ISB- Product Management

Week 11: Managing Distribution and Pricing

Video 1: Pricing and Distribution Strategies

Welcome to module 10B of product positioning and branding. Here, we're going to focus on product distribution and also on pricing issues. If you recall at the beginning of module 10 A, we talked about the fact that you cannot separate product positioning and branding, from distribution and from pricing. All three of these things go together. And in the last module, our focus was primarily on: How do we build the brand? How do we position our products and services relative to competition? And in this session, what we're going to do is we're going to be focusing on pricing strategies and distribution strategies. And how the two of them are actually intertwined? And how they actually linked to both customer engagement and to the branding perspective? These, of course, will lead to profitability, growth and resilience, which we will deal with in the next module.

The learning objectives for this module, module 10 B, are learning how to manage product launches. In the process, we will also focus on managing price competition, because when you launch a product, it's likely that the competitors are going to react to your product launch. We will also have to look at how do we manage distributors. Because you actually depend on the distributors for the product launch. And, there has to be a proper incentive for the distributors. For consumers, for the people buying our products and services, what they're looking at is the value propositions. What are the benefits to get relative to the prices that they will be paying? For the distributors, they have a business school and what is the business school. They want margin, and they want traffic. So, they want to make money on every unit. But they also want to sell a lot. So, they're interested in both issues. And here, the brand and the connectivity with the consumer is obviously going to be a major criteria. The easier it is for the distributors to sell your products and services, the more inclined are they going to be to accommodate what you're requesting. So, it's give and take and you have to learn how to manage them because obviously as business people, they are going to extract as much value as they possibly can. And so, you have to understand what you're giving them. But you also have to understand, what you're appropriating for yourself. Otherwise, you'll be killing your own profits. So, the final element in this module is: How do we integrate pricing and distribution? Most textbooks deal with pricing and distribution separately.

In my opinion, you really cannot separate because the distributors are dependent on that margin just to give you, a very simple example. Supposing we're looking at automobile tyres, you know the consumer is, of course, interested in a tyre that's going to last, you know, 160,000 kilometres or 100,000 miles. The consumers are going to love that. But the deal is the distributors, the repair shops hate it. Why? Because it means that instead of coming after 50,000 miles you're going to take 100000 miles before you'll be coming to them for a tyre change. So, improving the product doesn't necessarily mean you're going to get a great backing prices the distributors. So, in which case, if you're going to improve your product, you have to raise your prices and some of those price increases you have to pass on to the distributors. Otherwise, you're not going to get the appropriate support from them. The agenda is, we'll first talk about managing the product launch. We'll talk about Capital One, how they launched their credit card. We're also going to talk about launching water brands. That's the ultimate commodity. You can't be going to a product that's more of a commodity than water. And then, we're going to talk about a data storage product called LS-120 that I was involved in. It's a little bit of, you know, walking in the past, but it's very, very instructive in terms of what you can do right and what you can do wrong.

Then we're going to move on to pricing strategies. I'll talk about a favourite company of mine in India called Balaji Wafers. Their potato chips have taken, you know, PepsiCo., head on and they've been winning mostly and without much advertising. So I want to talk about that. I also want to talk about price promotions, and you know you don't have a stable price. But the price promotions are leading to variation in that price and want to alert you to the fact that price promotions can actually destroy your brand if you do too many price promotions. Then we're going to move on to how do we manage their distributors. A big battle going on today between the private labels and manufacturer brand. So, if you look at Unilever or Procter and Gamble, they're fighting, Walmart to the fighting Safeway and so on and so forth, and so that battle is continuing. So, I guess we talked about it a little bit earlier about co-opetition, cooperative competition, and so we'll elaborate on that. And then finally, we're going to move on to direct to customer strategies, because as the retailers are integrating backwards, they're making their own products, their own private labels. Many manufacturers are integrating forward and going direct to the customer. We'll talk about why they're doing it and whether it's working or not, and under what circumstances it's going to work.

Video 2: Managing Product Launch

Moving on to managing product launches. Most of you have had the pleasure of having a basic marketing 101 course, and you might remember from that, the four Ps of marketing. These are promotion, place, meaning distribution, pricing and the product itself. So, what we're doing with the sales and marketing programme when we're launching the product, we have to make sure that these programmes, the sales and marketing programmes are able to deliver value to the customer. So, what do the four Ps translate into? They really translate into number one; you know you do advertising and promotion and an output of that from the consumer viewpoint. The consumer becomes aware of, they develop some sort of affinity or preference for the product. The place aspect, it's clearly related to the accessibility of the product to the customers, so a customer may think well about your product. But if they can't access, if they can't reach it, then you've wasted your money in building the brand that's not available to customers. Third aspect related to prices, of course, affordability. And finally, related to the product itself is the acceptability of the product. So, the 4 Ps really translate into the 4 As that have to be achieved through the product launch and through integration of pricing and distribution.

The launching of a product is very expensive, because what we're doing is in the product launch, you're trying to get into the market. You may have to elbow some existing competitors out and get some part of the share, and nobody is out there to roll over and say, "Hey, take my market share". So, if the product is entirely new, you've got to get into the minds of the customers. You've got to get noticed. You've got to convince them, you've got to educate them, that this particular product or service that you have is actually to their benefit. You have to sell the value proposition. So, all the stakes energy and typically in the first year or two of building the product market, building the brand, your expenses are going to be pretty high. So, what we know is for sure, is we have high expenses. Now, what we don't know is going to be the benefit. And why are we doing all these investments? Well, one reason is, of course, that we want to make more money. So, we invest in the product launch with the idea that we're going to build up market share, and that we'll be able to build them some kind of a price premium relative to the basic product, relative to the generic, if you want to think of it that way, because why waste money, time, energy in the product launch if all you're going to do is extract the generic price. All right? So, one thing we want is volume, and we want the margins.

The second thing that we want is that perhaps, if we build the brand now, the marketing expenses in the future are going to be lower. There's plenty of evidence that shows that the cost of customer acquisition can be as much as 10 times the cost of customer retention. So, we're doing this acquisition spending upfront, meaning our cost structure in marketing and sales is going to be lower later on. This will also help us to navigate the distribution and sales cost, be better the presence in the market, the more we have to negotiate with the distributor. So, one trying to up the revenue and price. Second, lower the future costs by making these investments.

The third thing that we're probably doing is accelerating the market. You know, through this marketing investment, rather than waiting for word of mouth to develop, and typically you can wait for the word of mouth to develop. You don't need a sales and marketing budget. If your product is so great, you let it diffuse in the marketplace. You might notice that the better movies are rarely advertised. They are waiting for the word of mouth to get around. And in fact, if you see a movie that is heavily advertised, you know maybe a question mark should go up in your mind, whether you should see it or not. But anyway, the point I'm trying to make is that these efforts, the strategic marketing investments, are going to accelerate market acceptance for you.

So, let's look at all this in terms of managing and tracking the launch. Now, we have plenty of evidence that shows that tier 3 brands. No name brands, relative to mid-range brands, relative to the top tier brands are slow in defusing the market So, if you have a great brand. The consumer is already accepting. They already trust you, and you can penetrate the market faster. And if you have the brand, the question is, what do we do with it? It may be that you may decide well, I'm going to let somebody else take the new product risk. We don't know whether the market is going to accept it. What are going to be the problems? So, let somebody else take the arrows in the back, and because of our brand strength or distribution strength, we will move in. So, one way you can leverage the brand acceptance is to reduce the risk by entering late. The other is in a short cycle environment, you kind of jump in and take advantage of the fact that you can have a time premium, you can penetrate the market faster. All right, so, these are the options that the brand is providing you.

