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# Marketing


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MK-A5-engb 1/2014 (1004)

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# Marketing

**John Mullins** is Associate Professor of Management Practice in Marketing and Entrepreneurship at London Business School. He earned his MBA at the Stanford Graduate School of Business and, considerably later in life, his PhD in marketing from the University of Minnesota. An award-winning teacher, John brings to his teaching and research 20 years of executive experience in high-growth firms, including two ventures he founded, one of which he took public. Since becoming a business school professor in 1992, John has published more than 40 articles in a variety of outlets, including *Harvard Business Review*, *MIT Sloan Management Review* and the *Journal of Product Innovation Management*. His research has won national and international awards from the Marketing Science Institute, the American Marketing Association and the Richard D. Irwin Foundation. He has authored two best-selling trade books: *The New Business Road Test* (London: Prentice-Hall/FT, 3rd edition 2010), which shows entrepreneurs and executives what they should do *before* writing a business plan; and, with noted author and venture capital investor Randy Komisar, *Getting to Plan B: Breaking Through to a Better Business Model* (Boston: Harvard Business Press, 2009). He has served on the boards of fast-growing entrepreneurial companies in North America, Europe and Asia and is a frequent speaker on topics related to entrepreneurship and venture capital.

**Professor Orville C. Walker, Jr** was the James D. Watkins Professor of Marketing and Director of the PhD Programme, in the University of Minnesota's Carlson School of Management. He holds a Master's degree in social psychology from the Ohio State University and a PhD in marketing from the University of Wisconsin-Madison. Orville is the co-author of three books and has published more than 50 research articles in scholarly and business journals. He has won several awards for his research, including the O'Dell award from the *Journal of Marketing Research*, the Maynard award from the *Journal of Marketing* and a lifetime achievement award from the Sales Management Interest Group of the American Marketing Association. Orville has been a consultant to a number of business firms and not-for-profit organisations and he has taught in executive development programmes around the world, including programmes in Poland, Switzerland, Scotland and Hong Kong. Perhaps his biggest business challenge, however, was attempting to turn a profit as the owner-manager of a small vineyard in western Wisconsin.

The late **Professor Harper W. Boyd, Jr** was the Donaghey Distinguished Professor Emeritus of Marketing at the University of Arkansas at Little Rock. He was internationally known in the areas of marketing strategy and marketing research. He authored, co-authored, or edited more than 50 books and monographs and 100 articles, cases and other teaching materials and served as editor of the *Journal of Marketing Research*. He taught on the faculties of several prominent business schools around the world, including Stanford, Northwestern, Tulane and INSEAD; and he received an honorary Doctorate of Letters from the Edinburgh Business School in Scotland. He also consulted extensively with both consumer and industrial products companies around the world.

**Barbara Jamieson** is a Senior Teaching Fellow and Marketing course leader. With an extensive career in industry and academia, she brings a wealth of practical and theoretical knowledge to her teaching. Before entering academia she built up more than 15 years' commercial experience in advertising, marketing research and marketing consultancy. She holds an MBA, an honours degree in business organisation, and is a Chartered Marketer.

Barbara Jamieson delivers a broad range of marketing-related courses across the MBA, MSc and DBA programmes. As well as her teaching roles, she supports faculty in the Edinburgh Business School international learning partner network to promote quality in programme delivery, with particular emphasis on using the case method approach.

Since 2005 she has played a leading role in several projects supported by the Global Business School Network to build management education capacity in Kenya, involving seminars and workshops to promote case method teaching and develop case writing skills among university faculty.

She is pursuing doctoral-level research on the relationship between distance-learning student characteristics, the student learning experience and learning outcomes. She is leading a related initiative to explore how new technology can enrich the student learning experience.

First Published in Great Britain in 1996.

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## PART 3 MARKETING PROGRAMME DECISIONS

# Preface

## Why This Book?

Why did EBS choose this book? Chances are, it was for one or more of the following reasons:

- EBS wants to give you the necessary tools and frameworks to enable you to be an effective contributor to marketing decision making, whether as an entrepreneur or in an established firm. This book's **focus on decision making** sets it apart from other texts that place greater emphasis on description of marketing phenomena than on the strategic and tactical marketing decisions that marketing managers and entrepreneurs must make each and every day.
- EBS wants to use the most current and most **Web-savvy** book available. We integrate the latest new-economy developments into each module. In addition, we supplement the book with an interactive website to help you learn. Our goal is to make both the latest Web-based tools as well as time-tested marketing principles relevant to those of you who will work in either old – or new – economy companies.
- EBS appreciates and believes you will benefit from the **real-world, global perspectives** offered by the authors of this book. Our combined entrepreneurial, marketing management and consulting experience spans a broad variety of manufacturing, service, software and distribution industries and has taken us – and thereby you, the reader – around the world many times over.

As the reader will see from the outset in Module 1, marketing decision making is a critical activity in every firm, including start-ups, not just in big companies with traditional marketing departments. Further, it is not just marketing managers who make marketing decisions. People in nearly every role in every company can have powerful influence on how happy its customers are – or are not – with the goods and services the company provides. Stockbrokers must attract new customers. Accounting and consulting firms must find ways to differentiate their services from other providers so their customers have reasons to give them their business. Software engineers developing the next great Internet or other technology must understand how their technology can benefit the intended customer, for without such benefits, customers will not buy. Thus, we have written this book to meet the marketing needs of readers who hope to make a difference in the long-term strategic success of their organisations – whether their principal roles are in marketing or otherwise.

In this brief preface, we want to say a bit more about each of the three distinctive benefits – bulleted above – that this book offers its readers.

## A Focus on Decision Making

This revised edition of *Marketing* retains the strategic perspectives that have marked the earlier editions, while providing, in each module, specific tools and frameworks for making marketing decisions that take best advantage of the conditions in which the firm finds itself – both internally, in terms of the firm's mission and competencies and externally, in terms of the market and competitive context in which it operates.

This **decision-focused approach** is important to students and executives who are our readers. Our decision-focused approach is also important to employers, who tell us they want today's graduates to be prepared to 'hit the ground running' and contribute to the firm's decision making from day one. The ability to bring thoughtful and disciplined tools and frameworks – as opposed to seat-of-the-pants hunches or blind intuition – to marketing decision making is one of the key assets today's business school graduates offer their employers. This book puts the tools in the toolbox to make this happen. In the end, employers want to know what their new hires can *do*, not just what they *know*.

## Web-Savvy Insights

Because this book has been written by authors who teach at Web-savvy institutions and work with Web-savvy companies, it brings a realistic, informed and **Web-savvy perspective** to an important question many students are asking: 'Has the advent of the Internet changed all the rules?' Our answer is, 'Well, yes and no.' On one hand, the Internet has made available a host of new marketing tools – from banner ads to email marketing to delivery of digital goods and services over the Internet – many of which are available to companies in the so-called old and new economies alike. On the other hand, time-tested marketing fundamentals – such as understanding one's customers and competitors and meeting customer needs in ways that are differentiated from the offerings of those competitors – have become even more important in the fast-moving, dot-com world, as the many dot-com failures over the last few years attest.

Thus, throughout the book, we integrate examples of new-economy companies – both successful and otherwise – to show how both yesterday's and today's marketing tools and decision frameworks can most effectively be applied.

## A Real-World, Global Perspective

Theory is important, because it enhances our understanding of business phenomena and helps managers think about what they should do. It is in the application of theory – the world of marketing practice – where we believe this book excels. Our decision focus is all about application. But we don't just bring an academic perspective to the party, important as that perspective is.

Two of us on the author team, Orville Walker and John Mullins, have started successful entrepreneurial companies. One of these firms has 'gone public.' Orville Walker worked for many years in the United States, at the University of Minnesota. John Mullins works in Europe at the London Business School. Barbara Jamieson brings to this fully updated and revised edition her deep global understanding of distance learning to round out the picture. All of us have contributed the fruits of our research to the growing body of knowledge in the marketing management, marketing strategy, new products and entrepreneurship arenas. The result of our collective and varied experience and expertise is a book marked by its real-world, global perspective. The book's many examples of real people from around the world making real strategic marketing decisions include examples of start-ups and high-growth companies as well as examples of larger, more established firms.

# Introduction to this Course

This marketing distance learning study programme is based on the seventh edition of the book **Marketing Management: A Strategic Decision-Making Approach**.[1]

The programme has the following objectives:

1. To provide a strategic, globally informed understanding of the marketing management process.
2. To develop an awareness of the analytical process used to identify opportunities and threats in the firm's marketing environment which may influence profitability and market position.
3. To learn how to segment and target markets as well as position the firm's product(s) against market needs and competitive offerings.
4. To develop appropriate marketing strategies for exploiting opportunities and overcoming threats, especially those relating to new entries, growth markets, mature/declining markets and global markets.
5. To prepare strategic marketing programmes based on the components of product, price, channels and promotion.
6. To develop an understanding of the activities and organisational structures required to implement, monitor and control strategic marketing programmes.

The contents of this publication are organised around the above objectives on a sequential basis. It contains 19 modules that are structured around the 19 chapters in the text cited above. These modules are divided into five parts as follows:

1. An Overview of Marketing Management
2. Market Opportunity Analysis
3. Developing Strategic Marketing Programmes
4. Strategic Marketing Programmes for Selected Situations
5. Implementing and Controlling Strategic Marketing Programmes

In addition to an opening case of a real-world company that brings to life the key principles addressed in the module, each module contains seven sections: (1) a statement of module objectives; (2) the main text; (3) a learning summary; (4) end-of-module content questions; (5) end-of-module multiple-choice questions; (6) end-of-module application questions and case(s); and (7) extensive endnotes that point the way to supplementary readings. Real-world case studies and examples are employed throughout to bring marketing principles and practices to life. They feature companies large and small from around the world, and are designed to facilitate learning about a particular marketing activity. They should also help individual students apply what is being learned to their own organisations.

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1 Written by John W. Mullins and Orville C. Walker, Jr. Published by and copyright Irwin/McGraw-Hill, Burr Ridge, IL (2010).

## Instructions on Using the Study Programme Materials

Before studying any of the module materials, we suggest that you read the Preface (reproduced before this Introduction) which discusses the authors' rationale in using a strategic approach in writing (and revising) the text component of this study programme's materials. The material in the Preface will help you understand how the course merges the traditional approach to marketing management with the authors' newer, more relevant and more pragmatic strategic approach.

You should prepare yourself for studying Module 1 – and each successive module – by reading the first two sections of the module: the opening case and the learning objectives. In the process of doing so, try to relate the content of these sections – especially the one on the module's learning objectives – to how marketing interacts with other functional areas in your organisation such as finance and production.

When you finish this brief exercise, read carefully and thoroughly the main text of Module 1 (and each successive module). Some students find it desirable to read certain modules twice – once through quickly, and then a second, more careful reading. Some find it helpful to take notes or even outline the module. You should do whatever you feel provides the best results. Upon completion of your study of the module, you should proceed to the third section of the module which contains a learning summary of the module.

You are now ready to be examined on how well you understand the module and can apply its content to the real world. The answers to all three sets of test material in each module are contained in Appendix 1. The first two sets of test material involve the use of content and multiple choice questions which test – in different ways – your knowledge of the meaning of certain terms, your memory concerning important marketing concepts and facts and your ability to understand certain applications of the materials presented. You should write your answers down and then compare them to the answers contained in Appendix 1. Note any discrepancies between your answers and those provided and reconcile them by referring to the appropriate text material.

The next set of test material comprise application questions and minicases. They are concerned with how well you can apply module content to realworld problem situations. They are, by design, more analytical than the materials used in the first two sets of questions. Again, you should write down your answers and compare them with the answers given in Appendix 1. Since Appendix 1 gives the number of the module section where the correct answers to the content and multiple choice questions can be found, you should not have any difficulty in reconciling any differences with respect to these sets of materials. The summary outline of the text at the end of each module should prove helpful in enabling you to locate the appropriate materials in reconciling your answers to the application questions and the case studies.

## Conclusion

The time required to complete a module will, of course, vary between students – and even for the same student with regard to different modules. On average, we would expect you to spend a relatively short period of time studying the first two sections of the module, including thinking about their application to your organisation. You should be prepared to spend at least two to three hours studying the module's content. Some of this time will be spent in transferring what you are reading to your own job situation. The self-examination part of the learning procedure (the three batteries of questions at the end of each module) will take probably another two hours or more depending upon how much reviewing is necessary.

As you proceed through the modules, you may find it desirable, even necessary, to review certain parts of earlier modules. Thus, some of the later modules may well require additional study time. If you continuously try to apply what you are learning to your organisation, you will find yourself learning a great deal more not only about marketing, but about your organisation as well. We would hope that you will involve, where you feel it is appropriate, knowledgeable business people (including those in the organisation where you are employed) in your pursuit of an understanding of marketing management. We also hope that at the conclusion of the course you will be satisfied with what you have learned about this subject and feel confident in your ability to apply the basic concepts included in the text.

After completing your study of the 19 modules, you are now ready to take the two practice examinations (Appendix 2). *A word of caution* – be sure you thoroughly review all modules including the answers to the three test batteries before taking these exams.

For those of you wanting more exposure to certain marketing subjects, each module's references represent a major resource. These references not only identify a large number of useful and recent articles from a wide range of academic journals and business publications, but also refer to the best specialised textbooks which are concerned with the various marketing areas such as product development, marketing research, sales management, channels of distribution and advertising.

# Acknowledgements

Simply put, this book is not solely our work. Far from it. Many of our students, colleagues and those with whom we work in industry have made contributions that have significantly shaped our perspectives on marketing decision making. We are grateful to all of them.

We also thank a small army of talented people at Irwin/McGraw-Hill and Edinburgh Business School (EBS) for their work that has turned our rough manuscript into an attractive and readable book.

Finally, we thank Harper Boyd, co-author and originator of this course text's first edition, without whom this book would not exist and our parents, without whom, of course, none of us would be here. To all of you we extend our love, our respect and our gratitude for passing on to us your curiosity and your passion for learning. We therefore dedicate this book to Harper Boyd, to Jeannette and Orville Walker, Sr, to Jack and Alice Mullins, and to Brian and Joan Jamieson.

John Mullins

Orville C. Walker, Jr

Barbara Jamieson

# PART 1

# An Overview of Marketing Management

# Module 1

# The Marketing Management Process

## Contents



## RedEnvelope – Marketing Upscale Gifts Online[1]

A few years ago two recent MBA graduates started a company called 911Gifts. The firm combined a website and a toll-free customer service centre with gifts provided by two established merchants to cater to last-minute crisis shoppers. Although the new company attracted gift-givers, it also had some weaknesses: The company name, with its connotation of wailing ambulances, turned off many potential customers; the firm's suppliers provided an uninspired assortment of gifts; and a lack of capital inhibited the company's ability to grow. As a result, by its second year the firm was treading water. The site had managed only about $1 million in sales the previous year. Consequently, the owners decided to reinvent the company.

### *A New Mission and Strategy*

The owners' first move was to hire a marketing-savvy chief executive officer. They attracted Hilary Billings, a 36-year-old manager, away from Williams-Sonoma where she had successfully developed the firm's Pottery Barn catalogue operation.

After analysing 911Gifts' strengths and weaknesses, she crafted a new mission and competitive strategy for the company. Instead of positioning itself as a centre for emergency gifts, the firm would aim for upscale elegance. Further, it would try to broaden the definition of gift-giving opportunities. 'Most online retailers are inherently self-purchase,' Ms. Billings says. They 'repurpose themselves just before Christmas as gift companies. There's a big difference between that and a company that thinks only about gifts.'

Within six weeks of becoming CEO, Ms. Billings had developed marketing and business plans detailing how the firm would accomplish its new strategic mission and had hired the core of a new management team. She then made the rounds of Silicon Valley's venture capitalists with a slide show detailing the company's new plans and subsequently obtained $21 million in new financing from Sequoia Capital and $10 million from Weston Presidio in exchange for approximately a one-third ownership of the company.

## *The New Marketing Plan*

### The Target Market

Consistent with the firm's new strategic mission, it targeted its marketing efforts at a more selective segment of potential customers. The new target market was similar to the one Ms. Billings knew from her days at Williams-Sonoma: high income (over $85 000 per year), well-educated professionals, including both men and women. The focus was also on people who were connected to the Internet and had a history of buying online.

To understand the needs and preferences of the firm's target customers, managers did a little qualitative marketing research, informally interviewing some prospective customers and analysing past sales patterns. But initially the firm relied more heavily on the customer knowledge its managers had gained through past experience. 'We talked about our [target] customer in a very intimate way,' one manager recalls. 'What kind of clothes they wore, what kind of car they drove. We put up a poster labelled "him" and "her" and we'd put Post-it Notes under each with products we thought they'd want to buy.'

### The New Product Line and Company Brand

Armed with information and intuition concerning the desires of the target market, company managers set about upgrading the product line. A variety of suppliers were contracted to provide products that reflected a high-quality, upscale point of view: things such as amber heart necklaces, old-fashioned thermometers, and seven stalks of bamboo – an Asian symbol of good luck in a crystal vase for $46. The firm also partnered with suppliers to develop its first wave of exclusive merchandise: a series of gift baskets that might be described as 'lifestyle kits.' For instance, for fishing fanatics they developed a fishing creel filled with 12 hand-cut fish-shaped cookies for $48.

Another criterion the firm used to reorganise its product offerings was a high gross margin. Most of the firm's products carry margins of 50 per cent or more, a necessary offset for lavish spending on customer service, which Ms. Billings says is unavoidable. 'You have to own your customer's experience – and that comes at a price.' About half of the 450 stock keeping units (SKUs) that 911Gifts had been selling were dropped, and more than 300 items were added.

To simplify a customer's search for the perfect gift, the company also redesigned its website. The new website allowed customers to navigate through the offerings by type of recipient, by gift-giving occasion, or by product category.

Finally, to more clearly reflect the firm's new upscale positioning, the company name was changed to RedEnvelope. The name derives from an Asian custom of marking special occasions by giving cash or small presents enclosed in a red envelope. It also suggested a distinctive packaging approach: all RedEnvelope gifts are delivered in a red gift box with a hand-tied bow.

### Advertising and Promotion

With only a few weeks to go before the peak holiday selling season, RedEnvelope decided to devote a third of its new capital to advertising aimed at building customer awareness of the site. Rather than costly TV ads, the firm concentrated its money on a series of print ads to be run in newspapers and magazines, such as the *New York Times*, with readerships similar to RedEnvelope's target market,. The company also paid to establish partnerships with a number of online hubs such as America Online, web portals like Yahoo! and Google, and a select group of more narrowly focused websites such as iVillage.com. It devoted $2 million to these partnerships – paid for through either a flat fee or a percentage of sales – for a simple reason: 'To be where people are shopping online means being on the portals,' says RedEnvelope's vice president for business development.

