduce sales and costs of production would fall. So profits would rise. A business trying to make as much profit as possible should therefore continue raising price until demand is price elastic.

If demand is price elastic, raising price leads to a fall in sales revenue, but also a fall in costs because less is sold. At the profit-maximising point, any further increase in price would see the fall in sales revenue being greater than the fall in costs.

This would suggest that even strongly branded goods, such as Coca-Cola or McDonald's® meals, have a price elasticity of demand greater than one at the price at which they are sold. It also suggests that luxury brands, such as Chanel® or Gucci®, also have price elastic demand at their current price.

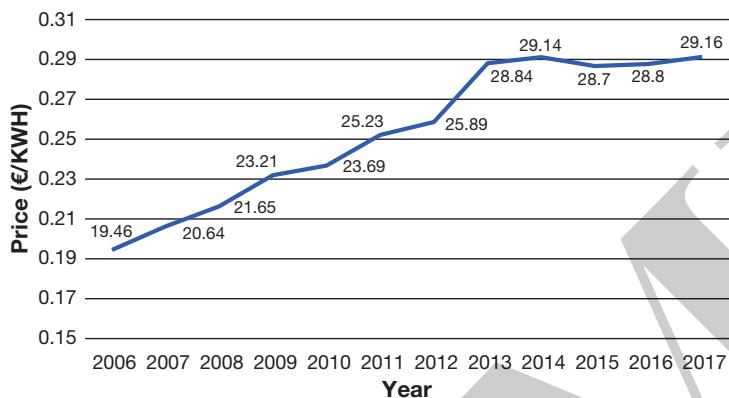
PRICE ELASTICITY OF DEMAND AND PRICING

A business may consider price elasticity of demand when setting the prices of its products. For a minority of products demand is price inelastic. This means that if a business raises its price there will be a less than proportionate fall in demand. For example, if a business (selling a product that is price inelastic) raises price by 10 per cent, demand might fall by, say, 7 per cent. This suggests that raising price when selling products with inelastic demand would be a good strategy.

Since 2006 in Germany, the price of electricity has risen significantly. Figure 2 shows that the price has gone

up by around 50 per cent over the time period (although prices have stabilised in recent years). However, there is no evidence to suggest that demand has fallen by a significant amount. This suggests that demand for electricity is price inelastic and energy suppliers can raise prices without suffering any significant fall in demand.

If goods have price elastic demand, a price change will result in a more than proportionate change in demand. For example, if a business selling a product that is price elastic raises the price by 10 per cent, demand might fall by, say, 18 per cent. This suggests that raising the price when selling products with price elastic demand would not be a good strategy. However, if the business lowers the price, demand will rise by a larger proportion than the price cut. This might help to explain the success of low-cost supermarkets, such as Aldi and Lidl. Their sales have risen significantly, probably due to charging lower prices in a highly competitive market.



▲ Figure 2 Average electricity price in Germany, 2006–17

PRICE ELASTICITY OF DEMAND AND TOTAL REVENUE

When a business changes its price there will be a change in demand and therefore a change in total revenue. It would be useful for a business to know what effect a particular price change might have on total revenue. The value of price elasticity can help here. In Figure 1, the demand for product A is price inelastic and the demand for product B is price elastic. At the price of £10 the demand for both products is 100 units. However, when the price falls demand for product A rises to 120 units while the demand for B rises to 200 units. The different effects on total revenue for each product are outlined below.

For product A: When the price falls from £10 to £6 there is an increase in demand from 100 units to 120 units. This means that total revenue will change. This is shown by the following calculations.

$$\text{When } P = \text{£}10 \text{ } TR = \text{£}10 \times 100 = \text{£}1000$$

$$\text{When } P = \text{£}6 \text{ } TR = \text{£}6 \times 120 = \text{£}720$$

The price reduction from £10 to £6 has resulted in a £280 fall in total revenue (£1000 – £720). This shows that when demand is inelastic, a price cut will cause total revenue to fall. The opposite will happen if the price is increased. If demand is inelastic, a price increase will cause total revenue to rise.

For product B: When the price falls from £10 to £6, demand rises from 100 units to 200 units. The effect on total revenue is calculated below.

$$\text{When } P = \text{£}10 \text{ } TR = \text{£}10 \times 100 = \text{£}1000$$

$$\text{When } P = \text{£}6 \text{ } TR = \text{£}6 \times 200 = \text{£}1200$$

This time, for product B, the price reduction has resulted in a £200 increase in revenue from £1000 to £1200. This shows that when demand is price elastic, a price cut will result in an increase in total revenue. The opposite will happen if the price is increased. If demand is price elastic, a price increase will cause total revenue to fall. The effect of price changes on total revenue for different price elasticities is summarised in Table 1.

Price elasticity	Value of elasticity	Price change	Effect on TR
Inelastic	< 1	Decrease	Fall
Inelastic	< 1	Increase	Rise
Elastic	> 1	Decrease	Rise
Elastic	> 1	Increase	Fall

▲ Table 1 The effect of price changes on total revenue when demand is elastic and inelastic

To conclude, if businesses know the value of price elasticity for their products, they can predict the effect on total revenue of any price changes they make. They will know, for example, that if demand for their product is elastic, a price reduction will increase total revenue. This might help to explain why many rail companies charge lower prices for off-peak rail travel. By lowering the price more travellers are attracted and revenue rises. Demand during the off-peak period must be price elastic.

ACTIVITY 2

SKILLS

INTERPRETATION, PROBLEM SOLVING,
CRITICAL THINKING

CASE STUDY: IBADAN PIZZAS

Rita Okobi runs a pizza takeaway restaurant called Ibadan Pizzas in the large city of Ibadan, Nigeria. The market for pizzas is growing but she faces competition from global brands such as Domino's®. However, she has traded profitably for a few years. She provides excellent customer service and uses a combination of flour and other grains to make the bases which gives them a distinctive taste.

In 2016, she wondered if she could increase her sales by charging less than her rivals. For example, a medium cheese pizza from Domino's costs about NGN 3000. Cheryl currently charges NGN 2600 for an equivalent product. She is considering a price cut to NGN 1950 to make the price difference more significant. Cheryl has done some research and reckons that the price elasticity of demand for her pizzas is about -2 . In 2017, Cheryl sold 10,000 cheese pizzas.



1. Calculate the number of pizzas Rita would expect to sell in 2017 if she cut the price to NGN 1950.
2. Calculate the change in total revenue resulting from the price change above.
3. Assess whether Rita's decision to cut price might be successful.

EXAM HINT

A common mistake made by students in examinations relates to products with inelastic demand. Sometimes students say 'demand for product x is inelastic.' This means that a business can raise the price and there will be no change in demand.' This is not the case. Even when demand is price inelastic, a price change will still cause a change in demand. It is just that the percentage change in demand is smaller than the percentage change in price.

THINKING BIGGER

When using price elasticity of demand to help make pricing decisions, businesses need to be aware of some possible drawbacks with the concept. The main problem is the origin of elasticity values. A business might estimate the value of price elasticity by measuring the effect on sales of previous price changes. For example, if a business cut the price by 12 per cent 4 years ago and demand rose by 18 per cent, price elasticity would be -1.5 . However, this data is historic; what happened 4 years ago may not happen again in the future.

Another way of estimating elasticity values is to carry out market research to find out how consumers will react to price changes in the future. This would give more up-to-date values, but there could be problems with the accuracy of the data collected by market researchers. For example, the sample may not be representative or consumers might not behave in the way they said they would. Consequently, imperfect data would be flawed. Businesses need to be aware, therefore, that elasticity values may not be entirely accurate.

CHECKPOINT

1. What is elasticity of demand?
2. Give two examples of products that might have inelastic demand.
3. What is the formula for calculating price elasticity of demand?
4. The price of a product is increased by 8 per cent; as a result demand falls by 12 per cent. Calculate price elasticity of demand.
5. The price elasticity of demand for a product is -0.67 . What will happen to total revenue if price is reduced?
6. The price elasticity of demand for a product is -2.7 . What will happen to total revenue if price is raised?
7. State two factors that affect the price elasticity of demand for a product.

SUBJECT VOCABULARY

price elastic demand a change in price results in a greater change in demand.

price elasticity of demand the responsiveness of demand to a change in price.

price inelastic demand a change in price results in a proportionately smaller change in demand.

EXAM PRACTICE

ROBBAT ENGINEERING

SKILLS
**ANALYSIS, INTERPRETATION,
CRITICAL THINKING**

Robbat Engineering operate from a factory in Kuala Lumpur, Malaysia, manufacturing components and spare parts for farm vehicles. The work undertaken by the company is quite specialised and it was thought that few rivals operate in the same market. At the end of 2016 the company had to make some modifications to two of the components, A and C. This was to comply with some new health and safety specifications. As a result the owner decided to raise the price of these two components by 20 per cent in 2017. Some financial information for three components made by Robbat Engineering is shown in Table 2.

	Price	Sales	PED
Component A	MYR 50	100,000	-0.8
Component B	MYR 35	150,000	-1.1
Component C	MYR 25	300,000	-1.2

▲ Table 2 Financial information and price elasticity of demand (PED) for three products, 2016


Q

- Define the term 'elastic demand'. (2 marks)
- Explain **one** factor that might affect the price elasticity of demand. (4 marks)
- Calculate the expected change in revenue generated by product A in 2017 if the price is increased by 20 per cent. (4 marks)
- Evaluate whether or not the price changes made by Robbat Engineering will benefit the business. (20 marks)

8 INCOME ELASTICITY OF DEMAND (YED)

LEARNING OBJECTIVES

By the end of this chapter you should be able to:

- calculate income elasticity of demand
- understand normal and inferior goods
- interpret numerical values of income elasticity of demand
- understand the factors influencing income elasticity of demand
- understand the significance of income elasticity of demand to businesses.

GETTING STARTED

The demand for some products can be affected by changes in income. However, for some other products changes in income will have very little impact on demand.

Look at the two photographs below.



How do you think changes in income will affect demand for the two products? What would you expect to happen to the demand for luxury goods in the

next 20 years? Can you think of any goods for which demand might actually fall if incomes rose? What might explain this fall in demand?

WHAT IS INCOME ELASTICITY OF DEMAND?

One of the main factors that can change the demand for products is the amount of income consumers have to spend. **Income elasticity of demand** measures the responsiveness of demand to a change in income.

Consider two products: A and B. If incomes rise by 10 per cent and demand for product A rises by 25 per cent, the change in demand is proportionately greater than the change in income. Economists would say that demand for product A is **income elastic**. Demand for many goods and services is income elastic. Examples might include cars, fashion accessories, entertainment, holidays and a wide range of luxury goods.

In contrast, if demand for product B only rose by 5 per cent, economists would say that demand for product B is **income inelastic**. This is because the percentage increase (or change) in demand is proportionately less than the percentage increase (or change) in income. Demand for some goods and services may be income inelastic. Examples are likely to be essential goods, such as milk, food in general and heating fuel.

CALCULATION OF INCOME ELASTICITY OF DEMAND

It is possible to calculate the income elasticity of demand for a product using the formula:

$$\text{Income elasticity of demand} = \frac{\text{Percentage change in quantity demanded}}{\text{Percentage change in income}}$$

WORKED EXAMPLE

For product A in the earlier example, income elasticity of demand would be:

$$\frac{25\%}{10\%} = 2.5$$

For product B in the earlier example, income elasticity of demand would be:

$$\frac{5\%}{10\%} = 0.5$$

NORMAL AND INFERIOR GOODS

The value of income elasticity can also show whether goods are **normal goods** or **inferior goods**. For normal goods, where an increase in income results in an increase in demand, the value of income elasticity will be positive (+).

Products A and B above are both normal goods because income elasticity is positive in both cases. For inferior goods, where, for example, an increase in income results in a decrease in demand, the value of income elasticity will be negative (-). Some examples are shown in Table 1.

Good	Income elasticity	Elastic or inelastic	Type of product	The effect of a 10% increase in income
Product W	0.6	Inelastic	Normal	Demand would increase by 6%
Product X	-2.4	Elastic	Inferior	Demand would fall by 24%
Product Y	1.9	Elastic	Normal	Demand would rise by 19%
Product Z	-0.8	Inelastic	Inferior	Demand would fall by 8%

▲ Table 1 Some examples of goods with different income elasticities of demand

INTERPRETATION OF THE NUMERICAL VALUES OF INCOME ELASTICITY OF DEMAND

The values calculated above show whether demand is income elastic or income inelastic.

- If the value of income elasticity is greater than 1, demand is said to be income elastic. Demand for product A is income elastic because income elasticity is 2.5. This means that the change in demand is proportionately greater than the change in income.
- If the value of income elasticity of demand is less than 1, demand is said to be income inelastic. Demand for product B is income inelastic because income elasticity is 0.5. This means that the change in demand is proportionately less than the change in income.

MATHS TIP

Always show the positive (+) and negative (-) signs when performing elasticity calculations. If you leave a negative sign out, you could end up getting a wrong answer. The signs also tell you whether the product is normal or inferior.



ACTIVITY 1

SKILLS

PROBLEM SOLVING, CRITICAL THINKING

CASE STUDY: DAR ES SALAAM PAPER

Dar Es Salaam Paper sell standard A4 paper to a wide variety of stationers, other retailers and office equipment suppliers. In 2016/17, incomes rose by 2 per cent; as a result, demand for paper rose from 2,000,000 reams to 2,030,000 reams.

- Calculate the income elasticity of demand for paper in this case.
- Explain whether (a) demand for paper in this case is income elastic or income inelastic and (b) whether paper is a normal good or an inferior good.

THE FACTORS INFLUENCING INCOME ELASTICITY OF DEMAND

The main factor affecting income elasticity of demand is whether or not goods are necessities or luxuries.

Necessities: These are basic goods that consumers need to buy. Examples include food in general, electricity and water. Demand for these types of goods will be income inelastic. Another example of a product which has income inelastic demand is cigarettes. A study in Ukraine a number of years ago found that the income elasticity of demand for cigarettes was 0.06. It could be argued that cigarettes are a necessity once people become addicted to them.

Luxuries: These are goods that consumers like to buy if they can afford them. Spending on these types of goods is **discretionary**, which means that customers can choose whether or not to make these purchases. Demand for these goods is income elastic. Examples include air travel, satellite television, fashion accessories, and many goods and services in the leisure and tourism industry. It is also argued that the demand for imported goods is income elastic. It has been found that as developing nations become better off, their demand for imports rises significantly.

The price of a product relative to incomes: This can also influence income elasticity. Demand for products that are relatively cheap, such as pencils, will tend to be income inelastic. However, demand for expensive items, such as houses, will be income elastic.

THE SIGNIFICANCE OF INCOME ELASTICITY OF DEMAND TO BUSINESSES

Businesses may be interested in income elasticity of demand because changes in income in the economy can affect the demand for their products.

Businesses selling goods with high income elasticity: The demand for goods that are very sensitive to changes in income (i.e. highly income elastic)

is often cyclical. This means that when the economy is growing, demand for these types of goods, such as air travel, restaurants and luxury goods, is also growing. But when the economy falls into recession, demand also falls. This can cause difficulties for such businesses. During a recession they may lay off workers and postpone or cancel investment projects. Predicting demand for goods that are influenced by the business cycle can be quite difficult. The business cycle is discussed in Chapter 41.

Businesses selling goods with low income elasticity:

Demand for goods that are income inelastic tends to be more stable during the different phases in the business cycle. For example, farmers are much less affected by income changes because demand for many food products is fairly stable. This makes production planning and investment decisions a little easier. In countries where economic growth is steady, over a period of time the demand for inferior goods and normal necessities tends to decline. It could be argued that businesses operating in these sectors should attempt to diversify into goods with higher income elasticity of demand in the long run.

Production planning: If businesses know the income elasticity of demand for their products they can respond to predicted changes in incomes. Businesses that produce goods that have income elastic demand will expect changes in income to affect demand. So if incomes are expected to rise in the future they can plan ahead, making sure they have enough capacity, for example. Whereas, if a recession is expected, these businesses would plan to cut output. This is because incomes are likely to fall during a recession. In 2008, as a result of the global recession, car manufacturers started to cut their output. For example, it was widely reported that Honda, the Japanese car manufacturer, stopped production in some factories around the world in 2009. In contrast, producers of inferior goods might start to increase capacity if they believed a recession was coming. When incomes fall, demand for inferior goods, such as those sold by low-cost supermarkets, starts to rise.

Product switching: Some manufacturers have flexible resources and can switch from the production of one product to another. For example, a manufacturer of plastic products may be able to switch from the production of plastic household goods to plastic toys. A predicted rise in incomes may encourage such a business to make more plastic toys if demand for them was income elastic.

EXAM HINT

It is important not to confuse income elasticity of demand and price elasticity of demand. Both changes in income and changes in price can affect demand but when calculating and discussing elasticity, you need to remain focused and not get them mixed up.

The formulae are very similar.

- Percentage change in demand is the numerator in both cases.
- For income elasticity, percentage change in income is obviously the denominator.
- For price elasticity, percentage change in price is the denominator.

CHECKPOINT

1. What does it mean when a product is described as 'income elastic'?
2. Give two examples of goods that might be income inelastic.
3. What is the formula for calculating income elasticity of demand?
4. If incomes rise by 12 per cent and demand rises by 20 per cent, what is income elasticity of demand?
5. A product has income elasticity of -0.9 . Is this good normal or inferior?
6. State two factors that might affect income elasticity of demand.
7. Why are imports believed to be income elastic?
8. State two implications of income elasticity for businesses.

SUBJECT VOCABULARY

discretionary expenditure non-essential spending or spending that is not automatic.

income elastic the percentage change in demand for a product is proportionately greater than the percentage change in income.

income elasticity of demand where the responsiveness of demand to a change in income.

income inelastic where the percentage change in demand is proportionately less than the percentage change in income.

inferior goods goods for which demand will fall if income rises or rise if income falls.

normal goods goods for which demand will rise if income rises or fall if income falls.