My experience has been that kind of driven markets, companies tend to exercise the time premium and go into the market earlier. In many instances, such as, let's say we take a branded items like Coca-Cola, they've got plenty of brand strength, they've got plenty of distribution strength, and they don't need to enter the market earlier. They can let somebody else take the risk of developing a new kind of beverage or whatever, and they can move in from behind them and take away the share. I'll put Microsoft in that category as well, because you know, while they're a tech brand, you might think of them as a short cycle environment, the level of customer loyalty, customer retention is so high, that they can always be a little bit late, and the brand actually buys them time, so they can enter the market late, a little bit later if they want to. And you might realise that, for example, in cloud computing, you know Amazon Web Services, AWS was the one that got started. It's still the market leader, but the Microsoft is coming in behind them and picking up a little bit of share. So, what the brand is, is a growth platform. The customer trust is a growth platform. You can exercise it as an option to enter early and capture share, or you can say, "Look! I'm going to wait for the market to develop before I jump in." So, we see a lot of this now happening in Fintech. The brand is being leveraged a lot in Fintech and we'll be talking a little bit more about that later in this programme. But importantly, in module 11, which is the next one.

Video 3: Customer Acquisition and Retention

Launching your product is, of course, about customer acquisition. But it is a retention side that is critical in the long run. Even in the short run, people forget, they get you know very enthusiastic about customer acquisition. Many salespeople are rewarded for new customers brought in. But, when we look at customer retention, that particular aspect of the market is very critical. Number one, it's far more cost effective. The second part is that you've got to protect the customers that you acquired, because, in all likelihood, the competition is shopping around for your best customers. So, the best customers are the ones that you have to protect. All of you or those of you who've been in the sales function, you all know about what is called the sales funnel. What is the sales funnel? We do some activities, advertising and promotions to catch the customer retention, so we build up the awareness. We build some interest in them partly by making some special offers. And what we're trying to do is we're trying to get into the choice set or the consideration set. There is evidence that shows, for example, if I ask you, "What are the brands of tea that come to your mind?" One might say very quickly, something like Tetley's. And then, if I press further, you might say Brooke Bond something like that. If I keep pressing, the time between the recalls, keeps increasing. So, the first brand comes like that, second brand comes quite quickly, the third brand you'll be saying, "Ah..." by the time we get to the fourth or fifth brand, it's not up there in your mind. The research shows that the longer it takes for you to retrieve a brand name mentally, the less likely it is that you're going to be looking for it and purchasing it. So, that's why we want to get into what is called the consideration set. And when a person goes shopping, we want to make sure that the purchase intent is there, and ultimately the purchase is going to have to take place.

So, this is a sales funnel. Whether we're talking about consumer sales or we're talking about business-to-business sales, this is the cycle that we go through in sales. But one cannot stop at the purchase because in the long run, what you have to do is manage the user experience because the users are going to be re-evaluating, "Was this a good buy?" "Did I waste my money?" or "if I had a problem, did somebody jump to it and help me figure out how to fix the problem?" So, these things are going to be very important, and we need to integrate the sales funnel with the retention strategies. So, what I'm doing is I'm creating a loop; in Texas, we call it a lasso to capture people. So, if I go to that, it turns out the acquisition strategies are pretty complicated because you're fighting to acquire the customers. The retention strategies tend to be a lot simpler because you already know the customer, you know through analysis what they want, and therefore, it is easier for you to serve them. So, let me take you through the loop. The typical acquisition retention loop, as we attract customers, build the awareness. The second part is to get into the consideration set, TOM is top-of-mind awareness, and so people who are aware of a product, they like a product, they also tend to have product knowledge. They know why they like, or at least they believe why they like something. And then, the question is, is it accessible? Is it available to them conveniently? We're then looking at; do we have the proper mechanisms? If they have a question, can we answer the questions? Can we interact with them? That will ultimately lead to transactions and, for example, support services, 24/7 phone support as an example. Then what we're doing is we're trying to get customer insights. We're trying to figure out why they like the product? What aspect of the product they like? And you might actually do some experimentation in the marketplace. You change product features, or you change your pricing. And through this experimentation, you begin to learn what is it that they like and don't like. Now, why are we doing all of this? We are doing all of this to figure out how to manage the customer experience, and how do we retain them. Now, this may seem very, very logical. And even if I go back two decades ago, we were already using analytics intelligence to figure out what we could learn from these transactions. And how could we use this information in order to manage customer retention? So, this framework is not new.

Today, it is frankly, just accelerated because of so much data that we have on consumers. In fact, we may have too much data, and the question is, how do we use it? Now, I'm going to take you through an example. And this example is based on a company called Capital One. Capital One started issuing credit cards in the 1990s. They were fresh into the market, and now they are the number three credit card provider in the world. So, this is a company; it's a greenfield project that they started. And how did they get into the market? See, the market was already there with Visa, MasterCard, everybody was already planted out there. So, it's not easy to take share away from competition. So, these guys came up with an angle. What was the angle? "Let's go after that market that does not have credit cards or find it hard to get credit cards." And what is this market? These were young people who did not have a credit history. So, it's Catch-22 situation, they said, "Going for young ones, we're going to take care of you." So, they went after this market, high credit risk because there was no credit history. And what were they doing? They're saying, "Okay, we're going to give you a customised product." And they were doing a little bit of arbitrage because these people could not get a credit card, you could charge a little bit more. And so, maybe the charges were higher; why? Because you were taking a greater amount of risk. But if you're going to take greater risk, it becomes important to get out of that risk if it is becoming a situation that you cannot handle. So, you needed to track the usage of the credit card, if they were not paying in time, etc. Maybe a few signals are going up saying that "You ought to stay back on the extension of further credit". And then the question becomes: How are we going to do it? The acquisition was through heavy advertising, and I'll walk you guys through it. And it also required analytics, quick response to problem situations. If somebody wasn't paying the bill, it's a good idea to figure out; why? And this is where the customer service representatives etc., came in. They would call up and find out "What's wrong", "Can we help you?" etc. But the idea was to control the risk. So, going back to the framework that we had: What did Capital One do? It literally covered every little step in the framework. So, to build awareness, it was a lot of direct marketing in those days or direct mailers advertising. And there were all kinds of promotional offers, things like, you know, no charges, no fee for the first year.

The second thing that they were doing is looking at building the brand, this is for young people, etc. They were focusing on educational seminars. They were also doing things like marketing the product through alumni unions to students. So, they were going after the young people market. So, that's what they were doing in building the brand. Multiple channels using call centres, using online, and also using branches later on. And the interaction was through relationship managers. So, these are people who would be in touch with consumers, not only to sell additional features, but also if something wasn't working to figure out what was going on. 24/7 support and followed by, today we call it data mining, in those days, we used to call it, you know, market research to figure out how to optimise the marketing mix, you know: What to advertise? What not to advertise? And the final element was building in loyalty rewards, airline miles, so on and so forth, in order to figure out how to hang on to the customers. So, this is what, you know, Capital One did, and very, very quickly, from a greenfield project, they moved to be one of the major providers of credit cards.

Video 4: Market Access: Value for Distributors

We will now focus on marketing access and how do we build access to the marketplace. The in-store and online experiences are getting to be more and more important. So, in this particular chart, you'll see that moving from awareness to building understanding, to getting into the customers' consideration set, to getting the customer to try the product and then to repurchase it. Particularly, when it comes to getting in top of the mind, getting into the consideration set, getting them to try the product for the first time and for repurchase, the in-store and the online experience is getting to be more and more important. Traditionally, what the advertising companies had done, we were using mass media in order to build the awareness. And then, we were relying on the retailer partnership in order to make the product favourably available at the eye level, for example, in the grocery store, etc. So, our product was more accessible, more visible. But increasingly, what we're finding out is that these things are in the hands of the retailer, not so much in the hand of the traditional media company. Now, the traditional media companies have been replaced by those companies that are building social media and e-commerce. So, what used to be done by advertising agencies is actually being done by the Googles and the Amazons of the world. Many of you may know, that over 90% of the revenues of Google, Facebook also, over 90% are really coming from advertising. So, while they are posing as tech companies, they're really technology-driven advertisers. That's frankly what they are, all right? So, the emerging battlefield is now in the airwaves, in the internet and on the storefront, and sometimes the storefront is a screen, these online stores, if you will. So, if I now look at that and I'm going back to a commodity product, and I really want to talk about the importance of the distributor in helping you build your market position.