### Distribution and Order Fulfilment

RedEnvelope owns its own inventory, marketing, systems management, and customer service operations. But it does not yet have sufficient capital to develop its own physical logistics and order fulfilment operation. Consequently, the company contracted with ComAlliance, a fulfilment firm in Ohio, to provide warehouse space and everything that goes with it, including the workers expected to produce scads of smartly wrapped packages. The ComAlliance facility is located at the end of an Airborne Express runway. Thus, merchandise that leaves the warehouse by 2 a.m. can be in the air by 4:30 and to its destination by noon. This setup allowed RedEnvelope to make a promise that was the core of its early brand-building efforts: Christmas Eve delivery of gifts ordered by midnight on December 23.

### Customer Feedback

Once the site was up and running, managers were able to track purchases hourly and quickly reformulate the product mix. For example, a line of wines was not selling as quickly as expected, generating only six purchases an hour. It was replaced with a Zen fountain that sold reliably at a rate of one every five minutes.

## *The Results*

RedEnvelope's management team brought the new operation online 60 days before its second Christmas. In two months the company shipped 20 000 packages and generated more revenue than the firm had managed in the preceding two years. Its Web alliances and ads were particularly effective. Most important, the firm lived up to its promises. It filled 98 per cent of its orders accurately, shipped 99 per cent of its packages on time, and only 2 per cent of recipients wanted to return their gifts.

On the minus side, during the first two months of its existence the company shelled out nearly $4 in marketing for every $1 in gross sales. But as awareness of the firm's brand began to grow within its target market, RedEnvelope was able to reduce its heavy media advertising budget and lower the cost of acquiring each new customer to only $30, far below the $55 thought to be average for online retailers. And while many other online retailers went bust, RedEnvelope continued to grow, reaching $50 million in sales and even managing a profit by its fourth year in business.

### Learning Objectives

This course provides prospective managers and entrepreneurs with the marketing tools, perspectives, and analytical frameworks they'll need to play an effective role in the marketing life and overall strategic development of their organisations, regardless of whether they occupy formal marketing jobs. Module 1 addresses a number of broad but important questions all managers must resolve in their own minds: Are marketing decisions important? Does marketing create value for customers and shareholders? What constitutes effective marketing practice? Who does what in marketing and how much does it cost? And finally, what decisions go into the development of a strategic marketing programme for a particular good or service and how can those decisions be summarised in an action plan?

## 1.1 Why Are Marketing Decisions Important?

The improved performance of RedEnvelope following the retooling of its strategic marketing plan illustrates the importance of good marketing decisions in today's business organisations. And according to many managers and expert observers around the world, a strong customer focus and well-conceived and executed marketing strategies will be even more crucial for the success of most organisations as the global marketplace becomes more crowded and competitive.[2]

The importance of marketing in a company's ongoing success can be better appreciated when you consider the activities marketing embraces. Marketing attempts to measure and anticipate the needs and wants of a group of customers and respond with a flow of need-satisfying goods and services. Accomplishing this requires the firm to

- Target those customer groups whose needs are most consistent with the firm's resources and capabilities.
- Develop products and/or services that meet the needs of the target market better than competitors.
- Make its products and services readily available to potential customers.
- Develop customer awareness and appreciation of the value provided by the company's offerings.
- Obtain feedback from the market as a basis for continuing improvement in the firm's offerings.
- Work to build long-term relationships with satisfied and loyal customers.

The most important characteristic of marketing as a business function is its focus on customers and their needs. This is a focus that all managers – not just marketers – need to adopt to ensure their organisations can build and sustain a healthy 'top line.'

### 1.1.1 The Importance of the Top Line

In the financial markets it is a company's bottom line – its profitability – that is most important. In the long run, all firms – even Internet start-ups – must make a profit to survive. But as the managers at RedEnvelope are well aware, there can never be a positive bottom line – nor financing, employees, or anything else – without the ability to build and sustain a healthy top line: sales revenue. As a wise observer once said, nothing happens until somebody sells something. Or to paraphrase management guru Peter Drucker, everything a company does internally is a cost centre. The only *profit* centre is a customer whose cheque doesn't bounce.

That is why the customer focus inherent in the marketing function is important. When properly implemented, a customer focus enables firms to enjoy success by exploiting changes in the marketplace, by developing products and services that have superiority over what is currently available, and by taking a more focused and integrated cross-functional approach to their overall operations. RedEnvelope, for example, started down the road to bottom line success by developing a unique and appealing line of gift products and backing them up with a user-friendly website and quick and reliable delivery. All the firm's activities were focused on satisfying its target market because, as Hilary Billings points out, 'Success … lies in creating a memorable experience for the customer.'[3]

## 1.2 Marketing Creates Value by Facilitating Exchange Relationships

While we have described marketing activities from an individual organisation's perspective, marketing also plays an important role in the broader context of the global economy. It helps facilitate exchange relationships among people, organisations, and nations.

> **Marketing** is a social process involving the activities necessary to enable individuals and organisations to obtain what they need and want through exchanges with others and to develop ongoing exchange relationships.[4]

Increased division and specialisation of labour are some of the most important changes that occur as societies move from a primitive economy toward higher levels of economic development. But while increased specialisation helps improve a society's overall standard of living, it leads to a different problem: Specialists are no longer self-sufficient. Artisans who specialise in making pots become very skilled and efficient at pot making, producing a surplus of pots, but they do not make any of the many other goods and services they need to survive and to improve their lifestyle. A society cannot reap the full benefits of specialisation until it develops the means to facilitate the trade and exchange of surpluses among its members. Similarly, a nation cannot partake of the full range of goods and services available around the world or penetrate all potential markets for the economic output of its citizens unless exchanges can occur across national boundaries.

## 1.2.1 What Factors Are Necessary for a Successful Exchange Relationship?

Many exchanges are necessary for people and organisations to reap the benefits of the increased specialisation and productivity that accompanies economic development. But such exchanges do not happen automatically, nor does every exchange necessarily lead to a mutually satisfying long-term relationship. The conditions for a successful exchange transaction can be met only after the parties themselves – or marketing intermediaries such as a wholesale distributor or a retailer like RedEnvelope – have performed several tasks. These include identifying potential exchange partners, developing offerings, communicating information, delivering products, and collecting payments. This is what marketing is all about. Before we take a closer look at specific marketing activities and how they are planned and implemented by marketing managers, we will discuss some terms and concepts in our definition of marketing and the conditions necessary for exchange. Let's examine the following questions:

1. Who are the *parties* involved in exchange relationships? Which organisations and people market things, and who are their customers?
2. Which *needs and wants* do parties try to satisfy through exchange, and what is the difference between the two?
3. *What* is exchanged?
4. How does exchange create *value?* Why is a buyer better off and more satisfied following an exchange?
5. How do potential exchange partners become a *market* for a particular good or service?

## 1.2.2 Who Markets and Who Buys? The Parties in an Exchange

Virtually every organisation and individual with a surplus of *anything* engages in marketing activities to identify, communicate, and negotiate with potential exchange partners. Some are more aggressive – and perhaps more effective – in their efforts than others. When considering extensive marketing efforts aimed at stimulating and facilitating exchange, we think first of the activities of goods manufacturers (Intel, BMW, Sony), service producers (Air France, McDonald's, Intercontinental Hotels), and large retailers (Zara, Marks & Spencer, Walmart).

However, museums, hospitals, theatres, universities, and other social institutions – whether for profit or nonprofit – also carry out marketing activities to attract customers, students, and donors. In the past, their marketing efforts were not very extensive or well organised. Now, increasing competition, changing customer attitudes and demographics, and rising costs have caused many nonprofit organisations to look to more extensive marketing efforts to solve their problems.[5] For example, some churches are using marketing techniques to address social problems, as well as to increase church attendance.

#### 1.2.2.1 Customers

Both individuals and organisations seek goods and services obtained through exchange transactions. **Ultimate customers** buy goods and services for their own personal use or the use of others in their immediate household. These are called **consumer goods and services**. **Organisational customers** buy goods and services (1) for resale (as when RedEnvelope buys several gross of Zen fountains for resale to individual consumers); (2) as inputs to the production of other goods or services (as when BMW buys sheet steel to be stamped into car body parts); or (3) for use in the day-to-day operations of the organisation (as when a university buys paper and printer cartridges). These are called **industrial goods and services**. Throughout this course we examine differences in the buying behaviour of these two types of customers and the marketing strategies and programmes relevant for each.[6]

### 1.2.3 Customer Needs and Wants

Needs are the basic forces that drive customers to take action and engage in exchanges. An unsatisfied **need** is a gap between a person's actual and desired states on some physical or psychological dimension. We all have *basic physical needs* critical to our survival, such as food, drink, warmth, shelter, and sleep. We also have *social and emotional needs* critical to our psychological well-being, such as *security, belonging, love, esteem*, and *self-fulfilment*. Those needs that motivate the consumption behaviour of individuals are few and basic. They are not created by marketers or other social forces; they flow from our basic biological and psychological makeup as human beings.

Organisations also must satisfy needs to assure their survival and well-being. Shaped by the organisation's strategic objectives, these needs relate to the resource inputs, capital equipment, supplies, and services necessary to meet those objectives.

**Wants** reflect a person's desires or preferences for specific ways of satisfying a basic need. Thus, a person wants particular products, brands, or services to satisfy a need. A person is thirsty and wants a Coke. A company needs office space and its top executives want an office at a prestigious address in midtown Manhattan.

Basic needs are relatively few, but people's many wants are shaped by social influences, their past history, and consumption experiences. Different people may have very different wants to satisfy the same need. Everyone *needs* to keep warm on cold winter nights, for instance. But some people *want* electric blankets, while others prefer old-fashioned down comforters.

This distinction between needs and wants helps put into perspective the charge that 'marketers create needs,' or that 'marketers make people want things they don't need.' Neither marketers nor any other single social force can create needs deriving from the biological and emotional imperatives of human nature. On the other hand, marketers – and many other social forces – influence people's wants. A major part of a marketer's job is to develop a new product or service and then to stimulate customer wants for it by convincing people it can help them better satisfy one or more of their needs.

### 1.2.3.1 Do Customers Always Know What They Want?

Some managers – particularly in high-tech firms – question whether a strong focus on customer needs and wants is always a good thing. They argue that customers cannot always articulate their needs and wants, in part because they do not know what kinds of products or services are technically possible. As Akio Morita, the late visionary CEO of Sony, once said:

> Our plan is to lead the public with new products rather than ask them what kind of products they want. The public does not know what is possible, but we do. So instead of doing a lot of marketing research, we refine our thinking on a product and its use and try to create a market for it by educating and communicating with the public.[7]

Others have pointed out that some very successful new products, such as the Chrysler minivan and Compaq's pioneering PC network server, were developed with little or no market research. On the other hand, some famous duds, like Ford's Edsel, New Coke, and McDonald's McLean low-fat hamburger, were developed with a great deal of customer input.[8]

The laws of probability dictate that some new products will succeed and more will fail regardless of how much is spent on marketing research. But the critics of a strong customer focus argue that paying too much attention to customer needs and wants can stifle innovation and lead firms to produce nothing but marginal improvements or line extensions of products and services that already exist. How do marketers respond to this charge?

While many consumers may lack the technical sophistication necessary to articulate their needs or wants for cutting-edge technical innovations, the same is not true for industrial purchasers. About half of all manufactured goods in most countries are sold to other organisations rather than individual consumers. Many high-tech industrial products are initiated at the urging of one or more major customers, developed with their cooperation (perhaps in the form of an alliance or partnership), and refined at customer beta sites.

As for consumer markets, one way to resolve the conflict between the views of technologists and marketers is to consider the two components of R&D. First there is basic research and then there is development – the conversion of technical concepts into actual saleable products or services. Most consumers have little knowledge of scientific advancements and emerging technologies. Therefore, they usually don't – and probably shouldn't – play a role in influencing how firms allocate their basic research dollars.

However, a customer focus is critical to development. Someone within the organisation must either have the insight and market experience (as was the case with Hilary Billings at RedEnvelope) or the substantial customer input necessary to decide what product to develop from a new technology, what benefits it will offer to customers, and whether customers will value those benefits sufficiently to make the product a commercial success. Iomega's experiences in developing the Zip drive into a commercially successful product – as described in Exhibit 1.1 – illustrate this point.

**Exhibit 1.1 Iomega's zip drive – Helping customers store their 'stuff'**

In the late 1980s Iomega Corporation pioneered a nifty technological innovation. The Bernoulli Box was a portable, add-on storage unit for personal computers (PCs). Resembling a grey shoebox with a hole in the front, it could hold 150 megabytes of data on one disk – the equivalent of 107 floppy disks.

But by late 1993 the product was in trouble. Its $600 unit price and $100 disk price had proven too high to attract many individual PC users, the 52-page user's manual was hard for customers to decipher and a competitor had already introduced a cheaper, faster alternative. Consequently, the firm reported an $18 million loss for the year and its stock price was at an all-time low.

The struggling company brought in a new CEO whose first priority was to convert the Bernoulli Box technology into a product line that would succeed in the marketplace. He appointed a cross-functional development team with representatives from engineering, marketing, operations and other areas. The team, together with designers from Fitch PLC, an industrial design firm, started by conducting exhaustive interviews with over 1000 people who used computers in large companies, in small organisations, or at home. Based on the information gathered, they created several generations of prototype products that were subsequently further refined in response to reactions from additional samples of potential customers.

Based on the extensive customer feedback received, the development team greatly streamlined the old Bernoulli Box, reducing its weight to about a pound so it could fit in a briefcase. To appeal to different segments of individual and business users, they designed three different models with different storage capacities and different prices. All three were given bright colours to make them stand out from their environment and to signal that they were different from the 'grey' competition. The most basic model – the Zip drive – held 100 megabytes and was initially priced at $200 per unit and $20 per disk (prices that have fallen substantially since) to appeal to individual PC owners for their personal use. Finally, a promotional campaign was crafted around the theme that Zip could help people organise their 'stuff' to make it more accessible and portable.

Within three years of its introduction, more than three million Zip drives were sold. Consequently, Iomega's share price soared from $2 to $150 (before stock splits) and the firm made it into the top 50 of Fortune's list of fastest-growing companies.

Unfortunately, the Zip drive also provides an excellent illustration of how advancing technology can shorten the life cycle of even the hottest product. Within five years of its introduction, a variety of read/write CD — and eventually DVD — players were being offered either as external add-ons or built-in components by the PC makers. Given that CDs offered much more functionality and storage capacity at a lower price, the market for Zip drives quickly dried up.

*Source*: 'The Right Stuff,' *Journal of Business and Design* 2 (Fall 1996), pp. 6–11; 'America's Fastest Growing Companies,' *Fortune*, October 14, 1996, pp. 90–104; and Paul Eng, 'What to Do When You Need More Space,' *Business Week*, November 4, 1996, p. 126.

Often, as was the case with the Zip drive, a new technology must be developed into a concrete product concept before consumers can react to it and its commercial potential can be assessed. In other cases, consumers can express their needs or wants for specific benefits even though they do not know what is technically feasible. They can tell you what problems they are having with current products and services and what additional benefits they would like from new ones. For instance, before Apple introduced the iPod, few consumers would have asked for such a product because they were unfamiliar with the possibilities of digitisation and miniaturisation in the electronics industry. But if someone had asked whether they would buy a product smaller than a Sony Walkman that could store and play thousands of songs they could download from their computer without messing with cassettes, tapes, or CDs, many probably would have said, 'Sure!'

A strong customer focus is not inconsistent with the development of technically innovative products, nor does it condemn a firm to concentrate on satisfying only current, articulated customer wants. More important, while firms can sometimes succeed in the short run even though they ignore customer desires, a strong customer focus usually pays big dividends in terms of market share and profit over the long haul,[9] as we'll see in the next module. As Iomega's CEO points out, 'I don't know how else you can sell in a consumer marketplace without understanding product design and usage. You have to know what the end user wants.'[10]

## 1.2.4 What Gets Exchanged? Goods and Services

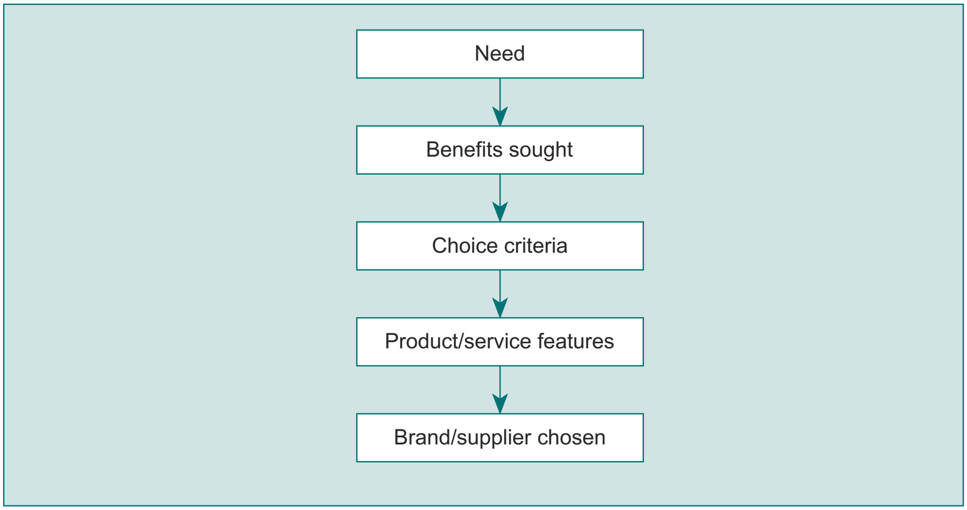
Goods and services help satisfy a customer's need when they are acquired, used, or consumed. **Products** are defined broadly in this course to include both goods and services that help satisfy a customer's need when they are acquired, used, or consumed. **Goods** are tangible physical objects (such as cars, watches, and computers) that provide a benefit. For example, a car provides transportation; a watch tells the time. **Services** are less tangible and, in addition to being provided by physical objects, can be provided by *people* (doctors, lawyers, architects), *institutions* (the Roman Catholic Church, the United Way), *places* (Walt Disney World, Paris), and *activities* (a contest or a stop-smoking programme).

## 1.2.5 How Exchanges Create Value

### 1.2.5.1 Customers Buy Benefits, Not Products

As argued earlier, when people buy products to satisfy their needs, they are really buying the **benefits** they believe the products provide, rather than the products per se. For instance, you buy headache relief, not aspirin. The specific benefits sought vary among customers depending on the needs to be satisfied and the situations where products are used. Because different customers seek different benefits, they use different choice criteria and attach different importance to product features when choosing models and brands within a product category; this is diagrammed in Exhibit 1.2. For example, a car buyer with strong needs for social acceptance and esteem might seek a socially prestigious automobile. Such a buyer would be likely to attach great importance to criteria relating to social image and engineering sophistication such as a high-powered motor, European-road-car styling, all-leather interior, and a state-of-the-art sound system.