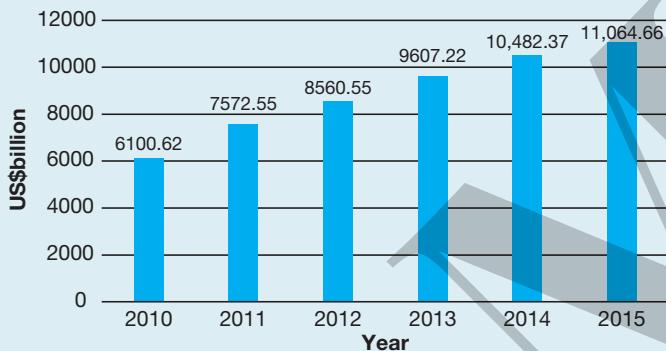
EXAM PRACTICE

CHINESE OUTBOUND TOURISM

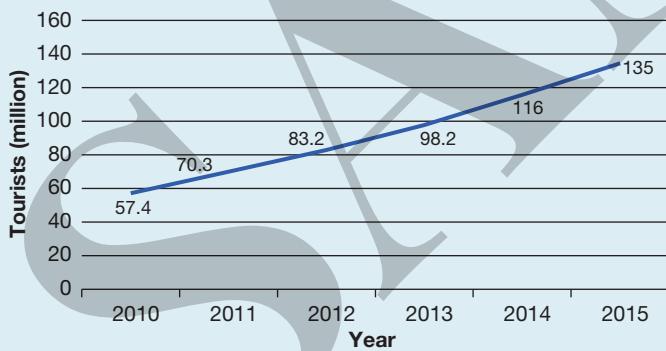
SKILLS
**ANALYSIS, INTERPRETATION,
CRITICAL THINKING**

In recent years the Chinese economy has grown significantly (Figure 1). Many people have benefited from the growth in manufacturing and a significant proportion of China's population has become wealthier. As a result the number of Chinese people taking holidays abroad has increased dramatically. Figure 2 shows the growth in the number of Chinese people crossing borders for holidays between 2010 and 2015.

In 2016, the most popular destination for Chinese tourists was the administrative region of Hong Kong. More than 35 million Chinese tourists visited the region. Other popular destinations included Macau, Thailand, South Korea, Japan, Taiwan and the USA.



▲ Figure 1 Chinese GDP, 2010–15



▲ Figure 2 Chinese outbound tourism, 2010–15


Q

- Define the term income elasticity of demand. **(2 marks)**
- Calculate the income elasticity of demand for foreign holidays in China between 2010 and 2015. **(4 marks)**
- Explain why an overseas holiday to China is classified as a normal good. **(4 marks)**
- Analyse **two** factors that might influence income elasticity of demand. **(6 marks)**
- Assess how useful income elasticity might be for a business selling holidays to Chinese tourists. **(10 marks)**

MARKETING MIX AND STRATEGY

This section covers the importance of marketing in business. It looks at different marketing objectives, such as increasing market share and brand building, and the different marketing strategies that businesses might use. It also looks at the different elements in the marketing mix – product, promotion, pricing and place (the 4 Ps). This includes the design of products and how elements of the design mix reflect changes in social trends, types of promotion and branding and how businesses might build a brand, different pricing strategies and the factors that might influence the choice of pricing strategy and, finally, the different distribution channels used by businesses.



9 MARKETING OBJECTIVES AND STRATEGY

UNIT 1
1.3.3

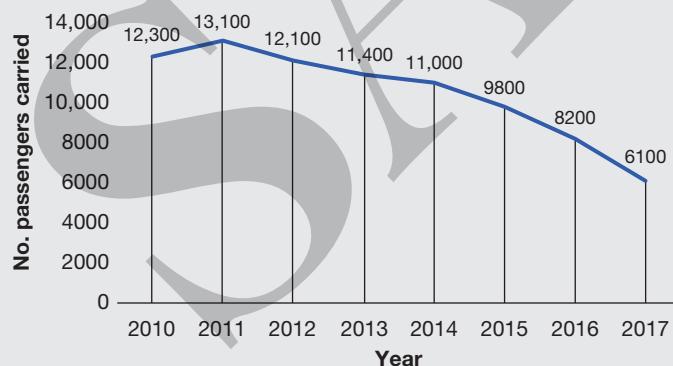
LEARNING OBJECTIVES

By the end of this chapter you should be able to understand:

- marketing objectives: increase market share, increase revenue and build a brand
- the product life cycle and extension strategies
- the Boston matrix and the product portfolio
- the concept of the marketing mix
- marketing strategies appropriate for different types of market: mass markets, niche markets, business to business (B2B) and business to consumer (B2C)
- consumer behaviour – how businesses develop customer loyalty.

GETTING STARTED

Karrandore is a large holiday company based in Santiago, Chile. It offers a very wide range of different holiday experiences for many different consumer groups. It is a stable and profitable company but one of its products is currently in decline. This is a product called Patagonia Cruises. It involves a 6-day trip on a cruise ship between Punta Arenas, Chile, and Ushuaia, Argentina. Passengers get to explore the heart of Patagonia's scenic beauty. They visit scenic coastline in search of whales and wildlife, and explore on guided tours given by an expert. Figure 1 shows sales figures for Patagonia tours from 2010 to 2017.



▲ Figure 1 Sales for Patagonia Cruises, 2010–17

After a senior management meeting, where the withdrawal of Patagonia Cruises was discussed, it was decided to extend the life of the product. The company has agreed to invest CLP 9000 million to upgrade the cruise ship and advertise a new and improved service. The service will include luxury cabins and improved restaurant facilities for all passengers. The objective is to relaunch the product and raise sales to 15,000 by 2020.



Discuss possible reasons why Karrandore decided not to withdraw Patagonia Cruises? What is Karrandore's marketing objective in this case? Would you describe Patagonia Cruises as a mass-market product or a niche-market product? Explain your answer. How might Karrandore develop some customer loyalty for its products?

MARKETING OBJECTIVES

The marketing activities of a business are likely to be more effective if there are clear **marketing objectives**. These are the goals that a business is trying to achieve through its marketing. Although the general role of marketing is to help sell products, it is possible to identify specific marketing objectives. These objectives may differ between different business organisations. It is also likely that the marketing objectives of a particular business will vary over time to match its changing marketing needs. Three key marketing objectives might include the following.

Increase market share: Businesses often want to gain a larger share in the market. This is because having a larger market share is likely to give a business a competitive edge. As market share grows, a business will have to produce more output. As a result it may exploit economies of scale, which will help to lower costs. For example, a business may get better prices from suppliers because they are buying larger volumes of resources. If a business can grow a large enough share it may also have some influence on the prices charged in the market.

To win a larger market share a business may have to invest in an advertising campaign or adjust its pricing strategy, for example. This is discussed in Chapters 11 and 12, respectively. Increasing market share is an important marketing objective for many businesses.

Increase revenue: Businesses often introduce specific marketing activities in order to boost their revenues. If revenues are higher it is likely that profits will also be higher. If a business sets out to increase revenue, there are a number of marketing activities that could be used to achieve this objective. For example, it could invest in an online advertising campaign, sponsor an international sporting event, reduce its price or widen its distribution. These activities are discussed in Chapters 11, 12 and 13, respectively.

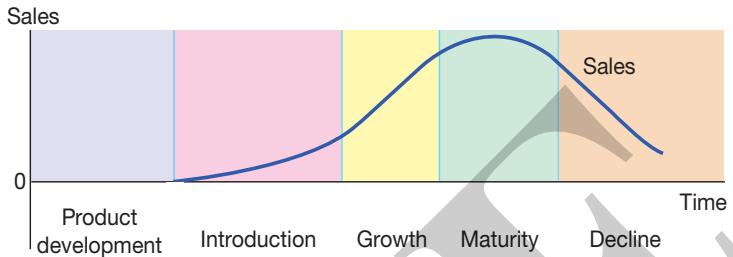
Build a brand: Many businesses want to establish the name of their company or their products. They can do this by giving products brand names. For example, the brand name Samsung, the South Korean electronics manufacturer, is likely to be recognised by many people worldwide. Strong brands can generate huge returns for a business, so building a brand over a period of time is important for many – particularly those in highly competitive markets. If a business aims to build a brand it may exploit a unique selling point, invest heavily in television advertising or use social media to achieve this specific marketing objective. This is discussed in detail in Chapter 11.

Finally, a business is more likely to achieve its marketing objectives if they are SMART. This means that they should be specific, measurable, agreed, realistic and time specific. An example of a SMART marketing objective might be to increase market share from 17 per cent to 20 per cent within 2 years. SMART objectives are discussed in Chapter 21.

THE PRODUCT LIFE CYCLE

Product is one part of the marketing mix. For marketing to be effective, a business must be aware of its **product life cycle**. The product life cycle shows the different stages that a product passes through over time and the sales that can be expected at each stage. By considering product life cycles, businesses can plan for the future.

Most products pass through six stages – development, introduction, growth, maturity/saturation and decline. These are illustrated in Figure 2.



▲ Figure 2 The product life cycle

Development: During the development stage the product is being researched and designed. Suitable ideas must be investigated, developed and tested. If an idea is considered worth pursuing then a prototype or model of the product might be produced. A decision will then be made about whether or not to launch the product. A large number of new products never progress beyond this stage and will fail. This is because businesses are often reluctant to take risks associated with new products. During the development stage it is likely that the business will spend to develop the product and costs will be high. As there will be no sales at this stage, the business will initially be spending but receiving no revenue.

Introduction: At the start of this stage the product will be launched. As the product is new to the market, initial sales are likely to be slow. Costs are incurred when the product is launched. It may be necessary to build a new production line or plant, and the firm will have to meet promotion and distribution costs. A business is also likely to spend on promotion to make consumers aware of the new product. Therefore, it is likely that the product will still not be profitable. Prices may be set high to cover promotion costs. But they may also be set low in order to break into the market. Few outlets may stock products at this stage. The length of this stage will vary according to the product. With brand-new technical products, for example, the introduction stage can be quite long. It takes time for consumers to become confident that such products 'work'. At first the price of such products may be quite high. Alternatively, a product can be an instant hit resulting in very rapid sales growth. Fashion products and some fast-moving consumer goods may enjoy this type of start to their life.

Growth: Once the product is established and consumers are aware of it, sales may begin to grow rapidly, new customers buy the product and there are repeat purchases. Unit costs may fall as production increases. The product then becomes profitable. If it is a new product and there is a rapid growth in sales,

competitors may launch their own versions. This can lead to a slowdown of the rise in sales. Businesses may need to consider their prices and promotion. For example, a high price charged initially may need to be lowered, or promotion may need to increase to encourage brand loyalty.

Maturity and saturation: At some stage the growth in sales will end. The product has become established with a stable market share at this point. Sales will have reached their highest point and competitors will have entered the market to take advantage of profits. As more firms enter the market, it will become saturated. Some businesses will be forced out of the market, as there are too many firms competing for consumers. During the maturity and saturation stages of the product life cycle, many businesses use extension strategies to extend the life of their products. These are discussed below.

Decline: For the majority of products, sales will eventually decline. This is usually due to changing consumer tastes, new technology or the introduction of new products. The product will lose its appeal to customers. At some stage it will be withdrawn or sold to another business. It may still be possible to make a profit if a high price can be charged and little is spent on promotion or other costs.

EXTENSION STRATEGIES

Extension strategies, ways to prolong the life of a product before it starts to decline, are popular with businesses. This is because the costs of product development are high and extension strategies help a product to generate more cash. Two general approaches are often used. One is to make some adjustments to the product; the second is to invest in promotion.

Product adjustments: Many companies try to prolong the life of the product by 'freshening' it up. This might involve making improvements, updating the product, repackaging the product or extending the range.

- Updating is quite a common approach for technical products and certain types of consumer durables. For example, in the car industry firms are keen to bring out updated versions of their successful models. An example is shown in Activity 1 on the next page.
- Some businesses add value to their products by making improvements. For example, computer manufacturers bring out new machines that are faster, have more memory, look more stylish and have more functions than previous versions. In the service industry, banks offer new accounts with extra services, such as travel insurance, breakdown cover and mobile phone insurance.
- Another common approach is to extend the product range. Crisp manufacturers have used this method

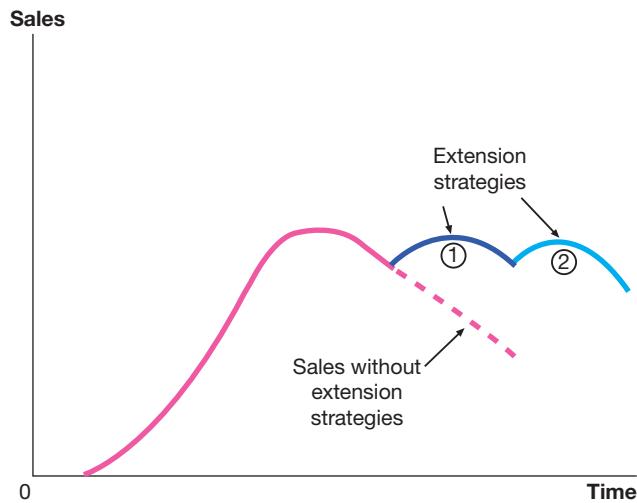
in the past by bringing out new flavours. However, a wide range of industries can adopt this approach. For example, CK International, a producer of waste compaction equipment based in Northern Ireland, extended its product range in 2017. It launched the CK300VX baler. This new design is ideal for volume reduction of medium quantities of plastic and cardboard and can produce up to 300 kg bale of cardboard, making it possible to gain revenue on bales.

- Some businesses give the impression that the product has been modified by changing the packaging. For example, many soft drinks manufacturers sell their brands in cans, glass bottles and different-sized plastic bottles. In the music industry, record companies often release albums that re-use hits from a number of previously released albums. The new album is supported with a new cover.

Promotion: Some businesses prefer to leave the product unchanged but give a boost to falling sales by investing in promotion campaigns.

- One approach is to find new uses for a product. For example, WD-40® was first developed in 1953 to protect metal corrosion by displacing water. Today it has multiple advertised uses, such as removing dirt, cleaning bike chains and displacing water in car engines.
- Some businesses try to find new markets for their products. For example, a local business might start to serve a larger region. A regional business might try to market its products nationally. A business with a national market might begin to export its products. Many Western business are looking to sell their existing products in growing overseas markets, such as India and China.
- Investment in a advertising campaign can sometimes boost sales. A big advertising campaign on television, for example, can get people interested in a product again.
- Another approach is to encourage more frequent use of the product. An example of this might be cereal manufacturers persuading people to eat cereals for supper as well as for breakfast.

The effect that an extension strategy can have on a product life cycle is shown in Figure 3. As the market becomes saturated and sales begin to fall, the decline in sales is delayed by the use of an extension strategy. It would be sensible for a business to extend the life of a mature product before sales start to decline. Firms that can predict falling sales from market forecasts may attempt to use extension strategies before the decline takes place – that is at the maturity stage.



▲ Figure 3 Extension strategies

ACTIVITY 1

SKILLS

ANALYSIS

CASE STUDY: GOLF GTI

The Golf GTI is produced by Volkswagen (VW), the German-based multinational car manufacturer. The Mk I GTI was launched at the Frankfurt Motor Show in 1975. The model could reach 60 mph (95 kpm) in 9 seconds. Designed with the emphasis on fun, it used colourful fabrics and an golf-ball-shaped gearstick. To extend the life of the model a further six versions were introduced, as outlined below.

- **1984** The Mk II GTI was launched with a new body structure, a 1781 cc engine and new styling to appeal to a new generation of drivers.
- **1987** The Mk III GTI had a new 2.0-litre eight-valve engine and a redesigned body that made the vehicle more efficient. This reduced the 0–60 mph (0–95 kpm) time to 8.3 seconds.
- **1998** The Mk IV GTI had improved safety features and updated styling. In 2002 the fastest and most powerful GTI produced to date was released for the 25th Anniversary Edition.
- **2004** Launched at the Paris Motor Show, the Mk V GTI was the most powerful GTI yet produced. The vehicle had other upgrades to make the driving experience quieter, smoother and safer.
- **2009** Mk VI GTI won the 'Best Hot Hatch' award at the Auto Express Awards. Testers complimented the sharp handling, impressive features and excellent comfort, and called it the best Golf to date.
- **2012** The Golf GTI Mk VII was launched with a lighter but stronger base. This was the most fuel-efficient GTI to date, and was capable of 0–62 mph (0–100 kpm) in 6.5 seconds.

VW plan to bring out an updated seventh version of the Golf GTI in 2018. The GTI range will have slightly

updated front and rear fenders and a tweaked cabin. The infotainment system will feature a super slick touch screen (with Apple CarPlay® and Android™ Auto). It has been described as not laggy, not slow but all very dependable and Golf-ish.

Source: Based on <https://www.cnet.com/roadshow/auto/2018-volkswagen-golf/preview/>

1. What is meant by an extension strategy?
2. Explain one way in which VW extended the life of the Golf GTI.
3. Explain one advantage to VW of using an extension strategy.

BOSTON MATRIX AND THE PRODUCT PORTFOLIO

Product life cycle analysis shows businesses that sales of products eventually decline. A well-organised business with one or more products will attempt to phase out old products and introduce new ones. This is known as managing the **product portfolio** or product mix.

The product portfolio: The product portfolio will be made up of **product lines**. A product line is a group of products which are similar. For example, televisions are a product line including flat screen, HD widescreen and portable televisions. With a constant launch of new products, a business can make sure gaps are not created as products reach the end of their life.

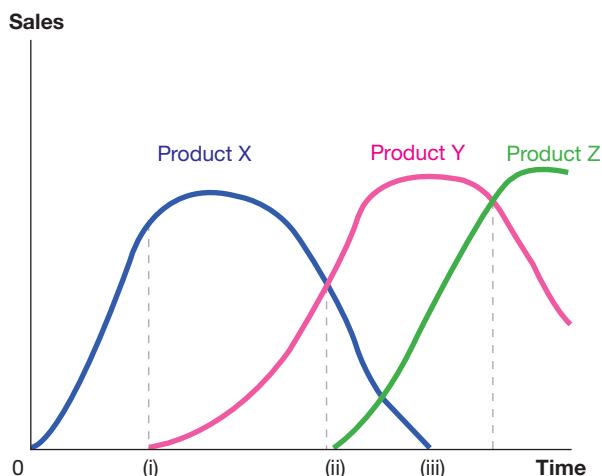
Figure 4 shows how a business can manage its product portfolio. Say that a business over a particular time period aims to launch three products. By organising their launch at regular intervals, there is never a gap in the market. As one product is declining, another is growing and further launches are planned. At point (i), as sales of product X are growing, product Y has just been launched. This means that at point (ii), when sales of product X have started to decline, sales of product Y are growing and product Z has just been launched.

This simple example shows only three products. In practice, a business may have many products. It would hope that existing products remain in 'maturity' for a long period. The profit from these mature products would be used to 'subsidise' the launch of new products. New products would be costly at first, and would make no profit for the business.

Examples of businesses that have successfully managed their product portfolios are sweet manufacturers. Companies such as Nestlé® produce a wide range of products, including KitKat®, Milkybar® and Yorkie®, and constantly look to launch new products.