So, I'm going to take an ultimate commodity like water. As an aside, I have some friends in Houston, who in Texas we call them there in the oil bidness. We don't say business; we say bidness. So, what do these guys do? They extract oil from below the ground, and they convert it into petroleum gasoline, so on and so forth. And one of them was complaining, he said, "I just can't understand how bottled water at the same convenience store that we purchase gasoline is more expensive than the gasoline, than the petrol?" And, well, it's your own fault if you are going to sell it like a commodity. We don't necessarily sell water like a commodity. Now, let me get to water. What I'm going to show you is the pricing over time of what we call promotional brands. These are brands that were primarily selling themselves as a price incentive. They were regional brands. They were not national brands. They did not have the economies of scale for doing advertising. So, you can see, as they compete amongst themselves, there is a downward trend; the more they compete amongst themselves, they're driving the price down. If I looked at the national brands, and these were Aquafina for Pepsi and the Dasani for Coca-Cola. You see that these brands, which are supported by national advertising, the price is actually creeping up, not creeping down. And when I positioned the pricing for the private label, this is a store brand, that's somewhere in between.

Now, put yourself in the position of the retailer, the distributor. And they are in the middle, the brands at the bottom that are driving the price down, they will probably be competing with the private label. So, when it comes to giving those branch shelf space, they're going to be persona non grata. On the other hand, the advertising-driven brands, they bring larger margins to the retailer. So, the retailer thinks, "Fine, if they cannibalise my private label, at least I make more money from them." So, intuitively, one might say that the advertised brands with a higher price are probably going to be treated more favourably by the distributor, by the retailer. So, let's check that out. As we check that out, we see; indeed, the distribution availability, this is availability at the shelf is higher for Aquafina and Dasani compared to the price-driven brands. And then, if you look at the market share, it's following the same trend. So, what does this tell us? That even for a commodity product, the commodity product in that category, a brand that can offer a better value proposition to the distributor, is going to find a greater presence on the shelf space. So, again, we keep hearing on commodity markets we got to compete on price. This is a perfect example that to get accessibility to be seen on the shelves, you've got to come up with a value proposition for the distributor. My message is you actually have two customers, the consumer, the end customer and importantly, the retailer who's a more important B2B customer.

Video 5: Balancing Brand and Customer Management Strategies

In the recent past, there's been a bit of confusion between this idea of brand equity vs customer equity. There are really two sides of the same coin sometimes. And, we need to understand when do we want to focus at sort of a mass market level, which is what most branding strategies are doing, and when do we want to use CRM customer relationship management which is targeting specific segments or specific customers in order to have a more customised strategy to these individuals.

So, if you recall, we talked about customer equity as aggregating across existing products and new products, and we talked about brand equity as aggregating across the existing market and potential new markets. So, this is the framework that we were using, and what I really want to do is give you some insight. When do we want to do one or the other? And often, you may end up by doing both. You may be building the brand and leveraging CRM strategies at the same time. So, out here I've drawn a little bit of schematic.

The red line is ranking customers from the least valuable to the most valuable. For what had the left towards the left, we have customers that have low value. These are perhaps, customers that demand too many services, are very price sensitive, they only buy on promotion, etc. Then towards the right, we have customers that are more valuable to you. So, what this is showing is that, in the red line, we have a lot of variability from what we might call great customers to average customers to customers that we don't really want to focus too much attention on.

On the other hand, when we are looking at certain product categories, but there's very little difference between a high-end customer and the lower end customer. So, let's say if you're talking about purchasing laundry detergent. Okay, the lower-end customer is probably buying it on coupon and buying it on sale. But there's not that much of a difference when it comes to that.

On the other hand, if we're talking about an automobile, there'll be some people who are buying, let's say, even within Honda, which is a car that we talked about. Some people who are buying the Civic, and then, there's some people who are buying the Acura, even within the Honda brand. So, what we want to do is we want to use the analytics these days, in order to avoid those customers that have low value. And we want to build our focus, and we want to nurture those customers. We want to protect the higher value customers from the competition. And often, we're going to have to balance building the brand with building the customer relationship management mechanisms, because it is the brand that makes us valuable to the customer. And it is our ability to engage with the customer that reinforces the brand. So, I'm not saying you do one or the other, sometimes, you're going to need to do both of them.

Video 6a: Managing Technology Product Launches

I would like to now talk about managing technology product launches. Out here, we very often have a B2C component while we have a B2B component; it's a lot more complicated than launching a hamburger or launching a detergent. A lot more complicated than a consumer products. The product I'm going to talk about is in the tech space, it was a data storage product, and you might recall, from the first module that we did that we were talking about how the technology adoption cycle runs into a snag, particularly there's a chasm that develops after the initial users have tried the product.

The rest of the market is taking its own sweet time in deciding or, for that matter, not to make the purchase. So, within this larger tech adoption framework, what I want to do, is I want to talk about initially a product called a Zip drive. Now, many of you today look at a memory stick. It's got 32 gigabytes, and it costs you five bucks or maybe 10 bucks. When I was growing up, sort of say, one of the first PCs I bought actually had two floppy drives; 360 kilobytes is all they had on each drive. And then, I thought I was in cloud nine, when I took out one of the floppy drives and I replaced it with the hard drive that had 10 megabytes. 10 megabytes was like, "Oh, the end of the world."

Now, around the late '90s, there's a product called the Zip drive. The Zip drive accommodate close to 80 megabytes on a single drive. And those people who were called road warriors, these are people who worked for companies like Accenture, in those days called Andersen Consulting. It was really hype to put the Zip drive in your hip pocket, so a little bit of it sticking out so people could see that, "Oh, you can afford a Zip drive." It was a branded item at that time. But the Zip drive was an external drive, external to the PC, but it could manage 80 megabytes of data. Now, there's a company called Imation that came out of 3M, and they had a product available called LS120.

Now, this particular product compared to the Zip drive that had 80 megabytes, these guys could store 120. Not only that, it was compatible. The drive was compatible with the older floppy that was 1.44 megabytes. So, the older floppy is at the bottom out here, the black one and the grey one is the super floppy, sort of say, which is almost 80 times in terms of storage capacity. So, what was the value proposition for this LS120? It was backward compatible, very high capacity for those, for that point in time, 120 megabytes. It was faster than the Zip drive. At the same time, it worked on all platforms. It could work in your laptop. It could work in your tower PC, and it could also be managed as an external drive. So, it worked on multiple platforms, but basically, it was a much better value proposition compared to the Zip drive.

Now, at the same time, there was also some additional service distribution that this was this was available globally and could be serviced globally, and the other drive, the Zip drive, was only for North America, for the US at were that point in time. So, what did we do? We said, "Okay, let's develop a marketing plan." It had to integrate or bundle, the drive with the media, the media being the floppy itself. So, those things had to be bundled, and we had to work out all kinds of benefits you could bring to the table. We could put virus control, etc., etc., on the drive. So, that was like a freeware, if you will. But we had two kinds of customers, the Value-Added Retailers, the VARs and the OEMs.

The OEMs would be companies like at that time, Compaq, and Dell, and so on and so forth. And then, they were going to two markets, the corporate markets would be companies like, let's say, Deloitte, or Anderson Consulting, or the University of Texas, and there will be individual consumers that was the other part of the market. And then, the final thing was, how do we market the entire product line then the mobiles, meaning the laptops, the towers, as well as the external drive. So, what we did was we spent quite a bit of time, and we came up with the campaign that went into the seven figures. I can't talk about exactly what it is. But basically, we came up with a push and pull plan, which is documented on the right-hand side. I'm not going to go through all of these things. But there were incentives that we created, for example, for the OEMs. What were the incentive for the OEMs? What were the incentives for the corporates? Because if the corporates like Deloitte or Anderson consulting at that time became early adopters, they could actually demonstrate to other users. So, they were, like, spreading the virus, if you will, to other potential users. And so, we came up with a PR programme.

We developed a catalogue. We did advertising, tech support, all kinds of things, both to the consumer side and the corporate side, as well as to the OEMs and VARs. We came up with this plan. It was working, all right? So, what were we doing? We were building the marketing plan. We did the test market. We did drive ad copy; we tested the ad copy. We worked with OEMs like Compaq, etc. Things are going well, and we actually got orders from some of the larger OEMs.