**Exhibit 1.2 Customers buy benefits, not products**




Keep in mind, too, that services offered by the seller can also create benefits for customers by helping them reduce their costs, obtain desired products more quickly, or use those products more effectively. Such services are particularly important for satisfying organisational buyers. For example, a few years ago the Massachusetts Institute of Technology discovered that it was doing business with about 20 000 vendors of office and laboratory supplies each year. To improve the efficiency of its purchasing system, MIT developed a computerised catalogue that staff members could access via the school's intranet. It then formed alliances with two main suppliers – Office Depot Inc. and VWR Corp. – who won the bulk of MIT's business by promising to deliver superior service. Both firms deliver purchases within a day or two right to the purchaser's desk rather than to a building's stockroom.[11]

### 1.2.5.2 Product Benefits, Service, and Price Determine Value

A customer's estimate of a product's or service's benefits and capacity to satisfy specific needs and wants determines the value he or she will attach to it. Generally, after comparing alternative products, brands, or suppliers, customers choose those they think provide the most need-satisfying benefits per dollar. Thus, **value** is a function of intrinsic product features, service, and price, and it means different things to different people.[12]

Customers' estimates of products' benefits and value are not always accurate. For example, after buying an air-conditioning installation for its premises, a company may find that the product's cost of operation is higher than expected, its response time to changes in the outside temperature is slow, and the blower is not strong enough to properly heat or cool certain remote areas in the building.

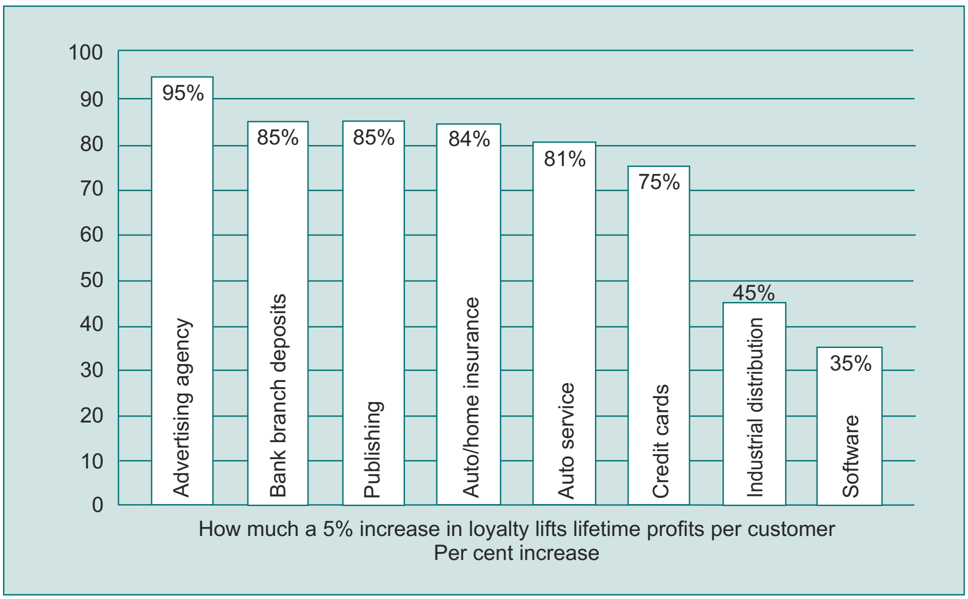
A customer's ultimate *satisfaction* with a purchase, then, depends on whether the product actually lives up to expectations and delivers the anticipated benefits. This is why customer services – particularly those occurring *after* a sale, such as delivery, installation, operating instruction, and repair – are often critical for maintaining satisfied customers.

Also it is essential that companies handle customer complaints effectively. The average business never hears from 96 per cent of its dissatisfied customers. This is unfortunate, for 50 per cent of those who complain say they would do business with the company again if their complaints were handled satisfactorily – 95 per cent if the complaints were resolved quickly.[13]

### 1.2.5.3 The Value of Long-Term Customer Relationships

Firms traditionally focused on the individual transaction with a customer as the fruition of their marketing efforts. But as global markets have become increasingly competitive and volatile, many firms have turned their attention to building a continuing long-term *relationship* between the organisation and the customer as the ultimate objective of a successful marketing strategy. They are taking action to increase **lifetime customer value** – the present value of a stream of revenue that can be produced by a customer over time. For an automobile manufacturer, for instance, the lifetime value of a first-time car buyer who can be kept satisfied and loyal to the manufacturer – buying all future new cars from the same company – is well over a million dollars.

**Exhibit 1.3 Big payoffs from keeping loyal customers**




*Source*: Reprinted with permission from 'Keeping the Buyers You Already Have,' by Patricia Sellers, *Fortune*, Special Issue, Autumn–Winter 1993, p. 57 ©1993 Time, Inc. All rights reserved.

Throughout this course we will discuss marketing decisions and activities geared to increasing the satisfaction and loyalty – and therefore the lifetime value – of customers. While such activities can add to a company's marketing costs, they can also produce big dividends, not only in terms of long-term revenues and market share, but also in terms of profitability. The reason is simple: It costs more to attract a new customer than to keep an existing one.[14] To persuade a customer to leave a competitor and buy your product or service instead usually takes either a financial inducement (a lower price or special promotional deal) or an extensive and convincing communication programme (advertising or sales force effort), all of which are costly. Consequently, the increased loyalty that comes through developing long-term customer relationships translates into higher profits. Exhibit 1.3 shows how much a 5 per cent improvement in customer loyalty is estimated to increase the lifetime profits per customer in a variety of goods and service industries.

#### 1.2.5.4 Brand Equity

The assets – including customers' perceptions of a product's benefits and value, their positive past experiences, and their loyalty over time – linked to a brand's name and symbol constitute the brand's *equity*.[15] Brand equity reflects the value of the brand name and logo as promotional tools for attracting future buyers and building market share and profitability. That is why Samsung's recent marketing efforts have concentrated on building the equity of the Samsung brand in global markets by incorporating innovative technologies and stylish design in the firm's offerings and advertising them as appropriate products for modern lifestyles. Ultimately, in other words, a brand's value to the company depends on how much value customers think the brand provides for them; value creation cuts both ways.

### 1.2.6 Defining a Market

A **market** consists of (a) *individuals and organisations* who (b) are *interested and willing* to buy a particular product to obtain benefits that will satisfy a specific need or want, and who (c) have the *resources (time, money)* to engage in such a transaction. Some markets are sufficiently homogeneous that a company can practise undifferentiated marketing in them. That is, the company attempts to market a line of products using a single marketing programme. But because people have different needs, wants, and resources, the entire population of a society is seldom a viable market for a single product or service. Also, people or organisations often seek different benefits to satisfy needs and wants from the same type of product (e.g., one car buyer may seek social status and prestige while someone else wants economical basic transportation).

The total market for a given product category thus is often fragmented into several distinct **market segments**. Each *segment* contains people who are relatively homogeneous in their needs, their wants, and the product benefits they seek. Also, each segment seeks a different set of benefits from the same product category.

Strategic marketing management involves a seller trying to determine the following points in an effort to define the target market:

1. Which customer needs and wants are currently not being satisfied by competitive product offerings.

2. How desired benefits and choice criteria vary among potential customers and how to identify the resulting segments by demographic variables such as age, sex, lifestyle, or some other characteristics.
3. Which segments to target, and which product offerings and marketing programmes appeal most to customers in those segments.
4. How to position the product to differentiate it from competitors' offerings and give the firm a sustainable competitive advantage.

Much of RedEnvelope's early success can be attributed to the fact that the firm focused on a clearly defined segment of up-scale gift buyers and then developed product offerings, customer services, a website design, and promotional materials that appealed to that target segment and set the firm apart from its competitors.

## 1.3 What Does Effective Marketing Practice Look Like?

Exchange transactions – and particularly long-term relationships – do not happen automatically. They are the result of many decisions that must be planned and carried out by somebody. Sometimes a single organisation has the necessary resources to plan and execute an entire marketing strategy by itself. Usually, though, a firm's marketing programme involves cooperative efforts from a network of more specialised institutions: suppliers, wholesalers, retailers, advertising agencies, and the like.

RedEnvelope's marketing programme, for instance, relies heavily on products supplied by a number of manufacturers or wholesale merchants, advertising developed and placed by an ad agency, warehouse and fulfilment facilities provided by ComAlliance, delivery by Airborne Express, and access to potential customers via partnerships with various Web portals. In some cases, major customers may be involved in shaping and executing parts of a firm's marketing programme, such as new product development and testing.

Regardless of who is involved, we refer to the entire sequence of analyses, decisions, and activities involved in planning, carrying out, and evaluating a strategic marketing programme as the marketing management process. We take a more detailed look at this process – and at the roles of different functional managers and marketing institutions in planning and executing the activities involved – next.

### 1.3.1 Marketing Management – A Definition

Our discussion suggests that marketing occurs whenever one party has something it would like to exchange with another. Marketing management is the process that helps make such exchanges happen. More specifically, **marketing management** is the process of analysing, planning, implementing, coordinating, and controlling programmes involving the conception, pricing, promotion, and distribution of goods, services, and ideas designed to create and maintain beneficial exchanges with target markets for the purpose of achieving organisational objectives.

Exhibit 1.4 diagrams the major decisions and activities involved in the marketing management process, and it also serves as the organisational framework for the rest of this book. For that reason, it is important to note the basic focus of this framework and the sequence of events within it.

#### 1.3.1.1 A Decision-Making Focus

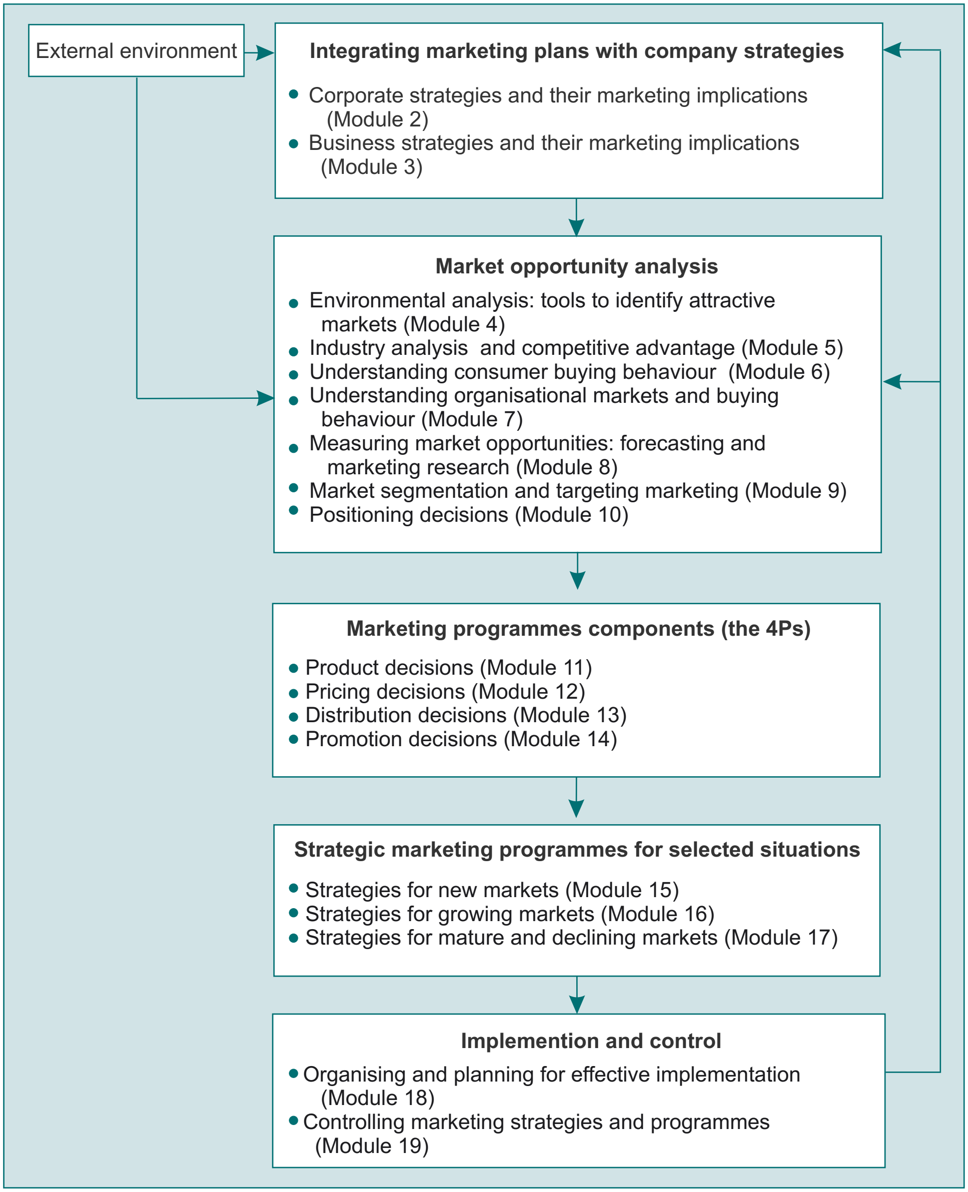
The framework has a distinct decision-making focus. Planning and executing an effective marketing programme involves many interrelated decisions about what to do, when to do it, and how. Those decisions are the major focus of the rest of this book. Every module details decisions that must be made and actions taken with respect to a specific piece of a strategic marketing programme and provides the analytical tools and frameworks you'll need to make those decisions intelligently.

#### 1.3.1.2 Analysing the 4 Cs

A substantial amount of analysis of customers, competitors, and the company itself occurs *before* decisions are made concerning specific components of the marketing programme. This reflects our view that successful marketing management decisions usually rest on an objective, detailed, and evidence-based understanding of the market and the environmental context. Of course, most marketing strategies never get implemented in quite the same way as they were drawn on paper. Adjustments are made and new activities undertaken in response to rapid changes in customer demands, competitive actions, or shifting economic conditions. But a thorough and ongoing analysis of the market and the broader environment enables managers to make such adjustments in a well-reasoned and consistent way rather than by the seat of the pants.

The analysis necessary to provide the foundation for a good strategic marketing plan should focus on four elements of the overall environment that may influence a given strategy's appropriateness and ultimate success: (1) the *company's* internal resources, capabilities, and strategies; (2) the environmental *context* – such as broad social, economic, and technology trends – in which the firm will compete; (3) the needs, wants, and characteristics of current and potential *customers*; and (4) the relative strengths and weaknesses of *competitors* and trends in the competitive environment. Marketers refer to these elements as **the 4 Cs**, and they are described in more detail below.

## Exhibit 1.4 The marketing management process



### 1.3.2 Integrating Marketing Plans with the Company's Strategies and Resources

Many firms – particularly larger organisations with multiple divisions or business units – develop a hierarchy of interdependent strategies. Each strategy is formulated at varying levels within the firm and deals with a different set of issues. For example, IBM has reduced its focus and the proportion of resources it devotes to its traditional computer hardware businesses. Instead, it is seeking future growth and profits by investing heavily in developing engineering, software, and e-commerce consulting services aimed at helping business clients integrate their old corporate databases into new online systems. This change in emphasis reflects IBM's new **corporate strategy**. This strategy reflects the company's mission and provides direction for decisions about what businesses it should pursue, how it should allocate its available resources, and its growth policies.

Iomega's heavy investment in R&D and consumer research to develop a new generation of technically superior, attractively designed, but reasonably priced data storage products (as described in Exhibit 1.1) represents part of a **business-level (or competitive) strategy** that addresses how the business intends to compete in its industry. Iomega sought to regain a competitive advantage by offering cutting-edge technology, innovative design, and superior customer value.

Finally, interrelated decisions about market segments, product line, advertising appeals and media, prices, and partnerships with suppliers, Web portals, and fulfilment and transportation companies all reflect RedEnvelope's **marketing strategy**. This is the company's plan for pursuing its objectives within the upscale segment of the online gift market. Because RedEnvelope is a small startup with only a single product line, its business-level competitive strategy and its marketing strategy substantially overlap. This is often the case with smaller organisations.

A major part of the marketing manager's job is to monitor and analyse customers' needs and wants and the emerging opportunities and threats posed by competitors and trends in the external environment. Therefore, because all levels of strategy must consider such factors, marketers often play a major role in providing inputs to – and influencing the development of – corporate and business strategies. Conversely, general managers and senior managers in other functions need a solid understanding of marketing in order to craft effective organisational strategies.

Marketing managers also bear the primary responsibility for formulating and implementing strategic marketing plans for individual product-market entries or product lines. But as the above discussion suggests, such strategic marketing programmes are not created in a vacuum. Instead, the marketing objectives and strategy for a particular product-market entry must be achievable with the company's available resources and capabilities and consistent with the direction and allocation of resources inherent in the firm's corporate and business-level strategies. In other words, there should be a good fit – or internal consistency – among the elements of all three levels of strategy. Module 2 and Module 3 describe in more detail the components of corporate and business-level strategies, their implications for strategic marketing programmes, and the role marketers and other functional managers play in shaping the strategic direction of their organisations and business units.

## 1.3.3 Market Opportunity Analysis

A major factor in the success or failure of strategies at all three levels is whether the strategy elements are consistent with the realities of the firm's external environment. Thus, the next step in developing a strategic marketing plan is to monitor and analyse the opportunities and threats posed by factors outside the organisation. This is an ongoing responsibility for marketing managers.

### 1.3.3.1 Environmental Analysis

To understand potential opportunities and threats over the long term, marketers must first monitor and analyse broad trends in the economic and social environment. These include demographic, economic, technological, political/legal, and social/cultural developments. Of particular concern within an organisation's economic environment are the actions and capabilities of its current and potential competitors. Module 4 identifies a number of macroenvironmental factors marketing managers should pay attention to. It discusses methods for monitoring, analysing, and perhaps even influencing the impact of those factors on the future performance of their product-market entries.

### 1.3.3.2 Industry Analysis and Competitive Advantage

The competitive and market environments of an industry are not static, but can change dramatically over time. For example, Iomega's initial product, the Bernoulli Box, lost much of its early momentum when SyQuest entered the market with a faster, cheaper alternative. Module 5 explores the competitive dynamics of an industry, emphasising how competition and customers' buying patterns are likely to change as an industry or product-market moves through various life-cycle stages.

### 1.3.3.3 Customer Analysis

The primary purpose of marketing activities is to facilitate and encourage exchange transactions with potential customers. One of a marketing manager's major responsibilities is to analyse the motivations and behaviour of present and potential customers. What are their needs and wants? How do those needs and wants affect the product benefits they seek and the criteria they use in choosing products and brands? Where do they shop? How are they likely to react to specific price, promotion, and service policies? To answer such questions, a marketing manager must have some notion of the mental processes customers go through when making purchase decisions and of the psychological and social factors that influence those processes. Module 6 discusses the processes and influences that shape consumers' buying behaviour. Because some aspects of the purchase process differ for organisations, Module 7 examines the buying behaviour of institutional customers.