The Boston matrix: One problem for firms when planning their product portfolios is that it is very difficult in practice to tell what stage of the life cycle

a product is at. Also, there is no standard lifetime for products. For example, young people's fashion clothing has life cycles which can be predicted with some certainty. Other products are less reliable. Who, for example, could have predicted the lengthy life cycles of products such as the VW Beetle, or the short life cycle of products such as the Sinclair C5 – a sort of electric 'minicar' introduced in the 1980s?



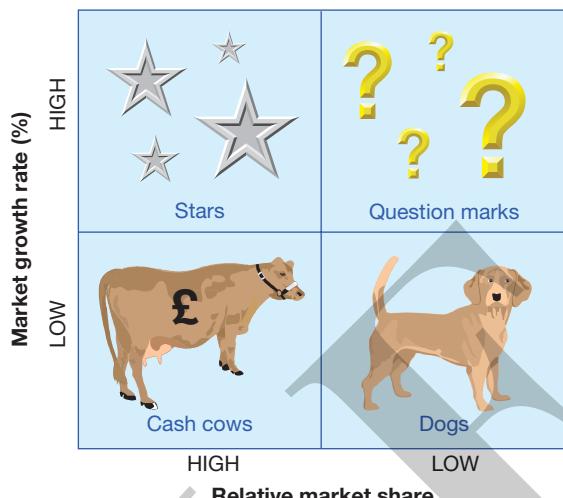
▲ Figure 4 Managing the product portfolio

A useful technique for allowing firms to analyse their product portfolios is the Product Portfolio Matrix developed by the Boston Consulting Group. It is sometimes called the **Boston matrix** or the Growth Share Matrix. This is shown in Figure 5. Products are categorised according to two criteria.

- **Market growth.** How fast is the market for the product growing? The market may be declining or it may be expanding. Sales of a product in a fast expanding market have a better chance of growing than a product in a mature or declining market.
- **Relative market share.** How strong is the product within its market? Is it a market leader that other products follow? Is it a product that is 12th in terms of sales? To measure this the market share of a product is compared with the strongest rival product. For example, if product X had a market share of 10 per cent and the market leader had 40 per cent, then the relative market share of product X is 0.25 (10 per cent ÷ 40 per cent). If product Y is a market leader with 50 per cent market share and the next most important product had a market share of 25 per cent, the relative market share of product Y is 2.0 (50 per cent ÷ 25 per cent).

Using these criteria the products of a business can be placed into one of four categories on the Boston matrix.

Stars: A star is a product with a high market growth and a relatively high market share. Stars are valuable to businesses. The product will be in a strong position in its



▲ Figure 5 The Boston matrix

Source: adapted from The BCG Portfolio Matrix from the Product Portfolio Matrix, © 1970, The Boston Consulting Group (BCG)

market as it has a high market share and the business can take advantage of a fast-growing market. A star is already likely to be profitable as it has a relatively high market share. But a business will need to invest in the product to cope with a growing market and growing sales. This could mean investing in new production facilities or promotion to protect the product from competition. **Net cash flow** may be nearly zero. This is because although profits will be high, bringing money in, investment spending will also be high, leading to outflows.

Cash cows: A cash cow is a product with a relatively high market share. It is therefore well positioned in the market and likely to be profitable. But the market it is in will have weak growth. So there will be little chance of increasing sales and profits in future. There will be little need for investment. With slow growth in sales there should be little need for new premises, for example. Cash cows have strong positive net cash flow. Money coming into the business from profits will not be taken out via investment.

Question marks: Question marks, sometimes known as problem children or wildcats, are products with a relatively low market share in a fast-growing market. This can be a problem for a business because it is unclear what should be done with these products. If a product is performing weakly it is unlikely to be profitable. But as it is in a fast-growing market, there is potential to turn it into a star. Net cash flow is likely to be zero or negative. Weak relative market share means that it will not be profitable. But investment will be needed to cope with expanding sales in a fast-growing market.

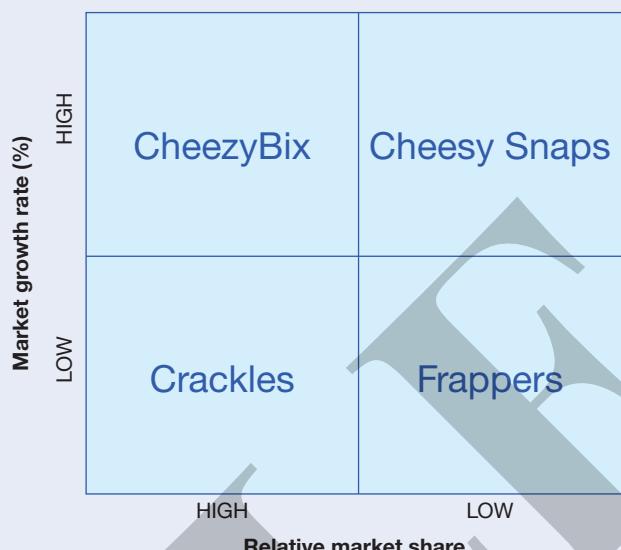
Dogs: These are products with a relatively low market share in a market with low growth. Dogs have poor prospects for future sales and profits. They may generate some positive net cash flow because they will need little investment but may earn some profit. But if they make little or no profit, net cash flow may be zero or even negative.

Businesses can make use of the Boston matrix to manage their product portfolios.

Balancing product lines: Businesses must ensure that their product portfolios do not contain too many items within each category. Naturally, they do not want lots of dogs, but they should also avoid having too many stars and question marks. Products on the top of the Boston matrix are in the early stages of the product life cycle and are in growing markets. But the cost of developing and promoting them will not yet have been recovered. This will use up resources. Balancing these with cash cows will mean that the positive net cash flow from the cash cows can be used to support products in a growing market. The development cost of cash cows is likely to have already been recovered and promotional costs should be low relative to sales. This does not mean though that a business would want lots of cash cows and few question marks and stars. This is because many of the stars and perhaps some question marks might become the cash cows of the future.

Taking appropriate decisions: Products in different categories in the matrix may require different approaches.

- Stars have great future potential. They are future cash cows. A business will need to build the brand of these products so that sales increase and competition is fought off successfully.
- Cash cows might be milked for cash, which can then be used to develop other products. Or the business may decide to spend just enough on promotion and development to maintain sales and market share, known as holding.
- For question marks a business has choices. It can build the brand, hoping to turn it into a star, harvest the product by raising price and cutting promotion so that profits are increased, or divest itself of the product, withdrawing it or selling it because it is not making a profit.
- Dogs may be divested if they are not making a profit or in some cases harvested.



▲ Figure 6 CheezyBix product portfolio

1. Explain how you would categorise the position of Crackles in the Boston matrix using Figure 6.
2. Explain one way in which CheezyBix might use the information in Figure 6.

THE CONCEPT OF 'MARKETING MIX'

In order to market its products effectively a business must consider its **marketing mix**. The marketing mix refers to those elements of a firm's marketing strategy that are designed to meet the needs of its customers. The marketing mix emphasises four particular elements often referred to as the 4 Ps – product, price, promotion and place. To meet customer needs and to create an effective marketing mix, businesses must produce the right product, at the right price, make it available in the right place and ensure that customers are aware of its existence through effective promotion.

Product: It is important that products meet customer needs. This means that businesses must address a number of features relating to the product.

- **How consumers use the product.** A ladies shoe manufacturer, for example, will understand that customers will need different footwear for going to work and for attending a dinner party.
- **The appearance of a product.** Businesses need to consider the different colours, sizes, shapes and styles when designing products. For example, many businesses try to differentiate their products by making them look more attractive than those of rivals. For some goods, such as cars, clothes and jewellery, this might be very important to consumers.
- **Financial factors.** Businesses need to develop products that customers can afford to buy. There is no point in developing an attractive and highly

ACTIVITY 2

SKILLS

ANALYSIS, INTERPRETATION

CASE STUDY: CHEEZYBIX

Helsinki-based CheezyBix manufactures a range of cheesy snacks in Finland. The business currently has four products in its portfolio. They are shown in Figure 6. CheezyBix, a product first launched in 1987, brings in about 65 per cent of the company's revenue. It has a high market share and it is still growing.

comfortable armchair if it costs US\$20,000. Customers want value for money and they may also take into account the quality of after-sales service before they make a purchase.

- **The product's life cycle.** Earlier in this chapter it was shown that sales for a product rise at first and then eventually fall. A business must decide whether to allow a product to decline or try to refresh it in some way. In 'Getting started', Karrandore decided not to withdraw Patagonia Cruises. Instead, the company invested in an upgraded service to improve the declining product.
- **A product's unique selling point (USP).** This is the aspect or feature of the product which distinguishes it from that of a rival. If a business can develop a USP it may gain a competitive edge in the market.

Price: The pricing policy of a business is often a reflection of the market at which it is aiming. Prices will not always be set at the level which will maximise sales or short-term profits. For example, a business may charge a high price because it is aiming to sell to consumers who regard the product as exclusive rather than because production costs are high. However, for most products, costs are a very important influence on price. Pricing is discussed in Chapter 12.

Promotion: Customers must be given information about products and encouraged to buy them. Businesses can choose from a wide range of different promotional methods. They can advertise on television, online or in newspapers and magazines, for example. Alternatively, they may decide to use sponsorship, coupons, free gifts, competitions or some other method that suits their product and customer target group. Promotion is discussed in Chapter 11.

Place: Products must be made available at convenient locations at times when customers want to buy them. This means that a business has to make decisions about the way in which products will be physically distributed, i.e. by rail, road, sea or air. It also means taking into account how the product is sold. Increasingly businesses are selling their products online rather than from physical outlets such as shops.

MARKETING STRATEGIES

A **marketing strategy** is a set of plans that aim to achieve a specific marketing objective. For example, a local company that rents cars might aim to become the market leader in the region. Its strategy to achieve this objective might be to:

- improve the quality of customer service by delivering cars to people's homes
- contact all previous customers offering them a half-price deal

- offer a 3-day weekend rental for the price of 2 days
- invest £500 in a local newspaper advert
- donate a vehicle to a local community group to get some PR
- set up a website to promote the business and take online bookings.

This strategy involves all aspects of the marketing mix and a number of different promotional methods.

Strategies for mass markets: Some businesses sell products into mass markets. Such markets are huge, often global, and can have millions of potential customers. Procter & Gamble, Kraft Heinz, Kellogg's, Coca-Cola and General Motors are examples of businesses that sell into mass markets. Mass markets are usually very competitive because the rewards for success can be significant. A wide range of different marketing strategies can be used in a mass market, but some general similarities are as follows.

- **Product.** In a mass market there will be many products competing for customer attention. Most of these products will be very close substitutes for each other. The most successful businesses are likely to be those that can differentiate their product in some way. Developing a USP will help a business's product 'stand out from the pack'. If a business is unable to differentiate its product it will have to rely on other elements in the marketing mix to compensate.
- **Price.** The prices charged by businesses in a mass market are likely to be very similar. All businesses in the market are likely to fear a price war because they usually reduce revenue for every competitor. This helps to explain why businesses are happy to charge the 'going rate' in the market. Price leadership is common in mass markets where the dominant business, perhaps the one with the lowest unit costs, sets the price and everyone else follows.
- **Promotion.** In the absence of price competition, firms look to non-price competition to help gain an edge. This means they are prepared to invest heavily in advertising and promotion because it is such an important part of the marketing mix in mass markets. An overwhelming majority of television adverts are placed by businesses selling into mass markets. Perhaps less than 5 per cent of those that see the adverts will buy the product. However, 5 per cent of several million is a significant number.
- **Place.** Businesses serving mass markets will often use multiple channels to distribute their goods. Businesses selling fast-moving consumer goods will target supermarkets, wholesalers, independents and any other outlet that is suited to their particular product. Some manufacturers pay supermarkets

to display their goods in prominent places – at eye level or at the end of aisles, for example. The Internet is used increasingly by businesses to sell goods and services in mass markets. All banks, for instance, offer online bank accounts and an increasing number of supermarkets offer online shopping and delivery or ‘click & collect’ services. The Internet has allowed small businesses and other independents to have access to mass markets. For example, a small glove manufacturer based in, say, Gothenburg in Sweden could distribute its products to individual customers anywhere in the world.

Strategies for niche markets: Customers in niche markets have very particular needs, which are sometimes neglected by larger firms. Consequently, there is a gap in the market for a business that is prepared to produce goods or services for this small customer group. Businesses selling to niche markets will use different marketing strategies from those selling into mass markets.

- **Product.** In a niche market the product is likely to have quite significant differences from its rivals. For example, in the eating-out market there are around 420,000 restaurants in the UK. However, only four of these have been awarded three Michelin stars (the highest award possible for food quality and service). These four restaurants serve stunning food of the highest possible quality – very different from that served in the overwhelming majority of other restaurants. They cater for a particular niche – people who want to experience the very best food, perhaps just as a one-off, and are prepared to pay for it. In niche markets products will be designed carefully in order to meet the very specific needs of the customer group. Product will be a key element in the marketing mix.
- **Price.** Businesses selling in niche markets have more flexibility in their pricing. There is less competition in niche markets so higher prices can be charged without losing significant market share to rivals. Also, customers may be prepared to pay higher prices if their specific needs are being met effectively. For example, the prices charged by restaurants with three Michelin stars can be over £100 per person.
- **Promotion.** In niche markets promotion and advertising will tend to be more targeted. Since niche markets are smaller there is less need to use national media when advertising. Businesses need to identify their customer profile very accurately to ensure that advertising and promotion expenditure is not wasted. Adverts are likely to be placed in specialised publications. For example, yachts and chandlery (boat equipment

and accessories) are likely to be advertised in magazines such as *Yachting Monthly* and *Boating World*. Some manufacturers of golf clubs and golf accessories advertise on television, but only use specialised channels, such as the golf channel on Sky Sports.

- **Place.** Businesses selling into niche markets are often more selective when choosing distribution channels. They are more likely to use exclusive distributors or to handle distribution privately. They will also use the Internet if it is practical. One example is Blue Mountain coffee. This is a high-quality coffee grown exclusively in Jamaica, which can only be purchased from selected stores and online. It is marketed at around £24 per 227 g compared to around £3.50 or less for rival beans, which might be sold in supermarkets, for example.

STRATEGIES FOR BUSINESS-TO-BUSINESS (B2B) AND BUSINESS-TO-CONSUMER (B2C) MARKETS

Many businesses supply goods and services to other businesses. For example, JCB produces a wide range of machinery for use in the construction industry. It sells most of its products to construction companies and plant hire companies all over the world. The marketing strategies used by companies that sell to other businesses (B2B) are likely to be different from those discussed above, that sell to consumers (B2C). In B2B marketing, one approach is to distinguish between outbound and inbound marketing strategies.

Outbound marketing strategies: This involves directing marketing material at potential customers whether they are expecting it or not. This could include sending direct mail, email, marketing by telephone, sponsorship, targeted adverts in specialist publications or trade shows. However, there are some drawbacks using this approach. People are increasingly ignoring adverts. How many do people remember? Also, many people are annoyed by being contacted by phone and other similar marketing methods. Frequent or repeated use of these approaches could damage a brand's reputation. Many of the potential customers obtained using these methods are poor quality and waste resources when they do not lead to sales. It has also been reported that potential customers found through outbound marketing cost significantly more to acquire than leads found through inbound marketing.

Inbound marketing strategies: This involves attracting potential customers to websites when they are looking for suppliers or solutions to problems. Some of the common inbound marketing techniques are summarised in Table 1.

Method	Description
Blogging	Provide content on company blogs to help draw in potential customers
Social media marketing	Develop a following on social media, such as Twitter, LinkedIn and Facebook
Search engine optimisation	Increase website traffic by getting a high-ranking placement in searches
Free e-books	Offer useful, in-depth information for website visitors to download
Video marketing	Produce short and informative video clips for website visitors
Targeted email marketing	Send personalised emails targeted to people – for example, those who have downloaded a free e-book

▲ Table 1 Common inbound marketing techniques

The use of inbound methods also has challenges. For example, it requires effort and resources to build up enough useful content on websites to convert visitors into leads. Recruitment of experienced inbound marketers can be difficult, and it can be tricky to keep the strategy up to date with rapidly emerging trends.

Hybrid strategies: This involves a combination of both outbound and inbound methods. It is reckoned that inbound strategies take at least 6 months to generate results, so some outbound methods can be employed in the short term. Once inbound methods start to generate meaningful leads some of the less effective outbound methods can be dropped. This will help to reduce costs and create sustainable growth in market share.

EXAM HINT

You need to understand that marketing strategies can vary hugely. They depend on a wide range of factors, such as the nature of the product, the resources available to a company, the aim of the strategy, the size and nature of the market, corporate strategy and the creativity of employees. You would expect very different products to be marketed differently; for instance, the way healthcare and toys are marketed is likely to be very different. However, businesses in the same industry can also have different marketing strategies. Small businesses will use different approaches to multinationals because they have fewer resources. Some businesses may have similarities in their marketing strategies, but they will rarely be identical.

HOW BUSINESSES DEVELOP CUSTOMER LOYALTY

A business is likely to be more successful if it can persuade customers to keep returning. How can businesses develop customer loyalty?

Communication: A business must keep customers informed. In a mass market this might involve using national advertising campaigns to tell customers about new products. Some businesses may use reassuring adverts. These help to convince customers that they have made the right purchase. Some firms send out regular newsletters, usually by email, to keep customers up to date with company events. Regular communication helps to build a relationship between a business and a customer. If a bond can be formed customers are more likely to return.

Customer service: Customers are more likely to return to a business if they receive high-quality customer service. Employees who interact with customers must be professional, reliable and conduct themselves honestly and sincerely. Customer service can often be improved by dealing with matters more promptly, providing a more effective after-sales service or making the ‘purchasing experience’ a pleasant one. Some businesses provide customers with refreshments while they are conducting a transaction.

Customer incentives: Many businesses reward their customers if they keep returning. For example, cafe chains and supermarkets use loyalty or reward cards. These give customers discounts, cash vouchers or free goods as rewards for loyalty. The value of the rewards are usually linked directly to the amount spent by customers. In some countries these are in decline. However, a survey of 1,524 respondents in the top 10–15 per cent of earners split equally across China, Hong Kong and Singapore, found that 72 per cent of mainland Chinese consumers ‘regard themselves as engaged members of loyalty programmes’. The survey also found that 89 per cent of mainland Chinese respondents and 87 per cent from Hong Kong agreed that a loyalty programme makes them want to spend more.

Personalisation: Some businesses try to deal with customers on a personal level. They may address individual customers by their name – perhaps in person or in letters. Some firms send customers birthday cards to help build relationships. However, dealing with a customer at a personal level is a lot easier for a smaller business than, say, a multinational.