On the other side, on the manufacturing side, we had to simultaneously make sure that the product would be available. Our problem and I'll stop here, was that we were too successful on the marketing side. And the demand started exceeding what we could supply in the marketplace. So, very successful if you will launch strategy. But what I want you to remind you is that our job is to make sure that we integrate supply and demand. So, if the demand is surging, we need to make sure that the supply is also able to surge. So, successful product but for the challenge.

Video 6b: Managing Technology Product Launches (Continued)

So, one of the morals of the story is that they ought to plan for everything that can go right but can also go wrong. What are some of the reasons why products don't work out? Very often, it's because we don't get distribution support, all right? Because everybody is clamouring for attention, for the shelf space, and we're not getting the support. The second thing very often that happens is that we did not anticipate how the competition is going to be able to respond in terms of either product improvements or price cuts or whatever the case may be. Then, there is the third item which is very often, we get the first sale, but we failed to get the repeat purchases. So, it could be a one-trick pony. We did well, but something about the product was not adequate to continue to hold the market's attention. Very often, I have also found that there's internal clash within the company. You got the sales and marketing people dancing to one tune, and the manufacturing and operations people like to be a little bit more organised. And so, there's a different culture, and sometimes the matching of the culture or fifth element rather is that we have insufficient returns on the investments. I'm not going to go through the other items, but the point I'm trying to make is there're many icebergs along the way. And we need to anticipate some of them and figure out how we're going to take care of them.

Video 7: Brand Value and Pricing Power

Let me now take you down the memory lane. If you recall, in the very first module, we talked about the fact that you need to change your mindset. You need to move away from pricing, that is very, very competitive, to looking at how do we decommoditise markets? And we said that one of the roles of marketing was to help manage cash-flows and not revenues. And in order to do that, we had to worry about segmentation and differentiation. And we talked very, very briefly, and we built up upon that later on. We talked about the power of the brand. And I don't even have to name these brands out here; just from the logos, you can tell which company's these guys are. This is also down the memory lane. We've talked about how consumer choice is really based on what we can call functional attributes. When we were talking about the BlackBerry, I mentioned the keyboard and the tracking wheel. But it's also based on experience and trust. And so, the transition has been from BlackBerry to iPhone. We talked about how in the automotive sector, you got brands like BMW and Mercedes, commanding a price premium. All right so, what is the net result of all of this? The net result is that the brand is creating the market imperfections, which is giving us pricing power. There's plenty of evidence that shows that there is more than just pricing power.

When you move from a low equity brand, a lesser-known brand, to a brand that is trusted more, what it attracts is a less price-sensitive market. In plainer English, you can command a price premium for the same unit sales for the same market share, or for the same price level, we can command the share premium, or it could be some combination of the two. But in effect, what we're getting is a profit and a revenue premium, because of a stronger brand.

Now, this also translates into greater power that the brand has over distribution. And there's been many instances that the retailer margins for strong brands are actually lower than the margins for mid-range brands. So, it's not a fixed percentage; if you have brand power, if consumers want your product, you can negotiate that, so your lower cost of distribution. At the same time, you have lower customer turnover, low churn, higher loyalty. And we also talked about the fact that there will be higher marketing productivity.

Now, this is all documented in research; 30, 40 years of research is saying, each and every one of these items is true, higher profitability, lower cost of distribution, higher loyalty, higher marketing productivity. It takes less money to market a well-known brand than a brand that we have to build up. We also know that with a strong brand, you're going to get faster market penetration. And we just talked about that in earlier in this particular module. Now, what does it all translate into? It translates into greater profitability, greater growth, and greater increase in value.

Now, I'm going to show you a list of drivers. I'm not going to be able to go through all of them. These are the things that brands can make happen, and corresponding to that we have, what are the benefits, if you will, in terms of a sustainable competitive advantage? So, clearly with the brand differentiation, we talked already about the revenue growth rate, we talked about higher margins, we talked about high-cash-flow and so on. One of the unique things about brands is that they can be classified as an asset in some places and could be regarded as 'intellectual property'. Many companies have been following the strategy that they will take their brands, and they will park them in a country like Switzerland. Then, those operations that use those brands, have to pay a licencing fee to Switzerland. So, what that allows you to do is allows you to transfer money from the North American market or from the Indian market into Switzerland. Why does it matter? Because Switzerland has a lower tax rate. It's not the only country that's playing the game. So is Singapore, so is Ireland. And that has caused a situation where, there's been some debate as to whether this is fair.

If money is made in India or the US, why should the taxes not be paid in India or the US? And this is some research that I did several years ago, that if you have a strong brand name, it actually reduces your cost of capital. I did some research that showed that if people were favourably inclined to the products of a company, they were more willing to buy a brand by that corporate security and the evidence basically showed that the cost of borrowing money was actually lower for companies that had a stronger brand name. So, in those days, the blue-chip companies like IBM had a lower cost of borrowing money in the equity markets compared to those companies that had a lesser brand name. So, these are some of the advantages, favourable tax rate, lower cost of capital in addition to, of course, the price margins and the revenue growth, etc., that we talked about. There's a debate going on about this tax avoidance. And just about a month, maybe six weeks ago, we had a situation where the G7 came out and said, "We need a global tax to be fairer to people." So, just as in India, we have the central government doing a GST, and that distributes the taxes to the 29 states. There is talk about a central agency doing the taxing around the world and redistributing the tax.

Now, we'll see what happens. I don't think the G7 is powerful enough. It does not include China, it does not include India, and these are two major economies which cannot be excluded and there are other countries also, that need to come in. So, the G20 would be a more appropriate forum than the G7. But indeed, we need to look at the value of the brands and the appropriation of that value, not only by the corporate sector but the appropriation of it by the public sector as well. So, one thing I just want to put as a placeholder in your mind, is brands are very valuable. And multiple companies have come into play, Interbrand, Brand Finance, Brand Economics and so on and so forth. What they're basically doing is they're trying to estimate, what is the value of a brand?

Now, what does the brand bring to the table? So, let me give you just a very simple example. If let's say the net margin in an industry is 10%, and if the brand gives you a 3% premium controlling for volume, then the profitability has gone from 10 to 13, which is a 30% jump in profits because of the price premium. Now, there are lots of ways in which we can estimate the value of the brand. One is to calculate the incremental earnings and multiplied by the price-earnings multiple. Okay, so if the incremental learning is, let's say, 50 million and the price-earnings multiple is 10, then 50 multiplied by 10 gives you 500 million as the value of the brand.

As simple as that. Another way to calculate the value of a brand is to look at the increases in cash flows that can be expected because of the brand. And we do something called discounted cash flow analysis. We take the future incremental earnings and bring them back to the present. These are all standard financial procedures, but using processes like that, companies like Interbrand, companies like Brand Finance, have started estimating the brand value as a percentage of the firm value.

And for consumer-packaged goods industry, the estimate is about 60% of the value in fast-moving consumer goods companies is actually coming because of the brand. They've also calculated for durables. Durables would be things like refrigerators, automobiles and so on, and they're also the value is close to 50%. Now, remember this is based on incremental earnings. What can a BMW earn over and above to, let's say, a similar Hyundai or Honda? Then there's the value in the services sector. I believe that if I go back to the intangible value, it is probably likely to be more in the service sector. It's a historical artefact that branding came out of fast-moving consumer goods. But the potential impact of branding, in my opinion, which is based on trust, which is based on beliefs and so on, is actually more in those categories where the intangible value is more and services is based a lot more on trust than a product that you can touch and feel.

The final element is that even for industrial goods, close to 20% of the value is in the trust and reputation of the product.

Video 8: Managing Price to Distributors: Price/Margin Incentives vs Rethinking GMROI

Let me focus for a few minutes on managing price and margin kinds of incentives, relative to the other things that we can do, beyond just cutting the price to the distributor. Certainly, giving the distributor a lower price, as an incentive for them. But, what can we do that can actually be more effective, and allow us to keep more of the margins with us? So, supposing we're looking at a situation, we want to generate revenue growth. Revenue growth will come from, either increasing the size of the market, it can come from increasing a market share, it can also come from increasing the price that we pay to the retailer.