#### 1.3.3.4 Marketing Research and Market Information

Marketing managers must obtain objective information about potential customers, the satisfaction and loyalty of current customers, the firm's wholesale and retail partners, and the strengths and weaknesses of competitors. Consequently, even relatively small organisations such as Iomega and RedEnvelope often expend substantial financial and personnel resources studying the needs and preferences of potential customers, developing new products, and tracking the sales patterns and satisfaction of existing customers and channel members.

If managers are to make informed decisions, however, research information must be converted into estimates of the sales volume and profit the firm might reasonably expect a particular marketing programme to generate within a given market segment. Module 8 discusses techniques and methods for collecting and analysing marketing research information and for measuring the market potential and likely sales volumes of particular market segments. The specific research methods that marketing managers use to make decisions about elements of a marketing programme – such as what price to charge or which advertising media to use – will be examined in more detail in modules dealing with each of these programme decisions.

#### 1.3.3.5 Market Segmentation, Targeting, and Positioning Decisions

Not all customers with similar needs seek the same products or services to satisfy those needs. Their purchase decisions may be influenced by individual preferences, personal characteristics, social circumstances, and so forth. On the other hand, customers who do purchase the same product may be motivated by different needs, seek different benefits from the product, rely on different sources for product information, and obtain the product from different distribution channels. Thus, one of the manager's most crucial tasks is to divide customers into **market segments** – distinct subsets of people with similar needs, circumstances, and characteristics that lead them to respond in a similar way to a particular product or service offering or to a particular strategic marketing programme. Module 9 examines analytical techniques that can help managers identify and define market segments in both consumer and organisational markets.

After defining market segments and exploring customer needs and the firm's competitive strengths and weaknesses within segments, the manager must decide which segments represent attractive and viable opportunities for the company; that is, on which segments to focus a strategic marketing programme. Iomega, for instance, targeted two market segments with its new line of data storage drives. The Zip drive was aimed at individual PC owners for their personal use, while larger capacity and more expensive drives were aimed at organisational buyers. Module 9 discusses some of the considerations in *selecting a target segment*.

Finally, the manager must decide how to **position** the product or service offering within a target segment, that is, to design the product and its marketing programme so as to emphasise attributes and benefits that appeal to customers in the target segment and at once distinguish the company's offering from those of competitors. Thus, RedEnvelope has positioned its offering as unique, high-quality, quickly delivered gifts for upscale buyers. Issues and analytical techniques involved in marketing positioning decisions are discussed in Module 10.

## 1.3.4 Formulating Strategic Marketing Programmes

Designing an effective strategic marketing programme for a product-market entry involves three interrelated sets of decisions:

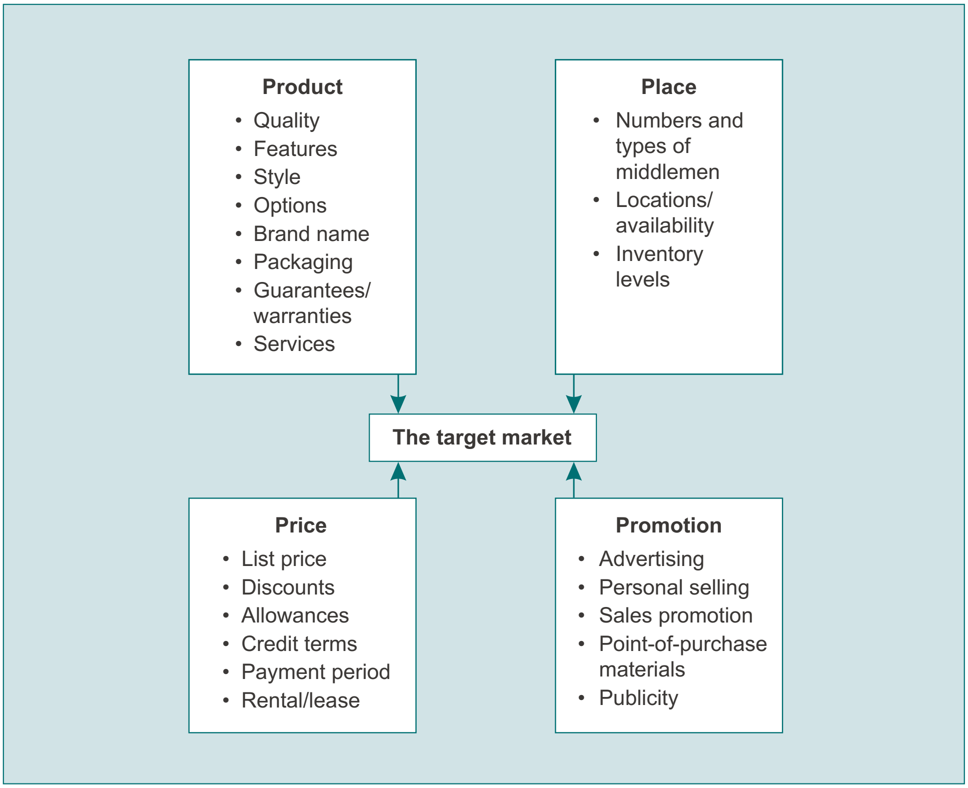
1. The manager must set specific objectives to be accomplished within the target market, such as sales volume, market share, and profitability goals. Those objectives must be consistent with the firm's corporate and business-unit strategic objectives, yet specific enough to enable management to monitor and evaluate the product-market entry's performance over time.
2. The manager must decide on an overall marketing strategy to appeal to customers – and to gain competitive advantage – in the target market. The strategy must be consistent with the firm's capabilities, its corporate and business-unit strategies, and the product-market objectives. The manager must then make decisions about each element of the tactical marketing programme used to carry out the strategy. These decisions must be internally consistent and integrated across all elements of the marketing programme.

### 1.3.4.1 Specifying Marketing Objectives and Strategies

The first step in developing a strategic marketing programme is to specify the objectives and the overall marketing strategy of each target market. As we've mentioned, these are partly dictated by corporate and business-level objectives, strategies, and resources. Module 3 describes a number of generic business-level competitive strategies and examines the way such strategies influence decisions about marketing objectives and programmes, as well as the role other functional managers play in implementing those marketing programmes.

### 1.3.4.2 Marketing Programme Components

**Exhibit 1.5 Decisions within the four elements of the marketing mix**




Dozens of specific tactical decisions must be made in designing a strategic marketing programme for a product-market entry. These decisions fall into four categories of major marketing variables that a manager has some ability to control over the short term. Often called **the 4 Ps**, the controllable elements of a marketing programme are the **product offering** (including the breadth of the product line, quality levels, and customer services); **price**; **promotion** (advertising, sales promotion, and salesforce decisions); and **place** (or distribution channel decisions). Because decisions about each element should be consistent and integrated with decisions concerning the other three, the four components are often referred to as the *marketing mix*.

The **marketing mix** is the combination of controllable marketing variables that a manager uses to carry out a marketing strategy in pursuit of the firm's objectives in a given target market.

Exhibit 1.5 outlines some of the decisions that must be made within each of the four elements of the marketing mix. Modules 11 through 14 discuss in more detail the various methods and criteria for making decisions about each of these programme components.

### 1.3.5 Formulating Strategic Marketing Programmes for Specific Situations

The strategic marketing programme for a product should reflect market demand and the competitive situation within the target market. But demand and competitive conditions change over time as a product moves through its life cycle. Therefore, different marketing strategies are typically more appropriate and successful for different market conditions and at different life cycle stages. Module 15 examines marketing strategies for introducing new goods or services to the market. Module 16 discusses strategies appropriate for building or maintaining a product's share of a growing market in the face of increasing competition. Module 17 then considers the marketing strategies a firm might adopt in mature and declining product-markets.

### 1.3.6 Implementation and Control of the Marketing Programme

A final critical determinant of a strategy's success is the firm's ability to implement it effectively. And this depends on whether the strategy is consistent with the resources, the organisational structure, the coordination and control systems, and the skills and experience of company personnel.[16] Managers must design a strategy to fit the company's existing resources, competencies, and procedures – or try to construct new structures and systems to fit the chosen strategy. For example, Iomega's attempt to develop a new generation of data storage products would not have been so successful without its substantial investments in R&D and marketing research and a team structure that encouraged communication and cooperation across functional areas throughout the development process. Module 18 discusses the structural variables, planning and coordination processes, and personnel and corporate culture characteristics related to the successful implementation of various marketing strategies.

The final tasks in the marketing management process are determining whether the strategic marketing programme is meeting objectives and adjusting the programme when performance is disappointing. This evaluation and control process provides feedback to managers and serves as a basis for a market opportunity analysis in the next planning period. Module 19 examines ways to evaluate marketing performance and develop contingency plans for when things go wrong.

### 1.3.7 The Marketing Plan – A Blueprint for Action

The results of the various analyses and marketing programme decisions discussed above should be summarised periodically in a detailed formal marketing plan.[17]

A **marketing plan** is a written document detailing the current situation with respect to customers, competitors, and the external environment and providing guidelines for objectives, marketing actions, and resource allocations over the planning period for either an existing or a proposed product or service.

**Exhibit 1.6 Contents of a marketing plan**

| Section | | Content |
|---|---|---|
| I | Executive summary | Presents a short overview of the issues, objectives, strategy and actions incorporated in the plan and their expected outcomes for quick management review. |
| II | Current situation and trends | Summarises relevant background information on the market, competition and the macroenvironment and trends therein, including size and growth rates for the overall market and key segments. |
| III | Performance review (for an existing product or service only) | Examines the past performance of the product and the elements of its marketing programme (e.g. distribution, promotions, etc.). |
| IV | Key issues | Identifies the main opportunities and threats to the product that the plan must deal with in the coming year and the relative strengths and weaknesses of the product and business unit that must be taken into account in facing those issues. |
| V | Objectives | Specifies the goals to be accomplished in terms of sales volume, market share and profit. |
| VI | Marketing strategy | Summarises the overall strategic approach that will be used to meet the plan's objectives. |
| VII | Action plans | This is the most critical section of the annual plan for helping to ensure effective implementation and coordination of activities across functional departments. It specifies:<br>• The **Target market** to be pursued.<br>• **What** specific actions are to be taken with respect to each of the 4 Ps.<br>• **Who** is responsible for each action.<br>• **When** the action will be engaged in.<br>• **How** much will be budgeted for each action. |
| VIII | Projected profit-and-loss statement | Presents the expected financial payoff from the plan. |
| IX | Controls | Discusses how the plan's progress will be monitored; may present contingency plans to be used if performance falls below expectations or the situation changes. |
| X | Contingency plans | Describes actions to be taken if specific threats or opportunities materialise during the planning period. |

While some firms – particularly smaller ones – do not bother to write their marketing plans, most organisations believe that 'unless all the key elements of a plan are written down … there will always be loopholes for ambiguity or misunderstanding of strategies and objectives, or of assigned responsibilities for taking action.'[18] This suggests that even small organisations with limited resources can benefit from preparing a written plan, however brief. Written plans also provide a concrete history of a product's strategies and performance over time, which aids institutional memory and helps educate new managers assigned to the product. Written plans are necessary in most larger organisations because a marketing manager's proposals must usually be reviewed and approved at higher levels of management and because the approved plan provides the benchmark against which the manager's performance will be judged. Finally, the discipline involved in producing a formal plan helps ensure that the proposed objectives, strategy, and marketing actions are based on rigorous analysis of the 4 Cs and sound reasoning.

Because a written marketing plan is such an important tool for communicating and coordinating expectations and responsibilities throughout the firm, we will say more about it in Module 18 when we discuss the implementation of marketing programmes in detail. But because the written plan attempts to summarise and communicate an overview of the marketing management process we have been examining, it is worthwhile to briefly examine the contents of such plans here.

Marketing plans vary in timing, content, and organisation across companies. In general, marketing plans are developed annually; though planning periods for some big-ticket industrial products, such as commercial aircraft, may be longer, and in some highly volatile industries, such as telecommunications or e-commerce, they can be shorter. Plans typically follow a format similar to that outlined in Exhibit 1.6.

There are three major parts to the plan. First, the marketing manager details his or her assessment of the current situation. This is the homework portion of the plan where the manager summarises the results of his or her analysis of current and potential customers, the company's relative strengths and weaknesses, the competitive situation, the major trends in the broader environment that may affect the product and, for existing products, past performance outcomes. This section typically also includes forecasts, estimates of sales potential, and other assumptions underlying the plan, which are especially important for proposed new products or services. Based on these analyses, the manager may also call attention to several key issues – major opportunities or threats that should be dealt with during the planning period.

The second part of the plan details the strategy for the coming period. This part usually starts by detailing the objectives (e.g., sales volume, market share, profits, customer satisfaction levels, etc.) to be achieved by the product or service during the planning period. It then outlines the overall marketing strategy, the actions associated with each of the 4 Ps necessary to implement the strategy, and the timing and locus of responsibility for each action.

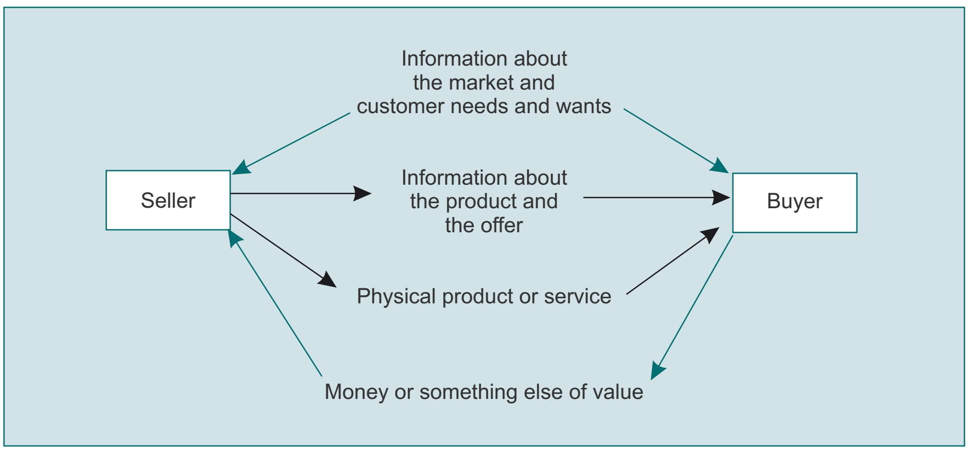
Finally, the plan details the financial and resource implications of the strategy and the controls to be employed to monitor the plan's implementation and progress over the period. Some plans also specify some contingencies: how the plan will be modified if certain changes occur in the market, competitive, or external environments.

# 1.4 Who Does What?

## 1.4.1 Marketing Institutions

A strategic marketing programme involves a large number of activities aimed at encouraging and facilitating exchanges and building relationships with customers. And *all* of those activities must be performed by somebody for exchanges to happen. One of the few eternal truths in marketing is that 'you can eliminate the middlemen, but you can't eliminate their functions.' Somebody has to gather information or feedback from customers concerning their needs and wants; use that information to design product or service offerings that will provide valued benefits; communicate the existence and benefits of the offering to the market; perform the storage, order fulfilment, and transportation activities necessary to make the product conveniently available to customers; finance purchases; collect payment; and resolve customer problems or complaints after the sale. The major flows of the physical product, payment, and information that occur during an exchange are summarised in Exhibit 1.7.

**Exhibit 1.7 What must change hands to complete an exchange between a buyer and a seller?**




In a few cases, nearly all these activities are performed by a single organisation and its employees. Such internal control of the full range of marketing functions and activities is referred to as **vertical integration**. Dell Computer's reliance on the Internet to attract customers and process orders together with a flexible manufacturing system that produces computers to order and minimises finished inventories, and GE Plastics' reliance on its own salesforce, website, and distribution facilities to service customers all are examples of highly integrated marketing organisations.

The majority of goods and services in most developed economies, however, are marketed through alliances or networks involving multiple institutions or middlemen. These networks are commonly referred to as **marketing channels** or **channels of distribution**. Each institution within the channel specialises in performing only a part of the activities or functions necessary to conduct exchanges with the end user. We will examine these institutions and the nature of their interactions with one another in more detail in Module 13. Marketing institutions fall into one of the following categories:

**Merchant wholesalers** take title to the goods they sell and sell primarily to other resellers (retailers) and industrial and commercial customers, rather than to individual consumers.

**Agent middlemen**, such as manufacturers' representatives and brokers, also sell to other resellers and industrial or commercial customers, but they do not take title to the goods they sell. They usually specialise in the selling function and represent client manufacturers on a commission basis.

**Retailers** sell goods and services directly to final consumers for their personal, nonbusiness use.

**Facilitating agencies**, such as advertising agencies, marketing research firms, collection agencies, railway companies, and Web portals, specialise in one or more marketing functions on a fee-for-service basis to help their clients perform those functions more effectively and efficiently.

### 1.4.2 Who Pays the Cost of Marketing Activities – and Are They Worth It?

The final selling price of the product reflects the costs of performing the activities necessary for exchange transactions. Those costs vary widely across different products and customers. They account for a relatively high proportion of the price of frequently purchased consumer package goods such as cereals and cosmetics. Extensive transportation, storage, and promotion activities facilitate the millions of consumer purchases that occur every year. On average, roughly 50 per cent of the retail price of such products is made up of marketing and distribution costs; one half represents retailer margins, and the other half the marketing expenses of the manufacturer and wholesale middlemen.[19] On the other hand, marketing costs for nontechnical industrial goods, such as sheet steel or basic chemicals, are much lower because they are sold in large quantities directly to a small number of regular customers.

Though both individual and organisational customers pay for the marketing activities of manufacturers and their middlemen, they are still usually better off than if they were to undertake all the functions themselves. This is true for two reasons: First, the purchasing, storage, promotion, and selling activities of wholesalers and retailers allow customers to buy a wide variety of goods from a single source in one transaction, thereby increasing **transactional efficiency**. For example, a consumer may buy a week's groceries on a single trip to the supermarket (or perhaps even over the Internet from a home-delivery service) rather than engage in separate transactions with a butcher, a baker, and a variety of farmers or food processors. Thus, the number of exchanges necessary for a consumer to acquire a desired assortment of goods and services is reduced and efficiency is increased when middlemen are added to an economic system.

A second benefit of an extensive marketing system is that specialisation of labour and economies of scale lead to **functional efficiency**. Manufacturers and their agents can perform the exchange activities more cheaply than can individual customers. A railway, for instance, can ship a load of new tyres from a plant in Akron to a wholesaler in Tucson more cheaply than an individual consumer in Arizona could transport them in the family station wagon.

From the customer's viewpoint, then, the increased transactional and functional efficiency of exchange produced by members of the marketing system increases the value – the **utility/price** relationship – of goods and services. A product has greater utility for a potential customer when it can be purchased with a minimum of risk and shopping time (**possession utility**), at a convenient location (**place utility**), and at the time the customer is ready to use the product (**time utility**).