Preferential treatment: Many people like the idea of receiving preferential treatment from a business. For example, many airlines have VIP lounges at airports where first class, business class or other select passengers can relax away from the loud and busy environment of normal airport business. The lounges usually offer free refreshments, free access to Wi-Fi, satellite television, comfortable seats and showers. The principle behind all this is that if a business can provide customers with preferential treatment they may return for more.

ACTIVITY 3**SKILLS****PROBLEM SOLVING, ANALYSIS****CASE STUDY: CREDIT CARD CASHBACK DEALS**

A number of banks offer their customers 'cashback deals' when using credit cards. This means that a credit card user can receive an amount of cash depending on how much is spent on the card. For example, American Express offered customers 5 per cent cashback if they spent up to £2000 in the first 3 months of a platinum card membership. After the initial 3 months customers could earn up to 1.25 per cent cashback, depending on how much they spent each month. If customers spent:

- between £0 and £3500, they got 0.5 per cent cashback
- between £3500 and £7500, they got 1 per cent cashback
- over £7500, they got 1.25 per cent cashback.

Provided customers spent a minimum of £3000 in a year, almost every pound spent using the card qualified for cashback. There was no annual fee charged on this level of membership (the Platinum Cashback Everyday Credit Card).

1. Calculate the amount of cashback a customer would be entitled to if £5000 is spent on the card in the ninth month of ownership.
2. Explain one way in which cashback cards might help to develop customer loyalty.

CHECKPOINT

1. Describe the first stage in the product life cycle.
2. What pricing strategy might be used in the launch stage of the product life cycle?
3. What happens to sales in the maturity stage of the product life cycle?
4. Why might some products decline very quickly?
5. Give three examples of possible extension strategies.
6. What is the difference between a product portfolio and a product line?
7. What is a question mark product in the Boston matrix?
8. How might businesses distribute their products in a mass market?
9. Why are prices likely to be higher in niche markets?
10. What is the difference between outbound and inbound B2B marketing?
11. Give three examples of inbound B2B marketing.
12. State three ways in which a business might develop customer loyalty.

SUBJECT VOCABULARY

Boston matrix a 2x2 matrix model that analyses a product portfolio according to the growth rate of the market and the relative market share of products within the market.

extension strategies methods used to prolong the life of a product.

marketing mix the mix of marketing elements used by a company, which are usually known as the 4Ps: product, price, place, and promotion.

marketing objectives goals that a business attempts to achieve through its marketing activities.

marketing strategy a set of plans that aim to achieve a specific marketing objective.

product lines a group of products that are very similar.

product portfolio the collection of products a business is currently marketing.

unique selling point the aspect or feature of the product that differentiates it from those of rivals.

EXAM PRACTICE

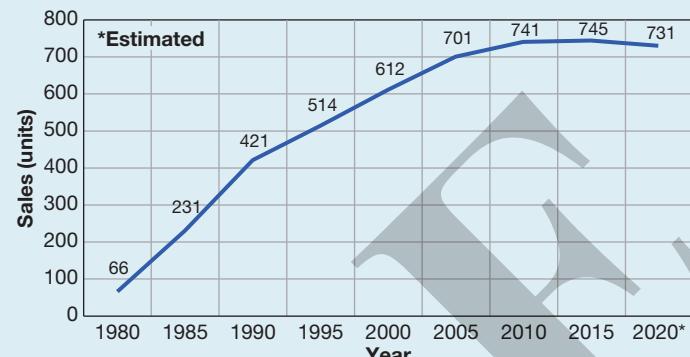
ENSCHDE GRASSMAAIERS

SKILLS ANALYSIS, INTERPRETATION,
CRITICAL THINKING, REASONING

In developed countries, most households with gardens have a lawnmower to cut their grass. Enschede Grassmaaiers, a Dutch company, manufacture ride-on mowers, which are purchased by the owners of properties with very large lawns, sports clubs and a few small farmers such as fruit growers. Enschede Grassmaaiers operate in a niche market. The company distributes its products through a small range of specialist dealers throughout most of the Netherlands. Established in 1980, sales grew steadily. However, in the last 10 years or so they have levelled out. Their main product, which accounts for 80 per cent of revenue, has reached the maturity stage in the product life cycle. Figure 7 shows sales levels of this product between 1980 and 2020.

The company directors believe that action is needed to extend the life of the product. There are fears that some of the very large manufacturers from overseas, such as Honda, might enter the market and drive them out of business. The company currently charges a premium price for its mowers. This is possible because an excellent after-sales service is available to all customers free of charge (excluding spare parts). The company has a breakdown support team which is on call 7 days a week. This means that customers can contact the company and organise a visit from the service team on the same day in the event of a breakdown. However, the lawnmowers are extremely well made. They are manufactured from high-quality materials and components and very rarely breakdown. The mowers often last for 20 years or more. The after-sales service facility helps to reassure customers when they first buy a ride-on lawnmower. They are happy to pay a premium price.

The directors of the company have organised a meeting to discuss the way forward and outline a clear marketing strategy for the main product. The company's goal is to extend the life of the product for another 20 years.



▲ Figure 7 Sales of Enschede Grassmaaiers' main product, 1980–2020



Q

- Explain what is meant by the marketing mix. (4 marks)
- Explain how a business like Enschede Grassmaaiers might benefit from having a specific marketing objective? (4 marks)
- Analyse **two** possible extension strategies that Enschede Grassmaaiers might consider. (6 marks)
- Assess how the marketing strategies of a business might differ for a business operating in a mass market. (10 marks)

10 PRODUCT/SERVICE DESIGN

LEARNING OBJECTIVES

By the end of this chapter you should be able to understand:

- the design mix: function, aesthetics and cost
- the changes in elements of the design mix to reflect social trends (concern over resource depletion, designing for waste minimisation, re-use and recycling, ethical sourcing).

GETTING STARTED



Look at the product in the image. Do you like the design? Explain your reasons. State three factors that might be important when designing a product like this. How might the design be affected by changes in social trends, such as health and safety issues, resource depletion and waste minimisation?

PRODUCT/SERVICE DESIGN

Many businesses are keen to bring new products and services to the market. New products and services help to generate more revenue and ensure that businesses remain competitive. The process of creating a new product or service is called **product design**. It involves the generation and development of ideas through a process that leads to new products/services.

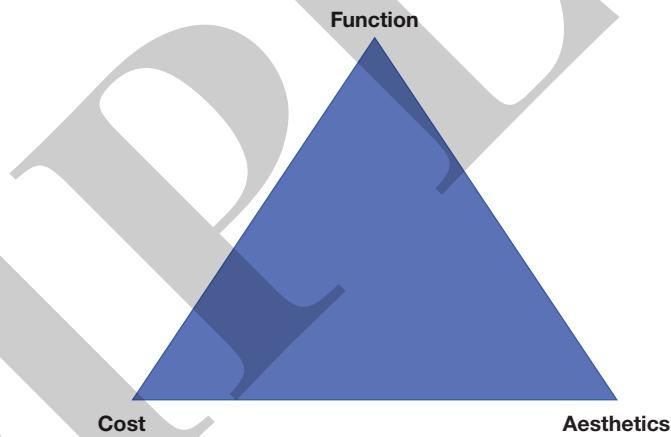
Once a business has identified a need for a product, a design brief can be written. This will contain features about a product that the designers can use. For example, a business aiming to produce a new travel iron may write a design brief such as 'a new travel iron that is compact and possesses all the features of a full-sized model'. Designers can work from this design brief. When designing the new travel iron they may take into account:

- the shape and appearance of the iron
- whether it fits the intended need

- how easily and cost effectively it can be produced from the design
- the dimensions and preferred materials to be used
- the image it gives when displayed
- whether the design should create a 'corporate identity', saying something about the image of the company.

DESIGN MIX

When designing any product or service a number of key features have to be considered. These features may be referred to as the **design mix** and are summarised in Figure 1.



▲ Figure 1 The design mix

Function: A product must be fit for purpose, which means that it must be capable of doing the job that it is sold to do. For example, a waterproof jacket must not let in rain. It must also be reliable and work every time the customer uses it. Product design is also important for services as well as goods. For example, an Internet service provider must provide a reliable and safe connection. The manufacturers of many **consumer durables** offer long warranties to show that they have confidence in the reliability and durability of their products. Products that are not fit for purpose are also likely to be returned, which will add to business costs.

Products and services should also be convenient and easy for the customer to use. People will get frustrated if they cannot download an app quickly or understand how to construct flat-pack furniture from a set of instructions. Technical products and machinery often need maintenance, so these products should be designed so that maintenance can be carried out easily. However, if there is adequate competition in the market this might not be an issue. Consumers can find

another supplier if they are unhappy with the level of convenience offered by a particular business.

Some products are designed with **ergonomics** in mind. This means that they are designed so that people can interact with them safely and without using unnecessary effort. Figure 2 shows how a workstation might be ergonomically designed to ensure that a person at work is entirely comfortable.

If a business can design a product or service with superior functionality, it may be used as a unique selling point, or USP. Most people recognise that Volvo emphasise the safety of their cars. This is their USP.

Designers must also ensure that new products or services are safe. Safety is particularly important if children, the elderly or pregnant women use the products. Safety issues could include ensuring that products do not contain poisons or dangerous materials, such as toxic paint. If potentially dangerous features are necessary, such as a sharp edge on a power tool, then it is important to design the product to provide adequate protection.

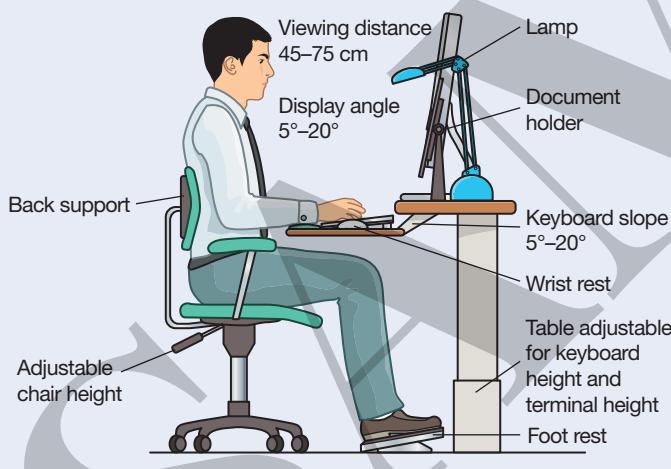
ACTIVITY 1

SKILLS

ANALYSIS, PERSONAL AND SOCIAL RESPONSIBILITY

CASE STUDY: ERGONOMIC WORKSTATIONS

An office supplies company has produced a new ergonomically designed computer workstation. Figure 2 shows how it has taken into account the needs of users.



▲ Figure 2 An ergonomically designed computer workstation

1. Explain what is meant by an ergonomically designed product.
2. Explain the possible benefits to a business of using ergonomically designed workstations.

Aesthetics: Products and services should stimulate people's senses in addition to performing a function. This is the product or service's aesthetic appeal. Designers must consider elements of a product, such as its size,

appearance, shape, smell or taste, or the presentation of a service, because it has an impact on the choices that consumers make. For example, some companies choose designs that use more expensive materials to add to the aesthetic appeal of a product, because a product that appeals to the senses may sell better. Someone may buy a luxury car because they like the smell of leather seats or the appearance of wooden components, and the atmosphere that these features create, rather than because of its fuel economy or speed.

As the cost of resources and manufacturing comes down over time, aesthetics is likely to become more important in the design mix. Product and service design has changed dramatically in recent years, as computers, vehicles, mobile phones and music players have become more compact and more powerful. Many consumers prefer smaller and more portable products that are more user-friendly.

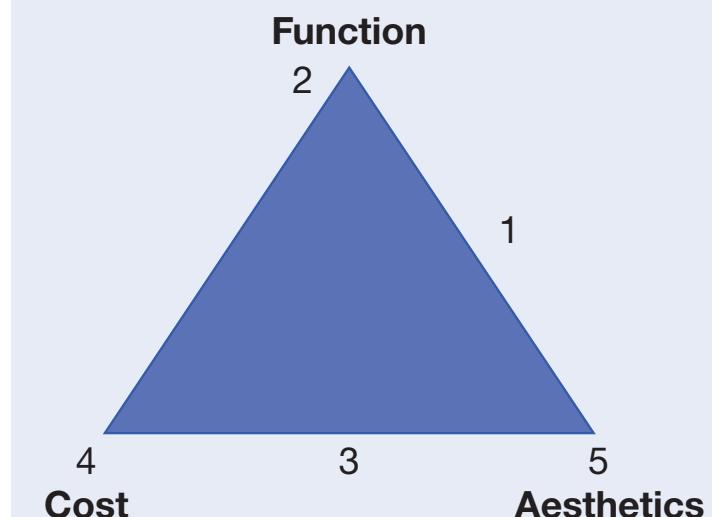
Cost/economic manufacture: A well-designed product or service is more likely to be economically viable. This means that a business should be able to produce and sell the product or service at a profit. Therefore, designers will need to select materials and processes that minimise costs. For example, it was reported that Apple wanted to use curved glass for early iPhone models. However, the prototypes were too expensive to manufacture, so they were abandoned. In the airline industry, new routes must be cost effective if they are to be introduced. Businesses often have to reach a compromise between design and cost. If costs are high, products or services may be dropped altogether.

ACTIVITY 2

SKILLS

INTERPRETATION, REASONING

CASE STUDY: THE DESIGN MIX



▲ Figure 3 The design mix – positions 1 to 5 represent different products

1. Match the following products with the positions (1 to 5) shown on the triangle which best represent the design mix in Figure 3. Each of the positions suggests which aspect of the mix may be relatively more important for particular products. (a) designer shoes, (b) a sports car, (c) a life assurance policy, (d) a dining room table, (e) a smartphone.
2. Explain how cost might affect the design of a package holiday.

EXAM HINT

The design of individual products may require emphasis on a particular element in the design mix. When answering questions, it will be helpful to give examples of products where a particular element is important. Functionality is important for products like hiking boots, tools, central heating systems and exercise bikes. Aesthetic appeal is important for products like fashion accessories, sunglasses, carpets and luxury goods. Cost is important for consumer durables, public transport and financial services, such as house and car insurance. This may help you to demonstrate that you understand the nature of the design mix and can apply your knowledge.

THE DESIGN MIX AND SOCIAL TRENDS

Product designers need to be aware of changes in social trends. For example, people have become increasingly aware about the effects their lifestyles have on the environment. Worries about global warming, **resource depletion** and pollution have encouraged many to adopt more environmentally friendly lifestyles. Businesses have also responded to pressure from the government, media and consumer groups by taking into account environmental issues in the design of their products. For example, their designs may now attempt to reduce waste and facilitate the re-use and **recycling** of products and packaging.

Design for waste minimisation: Firms are under increasing pressure to design products that minimise waste. **Waste minimisation** can take place in a number of ways.

- Products that use a lot of energy and other resources in manufacturing should be designed to be more durable by designing products that might last a lifetime. This could be achieved by including components in a design that can be replaced, or better still, repaired. For example, the Apple iPhone 6 included new design features that enabled the product to be opened and repaired more easily than earlier models.

- Products could be designed to be smaller and lighter. This will help to save the amount of material used in production. Resources used in handling, packaging and transport will also be reduced. Examples of this include laptops, tablet computers, smartphones, digital cameras, music systems and flat-screen televisions.
- Designers could be discouraged from designing single-use, disposable products. Products such as disposable razors, plastic spoons, cardboard plates and paper cups can be replaced with durable equivalents. There is probably a lot more scope here for businesses to make improvements. At the moment, the amount of packaging used by businesses and thrown away by customers is considerable.
- In the restaurant industry, dishes and menus could be designed to reduce food waste, such as meat offcuts.

Although there are clear benefits of designing products that reduce waste, many businesses have not embraced the idea. For example, many products are discarded because they are considered 'out of date'. In the fashion industry, for example, clothes and accessories are often worn for a limited period of time only. They are discarded even though they are still functional. This is because fashions change and businesses can make money by selling consumers 'new season' collections. At the moment this is unlikely to change. There would need to be a radical change in social trends for people to change their behaviour.

Design for re-use: Resources can be saved if products are designed so that they can be re-used. For example, mobile phones are designed to last for years but are thought to have an average first use of around 18 months, so it is important that their component parts can be re-used to prevent waste.

- Businesses could be encouraged to design packaging which can be re-used. In the past, fizzy drinks were sold in returnable bottles. Customers would return their empty bottles and get a refund. The empty bottles would then be returned to the supplier, washed and re-used. Many countries around the world, such as Holland and Germany, still give customers money for returning their empty bottles.
- Another approach is to design products so that components can be easily re-used. For example, Philips designed a new light bulb that was easier to take to pieces than previous light bulbs, so that the component parts could be re-used.

Design for recycling: Businesses are making increasing use of recycled materials in their designs.

- Some businesses are adapting their production methods so that newly designed products can be produced using recycled materials. For example, carpet manufacturers are developing ways of using their old carpets in the production of new ones. Glass manufacturers have long used recycled glass in the production of new glass.
- Some businesses specialise in the sole use of recycled materials in their manufacture. For example, the Reefer Sail Company makes its products from recycled materials, including boat and windsurf sails and kites, as well as from sail makers' roll ends and offcuts. Its product range includes deck chairs, cushions, buckets, bags and children's toys.
- Some firms make use of waste discarded by other businesses in their designs. For example, Yübe is a storage system built with panels made from sugar cane waste. The Yübe frames, which can be arranged in multiple ways, are made of a combination of sugar cane fibre, recycled plastic and bamboo.
- In the media, it may be possible to recycle material to save time and effort. For example, the same news stories might be adapted and used in several different formats. They might appear in print, online, as television broadcasts, as radio broadcasts and as podcasts.

Ethical sourcing: In order to reflect social trends, some businesses use ethically sourced resources in their designs. **Ethical sourcing** means that businesses only use materials, components and services from suppliers that respect the environment, treat their workforce well by paying them a fair wage and providing a safe working environment, and generally trade with honesty. For example, a clothes designer might insist that their collections are not manufactured by overseas businesses that use child labour in their factories.

In 2016, a US retailer called BJ's Wholesale Club, joined a boycott on cotton from Uzbekistan. The company discovered that cotton production in Uzbek involved the use of forced labour. According to a press release, 'The Uzbek government forces over 1 million citizens to labour in the country's cotton fields each year. The government shuts down universities and public offices for months at a time, mobilises the country's students, teachers, and civil servants, and sends them to the cotton fields every autumn.'

ACTIVITY 3

SKILLS

ANALYSIS, INTERPRETATION,
PERSONAL AND SOCIAL RESPONSIBILITY

CASE STUDY: DELL™

Dell, the Texan computer company, has responded positively to social trends by designing products and production process that are sensitive to the needs of the environment. Dell claims that it considers the environment at every stage of the product life cycle.