Now we can say, all right, let's look at revenue growth in new product markets, relative to revenue growth in existing markets. So, I'm going to go with existing markets. I'm going to say, how can I increase my revenue while increasing channel penetration in this strategy? I'm not going to bring any new products in place, I just want to get a larger share of the distributor's business, and how do I do that? So, we need to look at what drives the distributor's thinking? What is it they want to make? Now, they don't care, whether they sell your brand or my brand. What they're interested in, is making money, and that's measured by something called GMROI. GMROI stands for Gross Margin Return On Investment.

The retailer's investment, or close to 80-90% of the retailer's investment, is typically in the inventory they keep; the goods that they have on their premises, that is very, very expensive for them. And what we want to do? We want a larger share of the business, but they want to make more money simultaneously. So, I'm going to talk about this company called Balaji Wafers. So, this is a company that sells potato chips in multiple flavours, dozens of flavours. And they've got these flavours fine tuned. So, in the state of Gujarat, there some flavours may be popular, and when we look at the Madhya Pradesh, some other flavours are going to be popular. So, what they've done is, localised, regionalised the flavours, and some parts you eat spicier food and things like that. So, what they do now is to spend zero, literally zero on advertising. What they're advertising is, is the point-of-purchase display at the small little Kirana stores as you call them, these are mom-and-pop stores, for those people who are out of India, so these are Kirana stores.

Now, what you see is a picture of a point-of-purchase display at a Kirana store. And you walk into the Kirana store, and you're flooded with this vision of potato chips and maybe having a Coke in the bargain, but you need the potato chips to offset that. And this advertising is really, just literally the point-of-purchase advertising. They're not doing any advertising on the airwaves or in print advertising, it's all point-of-purchase advertising. Their value proposition is that, we will sell you the same product, but we're going to give you 30% more for the same price.

Now, it's a somewhat larger package than the Pepsi product. But the cost of producing that 30% more is very little, because most of the cost is really in marketing and distribution, and giving somebody 20% or 30% more potato chips isn't costing the company a lot of money. All right, so what's the impact of this? That this company, has outrun Pepsi's brands, in each and every state that they're in. They're still not a fully national brand, but every year they keep expanding into adjacent geographical markets, and they're doing very, very well. Because, what is their value proposition? Their value proposition is, if you look at GMROI, so just look at the numerators of the margin, right? That's the revenue minus costs, the denominators are investment.

If you can reduce the investment, and in this case, they deliver faster, they deliver more frequently. And for the very small retailers, in fact, their inventory, could be pretty much financed by Balaji. So, what you're looking at is a situation where, if you reduce the investment required, let's say, by a factor of 50%, you've automatically doubled the Gross Margin Return on Investment. And that is the number that the retailers are looking at. They want to make more money on their investment, and if you can help them make more money on their investment, they will be a happy group.

Video 9: Managing Pricing Promotions and Distribution Challenges

We will now focus on managing, pricing, promotions, distribution challenges, back with analytics. Again, analytics is not new to marketing, we've been doing it since the 60's and 70's. And so, what I'm going to do is provide you a framework that we can use to understand what is happening in the marketplace. So, we can make better decisions. And I'm saying better to differentiate it from efficient decisions. So, efficiency doesn't necessarily mean the best thing that you can do. I'm going to describe what is typically referred to as a marketing dashboard. What is a marketing dashboard? It's looking at the marketing budget, the marketing mix as we call it. So, one element of that mix is the price, the value that we are appropriating. But everything else is coming out of the pocket. What is coming out of the pocket, its advertising, the incentives that we're providing to the trade, we're looking at a, for example, the special incentives such as end of higher displays, the expenditure that we incur on our sales force that is calling on the retailers and so on and so forth. Now, when we do these activities, what is the outcome?

So, the next stage is really the outcome of this activity? Is it making our product more attractive to the consumer? Are we attracting the retailer's attention, so we can get better shelf space? Are we able to be top of mind for the consumer? And all these factors in the middle, these are marketplace outcomes, they are really resulting into higher consumer preference in a consumer loyalty. They're also leading to the trade pushing our products. So, it's creating the pull and the push, and it is also helping us get marketing incur in a market coverage. So, these are the outcomes, and when you aggregate these outcomes, you bring them together in a model, they will represent what will be the market share that we can generate.

Now, based on the pricing, you will also impact market size and the sales, and that multiplied by the prices is giving us revenues. So, what we want to do is we want to now look at the revenues that we're generating and compare it with all the marketing expenses that were incurred on the left-hand-side of this chart advertising etc. And by comparing the revenues to the expenses, basically, what we come up with is some measure of profitability, you divided by investment and that becomes ROI, you divided by assets, it becomes ROA and so on and so forth. And these days, a measure called ROMI, 'return on marketing investment' is becoming very popular, I'll talk about it in the next module, when we look at the financial metrics, related to brands and marketing. Now, let me put this in a context.

People talk about artificial intelligence and let me say, that we need to worry about augmented intelligence, we can't let the machine find all kind of wrong answers for us. So, if I look at the literature on when brands work and when they don't work, and what the gurus are saying, what we find is that price promotions work very well when the brand itself is differentiated. Okay, so if you have a great brand and you ran a promotion, it leads to a lot of effects. It can help generate trials. It attracts people to switch from other brands to your brand. And if they're sitting for the first time of first few times, it can generate hopefully, positive experience.

You can do price segmentation. It's a price signal, come and buy our stuff, it's a great deal right now, and so on. It's typically, used as an offense. Offense and defense is used as an offense and the short-term effects have been documented, and I'll show you some short-term effects in just a minute. So, when we do price promotions, we get a big bump in sales. Relative to advertising: Advertising also works for differentiated brand. It is there to help keep loyalists, it is there to help people interpret the experience, okay.

Sometimes you might find that you pay more attention to a product after you've purchased it. There's enough evidence that shows that when people have bought a car, they start paying more attention to the advertising for that car, perhaps to convince themselves that they made the right decision, okay? So, they're interpreting experience. There's also it's a quality signal, and very often we say, look, we're going to use the advertising, we are going to use the image, we're going to use the preference to defend our position in the marketplace. However, typically, in the short run, the long-term impact with assume it's positive. In the short run, when we do the analysis, in any given week, any given month, advertising is not going to have a huge impact on your sales, because it is the past experience that has been built up, right? Now, let me take you to some real data, in this data is a sort of weekly data, over almost a two-year period and what we're doing is we're looking at market share as the dependent variable, and we're running a regression. One part of the regression is the brand name.

How well does brand one do vs brand two vs brand three and so on? Then we're looking at the advertising coefficient. If we run advertising, the amount of advertising, what's the impact of that on sales? Sorry, market share. Similarly, if we gave the trade the retailer's incentives, what's the impact of the incentives, we give to the retailers on our share of the market? And finally, we're looking at if we have consumer promotions, coupons, three for the price of two etcetera. What impact is that having on our market share? So, now let me plot this thing out. At the very bottom is the impact of the brand intercept.

The reason is running up and down is that in some weeks, your competition's brand is more strong, because of whatever marketing, they have put in. So, the purple out here is saying, that part of the preference, that part of purchases I can explain, because of the brand name. The second part out here in green is saying, what part of the variance in sales can I explain, because of the trade promotion?

Now, you might notice the purple is larger than the green tone. What does the signaling a brand is more important than the trade promotion? I finally look at the consumer promotion, which is in yellow, it's saying, the consumer promotion, the price cuts the coupons, three for price of two is more important in explaining sales, than the trade promotion that was in green. And when I look at it in terms of advertising, you see very little impact in this picture.

Now, put on the hat of a brand manager, as a brand manager, I get my quarterly bonus, I get my part on the back in a promotion, by producing results now. So, if I'm looking at this output, I'm looking at this result, am I going to put my money on advertising, or am I going to put my budget on consumer promotions? The answer is very simple. We will find that more of the money is being spent on consumer promotions, and that was the yellow part we see in this picture, followed by trade promotions, followed by advertising.