## 1.4.3 Room for Improvement in Marketing Efficiency

While the existence of specialised institutions in our economy's marketing system has greatly increased the efficiency and value of most exchange transactions from the customer's point of view, that does not mean the current system is nearly as efficient as it could be. Marketing is one of the few functional areas of business whose efficiency has not substantially improved in recent years. Two authorities estimate that, on average, manufacturing costs have declined from about 50 per cent of total corporate costs after World War II to about 30 per cent today through automation, flexible manufacturing systems, product redesign for manufacturing, just-in-time approaches, and so on. Similarly, they argue that the average costs of 'management' – defined to include finance, accounting, human resources, and support functions like R&D – have fallen from about 30 per cent to 20 per cent as the result of downsizing, outsourcing, and process re-engineering. On the other hand, they estimate that the percentage of corporate costs accounted for by marketing activities actually went up substantially over the same period.[20]

Of course, there are some good reasons why marketing costs have increased in recent years, including the greater intensity of global competition, the rapid pace of technological change, the fragmentation of the communications media, and many other factors. Nevertheless, even modest improvements in marketing efficiency could produce dramatic cost reductions, increased profits, and improved customer value in many industries. The American grocery industry alone believes it can cut $30 billion, or nearly 10 per cent of its annual operating costs, by redesigning its logistics and distribution systems.[21] We will focus throughout this course on ways marketers are attempting to improve operational efficiency through (1) more effective use of telecommunications and information technologies, (2) the development of cooperative alliances with suppliers, middlemen, and ultimate customers, and (3) the search for new budgeting methods that are more clearly focused on improving cash flows and adding economic value.[22]

## 1.4.4 The Role of the Marketing Decision Maker

The title *marketing manager* is necessarily and intentionally vague because many people are directly involved with an organisation's marketing activities. This can include people not formally located in a marketing or sales department or even within the company. The exact nature of the marketing manager's job will vary widely depending on the industry involved, the organisation's structure, and its position in the managerial hierarchy.

While the marketing manager bears the primary responsibility for formulating and implementing a strategic marketing programme for a product or service, a single marketing manager (1) seldom does all the analysis or makes all the decisions involved in such plans all alone and (2) almost never has the formal authority to demand that all the activities specified in the plan be carried out by subordinates exactly as they are written down.

Many marketing activities are usually contracted out to independent middlemen or facilitating agencies or are performed in concert with a firm's suppliers, major customers, or other organisational partners. A marketing manager has no formal authority over these outsiders. Thus, the development and nurturing of long-term relationships with suppliers, channel members, and major customers can do more than simply improve marketing efficiency; they can provide the information, advice, and cooperation necessary to devise and carry out successful marketing strategies.[23]

Even those marketing activities that are performed in-house are seldom all within the domain of the marketing department or under the authority of a single marketing executive. Marketing is – or should be – everybody's business. After all, delivering superior value to customers is the key to business success, and that superior value flows from a combination of well-designed products or services, produced with high quality; efficient operations that enable low costs and competitive prices; and reliable customer service. Creating value is a cross-functional endeavour, and marketing and nonmarketing executives alike must operate with a clear customer focus to make it happen.

## 1.5 Some Recent Developments Affecting Marketing Management

While many of the basic tasks involved in developing and implementing strategic marketing programmes have remained unchanged for decades, recent developments in our economy and around the world have greatly changed the context in which those tasks are carried out and the information and tools that marketers have at their disposal. These developments include (1) the increased globalisation of markets and competition, (2) the growth of the service sector of the economy and the importance of service in maintaining customer satisfaction and loyalty, (3) the rapid development of new information and communications technologies, and (4) the growing importance of relationships for improved coordination and increased efficiency of marketing programmes and for capturing a larger portion of customers' lifetime value. Some recent impacts of these four developments on marketing management are briefly summarised below and will be continuing themes throughout this course.

### 1.5.1 Globalisation

International markets account for a large and growing portion of the sales of many organisations.

But while global markets represent promising opportunities for additional sales growth and profits, differences in market and competitive conditions across country boundaries can require firms to adapt their competitive strategies and marketing programmes to be successful. Even when similar marketing strategies are appropriate for multiple countries, international differences in infrastructure, culture, legal systems, and the like often mean that one or more elements of the marketing programme – such as product features, promotional appeals, or distribution channels – must be tailored to local conditions for the strategy to be effective.

### 1.5.2 Increased Importance of Service

A service can be defined as 'any activity or benefit that one party can offer another that is essentially intangible and that does not result in the ownership of anything. Its production may or may not be tied to a physical product.'[24] Service businesses such as airlines, hotels, restaurants, and consulting firms account for roughly two-thirds of all economic activity in the United States, and services are the fastest-growing sector of most other developed economies around the world. While many of the decisions and activities involved in marketing services are essentially the same as those for marketing physical goods, the intangible nature of many services can create unique challenges for marketers. We will discuss these challenges – and the tools and techniques firms have developed to deal with them – throughout this course.

As the definition suggests, services such as financing, delivery, installation, user training and assistance, and maintenance are often provided in conjunction with a physical product. Such ancillary services have become more critical to firms' continued sales and financial success in many product-markets. As markets have become crowded with global competitors offering similar products at ever-lower prices, the creative design and effective delivery of supplemental services has become a crucial means by which a company may differentiate its offering and generate additional benefits and value for customers. Those additional benefits, in turn, can justify higher prices and margins in the short term and help improve customer satisfaction, retention, and loyalty over the long term.[25]

### 1.5.3 Information Technology

The computer revolution and related technological developments are changing the nature of marketing management in two important ways. First, new technologies are making it possible for firms to collect and analyse more detailed information about potential customers and their needs, preferences, and buying habits. Thus, it is now possible for many firms to identify and target smaller and more precisely defined market segments – sometimes segments consisting of only one or a few customers – and to customise product features, promotional appeals, prices, and financing arrangements to fit such segments.[26]

A second impact of information technology has been to open new channels for communications and transactions between suppliers and customers. As Exhibit 1.8 suggests, one simple way of categorising these new channels is based on whether the suppliers and customers involved are organisations or individual consumers.

**Exhibit 1.8 Categories of e-commerce**

| | **Business** | **Consumer** |
|---|---|---|
| **Business** | **Business-to-Business (B2B)**<br>Examples:<br>• Purchasing sites of Ford, Oracle, Cisco<br>• Supply chain networks linking producers and distribution channel members, such as 3M and Walmart | **Business-to-Consumer (B2C)**<br>Examples:<br>• E-tailers, such as E*Trade, Amazon, RedEnvelope<br>• Producers' direct sales sites, such as Dell, British Airways<br>• Websites of traditional retailers, such as Sears, Lands' End |
| Consumer | **Consumer-to-Business (C2B)**<br>Examples:<br>• Sites that enable consumers to bid on unsold airline tickets and other goods and services, such as Priceline | **Consumer-to-Consumer (C2C)**<br>Examples:<br>• Auction sites, such as eBay, QXL |

*Source*: Adapted from 'A Survey of E-Commerce: Shopping Around the Web,' *The Economist*, February 26, 2000, p. 11.

New information and communications technologies are enabling firms to forge more cooperative and efficient relationships with their suppliers and distribution channel partners. For example, Procter & Gamble and 3M have formed alliances with major retailers – such as Walmart – to develop automatic restocking systems. Sales information from the retailer's checkout scanners is sent directly to the supplier's computers, which figure out automatically when to replenish each product and schedule deliveries direct to each of the retailer's stores. Such paperless exchanges reduce mistakes and billbacks, minimise inventory levels, improve cash flow, and increase customer satisfaction and loyalty.

Internet sales from businesses to consumers (the upper-right quadrant in Exhibit 1.8) accounted for only about $140 billion (excluding travel) in the United States in 2008.[27] However, sales volumes of firms such as Amazon, Dell Computer, and RedEnvelope are expanding rapidly, and many traditional retailers are expanding their marketing efforts on the Web as well. Information available over the Internet is affecting consumer purchase patterns even when the purchases are made in traditional retail outlets. For instance, recent studies indicate that 69 per cent of US consumers research products online before making a purchase, 62 per cent have looked at an online customer review, 39 per cent have compared product features and prices across retail outlets online before buying, and 9 per cent have used a mobile phone to text-message a friend or relative about a product while shopping.[28]

Clearly, the Web is presenting marketers with new strategic options – as well as new competitive threats and opportunities – regardless of what or to whom they are selling. The changes being wrought by these new technologies are so extensive and profound that we will discuss specific examples and their implications in every module.

### 1.5.4 Relationships across Functions and Firms

New information technologies and the ongoing search for greater marketing efficiency and customer value in the face of increasing competition are changing the nature of exchange between companies. Instead of engaging in a discrete series of arm's-length, adversarial exchanges with customers, channel members, and suppliers on the open market, more firms are trying to develop and nurture long-term relationships and alliances, such as the one between 3M and Walmart. Such cooperative relationships are thought to improve each partner's ability to adapt quickly to environmental changes or threats, to gain greater benefits at lower costs from its exchanges, and to increase the lifetime value of its customers.[29]

Similar kinds of cooperative relationships are emerging inside companies as firms seek mechanisms for more effectively and efficiently coordinating across functional departments the various activities necessary to identify, attract, service, and satisfy customers. In many firms, the planning and execution that used to be the responsibility of a product or marketing manager are now coordinated and carried out by cross-functional teams. Thus, the boundaries between functional areas are beginning to blur, and marketing programmes are increasingly a group activity. Regardless of who is responsible or who carries out the work, however, the decisions and activities involved in such marketing programmes remain the same. They are the focus of the rest of this course.

## Learning Summary

- Marketing is pervasive. It is a social process involving the activities that facilitate exchanges of goods and services among individuals and organisations.
- Customers buy benefits, not products. The benefits a customer receives from a firm's offering, less the costs he or she must bear to receive those benefits, determine the offering's value to that customer.
- Delivering superior value to one's customers is the essence of business success. Because delivering superior value is a multifunctional endeavour, both marketing and nonmarketing managers must adopt a strong focus on the customer and coordinate their efforts to make it happen.
- A focus on satisfying customer needs and wants is not inconsistent with being technologically innovative.
- The marketing management process requires an understanding of the 4 Cs: the company and its mission, strategies, and resources; the macroenvironmental context in which it operates; customers and their needs and wants; and competitors. Obtaining an objective, detailed, evidence-based understanding of these factors is critical to effective marketing decision making.

- Marketing decisions – such as choices about what goods or services to sell, to whom, and with what strategy – are made or approved at the highest levels in most firms, whether large or small. Therefore, managers who occupy or aspire to strategic positions in their organisations need marketing perspectives and analytical skills.

# Review Questions

## Content Questions

1.1 Define marketing.

1.2 What conditions are necessary for an exchange to take place?

1.3 Distinguish between a need and a want.

1.4 What is a market?

1.5 What does strategic marketing involve?

1.6 What flows are necessary for an exchange transaction to take place?

## Multiple Choice Questions

1.7 A society cannot reap the full benefits of specialisation until it develops the means to facilitate:

A. importation of essentials from other societies.
B. production of essentials by each member of society.
C. the trade and exchange of surpluses among its members.
D. countertrade with other societies.
E. production of services in addition to goods.

1.8 'A social process involving the activities necessary to enable individuals and organisations to obtain what they need and want through exchanges with others' is a definition of:

A. distribution.
B. marketing.
C. barter.
D. countertrade.
E. industrialisation.

1.9 The core functional focus of marketing is the _____ of goods and services.

A. creation.
B. distribution.
C. pricing.
D. promoting.
E. exchange.

1.10 The utilisation of marketing approaches by hospitals, theatres, universities and nonprofit organisations:

A. has not changed compared to practices in the past.
B. has increased substantially in the past decade.
C. is outside the domain of marketing per se.
D. is only appropriate in for-profit situations.
E. has decreased substantially in the past decade.

1.11 Those who buy goods and services for their own personal use or the use of others in their immediate household are:

A. utilitarian consumers.
B. organisational customers.
C. intermediaries.
D. industrial customers.
E. ultimate consumers.

1.12 Those who buy goods and services for resale, as inputs to production of other goods or services, or for use in the day-to-day operations of the organisation are:

A. intermediaries.
B. ultimate consumers.
C. organisational customers.
D. utilitarian consumers.
E. countertraders.

1.13 A gap between a person's actual and desired state on some physical or psychological dimension is a(n):

A. unsatisfied need.
B. want state.
C. market inefficiency.
D. demand function.
E. intermediary.

1.14 Factors not created by marketers or other social forces, but flowing from basic biological and psychological human makeup, are:

A. needs.
B. wants.
C. demands.
D. urges.
E. requirements.

1.15 The desire to drink a Coke instead of orange juice is an example of a(n):

A. urge.
B. need.
C. demand.
D. want.
E. requirement.

1.16 For some brand-loyal customers what does wearing Levi's 501 jeans provide that other jeans cannot?

A. need fulfilment.
B. need creation.
C. need recognition.
D. want satisfaction.
E. either B or C above.

1.17 In addition to being provided with physical objects, people's needs may be satisfied in a less tangible form through:

A. differential forms.
B. products.
C. goods.
D. services.
E. product modifications.

1.18 Whether the product actually lives up to expectations and delivers the anticipated benefits determines the customer's ultimate:

A. satisfaction.
B. credence qualities.
C. salience.
D. demand function.
E. choice criteria.

1.19 Studies have shown that, if their complaint is handled satisfactorily, _____ per cent of those who complain would do business with the same company again.

A. 10.
B. 30.
C. 50.
D. 70.
E. 90.

1.20 'Individuals and organisations who are interested in buying and willing to buy a particular product to obtain benefits that will satisfy a specific need or want, and who have the resources to engage in such a transaction' is the definition of a(n):

A. industrial buyer.
B. segment.
C. opportunity.
D. focus group.
E. market.

1.21 When a company is attempting to define its 'niche' in the market as part of its strategic management planning activities, which of the following is it attempting to define?

A. Why its competitors have not already exploited this niche.
B. What is the best promotion vehicle for this market.
C. Which segments to target.
D. How to position the product.
E. Its distribution strategy.

1.22 Avon's marketing of cosmetics through thousands of part-time door-to-door sales representatives and IBM's marketing of mainframe computers are examples of:

A. vertically integrated distribution systems, in that they involve manufacturers who sell their own product lines direct.
B. horizontally integrated distribution systems, in that the same product is sold in the same setting throughout the areas in which it is available.
C. wheel-and-spoke distribution systems, in that a central manufacturer 'spins out' the product from a central point to surrounding distribution points.
D. cohesive distribution systems, in that the distribution network is bound together through a common control framework.
E. pyramid selling systems, in that these marketers reply upon a system of 'others enlisting others' to increase sales.

1.23 Groups of institutions or middlemen that distribute goods are known as:

A. pyramid distribution systems.
B. cartels.
C. horizontal distribution systems.
D. wheel-and-spoke distribution systems.
E. marketing channels.

1.24 A manufacturer's representative for General Electric is an example of which type of 'middleman'?

A. Retailers.
B. Agent middlemen.
C. Merchant wholesalers.
D. Facilitating agents.
E. Commissioned agents.

1.25 All of the following are examples of facilitating agencies EXCEPT:

A. marketing research firms.
B. advertising agencies.
C. accounts receivable collection agencies.
D. public relations firms.
E. All of the above are examples of facilitating agencies.

1.26 Those who sell goods and services directly to final consumers for their personal nonbusiness use are:

A. retailers.
B. agent middlemen.
C. merchant wholesalers.
D. facilitating agents.
E. commissioned agents.

1.27 About what percentage of the retail price of consumer products consists of the costs of marketing and distribution of these products?

A. 10 per cent.
B. 30 per cent.
C. 50 per cent.
D. 70 per cent.
E. 90 per cent.

1.28 Because manufacturers and their agents can perform exchange activities at a lower cost than individual consumers, we say that they have achieved:

A. price efficiency.
B. functional efficiency.
C. transaction efficiency.
D. vertical integration.
E. horizontal integration.

1.29 When a consumer purchases a product at a convenient location and when she is ready to use the product, we say that the product has achieved _____ utility and _____ utility, respectively.

A. time; place.
B. place; time.
C. possession; place.
D. possession; functional.
E. time; possession.

1.30 Which of the following BEST summarises the way marketing managers communicate to potential customers about their offerings?

A. Advertising.
B. Pricing.
C. The product's features.
D. Publicity.
E. The marketing mix.

1.31 Advertising, personal selling, point-of-purchase displays and publicity are related to which elements of the marketing mix?

A. Place.
B. Product.
C. Price.
D. Promotion.
E. Personnel.

1.32 Quality, features, style, options, brand name, packaging, guarantees and warranties and service are related to which element of the marketing mix?

A. Place.
B. Price.
C. Product.
D. Promotion.
E. Personnel.

## Application Questions and Cases

1.33 You have just made a substantial monetary contribution to a well-known charitable organisation. Was this an exchange transaction? If so, what was exchanged? What need(s) or want(s) did you satisfy by making your contribution? Which marketing activities do managers of charitable organisations engage in to facilitate a transaction?

1.34 What is the difference between a customer's need and a customer's want? State which needs (or benefits) might be met by each of the following:

a. Toujours Moi perfume.
b. A BMW car.
c. A physical examination at a local hospital.
d. A mainframe computer.

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# Module 2

# Corporate Strategies and Their Marketing Implications

### Contents



## IBM Switches Strategies[1]

For decades International Business Machines focused most of its efforts on the hardware side of the computer industry: first on large mainframe computers, then on personal computers (PCs), and then, as the Internet began to take off in the mid-1990s, on servers and related equipment. Its target customers for that hardware were typically organisations rather than individual consumers and usually large organisations that needed lots of data processing capacity and had the financial resources to afford it. The firm did not ignore consumers or small businesses, but it relied on independent retailers and value-added resellers to reach those segments, while focusing much of its own marketing and sales effort on large organisations.

IBM's competitive strategy was also quite consistent over the years. Given that the firm was never the lowest cost producer in the industry, it did not try to compete with low prices. Instead, the firm pursued a quality differentiation strategy by offering superior products backed up by excellent technical service and selling them at premium prices.

To implement its strategy, the company tried to ensure a steady stream of cutting-edge products by allocating vast resources to R&D and product development. IBM also generally followed an 'open architecture' policy. In its PC business, for instance, the firm licensed its PC-DOS operating system (developed in collaboration with Microsoft) to other manufacturers and software developers. This helped expand the number of PC-DOS users, thereby providing incentives for IBM's licensees to develop more innovative applications software to run on PC-DOS systems, which in turn enhanced the usefulness and customer value of IBM's hardware.

On the marketing side, the firm maintained substantial advertising and promotion budgets to keep potential customers informed about its constantly evolving product lines and to burnish the identity of the IBM brand. More important, though, were the millions spent recruiting, training, and compensating one of the world's largest and most technically competent salesforces.