- Dell believes that all materials are valuable and waste should be eliminated.
- The company uses environmentally friendly materials, such as recycled plastics, and exceeds legal requirements when selecting 'safe' materials for production.
- Between 2015 and 2016 Dell reduced the average energy used to build each item in its product portfolio by around 16 per cent. Since 2012 the reduction has been 42.8 per cent.
- The use of glues and adhesives, which are not easily recycled, have been replaced with new 'snap-fits' and other substitutes.
- Dell uses a closed-loop plastics supply chain. This means that it repeatedly recycles and re-uses materials over and over again.
- Dell tries to use reputable third-party eco-labels such as ENERGY STAR, EPEAT and the 80 PLUS Program, when searching for technology to use in its organisation.

- Explain how Dell is reduces waste through its design process.
- Explain how Dell's approach reflects social trends.



▲ A plastic recycling plant

Although some businesses try to adopt an ethical approach to supplying products, it could be argued that the majority are still focused on lowering costs. For example, the cheap 'value brands' in supermarkets are still very popular. Perhaps this is because people are more concerned with getting products for the lowest possible price. They may have little regard for ethically sourced products.

BENEFITS OF ADAPTING PRODUCT DESIGNS TO CHANGES IN SOCIAL TRENDS

Although businesses may have to make an effort to reflect social trends in their designs, which could possibly increase costs, there are likely to be some lucrative benefits.

- If businesses can reduce waste they will use fewer resources. This will result in lower costs and higher profits.

CHECKPOINT

1. State two examples of products where aesthetics is particularly important in the design mix.
2. State two examples of products where functionality is of prime importance in the design mix.
3. Give one way in which the government might affect the design of products.
4. State three examples of products that are likely to be ergonomically designed.
5. State two benefits to consumers of designs that reflect changes in social trends.
6. State two benefits to businesses of designs that reflect changes in social trends.
7. How might ethical sourcing affect the design of clothing?

- If designs reflect social trends, products are likely to be more popular and sell in larger quantities. This will raise revenue and improve profits.
- Some businesses use their design features as a USP. This will help to market their products more effectively. For example, Ecover™ produces household cleaners made from plant and mineral materials. Avoiding the use of chemicals is environmentally friendly, and it is also their USP.
- Businesses that adopt some of the emerging design features relating to social trends are more likely to be viewed as good corporate citizens. Many businesses attempt to emphasise corporate social responsibility in their marketing strategy. By doing this they aim to raise sales revenue and profit. They may also avoid criticism for trading unethically.

SUBJECT VOCABULARY

consumer durables goods that can be used repeatedly over a period of time, such as cars and household appliances.

design mix the range of features that are important when designing a product.

ergonomics the study of how people interact with their environment and the equipment they use – often in the workplace.

ethical sourcing using materials, components and services from suppliers that respect the environment, treat their workforce well and generally trade with integrity.

product design the process of creating a new product or service.

recycling making use of materials that have been discarded as waste.

resource depletion the using up of natural resources.

waste minimisation reducing the quantity of resources that are discarded in the production process.

EXAM PRACTICE

STANLEY MODULAR

SKILLS ANALYSIS, INTERPRETATION, ADAPTABILITY

The construction sector generates millions of tonnes of waste every year in most countries. This includes building materials, such as nails, electrical wire, steel and waste from site preparation such as tree stumps and the remains of demolished structures. Some construction waste can be dangerous, as it can contain lead, asbestos or other dangerous substances, and this sort of waste needs to be disposed of carefully.

Construction companies have come under increasing pressure to reduce this waste. A construction firm in New Zealand, Stanley Modular, is committed to reducing waste and has come up with some effective designs. Stanley constructs schools and homes in New Zealand using a limited set of standard components. Wall, ceiling and floor panels are constructed in a factory and then transported to the building site. Almost all of the work is done in the factory, with just a small proportion done on site.



Constructing the panels in a factory cuts down the amount of waste on site, and the management of waste and materials becomes easier as they are all in one place, making it easier to collect and sort the waste.

Almost all the materials used by Stanley Modular end up in their completed buildings, because the parts of each building are created to fit the exact size of the finished structure. The small amount of excess is mostly recycled, with a tiny proportion discarded. Keeping the amount of waste to these levels requires more employees to actively work on waste management, as the factory environment has to be strictly controlled to ensure that waste is kept to a minimum.

Waste is minimised in a wide range of areas.

- **Transportation.** A Stanley Modular house can be transported to site on a single truck, with flat-

pack panels on the front, roofing on the back and a 4-metre trailer containing the bathroom components. More complex parts of the building process require more trips, but far fewer than would be required on a traditional building site.

- **Materials.** In a typical build, 1200 kg of wood is wasted – Stanley Modular only waste around 10 per cent of this. Reductions in waste have been found when all gun nails use standard nail strips, which prevents operators from mixing up nail types, resulting in rework. The use of computer numerical control (CNC) machinery maximises the usable material from pieces of wood and metal.
- **Time wastage.** Stanley Modular save a lot of time in their operations. They estimate that modular building is up to a third faster than traditional construction. The use of CNC machinery is also 50 per cent faster than machinery controlled by hand. Stanley Modular continually explore ways to decrease the impact of construction on the environment. Their projects show how a well-designed prefabricated building system can minimise waste, improve productivity and speed up construction projects.

Source: adapted from www.branz.co.nz/REBRI

Q

- Explain how designs that reduce waste benefit Stanley Modular. **(4 marks)**
- Explain the aspects of the traditional design mix that might be important to Stanley Modular. **(4 marks)**
- Assess the benefits to Stanley Modular of adapting its designs to reflect changes in social trends. **(10 marks)**



11 PROMOTION AND BRANDING

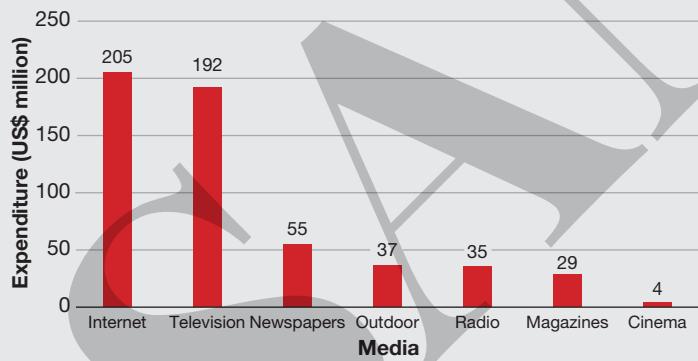
LEARNING OBJECTIVES

By the end of this chapter you should be able to understand:

- types of promotion
- types of branding
- the benefits of strong branding: added value, ability to charge premium prices and reduced price elasticity of demand
- ways to build a brand: unique selling points (USPs) / differentiation, advertising, sponsorship and the use of social media
- changes in branding and promotion to reflect social trends: viral marketing, social media and emotional branding.

GETTING STARTED

According to Zenith, the ROI Agency, in 2017 businesses will spend more on Internet advertising than on television advertising for the first time ever. In 2017, global spending on Internet advertising was US\$205,000 million. This compares with US\$192,000 million on television. Figure 1 shows how global advertising expenditure is allocated between different advertising media in 2017.



▲ Figure 1 Predicted global advertising expenditure by media, 2017

According to the predictions, how much in total will be spent on global advertising in 2017? Why do businesses spend so much on advertising? What might explain the changes in spending by businesses on newspaper and Internet advertising? What other methods might a business use to promote its products?

WHAT IS PROMOTION?

An important element in the marketing mix is **promotion**. This involves businesses drawing attention to their products, services or companies. Generally, businesses use promotion to obtain and keep customers. However, promotion is also likely to be used to achieve some specific aims.

- Tell consumers about a new product.
- Remind customers about an existing product.
- Reach a target audience that is spread over a wide area.
- Reassure customers about products.
- Show consumers that rival products are not as good.
- Improve or develop the image of the business.

ABOVE-THE-LINE PROMOTION

Above-the-line promotion involves **advertising** in the media. Businesses pay television companies or newspapers, for example, to have their adverts broadcast or printed. Advertising may be placed into different categories.

- **Informative advertising.** This means that the adverts are designed to increase consumer awareness of products. They may give clear information about the features of a product, for example. The classified advertisements in newspapers are examples of informative advertising.
- **Persuasive advertising.** Some advertising is designed to put pressure on consumers to buy a product. Persuasive advertisements often try to convince consumers to buy a particular brand rather than that of a competitor. They are often designed to appeal to people's emotions, such as fear and pity. Persuasive adverts may also appeal to people's respect for authority and fascination with celebrity. A lot of television and cinema adverts are persuasive.
- **Reassuring advertising.** This advertising is aimed at existing customers. It is designed to be comforting and suggest to consumers that they were 'right' to buy a particular product and that they should continue to do so. Businesses selling financial services may use this approach to reassure people that their money is 'safe'.

Table 1 shows the advantages and disadvantages of the main advertising media.

Media	Advantages	Disadvantages
Television	Huge audiences can be reached The use of products can be demonstrated Sound and movement can be used Scope for targeting groups with digital television	Very expensive Message may be short lived Some viewers avoid television ads Delay between seeing ads and shopping
Newspapers and magazines	National and local coverage Reader can look back Ads can be linked to articles and features Vouchers can be used Scope for targeting with specialist magazines Relatively cheap	No movement or sound Individual ads may be lost in a 'sea of ads'
Cinema	Big impact with a big screen Can be used for local and national advertising Specific age groups can be targeted Sound and movement can be used	Limited audience Message may only be seen once Message is short lived
Radio	Sound can be used Minority audiences allow targeting Cheap production Can target youngsters	Not visual May be ignored May lack impact Can be annoying or disrupting to listen to
Posters and billboards	Can produce national campaigns Seen repeatedly Good for short sharp messages Large posters can have big impact	Posters can be deliberately damaged by vandals Only limited information can be shown Difficult to evaluate effectiveness
Internet	Can be updated regularly Can be targeted Hits and response can be measured Can be sent to mobile devices For goods available online, there is no delay between seeing ads and shopping for the product online	Some ads such as pop-up ads are irritating Possible technical problems

▲ Table 1 The advantages and disadvantages of selected advertising media

ACTIVITY 1

SKILLS

ANALYSIS, CRITICAL THINKING, ETHICS, PERSONAL AND SOCIAL RESPONSIBILITY

CASE STUDY: WORLD WIDE FUND FOR NATURE

The World Wide Fund for Nature (WWF) is the largest independent conservation organisation in the world. Its mission is to create a world where people and wildlife can exist together. One of the ways in which the organisation tries to influence people's behaviour towards wildlife is to use poster campaigns. The poster shown was used by the WWF to raise awareness about global warming and the impact it might have on the planet.

- Define above-the-line promotion.
- Explain **one** advantage of using posters as an advertising media.
- Assess to what extent the advert in this poster is meant to be persuasive.



BELOW-THE-LINE PROMOTION

Below-the-line promotion refers to any form of promotion that does not involve advertising. It can take many forms.

Sales promotions: Incentives used to encourage people to buy products are called **sales promotions**. They are used to boost sales in the hope that if new customers are attracted they will continue to buy the product. They might be used to break into a new market. They may also be used to reward loyal customers and allow businesses to measure the impact of promotion, by counting the number of returned coupons, for example.

- **Free gifts.** Businesses might give free gifts to customers when they buy the product; for example, computer companies often give away free software.
- **Coupons.** Money-off vouchers can be used by businesses to attract customers. They may be attached to products, appear in newspaper adverts, or delivered to homes.
- **Loyalty cards.** Some businesses reward customers according to how much they spend. Points are collected and then exchanged for cash, vouchers or free goods. Loyalty cards are popular with supermarkets, credit card companies and stores.
- **Competitions.** People may be allowed free entry into a competition when they buy a particular product. An attractive prize is offered to the winners.
- **BOGOF offers.** BOGOF stands for 'buy one, get one free'. These offers are popular with many businesses, such as supermarkets, transport services and restaurants.
- **Money-off deals.** Businesses may offer customers discounts such as '30 per cent off' or 'an extra 20 per cent free'. These are similar to BOGOF deals and are used by a range of suppliers.

Public relations: Some businesses communicate with stakeholders using **public relations** (PR). The main purpose of PR is to increase sales by improving the image of the business. A number of approaches might be used by businesses to attract publicity.

- **Press releases.** Some information about the business may be presented to the media. This might be used to write an article or feature in a television programme. For example, a business might announce that it is to create 2000 new jobs. Such positive news would be of interest to the media and they might want full details.
- **Press conferences.** This is where representatives meet with the media and present information in person. This allows for questioning and other feedback. The press might be invited to a product launch, for example.
- **Sponsorship.** **Sponsorship** is when businesses attract publicity by linking their brands with events, particularly

ACTIVITY 2

SKILLS → ANALYSIS

CASE STUDY: SPORTS SPONSORSHIP

Sport has attracted funding from sponsors for many years. High-profile sporting events, such as the FIFA World Cup, the Wimbledon Tennis Championships, the Olympic Games, the Open Golf Championship and many others, raise considerable sums from a wide variety of different sponsors. In 2017, global sponsorship spending is expected to be US\$62,800 million. This is 4.5 per cent higher than in 2016 when it was US\$60,100 million. The majority of this was spent on sport.

Rolex, the luxury watchmaker, spends a lot of money on promoting its products. In 2014, it was reported to have spent US\$56.37 million on advertising. It is also reported to be the most active sports sponsor. Sponsors like Rolex benefit from having their name and logo 'splashed' everywhere at an event. For example, Rolex were one of the official partners of the US Open Golf Championship, which was broadcast around the world – this represents a massive potential audience.



1. Define sponsorship.
2. Explain the advantages of sponsorship to a company like Rolex.

sporting events, television programmes and films. For example, Amazon, Vodafone, Cheetah, Vivo and Yamaha® Motorcycles were some of the companies making financial contributions to the Indian Premier League in return for publicity at events in 2017. They were the sponsors. The sponsoring of television programmes is also popular. For example, in China, for several seasons Unilever has sponsored Televisa's localised version of the series *Ugly Betty*. The main advantage of sports

sponsorship is that brand names are shown globally on the television without having to pay the owners of television companies.

- **Donations.** Donations to charities and the local community might be used by businesses to improve their image. A large donation from a business is likely to be reported in the media, which is good publicity. The main advantage of PR to businesses is that it is often a cheap method of promotion. Some businesses have been known to deliberately seek bad publicity by being controversial. This can raise the profile of a business very quickly, sometimes at no cost.

Merchandising and packaging: Some businesses may arrange the **point of sale** so that it is interesting and eye-catching, and likely to encourage sales. This is called **merchandising**. Some examples are outlined below.

- **Product layout.** The layout of products in a store is often planned very carefully to encourage shoppers to follow particular routes and look at certain products. Products that stores want you to buy are placed at prominent locations, such as at the end of shelves and at eye level.
- **Display material.** Posters, leaflets and other materials may be used to display certain products with the aim of persuading customers to buy. Lighting and other special effects can improve the shopping environment. Window displays are considered important by retailers as they can draw in customers.
- **Stock.** Businesses must keep shelves well stocked because empty shelves create a bad impression. Also, if items are out of stock customers may shop elsewhere.

Direct mailing: This is where businesses mail out leaflets or letters to households. Sometimes personal letters are used. They may contain information about new products or details of price changes, for example. Increasingly, email and text messages (often called spam) are being used to contact consumers rather than the postal system. The development of sophisticated computer systems and use of customer databases has resulted in more personalised marketing.

Direct selling or personal selling: This might involve a 'sales rep' calling at households or businesses hoping to sell products. It could also be a telephone call from a call centre where sales staff are employed to sell over the telephone. One advantage of this approach is that the features of the product can be discussed. However, people are often irritated by this approach because the callers have not been invited.

Exhibitions and trade fairs: Some businesses attend trade fairs or exhibitions to promote their products. Businesses set up a stand and promote their products face to face. Trade fairs can be attended by commercial buyers or consumers, or both. The China Sports Show, the largest

and most influential sporting goods exhibition in the Asia-Pacific region, is held every year in Shanghai. In Dubai, the World Travel Catering & Onboard Services Expo is a trade fair for services for airports and the airline catering industry. It is aimed at manufacturers from home and abroad. There are certain advantages of this method of promotion.

- Products can be tested out on consumers before a full launch.
- Some exhibitions are overseas and can be used to break into foreign markets.
- Products can be physically demonstrated and questions answered.
- Exhibitions often attract the media.
- Customers can speak to business owners or senior personnel face to face.

CHOOSING METHODS OF PROMOTION

Many businesses use a range of different promotional methods. However, these must be co-ordinated so that they support each other. Small businesses often have limited budgets so careful consideration is needed when choosing a method of promotion.

What affects the choice of promotion?

- **Cost.** Not all businesses can afford to advertise on television and in national newspapers so they have to find other more cost effective, and often more appropriate, means.
- **Market type.** Local businesses often rely on adverts in local newspapers and listings in business phone directories. In contrast, businesses aiming their products at mass markets are more likely to use television and national newspapers, or specialist magazines.
- **Product type.** Certain products are better suited to certain methods of promotion. For example, a car manufacturer is not likely to use sales promotions such as coupons, BOGOF deals or loyalty cards, preferring television and cinema advertising, and billboards. Similarly, supermarkets are unlikely to use personal selling.
- **Stage in the product life cycle.** It is common for promotional methods to change as a product gets older. For example, PR is often used at the launch of a product, but when the product matures other methods will be used.
- **Competitors' promotions.** It is common for businesses to copy successful methods of promotion used by rivals. Once one business comes up with a successful promotion, others soon bring out their own versions.
- **Legal factors.** In many countries laws designed to protect consumers can affect the method and style of promotion. For example, in the EU tobacco products cannot be advertised on television.

TYPES OF BRANDING

The aim of many businesses is to build a powerful brand. Branding involves giving a product a name, sign, symbol or logo, design or any feature that allows consumers to instantly recognise the product and differentiate it from those of competitors.

Brands can come in a number of forms.