Now, what is the impact of spending all this money on consumer and trade promotion? What we're doing is we're attracting the consumer's attention to price. So, if I'm a Coke drinker, I don't buy Coke in the grocery store, unless it's on sale. If I'm price sensitive, because if I don't find it on sale this week, is there it will be on sale next week. And if this pattern is repeated every two weeks Coke is on sale, what do I do is buy Coke every two weeks, and I stock up for the week in between. So, there's a lot of consumer learning that takes place, and when we focus too much on pricing, we are actually training the consumer to become more and more price sensitive, and we forget that the largest part of the preference is actually, because of the brand reinforcement.

We forget to do that, because in this budget we're not going to spend money on advertising, we're going to spend money on consumer promotions. All right, so that is an issue that we need to deal with. How are we going to support our activities in the marketplace? Are we going to do it for the short run, which is the price promotions? Or are we going to manage a product for the long run, differentiated to suspect the competition and so on? Obviously, you can tell from our conversation, that I'm a proponent of longer-term strategy. But there are people who will live with the short-term strategy, because there's a saying, "That to fight tomorrow, you got to live today."

Video 10: Manufacturer and Retailer Brand

As we look at the market today, and this is on a global basis. We see that there's an increasing level of competition between the manufacturer brands and the retailer brands. So, you take a company like Amazon; you can buy a manufacturer brand, you could also buy Amazon Basics or Amazon Essentials and so on and so forth. So, that tussle is going on. This, however, is not new. It's been going on for a long time, and I'm giving you an example of an allergy pill called Zyrtec. That's the manufacturer's brand, and right next to it is a brand from CVS retailer. I mean, this is a pharmacy and the CVS brand. And then there's a Kirkland brand, which is a Costco brand. And what these pictures show is not only the formulation of the product exactly the same. So, if you look at the product details at the back, exactly the same formulation. But even the bottle, the green cap for the top of the bottle, etc., it is just really duplicating everything that the manufacturers are doing.

Now, what this is leading to is constant competition between the manufacturer and the retailer started a long time ago. And it started out in Europe, then it migrated to North America, and it's picking up a lot of pace very quickly in emerging markets, like India. So, let me talk you through the logic of it, supposing there were only two brands, We and Them, ourselves, our flagship brand and a key competitor. Life was good, we're doing well, then along comes a price-driven competitor and say, "Hey, we got the same stuff, but at a much lower price."

Now, we have to figure out what to do with them. If we compete with them directly on price, what we're doing is we're killing our margins. And remember the first thing I was saying, "Don't cut price." So, if we're not going to cut our price, which will also start a price war with the key competitor, what do we do? Very often, we throw in something called a fighter brand. So, this is the price brand that is going to compete with the low-price competitor.

Now, what impact does it have? It takes sales away from the low-price competitor. So, the low-price competitor, which is hoping to operate on low margins, but high volume is not able to make up the volume, so they're going out of business because their business model isn't working. At the same time, the market is realising that this fighter brand is actually very similar to our flagship brand, so it's taking sales away from the flagship brand. Anyway, this low-price brand starts going out of business, but rather than going completely out of business; they tell the retailer, "Hey, we can produce a private label for you." So, this low-price producer is now becoming a Contract Manufacturer, CM, and is producing the private label.

Now, in all of this, we as the manufacturer feel, that our unit sales are shrinking, is going to the low-end of the market. Now, we have excess capacity. So, if you have excess capacity, what do we do? And one of it is we can, instead of letting the contract manufacturer sell to the retailer, we tell the retailer we're going to give it to you to use excess capacity. So, this is like sitting on the branch of a tree and cutting it while you're sitting on it. You're going to compete with a yourself, rather than competing with competitor. At the same time, the retailer says, "Hey, I don't like this fighter brand. It's causing unnecessary problems with my low-price private label, so I want it out of there; I'm not going to give it shelf space." So, what's the result?

The result is manufacturers are now making private labels, the fighter brand is now killed because brands in the middle don't survive, and we're looking at this picture. Then the retailer goes out and say, "I can also hire some MBAs. It's not only the Procter & Gamble and Unilever's that are going to hire MBAs; we can hire them as well. And these MBAs come in, and they say, "Now, why are you competing at the low end? You can actually do a good better and best." So, if I look at Kroger, there's a Kroger brand in the middle, FMV is For Maximum Value, that's the price brand, and the high-end brand is called private selection. So, Kroger itself has three brands in the marketplace. And then, to top it all, we have new entrants coming called ODMs. ODM stands for Original Design Manufacturer. They're saying, "Hey, whatever the manufacturer can produce, we're specialist starters, we can do as well or perhaps even better." So, this is what has been happening in the marketplace with the battle between private labels and the manufacturer labels. What it is means financially is the following. On the left, we have the national brand. You got the retail margin, the margin the retailer makes, the manufacturers' margin and CM is the Cost of Manufacturing.

Now, what happens is that when we go to a private label, the manufacturer producing the private label for the retailer, the retailer margin is larger, and the manufacturers' gross margin is lower, and the cost of manufacturing stays about the same. So, if I'm a retailer, do I want to sell my brand or do I want to sell the national brand? Answer is very simple I make more money with my brand. So, I want to give my brand proximity and positioning in the retail store. And then the manufacturer comes and says, "Oh, we're not doing so well, this is not good, what can we do to build a better relationship between us?" Retailer says, "Look, we're in a competitive market. Tell you what? If you give us some incentives, then we will make sure that your product gets a better position on the shelves." What that means is in this friendly conversation, they're saying, "Hey, cut your margin some more."

So, this when you keep iterating on this cycle, very quickly, the manufacturers' margins start shrinking, and the only way you can hang on to your margin, is if you have a differentiated product that the retailer doesn't have that the competition doesn't have. So, again, your only solution out of this, is really product differentiation, with the end consumer, willing to buy your brand more than the competitive brand, including the retailer's brand. So, this was being done by Walmart. It's been done by Best Buy in the consumer electronics business, it has been done by Foot Locker in the athletic shoe business, and we can go on and on. So, this fight between retailers and manufacturers is pretty much across the board.

Video 11: Shift of Power to Retailers Resulting from Technological & Exogeneous Disruptions

So, we kind of ended on the note that there's a battle brewing between the manufacturer brand and the retailer brand. This battle that has been going on for decades, has now been accelerated because of emerging technologies, it's made a difference in how the manufacturers and retailers think. It's also made a difference on how we as consumers act and behave. So, this particular activity is leading to a shift of power to the retailers because of technological and competitive disruption that we see in the marketplace.

Let me talk very briefly about what has gone on in India with a company called Flipkart, you're all familiar with it, so I'll just walk through it. Flipkart was started by some founders that actually came from Amazon, and they said, "Well, we're going to adapt the Amazon-like model, not exactly the same model, but we're going to adapt it for the Indian marketplace." The logic was very similar to succeed in an online retailer.

For an online retailer, you need buyers, and you need sellers. The greater the number of buyers, the more attractive you are to sellers; the greater the product variety and options, the more attractive you are to buyers. And the more you can create price competition in this buyer seller market, the greater will be the growth in your particular channel. Now they had to make some changes in India. Number one, many Indians did not have a credit card, so they had to shift to a process called cash on delivery. It could also be looking at a situation where the distribution networks were not quite as efficient. So, rather than having centralised distribution centres, as that was the case, for example, in North America, we said we're going to have more regional and sometimes even local warehouses, in large cities like Mumbai or Delhi, there may be, indeed, just a local warehouse.

Now, not increased the time perhaps, or it reduced the geographical spread that could be served out of the warehouse, but there were actually some advantages. The advantage was that the product was available locally, and then you could use these guys on motorcycles that could deliver the product the same day, all right? In addition, it was also possible to make the product available at this corner store. So, I order on the Internet, and I pick it up on the way home at the corner store. Or indeed, in India labour is cheap, the corner store could deliver it to your home in the evening. So, these were the adoptions that were made not only by Flipkart but also by both Amazon and Walmart. So, this was the makeup of think, and we refer to it as omni-channel retailing. You can buy on a physical enterprise, you can buy on the Internet, and you could just have it delivered to you.