### *Technology Changes and Competitor Actions Require a Shift in Strategy*

For decades IBM's corporate, business, and marketing strategies were all very successful. By the mid-1990s, however, several of IBM's traditional businesses were in trouble. The company's share of the worldwide PC market fell to about 8 per cent in 1999, third behind Dell and Compaq. Worse, the firm's PC business was projected to lose $400 million, on top of a $1 billion loss in 1998. Similarly, while server sales, made up mostly of UNIX-based computers, were growing rapidly around the world, IBM was able to capture only a small share of that business. Its growth rate in the server market during the late 1990s was only about one-third as fast as that of major competitors such as Sun Microsystems. Even its venerable mainframe business, which had been a low-growth but highly profitable market throughout the 1980s and early 1990s, suffered a profit squeeze due to falling prices and declining demand.

IBM's performance problems can be traced to a variety of factors, which all worked to make the firm's tried-and-true corporate, competitive, and marketing strategies less effective than they once were. For one thing, major technological changes in the macroenvironment – such as the rapid increase in power of desktop PCs, the emergence of the Internet, and the development of internal, organisationwide computer networks (or intranets) – greatly contributed to the declining demand for large mainframe computers and centralised data processing systems.

Also, IBM's quality differentiation strategy became less effective as some of its product-markets began to mature and customers' purchase criteria changed. Technical and performance differences among competing brands became less pronounced as the PC industry matured, for example, and later buyers tended to be less technically sophisticated, more price-conscious, and more interested in buying equipment that was easy to use. IBM's premium price position put it at a disadvantage in attracting such customers. Worse, a number of competitors, notably Dell, provided more benefits at lower prices by offering custom-designed systems, convenient direct purchasing over the Web, and user-friendly service and support programmes.

Even IBM's traditional focus on large organisational customers contributed to the firm's problems in the newly emerging markets for servers and related equipment and software. It was slow to pursue the many small start-up businesses at the forefront of the dot-com revolution, leaving an open field for Sun, Hewlett-Packard, and other competitors. 'We've had to adapt our [strategy] model to them,' conceded Lou Gerstner, IBM's CEO. 'We were late.'

### *A New Corporate Strategy*

When Lou Gerstner took over as IBM's chief executive in 1994, he and a task force of other executives, including many from the marketing and sales ranks, re-examined all the firm's businesses, customer segments, competitors, and potential competitors. Their conclusion: The Internet would change everything. They foresaw that 'The real leadership in the [information technology] industry was moving away from the creation of the technology to the application of the technology,' says Gerstner. 'The explosive growth is in services.' Further, 'We concluded that this [the Internet] was not an information superhighway. This was all about business, doing transactions, not looking up information.'

Consequently, IBM's top executives began to refocus the corporate mission, de-emphasising the development and manufacture of high-tech hardware while increasing the emphasis on providing customers with e-business engineering, software, and outsourcing services. To leverage the firm's existing competencies and its long-term relationships with its traditional customers, many of the new services the firm developed concentrate on helping large, bricks-and-mortar firms (1) hook old corporate databases (often on mainframes) into new online systems, (2) integrate Web technology into their internal business processes to improve efficiency, and (3) develop and run company websites.

But the corporation also expanded the scope of both its new service and old hardware business to embrace smaller customers. For example, the firm released scaled down versions of its database, email, and network management software that are easier to maintain and up to 80 per cent cheaper than its standard versions. It also appealed to such customers with the promise of 'e-business on demand': a menu of consulting services and software packages that can be tailored to the unique needs of firms in specific industries.

More recently, Samuel J. Palmisano – the man who took over as CEO from Mr Gerstner – has further broadened the scope of IBM's service offerings. He has focused on the development and delivery of 'business transformation services' aimed at helping major customers rethink, redesign, and even run large chunks of their business; everything from accounting and customer service to human resources and procurement. The goal is to forge long-term partnerships with customers. For example, the firm has a seven-year, $180 million contract with Dun & Bradstreet to pull together credit information on 63 million companies and handle D&B's customer support, telemarketing, electronic credit-report distribution, and crucial finance operations.

### *New Business and Marketing Strategies*

IBM's new corporate emphasis on e-business services and software as its primary paths toward future growth has also forced some changes in the firm's competitive and marketing strategies. At the business level, the firm still seeks to differentiate itself from competitors on the basis of superior quality and to charge premium prices for that quality. But in its new service businesses, competitive superiority depends on the knowledge, experience, and expertise of its consultants – and their familiarity with a customer's operations that comes from continuing interaction – rather than the technical quality of its products. Therefore, to implement its new service-based differentiation strategy effectively, the company reorganised and reallocated many of its internal resources. For example, the firm created a stand-alone software division with its own salesforce organised to focus on making and selling products tailored to the most common business problems of companies in 12 different industry segments, such as financial services, life sciences, and consumer package goods. Similarly, a majority of the company's $6 billion R&D budget is now focused on solving business problems rather than improving the technical performance of its hardware.

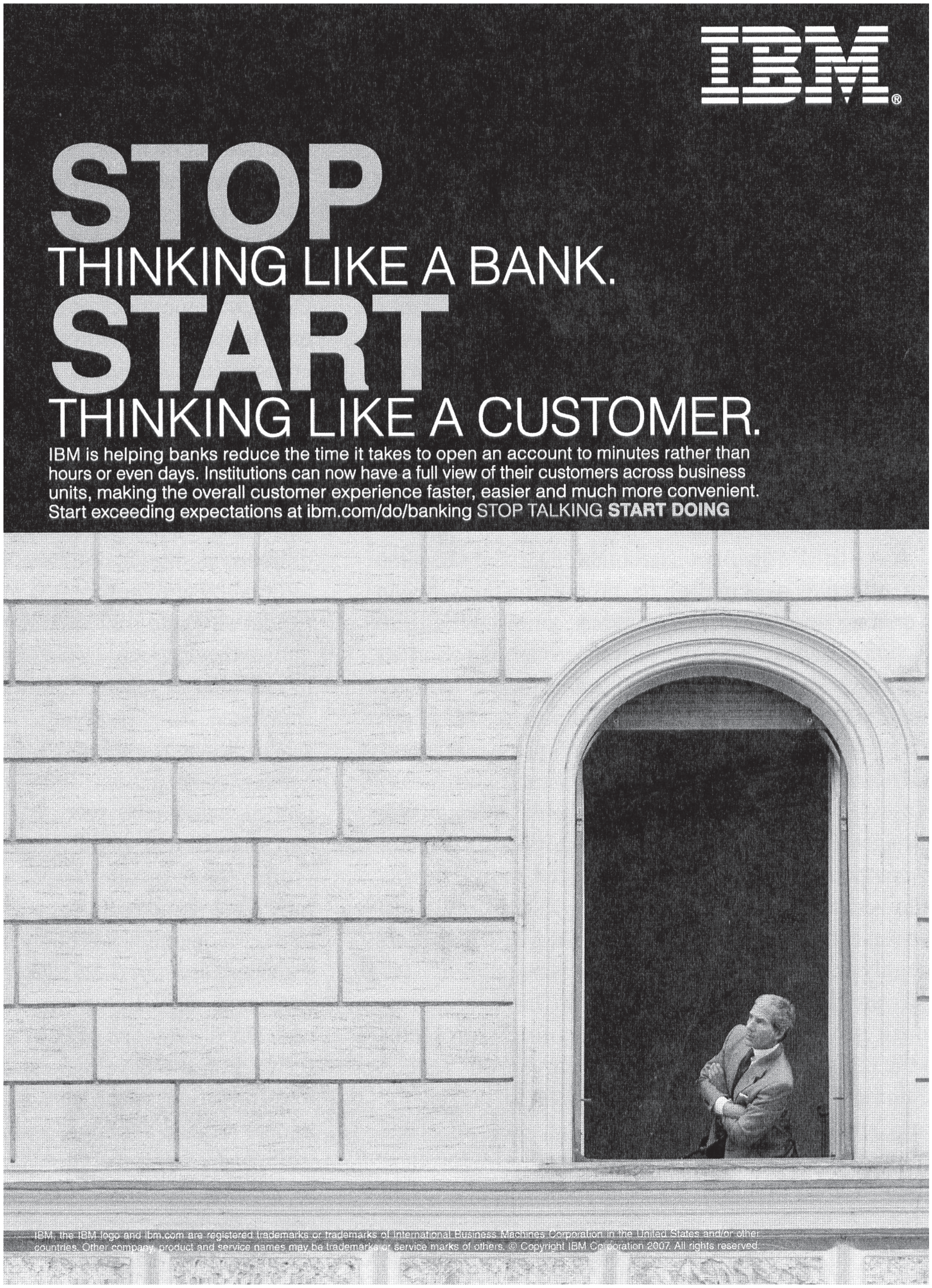
The company also found that in order to tailor services and software to a customer's specific business problems, a team approach was required. Consequently, customer relationships are typically managed by teams involving representatives from sales, the business services division, the software unit, the systems and technology unit, and often someone from the research labs. And a team's members may reside in different IBM offices around the world. Team managers post detailed personnel requests on the firm's internal database, which lists 170 000 employees around the world along with their skills, availability, pay rate, and the like.

Given that the success of IBM's competitive strategy depends heavily on the knowledge and expertise of its personnel and their ability to forge beneficial relationships with customers, the firm's salesforce is even more crucial than ever. But many salespeople who used to sell the company's hardware have been retrained and transferred to the software division or turned into business consultants. The company also acquired PricewaterhouseCoopers consulting, a move that helped IBM focus more on executive-level business consulting in addition to traditional technology consulting.

The superior expertise and experience of IBM's people – and the firm's ability to satisfy the e-commerce needs of customers in a variety of industries – was also effectively communicated via an advertising campaign featuring a series of ads such as that shown in Exhibit 2.1. The ads stressed the firm's extensive consulting resources and capabilities and were placed in a variety of media directed at managers and entrepreneurs.

While IBM's new strategies brought it face to face with new competitors in the business consulting and outsourcing industries, such as Accenture and India's Tata Consultancy Services Ltd., the results were encouraging. Total revenues in 2007 were about $99 billion – nearly a 20 per cent increase since the dot.com crash in the early years of the century – and income from continuing operations hit $10.4 billion. More important, revenues from the software unit were $20 billion in 2007, up 10 per cent from the previous year, and global business services generated revenues of $18 billion for a 13 per cent gain.

**Exhibit 2.1** **A print advertisement for IBM's global business services**




## Learning Objectives

Regardless of their participation or influence in formulating corporate and business-level strategies, marketing managers' freedom of action is ultimately constrained by those higher-level strategies. The objectives, strategies, and action plans for a specific product-market are but one part of a hierarchy of strategies within the firm. Each level of strategy must be consistent with – and therefore influenced and constrained by – higher levels within the hierarchy.

This module considers these interrelationships among the various levels of strategy raise several questions of importance to marketing managers as well as managers in other functional areas and top executives, including: What role does marketing play in formulating strategies at the corporate and divisional or business unit level? Why do some organisations pay much more attention to customers and competitors when formulating their strategies (i.e., why are some firms more market-oriented) than others, and does it make any difference in their performance? What do strategies consist of, and are they similar or different at the corporate, business, and functional levels? What specific decisions underlie effective corporate and business-level strategies, and what are their implications for marketing?

## 2.1 What Is Marketing's Role in Formulating and Implementing Strategies?

The essence of strategic planning at all levels is identifying threats to avoid and opportunities to pursue. The primary strategic responsibility of any manager is to look outward continuously to keep the firm or business in step with changes in the environment. Because they occupy positions at the boundary between the firm and its customers, distributors, and competitors, marketing managers are usually most familiar with conditions and trends in the market environment. Consequently, they are not only responsible for developing strategic plans for their own product-market entries, but are also often primary participants and contributors to the planning process at the business and corporate level as well.

The wide-ranging influence of marketing managers on higher-level strategic decisions is clearly shown in a recent survey of managers in 280 US and 234 German business units of firms in the electrical equipment, mechanical machinery, and consumer package goods industries.[2] The study examined perceptions of marketing managers' influence relative to managers from sales, R&D, operations, and finance on a variety of strategic and tactical decisions within their businesses. Exhibit 2.2 summarises the results.

**Exhibit 2.2 Influence of functional units over various business decisions**

| Decisions | Marketing | Sales | R&D | Operations | Finance |
|---|---|---|---|---|---|
| *Business strategy decisions* | | | | | |
| Strategic direction of the business | 38 | 29** | 11** | 9** | 14** |
| Expansion into new geographic markets | 39 | 45** | 3** | 3** | 10** |
| Choices of strategic partners | 33 | 38* | 7** | 9** | 12** |
| New product development | 32 | 23** | 29** | 9** | 7** |

| Decisions | Marketing | Sales | R&D | Operations | Finance |
|---|---|---|---|---|---|
| Major capital expenditures | 13 | 11** | 13 | 29** | 35** |
| *Marketing strategy decisions* | | | | | |
| Advertising messages | 65 | 29** | 3** | 1** | 2** |
| Customer satisfaction measurement | 48 | 35** | 5** | 8** | 4** |
| Customer satisfaction improvement | 40 | 37* | 7** | 10** | 6** |
| Distribution strategy | 34 | 52** | 1** | 6** | 6** |
| Customer service and support | 31 | 47** | 5** | 10** | 7** |
| Pricing | 30 | 41** | 4** | 9** | 16** |

The number in each cell is the mean of the amount of points given by responding managers to each function, using a constant-sum scale of 100. A *t*-test was performed to compare column 2 (mean of relative influence of marketing) with columns 3 through 6 (relative influence of sales, R&D, operations and finance).
Statistically significant differences with marketing are indicated by asterisks, where: * $p < .05$; ** $p < .01$.

*Source*: Christian Homburg, John P. Workman Jr and Harley Krohmer, 'Marketing's Influence Within the Firm,' *Journal of Marketing* 63 (April 1999), p. 9. Reprinted with permission from the *Journal of Marketing*, published by the American Marketing Association.

The study found that, on average, marketing and sales executives exerted significantly more influence than managers from other functions on strategic decisions concerning traditional marketing activities, such as advertising messages, pricing, distribution, customer service and support, and measurement and improvement of customer satisfaction. Interestingly, though, the influence of sales executives was perceived to be even greater than that of marketing managers on some of these decisions. One reason – particularly in the industrial goods firms selling electronic equipment and machinery – may be that sales managers have more detailed information about customer needs and desires because they have direct and continuing contact with existing and potential buyers.

More surprisingly, marketing managers were also perceived to wield significantly more influence than managers from other functional areas on cross-functional, business-level strategic decisions. While the views of finance and operations executives carry more weight in approving major capital expenditures, marketing and sales managers exert more influence on decisions concerning the strategic direction of the business unit, expansion into new geographic markets, the selection of strategic business partners, and new product development.

Might the relative influence of the different functions become more similar as firms adopt more integrative organisational forms, such as cross-functional work teams? The study's results suggest not. Marketing's influence was not significantly reduced in companies that had instituted cross-functional structures and processes.

But marketing managers may not play as pervasive a strategic role in other cultures as they do in the United States. The study found that marketers' influence on both tactical and strategic issues was significantly lower in German firms. As one of the study's authors points out, 'Germany has traditionally stressed technology and operations more than the softer, customer-oriented aspects central to marketing. So even when the environment changes, a signal to top-level German managers that marketing should be playing a greater role, they are reluctant to give it that role.'[3]

## 2.1.1 Market-Oriented Management

No matter where companies are located, however, marketing managers do not play an equally extensive strategic role in every firm because not all firms are equally market-oriented. Not surprisingly, marketers tend to have a greater influence on all levels of strategy in organisations that embrace a market-oriented philosophy of business. More critically, managers in other functional areas of market-oriented firms incorporate more customer and competitor information into their decision-making processes as well.

Market-oriented organisations tend to operate according to the business philosophy known as the marketing concept. As originally stated by General Electric four decades ago, the **marketing concept** holds that the planning and coordination of all company activities around the primary goal of satisfying customer needs is the most effective means to attain and sustain a competitive advantage and achieve company objectives over time.

Thus, market-oriented firms are characterised by a consistent focus by personnel in all departments and at all levels on customers' needs and competitive circumstances in the market environment. They are also willing and able to quickly adapt products and functional programmes to fit changes in that environment. Such firms pay a great deal of attention to customer research *before* products are designed and produced. They embrace the concept of market segmentation by adapting product offerings and marketing programmes to the special needs of different target markets.

Market-oriented firms also adopt a variety of organisational procedures and structures to improve the responsiveness of their decision making, including using more detailed environmental scanning and continuous, real-time information systems; seeking frequent feedback from and coordinating plans with key customers and major suppliers; encouraging entrepreneurial thinking among lower-level managers; and using interfunctional management teams to analyse issues and initiate strategic actions outside the formal planning process.[4] For example, IBM formed a high-level cross-functional task force to re-evaluate its market environment, develop a new strategic focus, and map new avenues toward future growth. And it has formed cross-functional teams to help individual customers identify and resolve their business problems and to sustain long-term relationships. These and other actions recommended to make an organisation more market-driven and responsive to environmental changes are summarised in Exhibit 2.3.

**Exhibit 2.3 Guidelines for market-oriented management**

1. Create customer focus throughout the business.
2. Listen to the customer.
3. Define and nurture your distinctive competence.
4. Define marketing as market intelligence.
5. Target customers precisely.
6. Manage for profitability, not sales volume.
7. Make customer value the guiding star.
8. Let the customer define quality.
9. Measure and manage customer expectations.
10. Build customer relationships and loyalty.
11. Define the business as a service business.
12. Commit to continuous improvement and innovation.
13. Manage culture along with strategy and structure.
14. Grow with partners and alliances.
15. Destroy marketing bureaucracy.

*Source*: Frederick E. Webster Jr, 'Executing the New Marketing Concept,' *Marketing Management* 3, no. 1 (1994), p. 10.

## 2.1.2 Does Being Market-Oriented Pay?

Since an organisation's success over time hinges on its ability to provide benefits of value to its customers – and to do that better than its competitors – it seems likely that market-oriented firms should perform better than others. By paying careful attention to customer needs and competitive threats – and by focusing activities across all functional departments on meeting those needs and threats effectively – organisations should be able to enhance, accelerate, and reduce the volatility and vulnerability of their cash flows.[5] And that should enhance their economic performance and shareholder value. Indeed, profitability is the third leg, together with a customer focus and cross-functional coordination, of the three-legged stool known as the marketing concept.

Sometimes the marketing concept is interpreted as a philosophy of trying to satisfy all customers' needs regardless of the cost. That would be a prescription for financial disaster. Instead, the marketing concept is consistent with the notion of focusing on only those segments of the customer population that the firm can satisfy both effectively *and* profitably. Firms might offer less extensive or costly goods and services to unprofitable segments or avoid them. For example, the Buena Vista Winery website (www.buenavistawinery.com) does not accept orders of less than a half case because they are too costly to process and ship.