- **Manufacturer brands.** **Manufacturer brands** are brands created by the producers of goods and services. The goods or services bear the producer's name. Examples might be Kellogg's Corn Flakes, Gillette® razors or Dell™ computers. The manufacturers are involved in the production, distribution, promotion and pricing decisions of these products.
- **Own-label brands.** **Own-label brands** (also known as **distributor** or **private brands**) are products which are manufactured for wholesalers or retailers by other businesses. But the wholesalers and retailers sell the products under their own name. One example of a product containing the retailer's name is French supermarket chain, Carrefour's Cola Classic or Nilgiris private label pasta (an Indian supermarket brand). Sometimes the retailer will create its own brand name, for example F&F clothes sold at Tesco. These products allow a retailer to buy from the cheapest manufacturer, reducing its cost. It will hope to promote its own products effectively to shoppers in its outlets.
- **Generic brands.** Some **generic brands** are products that only contain the name of the actual product category rather than the company or product name. Examples are aluminium foil, carrots or aspirin. These products are usually sold at lower prices than branded products. They tend to account for a small percentage of all sales.

THE BENEFITS OF STRONG BRANDING

If a business can establish a strong brand it will enjoy a number of benefits.

Added value: A strong brand may add value to a product in the eyes of customers. For example, if a business can capture a desirable image that is reflected in the brand, it is likely to have a competitive edge. It could be argued that perfume manufacturers are able to do this. They may use powerful television adverts that feature celebrities using the product. Some adverts suggest that if you buy a particular brand you will belong to a group of elegant and sophisticated consumers, similar to those featured in adverts. Such adverts may offer consumers glamour, confidence and style. This approach can add value for some consumers.

Ability to charge premium prices: Products with strong brands can be priced higher than those of competitors. This is because of the customer loyalty that has been built up over a period of time. People are less likely to switch to cheaper brands if they have developed the habit of buying a 'favourite' brand. Kraft Heinz, the food processing company, generally charges higher prices for its canned and bottled products because they are perceived to be 'superior' to those of rival brands.

Reduced price elasticity of demand: The strength of a brand may be reflected in the price elasticity of demand for a product (price elasticity of demand is explained in Chapter 7).

Firms would prefer their brands to be inelastic in demand. This means that a price increase will have less impact on demand. For example, if a product has price elasticity of demand of -1.5, a 10 per cent increase in price will result in a 15 per cent fall in demand. However, if demand is inelastic at say, -0.9, a 10 per cent increase in price will reduce demand by just 9 per cent. Consequently, with a strong brand and a more inelastic demand curve, price increases are more viable.

WAYS TO BUILD A BRAND

Different companies may use different methods in an effort to build a brand.

Exploiting a unique selling point: One of the best ways to build a brand is to develop a unique selling point (USP) for a product. If a product has a USP it is much easier to differentiate the brand and make it 'stand out from the pack'. Some companies develop USPs by incorporating special features in their designs. Another approach is to make promises to customers. For example, some companies offer to give customers their money back if they are not satisfied. Producers of luxury goods, such as Prada or Gucci, use the fact that they are only affordable to a few, select customers as their USP.

Advertising: Advertising may be used in different ways. A business might use advertising to introduce a new brand. If the brand becomes popular and established, advertising is likely to continue in order to remind consumers that 'it is still out there'. Advertising spreads the word about a brand, and the more people who are familiar with the brand the greater the firm's market power. Advertising also reassures customers. An important element of advertising is pride. Advertising may be a source of pride for customers who have chosen the brand. The importance of advertising to help build brands is reflected in the amount of money spent by businesses on advertising. In 2013, over US\$500,000 million was spent worldwide. Table 2 shows the top ten global advertisers in 2016.

	Company	Ad spend (US\$ million)
1	Pampers® (ranked 50th most valuable brand)	8300
2	Gillette (28th)	8300
3	L'Oréal (34th)	8200
4	Chevrolet (59th)	5100
5	Louis Vuitton (19th)	4400
6	Ford (35th)	4300
7	Coca-Cola (4th)	4000
8	Amazon (12th)	3800
9	Sony (76th)	3700
10	AT&T (13th)	3600

▲ Table 2 Top ten global advertisers in 2016

Source: Global Advertising Market – Statistics & Facts. Statista Inc.

Sponsorship: Some companies favour the use of sponsorship to help build their brands. Many argue that sponsorship is a cheaper method of promotion than advertising – although many companies use both. The majority of sponsorship spending is in sport. Companies sponsor both national and international sporting events. For example, Banco Santander currently sponsors the Spanish La Liga. Sponsorship helps to:

- raise brand awareness, create preference and develop brand loyalty
- create positive PR and raise corporate awareness
- build brand positioning by linking the product to attractive images at events
- support other promotional campaigns
- create emotional commitment to the brand
- promote good relations with customers because sponsors often provide corporate hospitality at events.

Using social media: An increasing number of businesses are switching marketing resources into social media. Social media can be used in more than one way. For example, a business can place its adverts in strategic places on sites such as Facebook, Twitter, Instagram and Google+. The use of social media often allows businesses to focus more easily on particular customer groups. Social media also helps businesses to get to know their customers better and enables them to communicate with them more effectively. Social media may help to increase trust in a business or brand. Seeing that a particular business is active on social media helps customers to develop trust. A social media presence may suggest that a business cares about its customers. For example, if anything goes wrong customers will feel more secure if they know that it is easy for them to make contact and raise their issues.

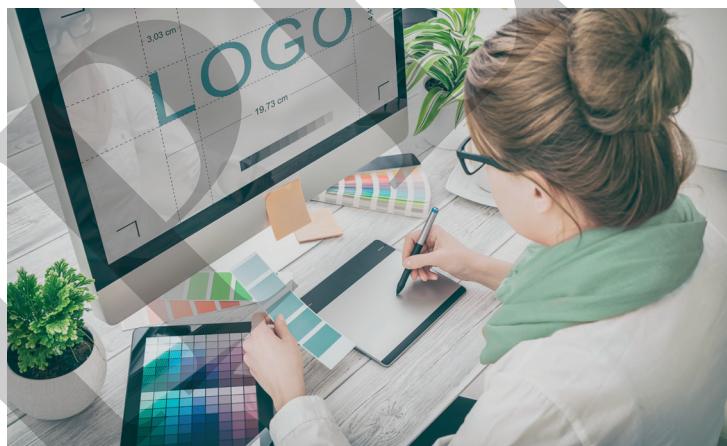
A large and increasing number of businesses use social media to help build their brands. For example, Kentucky Fried Chicken (KFC®) used a social media campaign to attract more young female customers.

It created a widely shared ad featuring the comedian Jenny Bede suggesting reasons for eating unhealthy food.

Building a brand is an ongoing process. Even companies with extremely strong brands, continually invest in advertising and promotional campaigns to support and reinforce their brands.

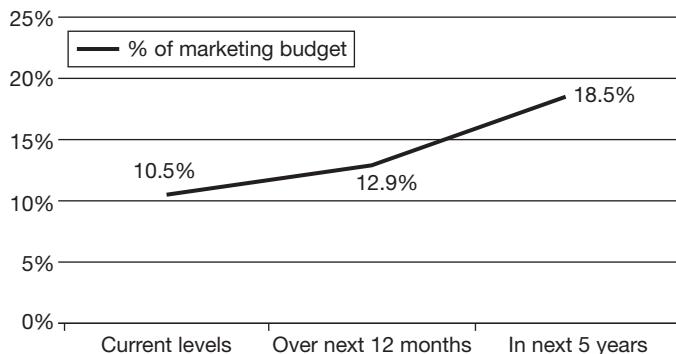
CHANGES IN BRANDING AND PROMOTION TO REFLECT SOCIAL TRENDS

Businesses are under constant pressure to keep up to date with trends, patterns, fashions and new technology. This pressure extends to the methods they use to promote and brand their products. For example, since the rise of the Internet, most firms have set up their own business websites. These are used to provide information, promote products and in some cases to sell goods directly to customers. Some other very recent developments are outlined below.



Viral marketing: Communication using the Internet has provided the opportunity for **viral marketing**. This involves any strategy that encourages people to pass on messages to others about a product or a business electronically. It creates the potential for rapid growth in the exposure of a message. Like a virus, these strategies exploit the process of rapid multiplication that results from people sending messages to family, friends and colleagues, who then send them on again. Not only can people send text relating to a marketing message, but they also can send images, such as photographs and video clips. One example of a successful viral marketing campaign was produced by Volvo. It featured a video clip of Jean-Claude Van Damme doing the splits between two Volvo trucks as they were being driven along a road. The clip was used to demonstrate the stability and precision of Volvo's steering system. The video had been seen over 76 million times at the time of writing.

Social media: A survey of marketing leaders in 2017 showed they devoted around 10.5 per cent of their marketing budgets to social media – a figure that continues to rise (see Figure 2). Using social media,



▲ Figure 2 Mean percentage of marketing budget spent on social media
Source: *The CMO Survey – Highlights and Insights Report*, Figure 5.1, February 2017

such as Facebook and Twitter, to help build a brand is important but many businesses go further. An increasing number are developing their own social networks, which are linked to the main platforms. Some analysts suggest that, while Facebook is a good platform to use to find customers and raise brand awareness, most people who 'like' a brand page on Facebook never visit it again. In comparison, some companies create their own social networks. Virgin Atlantic is one example of a business that has developed its own social platform.

ACTIVITY 3

SKILLS

ANALYSIS, CRITICAL THINKING,
CREATIVITY, INNOVATION

CASE STUDY: BLOGGING

One established social trend that has had an impact on marketing in business is blogging. Blogging involves sharing opinions, information, observations and other content online. Bloggers usually write regular articles, perhaps in a diary form, to express their views and provide updates on a very wide range of topics. One popular and large part of blogging is fashion blogging.

In China, fashion bloggers are having an increasing influence on the fashion industry. It is important for businesses in China to know about fashion bloggers because their views can influence what consumers buy. There are a number of high-profile fashion bloggers in the country including Fang Yimin, or 'Li Beika/Becky', as she is known to her fans. Consumers read her blogs for fashion and shopping tips and by mid-2016 she had over 700,000 followers. She writes about clothes and fashion accessories sold by well-known luxury brands and those available from little known high-quality independents. Li's background is in journalism – current affairs and politics. Although she has no real work experience or training in the fashion industry, she has developed the ability to identify trends in the industry, understand what readers like and dislike and what writing styles attract interest. The target audience of Li's WeChat blog is women of upper to middle-income class.

Every day Li advises readers where and how they should spend their money. Li has an excellent reputation

Emotional branding: Emotional branding refers to the practice of using the emotions of a consumer to build a brand. It is designed to appeal to a customer's emotion, human need, or a perceived ambition. The aim of emotional marketing is to develop a relationship between a consumer and a brand. Businesses try to develop in their customers the emotional attachment that football supporters have with their chosen clubs. The overwhelming majority of football supporters all over the world could not switch their support to another club even when theirs is performing badly – the bond is just too strong. Emotional branding is also based on the idea that people's actions are driven more by emotion than reason.

One example of a business that has used emotional branding effectively is Apple. Apple has found a way to connect with its customers and create with them a powerful bond. They achieved this by connecting with younger people in particular and creating a 'cool' product image. The Apple brand has associated itself with design innovation; the release of a new Apple product is an event and people will queue for hours. They have created an emotional attachment with their customers, one which is not defined by commerce.

for spotting fashion trends and knowing outlets from where products can be purchased. In one of her blogs, Li recommended an Italian handbag fashion brand. It was only known to few and only available in one store which was in south-west China. As a result of her blog, the brand saw very rapid sales growth. So far, Li has worked with brands like Gucci, Chanel, Jo Malone and many others.



1. Explain the potential role played by fashion bloggers in business.
2. Assess the benefits to businesses in the Chinese fashion industry of using social media in this way.

CHECKPOINT

1. State six examples of advertising media.
2. What is meant by below-the-line media?
3. What is direct mailing?
4. State four aims of promotion.
5. Identify four different methods of sales promotion.
6. State three different types of branding.
7. State two benefits of sponsorship.
8. Why can strong brands charge premium prices?
9. How might a business use social media as a promotional aid?
10. Why are businesses spending more money on social media to promote products?
11. What is emotional branding?
12. Why might viral marketing benefit a business?

SUBJECT VOCABULARY

above-the-line promotion placing adverts using the media.
advertising communication between a business and its customers where images are placed in the media to encourage the purchase of products.
below-the-line promotion any promotion that does not involve using the media.
emotional branding the practice of using the emotions of a consumer to build a brand.
generic brands products that only contain the name of the product category rather than the company or product name.
manufacturer brands brands created by the producers of goods or services.
merchandising a promotion specifically at the point of sale of a product.
own-label, distributor or private brands products that are manufactured for wholesalers or retailers by other businesses.
point of sale any point where a consumer buys a product.
promotion an attempt to obtain and retain customers by drawing their attention to a firm or its products.
public relations an organisation's attempt to communicate with interested parties.
sales promotions methods of promoting products in the short term to boost sales.
sponsorship making a financial contribution to an event in return for publicity.
viral marketing any strategy that encourages people to pass on messages to others about a product or a business electronically.

EXAM PRACTICE

PROCTER & GAMBLE (P&G)

SKILLS ANALYSIS, INTERPRETATION,
CRITICAL THINKING, ADAPTABILITY

Procter & Gamble (P&G) is a large US multinational. It manufactures and sells cleaning agents, personal care and hygiene products. The corporation has four key divisions:

- Global Beauty
- Global Baby, Feminine and Family Care
- Global Fabric and Home Care
- Global Health and Grooming.

Some of its globally recognised brands include Ambi Pur®, Ariel®, Bounty®, Charmin®, Crest®, Dawn®, Downy®, Fairy®, Febreze®, Gain®, Gillette, Head & Shoulders®, Lenor® and Olay®. These brands are powerful and valuable and their products are purchased by around 5000 million people worldwide. P&G has 23 multimillion-dollar brands worth between US\$1000 million to US\$10,000 million each. Many of P&G's brands are positioned at the 'top end' of the market. Much of the company's marketing is designed to show quality in the products which allows P&G to charge higher prices than many of its rivals. In 2015, P&G enjoyed sales revenue of US\$76,280 million and a profit for the year of over US\$7000 million.

P&G invests heavily in advertising. In 2013, P&G spent more on advertising than any other company in the world. In 2016, it also benefited from one of its adverts 'going viral'. At the beginning of the year P&G invested in a new television advert to promote Ariel, one of its cleaning products, in India. The 2-minute advert, referred to as 'sharetheload', features the challenges faced by a young Indian women attempting to balance the demands of raising a family with developing a career. The advert critically explores India's traditional male-dominated society. In the clip the visiting father is seen apologising to his adult daughter (by composing a letter in his head) for failing to help with the chores. The father

also apologises for her husband's seemingly naïve role reinforcing the idea that a woman's place is in the home – where her work is never done.

When the father returns home to his wife the film shows him emptying his suitcase, and much to his wife's shock, placing his dirty laundry into the washing machine. The advert ends with the lines: 'Why is laundry only a mother's job?' and 'Dads #ShareTheLoad'.

The 'sharetheload' advert went viral in India as soon as it was first broadcast. It was produced by BBDO Mumbai and won a Glass Lion, which is a special prize for adverts that address issues of gender inequality, at the Cannes Film Festival.



▲ Dads helping sharing the load

Q

- (a) Define viral marketing. (2 marks)
- (b) Explain **one** way in which P&G might have benefited from its Ariel advert that 'went viral'. (4 marks)
- (c) Explain how P&G differentiates many of its brands. (4 marks)
- (d) Assess the benefits to P&G of having very strong brands. (10 marks)

12 PRICING STRATEGIES

UNIT 1
1.3.3

LEARNING OBJECTIVES

By the end of this chapter you should be able to understand:

- types of pricing strategy: cost plus (mark-up on unit cost), price skimming, penetration, predatory, competitive and psychological
- factors that determine the most appropriate pricing strategy for a particular situation: number of USPs/ amount of differentiation, price elasticity of demand, level of competition in the business environment, strength of brand, stage in the product life cycle, costs and the need to make a profit
- changes in pricing to reflect social trends: online sales and price comparison sites.

GETTING STARTED

Lower Sackville Farm

Mark and Rosemary Valentine run Lower Sackville Farm in Nova Scotia, Canada. The dairy farm produces milk that is sold for CAD 10.58 per litre. Mark and Rosemary are 'price takers', which means they have no control over the price they get for their milk. In 2016, Lower Sackville Farm made a modest profit. Their total costs were CAD 1,220,000 and total revenue was CAD 1,251,500.

Zong (China Mobile Pakistan)

Chinese-owned Zong is a mobile telecommunications operator based in Islamabad, Pakistan. The company began trading in Pakistan in 2008 and is currently the second largest operator in the country. When it entered the market it offered many services at relatively low prices. However, at a later date prices were increased. For example, in 2017, the prices of some MBB packages were increased significantly. These are shown in the Table 1.

Package	Old price (PKR)	New price (PKR)
50 GB	2000	2500
10 GB	3800	4000
150 GB	5000	8000
200 GB	6000	10,000

▲ Table 1 MMB package prices, 2017

What would happen if Mark and Rosemary tried to increase the price of their milk to CAD 13.00 per litre? Calculate the percentage increase in the price of Zong's 150 GB package. Comment on the size of the increase. Why do you think Zong charged a low price originally? How might price elasticity of demand influence the price set by a business?

PRICING STRATEGIES

A strategy is a set of plans designed to meet objectives.

Pricing strategy is part of the marketing strategy of the business. Other strategies, such as product and distribution strategy, also make up a marketing strategy. Marketing strategy is then part of the corporate strategy of the business. Other strategies include production and financial strategy.

Pricing strategy is therefore a set of plans about pricing, which help a business to achieve its marketing and corporate objectives. For example, a corporate objective might be to double in size over the next 5 years. A marketing objective to achieve this might be to take the products of the business 'upmarket'. The pricing strategy developed from this could be to increase the average price of the products made by the business.

- Some pricing strategies can be used for new products, such as market skimming or penetration pricing (these strategies will be discussed on the next page).
- Some strategies may be more suitable for existing products.

COST PLUS PRICING

Businesses have to set prices that generate a profit. One method that ensures that all costs are covered is **cost plus pricing**. It involves adding a **mark-up to unit costs**. The mark-up is usually a percentage of the unit cost. This method is common with retailers. However, one of the drawbacks of this method is that it ignores market conditions. For example, the mark-up used by a business may be far too high in relation to the prices of rival products. This might result in low sales. Another problem is that it may be difficult to identify precisely all the costs associated with the production of a particular product – particularly for multi-product businesses.

WORKED EXAMPLE

The unit cost to a manufacturer of making a plastic rowing boat is £80. The manufacturer adds a mark-up of 25 per cent to get the price. Therefore the price of the boat is:

$$\text{Price} = \text{unit cost} + (\text{mark-up} \times \text{unit cost})$$

$$\text{£}80 + (25\% \times \text{£}80) = \text{£}80 + \text{£}20 = \text{£}100$$

ACTIVITY 1**SKILLS**ANALYSIS, PROBLEM SOLVING,
REASONING**CASE STUDY: BANGLADESHI STREET FOOD**

Raihan Mahmud sells street food from a stall that is located close to the busy railway station in Sylhet, Bangladesh. He offers customers a variety of snacks but his three best sellers are singara, fish somosa and poori bhaji. He buys most of his produce from a local supplier every day and the costs of his three best sellers are:

- singara – BDT 10
- fish samosa – BDT 12
- poori bhaji – BDT 8.