Now, what is the outcome of all of this? If I go back in time and I go back to the European operations, what was important was the concentration. The concentration was referring to the percentage of sales coming from, let's say, the top five retailers. As this concentration of distribution got higher and higher, it means the retailer power was increasing. And therefore, we would expect that more private labels would be sold when the distributors became more and more powerful. That indeed is reflected in this chart; Y-axis is private label penetration, X-axis is power of the distributors. And we see that in countries like India and China, there's a growth in concentration. But in countries like Germany and many of the European countries, that concentration was already there. So, what we expect is that the Walmart's of the world are going to benefit with this increase in concentration.

As the e-commerce industry gets more and more competitive, they are going to capture share away from the less-organised retailing sector. And we see that, in India, we have Dior with the reliance retail framework coming in; we've got Amazon as the big gorilla. And more recently, we've seen the emergence of Shopify in that market, which is centrally because these guys are saying, "We're on the manufacturing side; we're not going to compete with the manufacturer." This is an article out of Wall Street Journal and what this article is basically saying is that companies like Amazon, and you'll recognise Mr. Bezos there. They are using algorithms that when I as a consumer type in a particular product category, we will find that the Amazon brand is likely to come up first.

Many people don't know that the number three diaper company in the world is now Amazon, the number one company for flashlight batteries and so on is Amazon. And so, this is a retailer that is fast turning in and using its information power to start competing with the manufacturers. But Amazon is actually a late entrant. Many tech companies like Target. They were already selling almost 30% of the output as Target brands.

We don't recognise them as Target brands because they look like brands, but they're basically distributor brands that are being sold. All right, so, what are the Amazon doing? It's got their own brands now. They've got Amazon Basics, they got Amazon Essentials and Happy Belly and so on and so forth. So, these are now branded products that there are coming out of Amazon. If you go to Costco, it'll be company brands like Kirkland and things like that.

So, a lot of competition that is taking place. Now, what does this all lead to? What this competition is leading to is going to be a shift in strategies, not only from the retailers, but the question will be, how will the other manufacturers react to this? And in particular, what I want to do is I want to talk about how the positioning of a company like Shopify, which is one of the fastest growing online retailing platform in the world. How the positioning of Shopify is different from the positioning of Amazon and we will see whether they are likely to make a penetration in the marketplace, and will they be able to take on organisations like Amazon.

Video 12: Shift Direct to Customer Strategies

If I go back the memory lane, if I go back 25 years ago, I remember having a conversation with some of my friends, some of my students who were working with companies like Procter & Gamble. At that time, there was a lot of conversation taking place that if the Procter & Gamble's of the world work closely with Walmart, they could bring about market efficiencies. And through that partnership, they could generate more profits that could be split between the two. So, the talk was about partnership. I also remember making a comment at that point in time, that, "Yes it's going to lead to perhaps the greater profitability in the short run.

But what if Walmart's share of retail sales went from 9% to 12, to 15, to 17, to 20? If Walmart started selling 17, 18, 19% of the total retail sales, they will become so powerful, that what was a positive relationship, might turn into a bit of an acrimonious one." Now, this is indeed what was happening with Walmart hasn't been accelerated to some extent because of the online nature of the business. And this has led to friction between the manufacturer's brand and the retailer brands.

So, along comes a company called Shopify. What they are telling to the manufacturers is, "Look, we're not going to compete with you; we're on your side." So, what are Shopify doing? They're saying, "Look, if you want to set up your online business, we're going to help you set up that store. If you need web designers, we will connect you to the web designers. If you need people who can develop the product for you, we'll help you do that. If you need advertising agencies to work with you, if you need accounting help, whatever you need to set up your shop, we will do it. And we will do it in a fair way." So, somebody who's a small micro-sized retail of 5, 10, 20 employees will charge you only $29 a month.

For a mid-size businesses for about $300 a month. And for larger business, 2,000 to 3,000 a month, depending on the nature of the business. Now, clearly what they're trying to do is they're trying to go after the smaller manufacturers first and building it up in the upper end. Now, so they're getting the manufacturer's attention. If I am a manufacturer and I'm going to use the Shopify platform, let me call it that. What is missing out here to some extent? What is missing or what is less visible, is the marketplace. So, when I'm looking for information, I go to a search engine called Google, and I Google things. Today if I'm looking for a product, I go and Amazon it. They have a platform not only for interaction, but they also have the delivery mechanism. They have the airplanes. They have the trucks; they have the delivery mechanism. They have the relationship even with the United States Postal Service to deliver the products on their behalf. So, what Shopify does not have is really the marketplace, okay? That side has to be built up.

Now, what would be a partnership that will help them get it? So, it would be somebody who's got a big presence in the marketplace, but also possibly somebody who doesn't like Amazon, all right? And that actually turned out to be Walmart. So, Walmart has a big presence in the marketplace. They have been a little bit late in terms of being able to adopt the electronic medium in terms of being able to sell online. And while Walmart is investing a lot in the online business, it is not at the same scale as Amazon. So, this is obviously a natural partnership between Walmart and Shopify. On June 15th last year, they announced this partnership. And on that single day, the stock price of Shopify went up by almost 10%, 9.5%. It went up in a single day. And what has that done over a period of time? If you want to go to the Shopify stock, you'll see that the Shopify stock in the last 12 to 15 months has grown 400%. Amazon has grown 60%, but these guys have grown 400%. So, again, you had the manufacturers on one side, the retailers on another side. And Shopify has come out on the side of the manufacturers, saying that, "We will help you in the game."

Now, what is an outcome of all this? Obviously, Amazon has to react in some way, right? So, now what Amazon is saying is they're starting a seller university. "We will tell our business clients how to use the online platform more effectively. And by the way, we will do fulfilment by Amazon FBA to better support your online retail activities." So, now though, the battle is brewing, not just between the manufacturers and Amazon, but between Amazon and Shopify. And we expect that to continue over a period of time. So, one thing I wanted to point out is that this is not going away. This change that we're seeing is continuous. What has happened over the last decade is that the computing power has been shifted to a miniature platform called the smartphone. We don't need to be on the computer anymore;

we're using a smartphone for doing all kinds of searches. We don't sit at home and search for information and then go and shop; we are walking around and shopping and searching at the same time. So, what are some of the platforms? It's Google, it's Bing, and I can go on and on, Yahoo and so on. But Google is obviously the Big Kahuna. Now what has happened last year or so, I'll say last 15 months, that while we used to Google for information. If we want to purchase something, many people are going directly for Amazon.

About a year ago, the count was almost 50% of the people. When it came to purchases were not Googling, they were Amazoning. And I am willing to bet that 50% at least, has gone up to 60 or 70%. So, if I look at my own family behaviour, we are on Amazon Prime half the time searching for things. And so, about a year ago, I wrote an article titled, Will Google be Amazoned? Now, to justify what I'm saying, to help you understand what I'm saying, I want you to go back to the loop. Remember we talked about the sales funnel and the loopback.

Now, what does Amazon have that Google doesn't have? Amazon actually has the purchase information and the repurchase information. So, you can do all the attitudinal analysis that you want, and how sticky is a website page, etc., etc. You can run all the Google analytics. But what Amazon has is our purchase behaviour and our repurchase behaviour. And while people talk about demographics and psychographics, there's a term called bio graphics.

So, Amazon has the bio graphics, Google doesn't. Google is now trying to build it up through Google Pay and so on. So, this battle will continue. But the real thing is to use the online medium and connect it back to the way the human mind thinks. And so, the example that we used in the context of Capital One for credit cards, that kind of thing can be accelerated in literally every product category that you want to think of.

Video 13: Leveraging Data and Technology to Drive Business Value in Dynamic Market

As you can see from the competitive dynamics, you know what Amazon is doing, what Shopify is doing, what Flipkart is doing. And if we move to the fintech sector, for example, there's almost a continuous daily change that is focusing on data and technology. What is happening is that we are increasingly leveraging data to generate insights about the marketplace, and we are accelerating the pace of actions that we take in the marketplace that is based on these insights. So, really, it's about leveraging data to make the marketplace much more dynamic. And in this context, I want to talk about dynamic pricing.