Substantial evidence supports the idea that being market-oriented pays dividends, at least in a highly developed economy such as the United States. A number of studies involving more than 500 firms or business units across a variety of industries indicate that a market orientation has a significant positive effect on various dimensions of performance, including return on assets, sales growth, and new product success.[6]

### 2.1.3 Factors That Mediate Marketing's Strategic Role

Despite the evidence that a market-orientation boosts performance, many companies around the world are not very focused on their customers or competitors. Among the reasons firms are not always in close touch with their market environments are these:

- Competitive conditions may enable a company to be successful in the short run without being particularly sensitive to customer desires.
- Different levels of economic development across industries or countries may favour different business philosophies.
- Firms can suffer from strategic inertia – the automatic continuation of strategies successful in the past, even though current market conditions are changing.

#### 2.1.3.1 Competitive Factors Affecting a Firm's Market Orientation

The competitive conditions some firms face enable them to be successful in the short term without paying much attention to their customers, suppliers, distributors, or other organisations in their market environment. Early entrants into newly emerging industries, particularly industries based on new technologies, are especially likely to be internally focused and not very market-oriented. This is because there are likely to be relatively few strong competitors during the formative years of a new industry, customer demand for the new product is likely to grow rapidly and outstrip available supply, and production problems and resource constraints tend to represent more immediate threats to the survival of such new businesses.

Businesses facing such market and competitive conditions are often **product-oriented** or **production-oriented**. They focus most of their attention and resources on such functions as product and process engineering, production, and finance in order to acquire and manage the resources necessary to keep pace with growing demand. The business is primarily concerned with producing more of what it wants to make, and marketing generally plays a secondary role in formulating and implementing strategy. Other functional differences between production-oriented and market-oriented firms are summarised in Exhibit 2.4.

**Exhibit 2.4 Differences between production-oriented and market-oriented organisations**

| Business activity or function | Production orientation | Marketing orientation |
|---|---|---|
| Product offering | Company sells what it can make; primary focus on functional performance and cost. | Company makes what it can sell; primary focus on customers' needs and market opportunities. |
| Product line | Narrow. | Broad. |
| Pricing | Based on production and distribution costs. | Based on perceived benefits provided. |

| Business activity or function | Production orientation | Marketing orientation |
|---|---|---|
| Research | Technical research; focus on product improvement and cost cutting in the production process. | Market research; focus on identifying new opportunities and applying new technology to satisfy customer needs. |
| Packaging | Protection for the product; minimise costs. | Designed for customer convenience; a promotional tool. |
| Credit | A necessary evil; minimise bad debt losses. | A customer service; a tool to attract customers. |
| Promotion | Emphasis on product features, quality and price. | Emphasis on product benefits and ability to satisfy customers' needs or solve problems. |

As industries grow, they become more competitive. New entrants are attracted and existing producers attempt to differentiate themselves through improved products and more-efficient production processes. As a result, industry capacity often grows faster than demand and the environment shifts from a seller's market to a buyer's market. Firms often respond to such changes with aggressive promotional activities – such as hiring more salespeople, increasing advertising budgets, or offering frequent price promotions – to maintain market share and hold down unit costs.

Unfortunately, this kind of **sales-oriented** response to increasing competition still focuses on selling what the firm wants to make rather than on customer needs. Worse, competitors can easily match such aggressive sales tactics. Simply spending more on selling efforts usually does not create a sustainable competitive advantage.

As industries mature, sales volume levels off and technological differences among brands tend to disappear as manufacturers copy the best features of each other's products. Consequently, a firm must seek new market segments or steal share from competitors by offering lower prices, superior services, or intangible benefits other firms cannot match. At this stage, managers can most readily appreciate the benefits of a market orientation, and marketers are often given a bigger role in developing competitive strategies.[7] Of course, a given industry's characteristics may make some components of a market orientation more crucial for good performance than others. For example, in an industry dominated by large, dynamic competitors – as in the global automobile industry – being responsive to competitor moves may be even more important than a strong customer focus.[8] But the bottom line is that an orientation towards the market – competitors, customers and potential customers – is crucial for continued success in global markets.

#### 2.1.3.2 The Influence of Different Stages of Development across Industries and Global Markets

The previous discussion suggests that the degree of adoption of a market orientation varies not only across firms but also across entire industries. Industries that are in earlier stages of their life cycles, or that benefit from barriers to entry or other factors reducing the intensity of competition, are likely to have relatively fewer market-oriented firms. For instance, in part because of governmental regulations that restricted competition, many service industries – including banks, airlines, physicians, lawyers, accountants, and insurance companies – were slow to adopt the marketing concept. But with the trend toward deregulation and the increasingly intense global competition in such industries, many service organisations are working much harder to understand and satisfy their customers.[9]

Given that entire economies are in different stages of development around the world, the popularity – and even the appropriateness – of different business philosophies may also vary across countries. A production orientation was the dominant business philosophy in the United States, for instance, during the industrialisation that occurred from the mid-1800s through World War I.[10] Similarly, a primary focus on developing product and production technology may still be appropriate in developing nations that are in the midst of industrialisation.

International differences in business philosophies can cause some problems for the globalisation of a firm's strategic marketing programmes, but it can create some opportunities as well, especially for alliances or joint ventures. Consider, for example, the partnership between French automaker Renault-Nissan and the Russian car manufacturer AvtoVAZ discussed in Exhibit 2.5.

**Exhibit 2.5** **Renault's partnership with Russian automaker AvtoVAZ benefits both parties**

The AvtoVAZ car factory in the central Russian city of Togliatti is a decrepit, mile-long building where the company's Lada sedans are turned out by 40-year-old equipment. Nevertheless, the French carmaker Renault-Nissan recently paid $1 billion for a 25 per cent stake in AvtoVAZ. Even after investing more millions to modernise the plant, Renault figures that Russia's low labour and energy costs will make the plant ideal for producing the Logan line-up of cars that the firm introduced in 2004. The no-frills Logan, starting at about $9000, has become the world's most successful cheap car. Its partnership with AvtoVAZ should also help Renault appeal to Russian car buyers and capture a larger share of that country's rapidly growing market.

But AvtoVAZ will also benefit from the partnership, especially on the production side. A key reason the firm agreed to the deal with Renault was 'the modern technology and know-how that the company will provide us,' according to chairman Sergei Chemezov. The partnership may also encourage global auto parts suppliers to build new, more efficient plants near the AvtoVAZ factory.

*Source*: Based on material in Carol Matlack, 'Renault's Ghosn takes on a Russian relic,' www.businessweek.com, February 29, 2008; and Carol Matlack, 'Carlos Ghosn's Russian gambit,' *BusinessWeek*, March 17, 2008, pp. 57–58.

#### 2.1.3.3 Strategic Inertia

In some cases, a firm that achieved success by being in tune with its environment loses touch with its market because managers become reluctant to tamper with strategies and marketing programmes that worked in the past. They begin to believe there is one best way to satisfy their customers. Such strategic inertia is dangerous because customers' needs and competitive offerings change over time. IBM's traditional focus on large organisational customers, for instance, caused the company to devote too little effort to the much faster-growing segment of small technology start-ups. And its emphasis on computer technology and hardware made it slow to respond to the explosive growth in demand for Internet-based applications and services. Thus, in environments where such changes happen frequently, the strategic planning process needs to be ongoing and adaptive. All the participants, whether from marketing or other functional departments, need to pay constant attention to what is happening with their customers and competitors.

## 2.2 Three Levels of Strategy: Similar Components But Different Issues

We have argued that marketing managers have primary responsibility for the marketing strategies associated with individual product or service offerings, and that their perspectives and inputs often have a major influence on the decisions that shape corporate and business-level strategies. But we haven't said much about what those strategic decisions are. Consequently, it's time to define what strategies are and how they vary across different levels of an organisation.

### 2.2.1 Strategy: A Definition

Although *strategy* first became a popular business buzzword during the 1960s, it continues to be the subject of widely differing definitions and interpretations. The following definition, however, captures the essence of the term:

> A **strategy** is a fundamental pattern of present and planned objectives, resource deployments, and interactions of an organisation with markets, competitors, and other environmental factors.[11]

Our definition suggests that a strategy should specify (1) *what* (objectives to be accomplished), (2) *where* (on which industries and product-markets to focus), and (3) *how* (which resources and activities to allocate to each product-market to meet environmental opportunities and threats and to gain a competitive advantage).

### 2.2.2 The Components of Strategy

A well-developed strategy contains five components, or sets of issues:

1. *Scope*. The scope of an organisation refers to the breadth of its strategic domain – the number and types of industries, product lines, and market segments it competes in or plans to enter. Decisions about an organisation's strategic scope should reflect management's view of the firm's purpose or *mission*. This common thread among its various activities and product-markets defines the essential nature of what its business is and what it should be.
2. *Goals and objectives*. Strategies should also detail desired levels of accomplishment on one or more dimensions of performance – such as volume growth, profit contribution, or return on investment – over specified time periods for each of those businesses and product-markets and for the organisation as a whole.
3. *Resource deployments*. Every organisation has limited financial and human resources. Formulating a strategy also involves deciding how those resources are to be obtained and allocated, across businesses, product-markets, functional departments, and activities within each business or product-market.
4. *Identification of a sustainable competitive advantage*. One important part of any strategy is a specification of *how the organisation will compete* in each business and product-market within its domain. How can it position itself to develop and sustain a differential advantage over current and potential competitors? To answer such questions, managers must examine the market opportunities in each business and product-market and the company's distinctive competencies or strengths relative to its competitors.
5. *Synergy*. Synergy exists when the firm's businesses, product-markets, resource deployments, and competencies complement and reinforce one another. Synergy enables the total performance of the related businesses to be greater than it would otherwise be: The whole becomes greater than the sum of its parts.

### 2.2.3 The Hierarchy of Strategies

Explicitly or implicitly, these five basic dimensions are part of all strategies. However, rather than a single comprehensive strategy, most organisations have a hierarchy of interrelated strategies, each formulated at a different level of the firm. The three major levels of strategy in most large, multiproduct organisations are (1) **corporate strategy**, (2) **business-level strategy**, and (3) **functional strategies** focused on a particular product-market entry. In small, single-product-line companies or entrepreneurial start-ups, however, corporate and business-level strategic issues merge.

Strategies at all three levels contain the five components mentioned earlier, but because each strategy serves a different purpose within the organisation, each emphasises a different set of issues. Exhibit 2.6 summarises the specific focus and issues dealt with at each level of strategy; we discuss them in the next sections.

**Exhibit 2.6 Key components of corporate, business and marketing strategies**

| Strategy components | Corporate strategy | Business strategy | Marketing strategy |
|---|---|---|---|
| Scope | • Corporate domain: 'Which business should we be in?'<br>• Corporate development strategy:<br>– Conglomerate diversification (expansion into unrelated businesses)<br>– Vertical integration<br>– Acquisition and divestiture policies | • Business domain: 'Which product-markets should we be in within this business or industry?'<br>• Business development strategy:<br>– e.g. products for existing customers or new customers for existing products | • Target market definition<br>• Product-line depth and breadth<br>• Branding policies<br>• Product-market development plan<br>• Line extension and product elimination plans |
| Goals and objectives | • Overall corporate objectives aggregated across businesses:<br>– Revenue growth<br>– Profitability<br>– ROI (return on investment)<br>– Earnings per share<br>– Contributions to other stakeholders | • Constrained by corporate goals<br>• Objectives aggregated across product-market entries in the business unit:<br>– Sales growth<br>– New product or market growth<br>– Profitability<br>– ROI<br>– Cash flow<br>– Strengthening bases of competitive advantage | • Constrained by corporate and business goals<br>• Objectives for a specific product-market entry:<br>– Sales<br>– Market share<br>– Contribution margin<br>– Customer satisfaction |
| Allocation of resources | • Allocation among businesses in the corporate portfolio<br>• Allocation across functions shared by multiple businesses (corporate R&D, MIS) | • Allocation among product-market entries in the business unit<br>• Allocation across functional departments within the business unit | • Allocation across components of the marketing plan (elements of the marketing mix) for a specific product-market entry |
| Sources of competitive advantage | • Primarily through superior corporate financial or human resource; more corporate R&D; better organisational processes or synergies relative to competitors across all industries | • Primarily through competitive strategy; business unit's competencies relative to competitors in its industry | • Primarily through effective product positioning; superiority on one or more components of the marketing mix relative to competitors within a specific product-market |

| Strategy components | Corporate strategy | Business strategy | Marketing strategy |
|---|---|---|---|
| Sources of synergy | • Shared resources, technologies or functional competencies across businesses within the firm | • Shared resources (including favourable customer image) or functional competencies across product-market within an industry | • Shared marketing resources, competencies or activities across product-market entries |

## 2.2.4 Corporate Strategy

At the corporate level, managers must coordinate the activities of multiple business units and, in the case of conglomerates, even separate legal business entities. Decisions about the organisation's scope and resource deployments across its divisions or businesses are the primary focus of corporate strategy. The essential questions at this level include, What business(es) are we in? What business(es) *should* we be in? and What portion of our total resources should we devote to each of these businesses to achieve the organisation's overall goals and objectives? Thus, new CEO Palmisano and other top-level managers at IBM decided to pursue future growth primarily through the development of consulting services and software rather than computer hardware. They shifted substantial corporate resources – including R&D expenditures, marketing and advertising budgets, and vast numbers of salespeople – into the corporation's service and software businesses to support the new strategic direction.

Attempts to develop and maintain distinctive competencies at the corporate level focus on generating superior human, financial, and technological resources; designing effective organisation structures and processes; and seeking synergy among the firm's various businesses. Synergy can provide a major competitive advantage for firms where related businesses share R&D investments, product or production technologies, distribution channels, a common salesforce and/or promotional themes – as in the case of IBM.[12]

## 2.2.5 Business-Level Strategy

How a business unit competes within its industry is the critical focus of business-level strategy. A major issue in a business strategy is that of sustainable competitive advantage. What distinctive competencies can give the business unit a competitive advantage? And which of those competencies best match the needs and wants of the customers in the business's target segment(s)? For example, a business with low-cost sources of supply and efficient, modern plants might adopt a low-cost competitive strategy. One with a strong marketing department and a competent salesforce may compete by offering superior customer service.[13]

Another important issue a business-level strategy must address is appropriate scope: how many and which market segments to compete in, and the overall breadth of product offerings and marketing programmes to appeal to these segments. Finally, synergy should be sought across product-markets and across functional departments within the business.

### 2.2.6 Marketing Strategy

The primary focus of marketing strategy is to effectively allocate and coordinate marketing resources and activities to accomplish the firm's objectives within a specific product-market. Therefore, the critical issue concerning the scope of a marketing strategy is specifying the target market(s) for a particular product or product line. Next, firms seek competitive advantage and synergy through a well-integrated programme of marketing mix elements (the 4 Ps of product, price, place, promotion) tailored to the needs and wants of potential customers in that target market.

## 2.3 The Marketing Implications of Corporate Strategy Decisions

To formulate a useful corporate strategy, top management must address six interrelated decisions: the overall scope and mission of the organisation; company goals and objectives; the means for gaining a competitive advantage; a development strategy for future growth; the allocation of corporate resources across the firm's various businesses; and the development of synergies across those businesses and their products. While a market orientation – and the analytical tools that marketing managers use to examine customer desires and competitors' strengths and weaknesses – can provide useful insights to guide all six of these strategic decisions, they are particularly germane for revealing the most attractive avenues for future growth and for determining which businesses or product-markets are likely to produce the greatest returns on the company's resources.

In turn, all six of these corporate decisions have major implications for the strategic marketing plans of the firm's various products or services. Together, they define the general strategic direction, objectives, and resource constraints within which those marketing plans must operate. We examine the marketing implications involved in both formulating and implementing these components of corporate strategy next.

### 2.3.1 Corporate Scope – Defining the Firm's Mission

A well-thought-out mission statement guides an organisation's managers as to which market opportunities to pursue and which fall outside the firm's strategic domain. A clearly stated mission can help instil a shared sense of direction, relevance, and achievement among employees, as well as a positive image of the firm among customers, investors, and other stakeholders.

To provide a useful sense of direction, a corporate mission statement should clearly define the organisation's strategic scope. It should answer such fundamental questions as the following: What is our business? Who are our customers? What kinds of value can we provide to these customers? and What should our business be in the future? For example, 20 years ago PepsiCo, the manufacturer of the soft drink Pepsi-Cola, broadened its mission to focus on 'marketing superior quality food and beverage products for households and consumers dining out.' That clearly defined mission guided the firm's managers toward the acquisition of several related companies, such as Frito-Lay, Taco Bell, and Pizza Hut.

More recently, in response to a changing global competitive environment, PepsiCo narrowed its scope to focus primarily on *package* foods (particularly salty snacks) and beverages distributed through supermarket and convenience store channels. This new, narrower mission led the firm to: (1) divest all of its fast-food restaurant chains; (2) acquire complementary beverage businesses, such as Tropicana fruit juices, Lipton iced teas, and Gatorade sports drinks; and (3) develop new brands targeted at rapidly growing beverage segments, such as Aquafina bottled water.

### 2.3.1.1 Market Influences on the Corporate Mission

Like any other strategy component, an organisation's mission should fit both its internal characteristics and the opportunities and threats in its external environment. Obviously, the firm's mission should be compatible with its established values, resources, and distinctive competencies. But it should also focus the firm's efforts on markets where those resources and competencies will generate value for customers, an advantage over competitors, and synergy across its products. Thus, PepsiCo's new mission reflects the firm's package goods marketing, sales, and distribution competencies; its perception that substantial synergies can be realised across snack foods and beverages within supermarket channels via shared logistics, joint displays and sales promotions, and the like; and a corporate culture that believes the company should be an active player is solving some of the social problems – such as obesity and global warming – the world faces.

### 2.3.1.2 Criteria for Defining the Corporate Mission

Several criteria can be used to define an organisation's strategic mission. Many firms specify their domain in *physical* terms, focusing on *products* or *services* or the *technology* used. The problem is that such statements can lead to slow reactions to technological or customer-demand changes. For example, Theodore Levitt argues that Penn Central's view of its mission as being 'the railroad business' helped cause the firm's failure. Penn Central did not respond to major changes in transportation technology, such as the rapid growth of air travel and the increased efficiency of long-haul trucking. Nor did it respond to consumers' growing willingness to pay higher prices for the increased speed and convenience of air travel. Levitt argues that it is better to define a firm's mission as *what customer needs are to be satisfied and the functions the firm must perform to satisfy them*.[14] Products and technologies change over time, but basic customer needs tend to endure. Thus, if Penn Central had defined its mission as satisfying the transportation needs of its customers rather than simply being a railway, it might have been more willing to expand its domain to incorporate newer technologies.