Raihan uses cost plus pricing to set the price of his snacks. He adds a 50 per cent mark-up. Raihan is happy with this profit margin and hopes one day to open a shop where he can make his own snacks to sell.



One busy day in May 2017, Raihan sold 80 singara, 100 fish somosa and 70 poori bhaji.

1. (a) Calculate the prices charged by Raihan for his three best sellers.
(b) Calculate the total profit (before overheads) made by Raihan from these sales.
2. Explain **one** possible disadvantage to businesses of using cost plus pricing.

MATHS TIP

It may be necessary to calculate the percentage mark-up. This is the difference between unit cost and price, expressed as a percentage of the unit cost. For example, if unit cost is £40 and price is £70, the percentage mark-up is 75 per cent ($\frac{70 - 40}{40} \times 100 = 75\%$).

PRICE SKIMMING

Some businesses may launch a product into a market charging a high price for a limited time period. This is called **skimming** or **creaming**. The aim of this strategy is to generate high levels of revenue with a new product before competitors arrive, and exploit the popularity of a new product while it is unique.

This method is common with technical products. For example, when laptop computers were first introduced they were over £1000. However, they can now be purchased for less than £200 in many countries. Pharmaceutical companies also use this method. They sell new drugs for high prices when they are first launched. However, when a patent (a licence that prevents competition for a number of years) runs out, competition emerges and prices fall. Charging a high price initially helps such companies recover high development costs.

An advantage of skimming is that high prices are charged in a market where there are people who are prepared to pay them. This helps to maximise revenue. As the price is lowered, other customer groups are drawn into the market. The higher, initial revenues help a business to recover the cost of research and development. The higher price also helps to make a product appear more prestigious. However, skimming can only be used if demand is price inelastic. Skimming might also attract competitors into the market.

PENETRATION PRICING

Sometimes a business will introduce a new product and charge a low price for a limited period. This is called **penetration pricing**. The aim of this strategy is to develop a secure initial position in the market from which further progress can be made. Businesses using this strategy hope that customers are attracted by the low price, and then carry on buying it when the price rises. One approach is to offer products at a very cheap rate for a trial period – sometimes as low as half price or even free. Another is to offer the first one or few items free, or at a low price, such as driving lessons. Such a strategy is sometimes called an introductory offer. Penetration pricing has a number of benefits.

- It is particularly beneficial when products are targeted at middle- or low-income consumer groups. This is because such groups are more likely to be responsive to low-price introductory offers.
- It can grow sales of new product lines very quickly. Usually, the lower the introductory offer the faster the growth in sales.
- Fast growth in sales may allow a business to lower production costs by exploiting economies of scale.
- This strategy can put pressure on rivals. They may have to lower their prices or make an effort to differentiate their products. Either way financial pressure is applied.

Businesses using this strategy are better placed if they have lower costs. They must also resist the temptation of extending such offers for too long. If consumers become accustomed to low prices they may be lost when the introductory offer expires as they are not prepared to pay the higher price.

Penetration pricing is used by a variety of industries. For example, sports clubs to attract members, and satellite broadcasters to attract subscribers and driving schools (businesses that teach people how to drive a motor car) to attract learners.

ACTIVITY 2

SKILLS

ANALYSIS, REASONING

CASE STUDY: PLAYSTATION 3

Sony launched PlayStation 3 at a price of US\$599 (60 GB Model) in 2006 but eventually dropped the price to US\$299 in 2009. This pricing strategy is common with technological goods, such as gaming machines. When Sony launched PlayStation 4 it was priced at US\$399 and near the end of the first year it had sold around 14 million units worldwide. Many gaming enthusiasts were waiting for the price to fall before buying their own. However, it was reported in November 2014 that a price cut was not planned for the short term.

1. Explain the pricing strategy used by Sony in this case.
2. Assess the advantages and disadvantages of the pricing strategy used by businesses like Sony.

PREDATORY PRICING

Predatory pricing or **destroyer pricing** aims to eliminate competitors from the market. It involves charging a very low price for a period of time until one or more rivals leave the market. In many countries some forms of predatory pricing are illegal. This is when a business is selling a product below the cost of production with the deliberate aim of forcing a competitor out of the market. This practice is illegal because in the long term it can lead to a lack of competition in a market. As a result, if all firms have left the market except for the predator, the price is likely to be raised beyond the initial level.

Such low-price strategies are allowed if low-cost businesses are prepared to endure low profit margins for extended periods of time. They can also be used to sell stocks that would otherwise remain unsold or as a means of breaking into a new market.

In 2016, Ola, India's largest ride-hailing app, accused Uber, a fierce competitor, of predatory pricing. The founder of Ola suggested that the Indian government could do the same as the Chinese government and impose regulations preventing such operators from setting prices below cost.

COMPETITIVE PRICING

Some businesses take a very close look at what their rivals are charging when setting their prices. This approach is called **competitive pricing** and is likely to be used by businesses operating in a fiercely competitive market. One approach is to charge the same price as competitors. The advantage of this strategy is that a price war is likely to be avoided. It is considered to be a safe pricing strategy. Another approach is for the market leader to set the price and all others follow. This is called price leadership. Price leaders are usually the dominant firms in the market. They may have developed their dominance through being a low-cost operator or perhaps by building a strong brand over a period of time.

PSYCHOLOGICAL PRICING

One common pricing strategy is to set the price slightly below a round figure – charging US\$99.99 instead of US\$100. This is called **psychological pricing**. Consumers are ‘tricked’ into thinking that US\$99.99 is significantly cheaper than US\$100. Of course it is not but this psychological effect often works for businesses. This approach targets consumers who are looking for bargains. It is not likely to be used by businesses selling ‘upmarket’ products.

ACTIVITY 3

SKILLS

INTERPRETATION, REASONING

CASE STUDY: PETROL PRICING



1. Explain the pricing strategy used by the petrol station in the image.
2. Explain one reason why such a pricing strategy might be so popular with businesses such as petrol stations.

EXAM HINT

You should avoid confusing penetration pricing with predatory pricing. Both of these pricing strategies involve charging a low price. However, penetration pricing involves charging a low price for a short time in order to break into a new market. Predatory pricing involves trying to eliminate rivals in the market. Penetration pricing is legal, but predatory pricing may be illegal. This is likely to be the case if a business is selling a product below cost price for a period of time with the deliberate aim of driving out a rival.

FACTORS THAT DETERMINE THE MOST APPROPRIATE PRICING STRATEGY FOR A PARTICULAR SITUATION

Setting the right price is an important marketing decision for businesses. A number of factors have to be taken into account before the price is set.

Differentiation and USP: A business can generally charge a higher price if its product has a USP or is sufficiently differentiated from those of its rivals. This is because many consumers are prepared to pay more for products with some individuality or additional features. For example, restaurants can differentiate their service if they offer innovative dishes, in a uniquely interesting and comfortable environment with warm and friendly customer service. As a result they may be able to charge higher prices.

Price elasticity of demand: If the demand for a firm's products is price inelastic, there will be scope for price increases. For example, if price elasticity was -0.8, a business could raise its price by 10 per cent and demand would only fall by 8 per cent. As a result, total revenue would rise. Some utility companies, such as those supplying gas, electricity and water, have been able to raise prices quite significantly in recent years without any serious negative impact on demand. This is because demand for these services is price inelastic. In contrast, if a firm's product is price elastic, it may benefit from price cuts. For example, if price elasticity was -2.7, a 10 per cent reduction in price would result in a 27 per cent increase in demand. This would increase total revenue. Many low-cost supermarkets around the world have benefited from this strategy. See Chapter 7 for detailed information about price elasticity of demand.

Amount of competition: The amount of competition in a market will have a big influence on pricing. If there is very little competition in the market, a business can charge much higher prices because consumers cannot switch to a rival. For example, a grocery shop in an isolated village in the Scottish Highlands, UK, may be able to charge much higher prices because there is no other

shop nearby. In contrast, in highly competitive markets, firms are not generally able to charge higher prices. In some cases, firms might be price takers. This means they have to charge the market price. This is often the case for farmers who sell their produce in national or international commodity markets.

In competitive markets, businesses are likely to use competition-based pricing strategies. Many will prefer to charge the 'going rate' price, i.e. the same or very similar price to those of competitors. This will help to avoid price wars. If a firm has some power in a competitive market it may become the price leader. In this situation all other firms are likely to be content just copying or following the leader.

Strength of the brand: A business with a strong brand can generally charge a higher price than those with weaker brands. One of the reasons why companies like Coca-Cola and Unilever spend so much money on supporting their brands, with advertising for example, is so they are able to charge higher prices. Companies with strong brands are in a better position to use price skimming when introducing new products. They might also consider predatory pricing to discourage other companies from entering into the market.

Stage in the product life cycle: Products pass through a number of stages over their lifetime. Life for a product begins with its development and, for many products, ends when they are withdrawn from the market. The level of sales that can be expected in each stage over this time period is called the product life cycle. This is discussed in detail in Chapter 9.

As a product passes through the different stages of this cycle, a business may adjust the price charged. For example, when a product is first launched a business might use penetration pricing to try and get established in the market. Later, when sales start to grow, the price can be increased. As the product matures, prices might be reduced a little in order to remain competitive. Alternatively, a business may use price skimming when the product is launched. This approach might be used if the product is new and has few, if any, rivals. Later, when rivals copy the product or bring out versions of their own, prices are likely to gradually decrease.

Costs and the need to make a profit: In the long term, price must cover all the costs of production and generate a profit. This might explain why many businesses use cost plus pricing. Once the unit cost of a product has been calculated, a business knows that if it adds mark-up a profit will be made. However, customers do not care about costs, they care about value for money. It is possible to under-price a product and not maximise potential revenue using this approach. Businesses need to consider the value of their products in addition to costs if they are to extract the most from consumers.

CHANGES IN PRICING TO REFLECT SOCIAL TRENDS

It is possible for social trends to have an impact on pricing strategies. For example, it could be argued that today's consumers are more aware and better informed than ever before. As a result they may challenge the prices charged by businesses. They may negotiate prices or spend more time searching for bargains. They may also be less tied to particular brands and consider instead the views and experiences of friends and colleagues posted on social media sites.

Online sales: Businesses are having to adapt to selling goods online. Many businesses use traditional pricing strategies, such as cost plus pricing. However, for others, selling goods online has provided opportunities for new pricing strategies.

Dynamic pricing: Often used in the travel industry. For example, in the airline industry prices are flexible and different passengers can pay different fares depending on the day of the week, time of day and number of days before the flight. For airlines, there are dynamic pricing factors in different components, such as how many seats a flight has, departure time and average cancellations on similar flights. Dynamic pricing is also used in the hotel industry, entertainment and retail. The aim of dynamic pricing is to maximise revenue and profits by filling capacity such as stadiums, flights or other products with limited sales quantities.

Auction sites: Avabid, eBay® and Serukuru, for instance, sell goods to the customer who offers the highest price. This allows sellers to get the best possible price for goods. However, the seller has to pay a fee for the use of the site. One other advantage of this method of pricing is that online auction platforms create a sense that it is important to act quickly. Consumers fear missing a bargain if they wait too long. This helps to encourage more sales.

Personalised pricing: Involves the use of data relating to a specific online shopper, such as purchase history, browsing history, demographic data, hardware and operating system used, to set a unique price for that shopper. This data could come from a retailer's own database, be enhanced by a third party or be offered up by the user's own computer, tablet or mobile phone. The advantage of this method to businesses is that they can charge higher prices to those customers who are prepared to pay more. It has been reported that Amazon has tried this method of pricing.

Subscription pricing: Usually involves charging customers a regular monthly fee for the use of a service

or access to a specific product range. This is not a new concept, but it lends itself well to online shopping. Online magazines and newspapers; software providers, such as Adobe® Systems; music streaming services such as Spotify®; gaming sites, such as PlayStation Plus; fashion retailers, such as ASOS Premier; and television and film providers, such as Netflix®, are examples of businesses that use subscription pricing. The main advantage is that customers are tied into long-term agreements with businesses. Although customers have the right to cancel subscriptions, many do not. This is an attractive proposition. It helps to improve cash flow and removes some of the uncertainty about future sales levels.

Price comparison sites: Many online shoppers make use of comparison websites. The sites simply compare the prices of goods and services from a range of suppliers. Some sites are general, but an increasing number are specialists. For example, trivago® provides a comparison of hotel prices, KAYAK the prices of flights, Carrentals the prices of car hire, uSwitch® energy prices and Mobile Checker for mobile phone prices. Comparison sites are useful for consumers because they may be able to identify the cheapest deals available. These sites might also be used by people who prefer not to shop online. They may check out prices online and then go to the store that is offering the best deal.

Consumers should understand that no two price-comparison websites are likely to give exactly the same results – even if you provide them with identical information. This is because they may provide prices from different providers, depending on which companies they have access to.

CHECKPOINT

1. In competitive markets some firms are price takers. What does this mean?
2. What is the main disadvantage of cost plus pricing?
3. If a product costs £500 and sells for £600, what is the percentage mark-up?
4. When is a business likely to use penetration pricing?
5. What is likely to happen to price as a product nears the end of its life in the product life cycle?
6. State two advantages of skimming.
7. How can firms avoid a price war in a highly competitive market?
8. What is the aim of predatory pricing?
9. How might price comparison sites benefit consumers?
10. What is meant by dynamic pricing?

SUBJECT VOCABULARY

competitive pricing pricing strategies based on the prices charged by rivals.

cost plus pricing adding a percentage (the mark-up) to the costs of producing a product to get the price.

mark-up the percentage added to unit cost that makes a profit for a business when setting the price.

penetration pricing setting a low price when launching a new product in order to get established in the market.

predatory or destroyer pricing setting a low price forcing rivals out of business.

pricing strategy the pricing policies or methods used by a business when deciding what to charge for its products.

psychological pricing setting the price slightly below a round figure.

skimming or creaming setting a high price initially and then lowering it later.

unit costs the same as average cost (total cost divided by output).

EXAM PRACTICE

ADOBE®

SKILLS ANALYSIS, INTERPRETATION,
CRITICAL THINKING, ADAPTABILITY

Adobe Systems is a multinational software provider based in California, USA, and is probably best known for creating Photoshop®, Acrobat®, InDesign® and Dreamweaver®. In 2013, Adobe announced that subscription pricing would be introduced. Before the new pricing system, customers paid a single fee for Adobe's Creative Suite® (many of its applications integrated to one product) and had permanent access. However, from June 2013, a monthly fee was required to continue to access programs individually or as a suite of programs through Adobe's Creative Cloud®. Although individual Creative Suite products were still available, there were no further upgrades outside Creative Cloud.

The announcements from Adobe stated that improvements to Creative Cloud from June 2013 would be released on a regular basis as features rolled out. The subscription system would no longer be limited by a traditional upgrade cycle that meant that customers waited for new features. Development of Creative Suite was frozen at version 6, with no improvements or new features, though bug fixes were available. Before June 2013, it cost over £1500 for the version of Creative Suite 6, with 16 programs such as Dreamweaver, Photoshop, Illustrator®, Adobe Premiere® and Adobe Audition®.

Customers were only able to access updates and changes to Creative Suite applications by subscription to

Adobe's Creative Cloud, a web-based system that gave access to all of Adobe's software. It also provided an online storage system and project management tools. The cost for UK customers to access all programs in the Creative Cloud was £47 a month, if they agreed this payment for at least a year.

Some Adobe customers preferred the company's traditional sales approach. However, it was widely reported that by the end of 2014 there were over 3 million subscribers to Creative Cloud, and feedback that the satisfaction level was high.

In 2011, Microsoft introduced Office 365, a subscription version of Office applications plus other productivity programs. Adobe's introduction of a subscription pricing strategy in 2013 reflected a growing trend for large software firms to adopt a subscription pricing strategy. Feedback on customer satisfaction indicated that more customers were comfortable, as part of this trend, in paying for an online service.



- Define subscription pricing. (2 marks)
- Explain one reason why Adobe switched to subscription pricing. (4 marks)
- Discuss the success of Adobe's subscription pricing strategy. (8 marks)
- Evaluate whether subscription pricing or cost plus pricing would be the most suitable pricing strategy for Adobe. (20 marks)

13 DISTRIBUTION

UNIT 1
1.3.3

LEARNING OBJECTIVES

By the end of this chapter you should be able to understand:

- distribution channels: four stage, three stage and two stage
- changes in distribution methods.

GETTING STARTED

Cadbury

Cadbury is a well-known confectionery (sweets and chocolates) manufacturer. It is owned by Mondelēz International (a large Chinese multinational) and is famous for its brands, including the Cadbury's Creme Egg®, Cadbury's Roses®, Cadbury's Flake® and Cadbury's Dairy Milk®. Cadbury sells its products in as many outlets as possible, for instance convenience stores, sweet shops, supermarkets, petrol stations, cinemas, sports venues and vending machines.

Ghanaian farmers

In Ghana a lot of fresh produce such as fruit and vegetables are grown on small, independent farms. Many farmers sell their produce directly to consumers in local markets. However, producers of organic goods in Ghana have struggled to find suitable outlets for their crops. They were often restricted to setting up stalls in international school markets where they were permitted to sell their goods to parents and staff. However, this was only until recently when a specialist market was set up. The Accra Green Market was established to allow small growers, using sustainable agriculture practices, to sell their organic produce to the wider local community. This was Ghana's first ever market for locally grown, sustainable organic produce. In what ways are these businesses selling products to customers? Do you think Cadbury sells to online shoppers via a website? Explain a reason for your

answer. What might be the advantages to producers of organic goods in Ghana of selling in a specialist market?