Again, dynamic pricing is not a new concept. It's picked up a lot of speed over the last decade and certainly over the last couple of years. People are talking about pricing dynamics. Why? Because we see it's used almost across the board in multiple categories. I will take you back about 25-30 years. This is to American Airlines that owned a subsidiary called Sabre. Sabre was the system that was being used to make reservations and based on the Sabre system, it was possible for American Airlines to tell how many seats on a particular flight from Dallas to Phoenix on a particular day of the week have already been sold, and therefore obviously they knew the seats that were not sold. And it was also possible to look at the same day the previous week and say that based on last week's behaviour, how many seats can we expect to be sold? And if that still led to a difference, that led to the logic that for these seats that we don't expect to sell, maybe we could sell them on a price promotion. So, almost on a continuous basis, one could adjust the pricing.

The problem was in those days the analytics, were not quite as easy as they're today, so this was being done on a limited sense because to set the pricing tomorrow, we did the analysis today. What is happening now is to set the price five minutes from now; we can be doing the analysis a lot more dynamic marketplace. This kind of logic was also used at Dell computers. What they were doing was a bit of price experimentation, trying one price Monday afternoon, another price Wednesday morning. They were also doing bundling; what if we bundle the printer with the CPU, with the PC. And so, they did all this price experimentation to learn from this experimentation as to how to better manage the pricing. And again, this was done in a fairly dynamic manner.

What is happening today is because all this information is on the web and all the information is on the cell phone that companies like Uber and its Indian counterpart Ola are using information on pretty much an instantaneous basis. But I don't want you to think it's only Ola and Uber, it's also Hilton, it's also, Amazon and so on, a lot of price experimentation is taking place and rather than thinking of it as Artificial Intelligence, when you couple the experimentation with the theory and the data insights that you get from the real data, I would call it Augmented Intelligence. So, you're taking Artificial Intelligence and you augmenting it with what you know about your own marketplace in order to make better decisions.

Now, what is the logic behind dynamic pricing? The logic is very simple that when the price is high, more people are willing to provide a product or a service. When the price is low, some people are saying no, no, no, not for me; it's not worth it. So, the idea behind dynamic pricing is that as demand goes up, if we can increase the price, it will bring more service into the market, and at the same time, it will drive some consumers out of the market because the price has gone up.

So, very often, it's termed as search pricing; for example, finding a taxi or finding a Lyft or Uber at 4:30 in the afternoon and everybody else is going home is very difficult. So, that is when will be having search pricing. But the logic is very, very simple. What we're trying to do is use the consumer response to the price structure and the seller response. It has to be both sides that the volume that is available will depend on the price and the demand will also. So, as the price goes up, demand comes down.

As the price goes up, supply goes up. So, this is the dynamic nature that has to take place, and basically what we're trying to do is saying, let us look at the variability in supply and demand in terms of price sensitivity, and the price sensitivities on both sides, the supply side and the demand side. So, it's important to remember it's not just a consumer price sensitivity. If we do that, and we'll take an example, this is out of Uber and there's something called Latitude of Price Acceptance. What is the Latitude of Price Acceptance? Think, if you're looking for a mortgage loan, and if the going rate is maybe 3% for the loan, you might say, well, if it is convenient etc. and I can save some time, I can bring down my down payment, I'm willing to pay maybe three-and-a-quarter percent.

But you're not going to go up to 4%. So, the sensitivity is very high when it comes to financial products because you're paying for them over a long period of time. When it comes to consumer branded goods, 15, 20% may not make that much of a difference depending on when you're consuming the product, and when it comes to durable when it comes to engineering products, I think you know 5-10% is what the data shows people are willing to tolerate. So, there's some variability, and this is called the Latitude for Price Acceptance, and you're not going to be able to double prices, but whether it is 2% and financial services are 15-20% and consumer goods is an empirical matter, and it's going to depend obviously, on the level of competition and so on. All right, so what we need out here is that we need to be within the Latitude of Price Acceptance range. If we go outside of that, then the consumer is going to say no, no, I've had it, I can't, I am not going to participate. All right, so if you look at Uber, which I mentioned earlier, and this is something called a heat map.

You might notice towards the bottom right is the darkest portion, and that is 11 o'clock in the evening on Saturday. And that demand continues on Sunday at the top early morning, 12 o'clock, 1 o'clock right after midnight. So, obviously, that's a time period where the demand is high, and that's where pricing is going to search. On the other hand, if you look at Tuesday at 11 o'clock in this chart, we see that's where the demand is the lightest, and that is when we would expect the prices to drop, and therefore, the supply to also drop. So, what we want to do in this is to say, all right, can we balance, can we come up with additional strategies that are going to allow us to match the market needs.

And then companies like Uber and Lyft, and Ola have come up with a structure where they're saying, look, we will let you split the fare, if you're willing to pick up another passenger on your way home. Or you can split the fair with somebody who's riding with you; then, you can actually bring your cost down during the search pricing. So, all this is continuing to be evolved over a period of time, and what has happened with this is that the Taxi services are under a lot of pressure, and there's a lot of competition between Taxi services that are driven on old technology, radio technology, etc. compared to the Ubers and Olas of the world that are being driven strictly on real-time data analysis and availability. And what we see is that in India, we see that the second largest transportation system after the Indian Railways are the taxi health services. I just wanted to remind you that it's important to understand who is the customer. The customer is the driver, and the customer is also the rider because what we're doing is the supply depends on price, the demand depends on price. You cannot look at the driver and the consumer separately in a dynamic pricing situation or in the context of, let's say, hotels, the availability of rooms and the demand of rooms.

Video 14: Summary

Let me quickly summarise what we focused on in this module on pricing and distribution related to brand positioning. So, the first thing we talked about was how do we manage product launches? We looked at it in three different settings. We looked at it in a commodity like consumer product, water. And in that, we showed that supporting the brand through advertising and sustaining a higher price, gave the distributors, the retailers, a higher margin. And we saw that the retailers were more supportive of products that they could make more money on.

We also looked at launching a credit card product from Capital One, and we took you through the cycle of how to build awareness preference, but ultimately looping in the customer, so you can hang on to the customer. So, the acquisition is actually just as important as retention and retention in the long run, becomes more important than acquisition because as the market is mature, it becomes very, very difficult to take share away from competition. So, if you're going to build share, it's better to build it up earlier in the product lifecycle. We also looked at a more difficult situation in the context of LS-120, where we had to do B2B marketing along with B2C but where we also had to sell two products, the drive and the floppy, and they had to be merged together. And we looked at the various things that had to be done along the way. And the message was that the marketing side of the business has to be coordinated with the manufacturing and operation side of the business, because otherwise we'll be dancing to two different tunes, and our success is going to be mitigated. We talked also about pricing strategies; in particular, our focus was quite a bit on price promotions, and my message was, be careful.

When you do price promotions, you're killing your brand to some extent, and you're sensitising your customers to the price. In fact, you're making the market more price sensitive. Instead, you should be focused on the long-term value of the brand. We also talked about the Balaji Wafers, where they built their brand through on-site point-of-purchase displays, and that was managed largely by the distributors. So, we're looking at a brand that has succeeded through a distribution strategy rather than advertising and promotion. We clearly went quite deeply into this ongoing battle between the manufacturer's brand and the retailer's private label.

This market is intensifying, this battle is intensifying, and it is not going to go away. And what we will be doing later on, is talking about direct-to-consumer strategies. So, as the retailers are competing with the manufacturers, what is happening is that manufacturers are going direct to customers. Today we talked about it in the context of leveraging the services provided by Shopify, so a manufacturer can build on the Shopify platform to go to the end market. When we come back to Module 11, I will also talk a little bit more about direct-to-customer strategies, and these have emerged largely within the last two years.

So, many companies like Nike and so on, are also going direct to customer as a way to accelerate their own position in the marketplace, but also as a way to protect themselves against the competition that is coming from retailers. So, direct-to-customer strategies, we will continue on, and in the next module, my main focus is going to be, how do we manage the product market performance? What are the metrics that we ought to be paying attention to? And these metrics will be in the context of managing cash flow, will be in the context of managing growth, and also how to reduce risk and enhance resilience. If we can do the three, enhanced profitability, support growth, and increased resilience or reducing risk, what we are doing is pushing up the value of our business, pushing up the value of our brand.