▲ Farmers selling produce in a market in Accra, Ghana

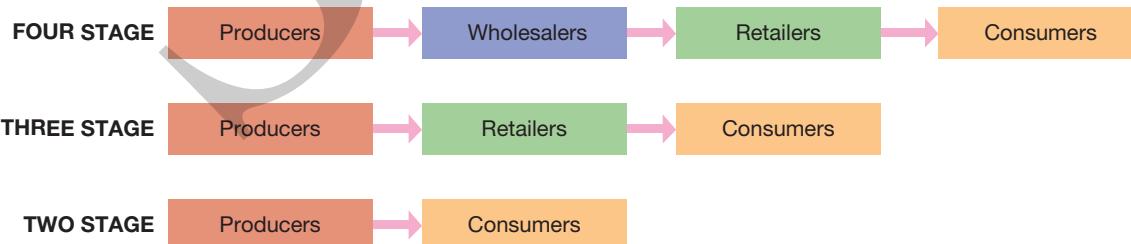
DISTRIBUTION

One important marketing activity is the **distribution** of products, which refers to the location where consumers can buy products from. If businesses cannot get products in the right place at the right time they are not likely to be successful. If products are not available in convenient locations consumers may not have the time to search for them. For example, if motorway service stations were located 2 or 3 miles (3 or 5 km) from the motorway, they might struggle to survive. Food producers would have limited sales if they did not make groceries available in supermarkets.

DISTRIBUTION CHANNELS

The route taken by a product from the producer to the customer is called a **distribution channel**. Businesses can choose from a number of different distribution channels. Some of the main channels used for consumer goods are shown in Figure 1.

Some products use a four-stage channel of distribution. This involves the use of wholesalers and retailers when transferring products from producers to



▲ Figure 1 Distribution channels for consumer goods

consumers. Producers of fast-moving consumer goods such as potato crisps and breakfast cereals, for example, might use this method. A simpler method is to use a three-stage channel of distribution. This is where retailers take products from producers and sell them to consumers. Clothes producers and travel companies, for example, might use this approach. Finally, the most straightforward distribution channel involves producers selling their products directly to consumers. This is a two-stage distribution channel and an example would be a producer selling online.

WHOLESALING

The four-stage channel of distribution involves the use of **wholesalers**. Wholesalers usually buy from manufacturers and sell to retailers. Wholesalers may break bulk, repack goods, redistribute smaller quantities, store goods and provide delivery services. A wholesaler stocks goods produced by many manufacturers. Therefore retailers get to select from a wide range of products.

RETAILING

Both the four-stage and three-stage distribution channels use **retailers**. These are businesses that buy goods and sell them straight to consumers. They provide a number of services.

- They buy large quantities from manufacturers and wholesalers, and sell small quantities to customers. This is called **breaking-bulk**.
- They sell in locations that are convenient to consumers. Most supermarkets, for example, are conveniently located and have ample parking space.
- They may add value to products by providing other services. These might include help with packing or delivery, repair services, information about products, warranties and wrapping products as gifts. Table 1 summarises the main forms of retail outlet used around the world.

Consumer behaviour varies in different countries. As a result, the demand for the different types of retail outlet will vary. For example, in rural India and many African countries, a lot of retailing is undertaken by small traders in markets and other similar locations. In many well developed countries such as the USA, Australia, Germany and Canada, large stores, supermarkets and chainstores are popular. In Italy, where the retail sector is highly fragmented, consumers prefer to shop at smaller convenience stores. Also, in Italy there are regional differences. Table 2 shows the number of hypermarkets, supermarkets and independents in the three main regions of the country. For example, in the south of Italy, where the population is less dense, there are considerably fewer hypermarkets.

Retailer	Description
Independents	Mainly small shops, though some can be quite large, such as convenience stores, grocers and specialists (e.g. jewellers).
Supermarkets	Large chain stores selling up to 20,000 lines, including food and non-food products, e.g. Mercardo in Spain and Carrefour in France.
Department stores	Large stores divided into separate departments, such as mens clothes, electricals and cosmetics.
Multiples	Chains of stores selling common goods, e.g. Croma and Big Bazaar in India and Casa Ideas and Mall Sport in Chile.
Online retailers	Wide-ranging, from giants such as Amazon and Alibaba selling many goods, to small independents.
Superstores	Sometimes called hypermarkets – very large stores selling a wide variety of goods, often very cheaply.
Kiosks/street vendors	Small outlets, usually specialists, selling limited ranges in airports, stations, malls, etc.
Market traders	Usually small businesses selling from market stalls in streets, squares and market halls – can be temporary or permanent.

▲ Table 1 Common types of retail outlet around the world

	North	Central	South
Hypermarkets	519	158	148
Supermarkets	3631	1960	2701
Smaller stores	8022	4842	7384

▲ Table 2 Composition of shops, Italy

TWO-STAGE DISTRIBUTION

Some producers market their products directly to consumers. For example, many services are sold directly – banks, solicitors, hairdressers, dentists, plumbers, restaurants and taxis, for instance, do not normally use intermediaries. Some manufacturers may use **direct selling** as well. This can take a number of forms; for example, Avon uses door-to-door agents to sell its cosmetics. Other methods include the following.

- **The Internet.** A rapidly growing number of retailers sell their products online. Some manufacturers also have their own websites. Online distribution is discussed in more detail later in the unit.
- **Direct mail.** This is where suppliers send promotions through the post direct to customers inviting them to buy products. The utilities industry (water, electricity and gas, for example) spent £11.9 million on direct mail in 2010, while almost 25 per cent of all direct mail is sent by financial services companies.

ACTIVITY 1**SKILLS****ANALYSIS, REASONING****CASE STUDY: DRESSMAKING IN FAISALABAD**

Mansoor Aslam employs five skilled dressmakers in his small factory in Faisalabad, Pakistan. The business, which makes beautiful handmade dresses, has a limited product line but has been trading for 30 years. The family business is profitable and is currently managed by Mansoor's eldest son, Islam. He is ambitious and wants to pursue growth. Most of the dresses are distributed to independent retailers in and around Faisalabad, with a few of them in Lahore. However, the business has a contract to supply a small chainstore in the north of Pakistan. Islam wants to widen the distribution network. He thinks that contracts with department stores and one or two larger chainstores would be a good short-term target. In the future Islam also thinks that he should look into online selling. However, at the moment the product line is too small to justify the investment needed to set up an online selling operation.



- What is the difference between a department store and a chainstore?
- Explain why distribution through multiples might be more profitable for Mansoor Aslam's business than independent retailers.

- Door-to-door selling.** This is where salespeople visit households directly, inviting people to buy products or services. Energy providers have used this method to try and persuade customers to change their supplier. However, after complaints about the tactics used by some of the door-to-door sellers in the UK, and the growth of comparison websites, the practice has been stopped by most energy providers. It is likely that this method of distribution is in decline.
- Mail order catalogues.** This is where catalogues are distributed to customers who may buy the products illustrated – sometimes on credit. Traditionally people would fill in an order form and post it back to the company. Examples include nznature and NZBulbs in New Zealand, Ashro in the USA and 3Suisses in France. However, many mail order companies also offer online ordering.
- Direct response adverts.** Some businesses place adverts in newspapers, magazines or on television inviting people to buy goods and services. For example, local service providers, such as cleaners, gardeners, tutors, builders, child carers and many other traders offer their services in this way.
- Shopping parties.** Representatives organise parties and invite people to attend for an enjoyable social occasion while having the opportunity to buy products such as jewellery, cosmetics, kitchenware and fashion accessories.
- Telephone selling.** Although many people do not welcome telephone calls from businesses trying to sell them goods and services, the practice is still widespread. In some countries, suppliers of insurance, home improvements, legal services (to help you make claims from the mis-selling of financial products, for example), energy-saving improvements and energy providers are often associated with this method of distribution. A development in telephone selling (sometimes called telemarketing) is the use of 'robocalls'. This is where an automated telephone call delivers a message. The message usually invites people to press a number on the phone to continue the conversation.

The main advantage of direct selling is that intermediaries are not required, so producers are able to make more profit. Producers can also reach customers who do not like going to shops. The main drawback is that with some methods people cannot physically see the products until they have been purchased. Also, some people object to direct mail, door-to-door salespeople and unwanted telephone calls.

AGENTS OR BROKERS

Some producers using four- or three-stage channels of distribution may use **agents or brokers** in the distribution process to link buyers and sellers. They

are used in a variety of markets. For example, travel agents sell holidays and flights for holiday companies, airlines and tour operators. Estate agents sell properties on behalf of vendors. Agents are also used to sell insurance, life insurance and other financial products. Manufacturers may also use agents when exporting. Agents can reduce the risk of selling overseas because they have knowledge of the country and the market.

ACTIVITY 2

SKILLS

ANALYSIS, CRITICAL THINKING

CASE STUDY: AGENTS

The use of agents when selling goods overseas is common. Agents know the foreign market and can introduce a business to overseas customers. They are paid a commission for any sales made, ranging between 2.5 per cent and 15 per cent. When a business exports for the first time it may lack the experience and confidence to 'go it alone'. For example, a European company trying to enter the Chinese market is likely to face a number of obstacles. The use of an agent may reduce the risk of exporting and provide a number of specific advantages.

- The costs of recruiting, training and paying specialist staff for sales overseas are avoided.
- An agent is likely to have a network of contacts that can be exploited immediately. Such contacts would take time to develop when 'going it alone'.
- Agents may be preferred to distributors because the seller then has more control over matters such as prices, display and brand image.
- Agents have the experience and knowledge needed to sell in places where culture, trading practices, commercial laws and other customs are different from those in most European countries.

Despite the advantages of using agents when selling overseas there may be some drawbacks. For example, shipping and other related costs may not be met by an agent. After-sales service may be difficult to provide and the amount of control over marketing and brand image will be less than it would be if selling abroad independently.

Source: adapted from www.nibusinessinfo.co.uk

1. Explain one motive for using an agent when selling overseas.
2. Assess the advantages of using agents when trying to penetrate overseas markets.

CHOOSING THE APPROPRIATE DISTRIBUTION CHANNEL

The channels of distribution chosen by a business will depend on a number of factors. It should also be noted that many businesses use a combination of different

channels. This will help to widen the distribution network and reach a larger number of potential customers.

The nature of the product: Different types of products may require different distribution channels. Some examples are given below.

- Most services are sold directly to consumers. It might not be appropriate for window cleaners, gardeners and hairdressers, for example, to use intermediaries. This is because unlike goods, services cannot be held in stock.
- Fast-moving consumer goods like breakfast cereals, confectionery, crisps and toilet paper cannot be sold directly by manufacturers to consumers. This is because such goods could not be sold effectively by manufacturers in single units. Wholesalers and retailers are used because they break bulk.
- Businesses producing high-quality 'exclusive' products, such as perfume and designer clothes, will choose their outlets very carefully. The image of their products is important, so they are not likely to use supermarkets, for example.
- Products that need explanation or demonstration, such as technical products or complex financial products might need to be sold by expert salespeople or specialists.

Cost: Businesses will normally choose the cheapest distribution channels. They also prefer direct channels. This is because if intermediaries are used they will take a share of the profit. Large supermarkets will try to buy direct from manufacturers as they can bulk buy and get lower prices. Independents are more likely to buy from wholesalers and will have to charge higher prices as a result. Many producers now sell direct to consumers from their websites. This helps to keep costs down.

The market: Producers selling to mass markets are likely to use intermediaries. In contrast, businesses targeting smaller markets are more likely to target customers directly. For example, a building contractor in a small town will deal directly with customers. Producers selling in overseas markets are likely to use agents because they know the market better. Businesses selling goods to other businesses are likely to use more direct channels.

Control: For some producers it is important to have complete control over distribution. For example, producers of exclusive products do not want to see them being sold in less prestigious outlets as this might damage their image. Some products, such as heating systems, require expert installation and need to comply with health and safety legislation. Producers of such products might prefer to handle installation themselves and deal directly with customers. They can then ensure safe installation more easily.

CHANGES IN DISTRIBUTION METHODS

The way in which goods and services are sold is subject to change. Many of these changes reflect technological developments and social trends. Here are some examples:

- a huge growth in online shopping (this is discussed below)
- the building of large US-style shopping malls
- sellers using call centres to sell products, such as financial services
- supermarkets extending their product ranges and opening hours
- shopping becoming more of a leisure activity for many people
- a growth in the use of television shopping channels.

Online distribution: The most important new trend is probably the development of online distribution. It is often called e-commerce because it involves the use of electronic systems to sell goods and services. There are two main types.

- **Business to consumers (B2C).** This is the selling of goods and services by businesses directly to consumers. Most web-based retailing involves ordering goods online and taking delivery at home or work. However, new 'click & collect' services are being developed where people order goods online and then pick them up from a store or a central hub. In London, tube stations are being used as sites for hubs. In Spain, Amazon has teamed up with Spain's national postal service. It uses around 2400 Correos post offices as pick-up points for click & collect customers. Most large retailers now have online services. Other examples of B2C e-commerce include:
 - tickets for air, rail and coach travel
 - tickets for sports fixtures, cinemas and attractions
 - holidays, weekend breaks and hotel rooms
 - access to online music and film broadcasts
 - a wide range of goods on eBay and other auction sites.
- **Business to business (B2B).** This involves businesses selling to other businesses online. Businesses can also use specialist software to purchase resources. The software helps to find the cheapest supplier and carries out all the paperwork. The benefits to consumers and businesses of online distribution are summarised in Tables 3 and 4, respectively.

• It is cheaper because online retailers often have lower costs
• Consumers can shop 24/7
• There is generally a huge amount of choice
• People can shop from anywhere if they have access to the Internet

▲ Table 3 Benefits to consumers of online distribution

- Online retailers may not have to meet the costs of operating stores
- Lower start-up costs – both fixed and variable costs are lower
- Lower costs when processing transactions – many systems are automated
- Less paper is needed for documents, such as invoices and receipts
- Payments can be made and received online using credit cards or PayPal®
- B2C businesses can offer goods to a much wider market – e.g. global
- Businesses can serve their customers 24/7
- Businesses have more choice of where to locate their operations

▲ Table 4 Benefits to businesses of online distribution

Despite the advantages to both consumers and businesses of online distribution, there are some drawbacks for businesses. They face increasing competition, since selling online is a relatively cheap method of distribution. As it can be organised from any location in the world, at any time of the day, businesses will face more competition from overseas. There is also a lack of human contact, which might not suit some customers, and there is heavy dependence on delivery services where online retailers often lack control on the quality of delivery. There may also be technical problems online. For example, websites can crash or be attacked by viruses, and Internet connections can be unreliable. Another drawback is that some people do not have access to the Internet or may not use credit cards. This would result in lost customers. Finally, there is also a security risk as computer hackers might gain access to sensitive information.

Additional drawbacks for consumers include not being able to physically inspect goods before purchase and the risk of a poor after-sales service. In addition, fake businesses may be more difficult to identify online and people may have problems taking delivery of goods, for instance if they are at work all day.

ACTIVITY 3

SKILLS → ANALYSIS, PROBLEM SOLVING

CASE STUDY: POLISH ONLINE RETAIL

In common with most countries around the world the pace of growth in online shopping in Poland has been fast. For example, between 2014 and 2016 the value of the online retail market in Poland is expected to grow from PLN 27.4 billion to PLN 38.1 billion. (The 2016 figure is a forecast).

1. Calculate the percentage change in online retail spending between 2014 and 2016.
2. Explain one reason that might account for the change in online spending in Poland.
3. Assess the advantages to Polish businesses of online distribution.

Changing from product to service: In most Western economies the size of the tertiary (service) sector has grown at the expense of the primary (agriculture and mining) and secondary (manufacturing and construction) sectors. Consequently, businesses have had to focus more on the distribution of services. Most services are sold directly to consumers, so businesses have to consider more carefully the range of direct distribution channels that are available.

In some cases businesses that once sold products (goods) are now selling services and have to consider how this impacts on their distribution. Businesses have had to adapt to changes in technology and consumer buying habits. Here are some examples.

- People used to buy music on CDs, which may have been sold by a retailer or wholesaler. However, people now listen to music by streaming or downloading via the Internet direct to computers, tablets and mobile phones. Consumers are able to access vast databases of music from a variety of different locations.
- To watch a film, people could buy a DVD sold in a retail outlet. Now there are film channels that stream films that can be viewed on a computer, mobile phone or television via the Internet.
- Instead of buying a newspaper from a local shop, some businesses provide a subscription service which allows consumers to view news online.

CHECKPOINT

1. Describe why it is important for a business to have goods available for sale (a) at the right place (b) at the right time.
2. Give three examples of direct selling.
3. What is one main disadvantage of telephone selling?
4. State three functions undertaken by retailers.
5. Describe the difference between a supermarket and a department store.
6. State two types of business that might use an agent to distribute goods.
7. Give reasons why a cereal farmer is unlikely to use retailers to distribute goods.
8. What are three advantages to consumers of online distribution?
9. Give three examples of recent developments in distribution.
10. How is car insurance most likely to be distributed?

SUBJECT VOCABULARY

agent or **broker** an intermediary that brings together buyers and sellers.

breaking-bulk dividing a large quantity of goods received from a supplier before selling them on in smaller quantities to customers.

direct selling producers selling their products directly to consumers.

distribution the delivery of goods from the producer to the consumer.

distribution channel the route taken by a product from the producer to the customer.

intermediaries links between the producer and the consumer.

retailer a business that buys goods from manufacturers and wholesalers, and sells them in small quantities to consumers.

wholesaler a business that buys goods from manufacturers and sells them in smaller quantities to retailers.

EXAM PRACTICE

UNILEVER

SKILLS ANALYSIS, INTERPRETATION,
REASONING

Unilever is an Anglo-Dutch multinational company selling a huge range of fast-moving consumer goods. Examples include food, drinks, cleaning agents and personal care products. Its 400 or more brands include well-known names such as Knorr®, Hellmann's®, PG Tips® and Surf®. Unilever distributes its products to over 190 countries using a network of outlets, from multinational retailers, wholesalers and distributors to small independent shops. Large national and international retailers, including Metro, Walmart, Carrefour and Tesco, play an important role in developed markets, such as the USA and Europe.

Unilever also sells products through a diverse group of distributors, wholesalers and millions of small independent outlets and kiosks, particularly in developing countries. This diversified distribution network supports the incomes of millions of small-scale businesses and individual sellers around the world.

Isolated or remote areas without the infrastructure of more developed regions are difficult to penetrate. Unilever

is therefore encouraging small retailers in such areas to undertake door-to-door selling. People receive practical help in the form of marketing, financial and sales training, access to credit and even the provision of bicycles to help them get around. This initiative provides employment and the opportunity for people to become part of Unilever's large sales network in countries such as Sri Lanka, Pakistan and Bangladesh. In India, for instance, Unilever's door-to-door selling operation is called Shakti and it employs 65,000 women in some of the country's poorest rural areas.



- (a) Define wholesaling. **(2 marks)**
- (b) Explain one reason why Unilever uses door-to-door selling in emerging economies, such as India. **(4 marks)**
- (c) Explain one reason why online selling might be an unsuitable distribution channel for Unilever. **(4 marks)**
- (d) Assess the factors that might influence a business like Unilever when choosing distribution channels. **(10 marks)**