One problem with Levitt's advice, though, is that a mission statement focusing only on basic customer needs can be too broad to provide clear guidance and can fail to take into account the firm's specific competencies. If Penn Central had defined itself as a transportation company, should it have diversified into the trucking business? Started an airline? As the upper-right quadrant of Exhibit 2.7

suggests, the most useful mission statements focus on the customer need to be satisfied and the functions that must be performed to satisfy that need. But they are also *specific* as to the customer groups and the products or technologies on which to concentrate. Thus, instead of seeing itself as being in the railway business or as satisfying the transportation needs of all potential customers, Burlington Northern Santa Fe Railroad's mission is to provide long-distance transportation for large-volume producers of low-value, low-density products, such as coal and grain.

**Exhibit 2.7 Characteristics of effective corporate mission statements**

| | Broad | Specific |
|---|---|---|
| **Functional** Based on customer needs | Transportation business | Long-distance transportation for large-volume producers of low-value, low-density products |
| **Physical** Based on existing products or technology | Railroad business | Long-haul, coal-carrying railroad |

*Source*: Reprinted with permission from C. W. Hofer and D. Schendel, *Strategy Formulation: Analytical Concepts*, p. 43. Copyright © 1978 by West Publishing Company. All rights reserved.

### 2.3.1.3 Social Values and Ethical Principles

An increasing number of organisations are developing mission statements that also attempt to define the social and ethical boundaries of their strategic domain. Some firms are actively pursuing social programmes they believe to be intertwined with their economic objectives, while others simply seek to manage their businesses according to the principles of *sustainability* – meeting humanity's needs without harming future generations. For example, Unilever has launched a variety of programmes to help developing nations wrestle with poverty, water scarcity, and the effects of climate change. The firm's motives are at least as much economic as moral. Some 40 per cent of the Dutch–British giant's sales and most of its growth now take place in developing nations, and Unilever food products account for about 10 per cent of the world's tea, 30 per cent of all spinach, and a large portion of all processed fish. As environmental regulations grow stricter around the world, the firm must invest in green technologies or its leadership in packaged foods, soaps, and other products could be imperilled. 'You can't ignore the impact your company has on the community and the environment,' points out CEO Patrick Cescau. These days, 'it's also about growth and innovation. In the future, it will be the only way to do business.'[15]

Outside America, fewer firms have formal ethics bureaucracies. To some extent, this reflects the fact that in other countries governments and organised labour both play a bigger role in corporate life. In Germany, for instance, workers' councils often deal with issues such as sexual equality, race relations, and workers' rights.[16]

**Ethics** is concerned with the development of moral standards by which actions and situations can be judged. It focuses on those actions that may result in actual or potential harm of some kind (e.g., economic, mental, physical) to an individual, group, or organisation.

Particular actions may be legal but not ethical. For instance, extreme and unsubstantiated advertising claims, such as 'Our product is far superior to Brand X,' might be viewed as simply legal puffery engaged in to make a sale, but many marketers (and their customers) view such little white lies as unethical. Thus, ethics is more proactive than the law. Ethical standards attempt to anticipate and avoid social problems, whereas most laws and regulations emerge only after the negative consequences of an action become apparent.[17]

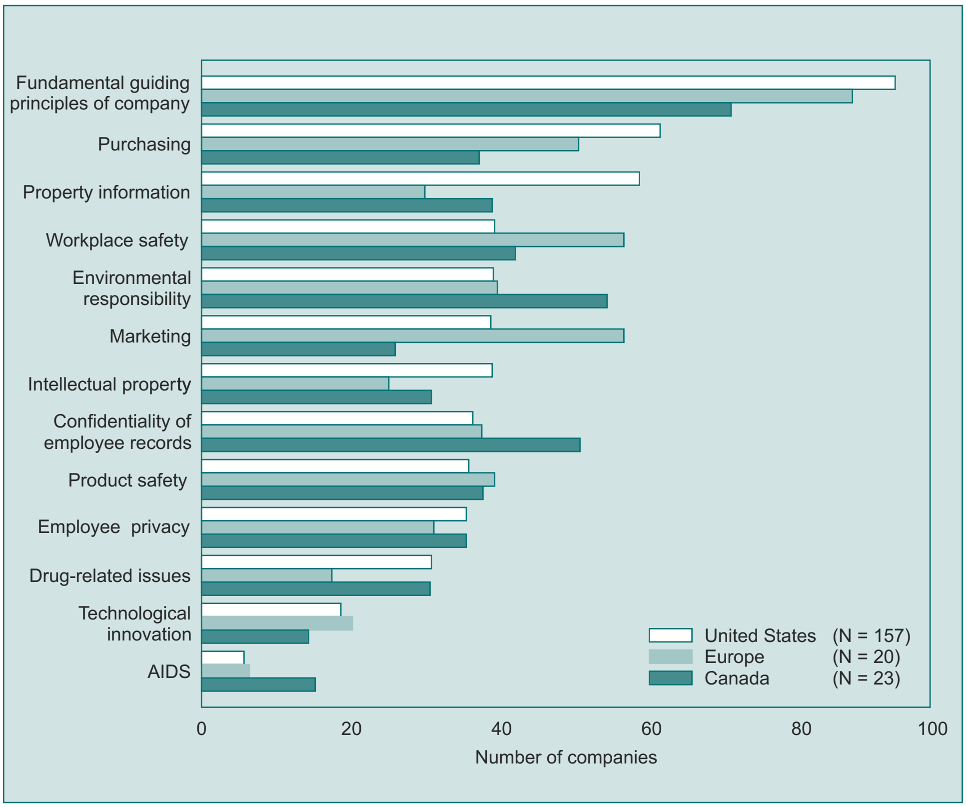
### 2.3.1.4 Why Are Ethics Important? The Marketing Implications of Ethical Standards

One might ask why a corporation should take responsibility for providing moral guidance to its managers and employees. While such a question may be a good topic for philosophical debate, there is a compelling, practical reason for a firm to impose ethical standards to guide employees. Unethical practices can damage the trust between a firm and its suppliers or customers, thereby disrupting the development of long-term exchange relationships and resulting in the likely loss of sales and profits over time. For example, one survey of 135 purchasing managers from a variety of industries found that the more unethical a supplier's sales and marketing practices were perceived to be, the less eager were the purchasing managers to buy from that supplier.[18]

Unfortunately, not all customers or competing suppliers adhere to the same ethical standards. As a result, marketers sometimes feel pressure to engage in actions that are inconsistent with what they believe to be right – either in terms of personal values or formal company standards – in order to close a sale or stay even with the competition. This point was illustrated by a survey of 59 top marketing and sales executives concerning commercial bribery – attempts to influence a potential customer by giving gifts or kickbacks. While nearly two-thirds of the executives considered bribes unethical and did not want to pay them, 88 per cent also felt that *not* paying bribes might put their firms at a competitive disadvantage.[19] Such dilemmas are particularly likely to arise as a company moves into global markets involving different cultures and levels of economic development where economic exigencies and ethical standards may be quite different.

Such inconsistencies in external expectations and demands across countries and markets can lead to job stress and inconsistent behaviour among marketing and sales personnel, which in turn can risk damaging long-term relationships with suppliers, channel partners, and customers. A company can reduce such problems by spelling out formal social policies and ethical standards in its corporate mission statement and communicating and enforcing those standards. Unfortunately, it is not always easy to decide what those policies and standards should be. There are multiple philosophical traditions or frameworks that managers might use to evaluate the ethics of a given action. Consequently, different firms or managers can pursue somewhat different ethical standards, particularly across national cultures. Exhibit 2.8 displays a comparison (across three geographic regions) of the proportion of company ethical statements that address a set of specific issues. Note that a larger number of companies in the United States and Europe appear to be more concerned with the ethics of their purchasing practices than those of their marketing activities. Comparing firms across regions, US companies are more concerned about proprietary information. Canadian firms are more likely to have explicit guidelines concerning environmental responsibility, and European companies more frequently have standards focused on workplace safety.

**Exhibit 2.8** **Issues addressed by company ethics statements**




*Source*: Ronald E. Berenbeim, *Corporate Ethics Practices* (New York: The Conference Board, 1992).

## 2.3.2 Corporate Objectives

Confucius said, 'For one who has no objective, nothing is relevant.' Formal objectives provide decision criteria that guide an organisation's business units and employees toward specific dimensions and performance levels. Those same objectives provide the benchmarks against which actual performance can be evaluated.

To be useful as decision criteria and evaluative benchmarks, corporate objectives must be specific and measurable. Therefore, each objective contains four components:

- A *performance dimension* or attribute sought.
- A *measure or index* for evaluating progress.
- A *target or hurdle* level to be achieved.
- A *time frame* within which the target is to be accomplished.

Exhibit 2.9 lists some common performance dimensions and measures used in specifying corporate as well as business-unit and marketing objectives. When specifying short-term business-level and marketing goals, however, two additional dimensions become important: their relevance to higher-level strategies and goals and their attainability. Thus, we find it useful to follow the SMART acronym when specifying objectives at all levels: **s**pecific, **m**easurable, **a**ttainable, **r**elevant, and **t**ime-bound.

**Exhibit 2.9 Common performance criteria and measures that specify corporate, business-unit and marketing objectives**

| Performance criteria | Possible measures or indices |
|---|---|
| • Growth | $ sales |
| | Unit sales |
| | Per cent change in sales |
| • Competitive strength | Market share |
| | Brand awareness |
| | Brand preference |
| • Innovativeness | $ sales from new products |
| | Percentage of sales from product-market entries introduced within past five years |
| | Percentage cost savings from new processes |
| • Profitability | $ profits |
| | Profit as percentage of sales |
| | Contribution margin* |
| | Return on investment (ROI) |
| | Return on net assets (RONA) |
| | Return on equity (ROE) |
| • Utilisation of resources | Per cent capacity utilisation |
| | Fixed assets as percentage of sales |
| • Contribution to owners | Earnings per share |
| | Price/earnings ratio |
| • Contribution to customers | Price relative to competitors |
| | Product quality |

| Performance criteria | Possible measures or indices |
|---|---|
| | Customer satisfaction |
| | Customer retention |
| | Customer loyalty |
| • Contribution to employees | Wage rates, benefits |
| | Personnel development, promotions |
| | Employment stability, turnover |
| • Contribution to society | $ contributions to charities or community institutions |
| | Growth in employment |

* Business-unit managers and marketing managers responsible for a product-market entry often have little control over costs associated with corporate overheads, such as the costs of corporate staff or R&D. It can be difficult to allocate those costs to specific strategic business units (SBUs) or products. Consequently, profit objectives at the SBU and product-market level are often stated as a desired *contribution margin* (the gross profit prior to allocating such overhead costs).

#### 2.3.2.1 The Marketing Implications of Corporate Objectives

Most organisations pursue multiple objectives. This is clearly demonstrated by a study of the stated objectives of 82 large corporations. The largest percentage of respondents (89 per cent) had explicit profitability objectives: 82 per cent reported growth objectives; 66 per cent had specific market share goals. More than 60 per cent mentioned social responsibility, employee welfare, and customer service objectives, and 54 per cent of the companies had R&D/new product development goals.[20] These percentages add up to more than 100 per cent because most firms had several objectives.

Trying to achieve many objectives at once leads to conflicts and trade-offs. For example, the investment and expenditure necessary to pursue growth in the long term is likely to reduce profitability and ROI in the short term.[21] Managers can reconcile conflicting goals by prioritising them. Another approach is to state one of the conflicting goals as a constraint or **hurdle**. Thus, a firm attempts to maximise growth subject to meeting some minimum ROI hurdle.

In firms with multiple business units or product lines, however, the most common way to pursue a set of conflicting objectives is to first break them down into sub-objectives, then assign sub-objectives to different business units or products. Thus, sub-objectives often vary across business units and product offerings depending on the attractiveness and potential of their industries, the strength of their competitive positions, and the resource allocation decisions made by corporate managers. For example, PepsiCo's managers probably set relatively high volume and share-growth objectives but lower ROI goals for the firm's Aquafina brand, which is battling for prominence in the rapidly growing bottled water category, than for Lay's potato chips, which hold a commanding 40 per cent share of a mature product category. Therefore, two marketing managers responsible for different products may face very different goals and expectations – requiring different marketing strategies to accomplish – even though they work for the same organisation.

As firms emphasise developing and maintaining long-term customer relationships, *customer-focused objectives* – such as satisfaction, retention, and loyalty – are being given greater importance. Such market-oriented objectives are more likely to be consistently pursued across business units and product offerings. There are several reasons for this. First, given the huge profit implications of a customer's lifetime value, maximising satisfaction and loyalty tends to make good sense no matter what other financial objectives are being pursued in the short term. Second, satisfied, loyal customers of one product can be leveraged to provide synergies for other company products or services. Finally, customer satisfaction and loyalty are determined by factors other than the product itself or the activities of the marketing department. A study of one industrial paper company, for example, found that about 80 per cent of customers' satisfaction scores were accounted for by non-product factors, such as order processing, delivery, and postsale services.[22] Since such factors are influenced by many functional departments within the corporation, they are likely to have a similar impact across a firm's various businesses and products.

### 2.3.3 Gaining a Competitive Advantage

There are many ways in which a corporation might attempt to gain an advantage over competitors within the scope of its strategic domain. In most cases, though, a *sustainable* competitive advantage at the corporate level is based on company resources; resources that other firms do not have, that take a long time to develop, and that are hard to acquire.[23] Many such unique resources are marketing-related. For example, some businesses have highly developed information systems, extensive market research operations, and/or cooperative long-term relationships with customers that give them a superior ability to identify and respond to emerging customer needs and desires. Others have a brand name that customers recognise and trust, cooperative alliances with suppliers or distributors that enhance efficiency, or a body of satisfied and loyal customers who are predisposed to buy related products or services.[24]

But the fact that a company possesses resources that its competitors do not have is not sufficient to guarantee superior performance. The trick is to develop a competitive strategy for each division or business unit within the firm, and a strategic marketing programme for each of its product-market entries, that convert one or more of the company's unique resources into something of value to customers. While one can conceive of a nearly infinite assortment of competitive strategies based on a firm's superior resources and capabilities, most can be classified into a few 'generic' types. We devote Module 3 to a detailed discussion of these basic competitive strategies and their implications for marketing programmes. For now, the key point is that those strategies are built – at least in part – on the firm's marketing-related resources and competencies. And to the extent that a single corporate resource – such as a prestigious corporate brand or an excellent salesforce – might serve as the foundation for effective competitive and marketing strategies in more than one of a firm's business units or product lines, it may also produce synergy, as we shall see later.

## 2.3.4 Corporate Growth Strategies

Often, the projected combined future sales and profits of a corporation's business units and product-markets fall short of the firm's long-run growth and profitability objectives. There is a gap between what the firm expects to become if it continues on its present course and what it would like to become. This is not surprising because some of its high-growth markets are likely to slip into maturity over time and some of its high-profit mature businesses may decline to insignificance as they get older. Thus, to determine where future growth is coming from, management must decide on a strategy to guide corporate development.

Essentially, a firm can go in two major directions in seeking future growth: **expansion** of its current businesses and activities, or **diversification** into new businesses, either through internal business development or acquisition. Exhibit 2.10 outlines some specific options a firm might pursue while seeking growth in either of these directions.

**Exhibit 2.10 Alternative corporate growth strategies**

| | Current products | New products |
|---|---|---|
| **Current markets** | **Market penetration strategies**<br>Increase market share<br>Increase product usage<br>– Increase frequency of use<br>– Increase quantity used<br>– New applications | **Product development strategies**<br>Product improvements<br>Product-line extensions<br>New products for same market |
| **New markets** | **Market development strategies**<br>Expand markets for existing products<br>– Geographic expansion<br>– Target new segments | **Diversification strategies**<br>Vertical integration<br>– Forward integration<br>– Backward integration<br>Diversification into related businesses (concentric diversification)<br>Diversification into unrelated businesses (conglomerate diversification) |

### 2.3.4.1 Expansion by Increasing Penetration of Current Product-Markets

One way for a company to expand is by increasing its share of existing markets. This typically requires actions such as making product or service improvements, cutting costs and prices, or outspending competitors on advertising or promotions. Amazon.com pursued a combination of all these actions – as well as forming alliances with Web portals, affinity groups, and the like – to expand its share of Web shoppers, even though the expense of such activities postponed the firm's ability to become profitable.

Even when a firm holds a commanding share of an existing product-market, additional growth may be possible by encouraging current customers to become more loyal and concentrate their purchases, use more of the product or service, use it more often, or use it in new ways. In addition to its promotional efforts, Amazon.com spent hundreds of millions of dollars on warehouses and order fulfilment activities, investments that earned the loyalty of its customers.[25] Other examples include museums that sponsor special exhibitions to encourage patrons to make repeat visits and the recipes that Quaker Oats includes on the package to tempt buyers to include oatmeal as an ingredient in other foods, such as cookies and desserts.

#### 2.3.4.2 Expansion by Developing New Products for Current Customers

A second avenue to future growth is through a product-development strategy emphasising the introduction of product-line extensions or new product or service offerings aimed at existing customers. For example, Arm & Hammer successfully introduced a laundry detergent, an oven cleaner, and a carpet cleaner. Each capitalised on baking soda's image as an effective deodoriser and on a high level of recognition of the Arm & Hammer brand.

#### 2.3.4.3 Expansion by Selling Existing Products to New Segments or Countries

Perhaps the growth strategy with the greatest potential for many companies is the development of new markets for their existing goods or services. This may involve the creation of marketing programmes aimed at nonuser or occasional-user segments of existing markets. Thus, theatres, orchestras, and other performing arts organisations often sponsor touring companies to reach audiences outside major metropolitan areas and promote matinee performances with lower prices and free public transportation to attract senior citizens and students.

Expansion into new geographic markets, particularly new countries, is also a primary growth strategy for many firms. For example, the strategic plan of Degussa, the large German speciality chemicals manufacturer, calls for greatly increased resources and marketing efforts to be directed toward China over the next few years. As Utz-Hellmuth Felcht – the chairman of the firm's management board – points out, the vast number of untapped potential customers for the firm's product means China offers greater promise for future sales growth than Western Europe and North America combined.[26]

While developing nations represent attractive growth markets for basic industrial and infrastructure goods and services, growing personal incomes and falling trade barriers are making them attractive potential markets for many consumer goods and services as well. Even developed nations can represent growth opportunities for products or services based on newly emerging technologies or business models. For instance, Ireland's Ryanair grew rapidly into one of Europe's largest and most profitable airlines by pursuing a new business model based on a low-price, no-frills competitive strategy.[27]

### 2.3.4.4 Expansion by Diversifying

Firms also seek growth by diversifying their operations. This is typically riskier than the various expansion strategies because it often involves learning new operations and dealing with unfamiliar customer groups. Nevertheless, the majority of large US, European, and Asian firms are diversified to one degree or another.

**Vertical integration** is one way for companies to diversify. **Forward vertical integration** occurs when a firm moves downstream in terms of the product flow, as when a manufacturer integrates by acquiring or launching a wholesale distributor or retail outlet. For example, most of Europe's fashion houses – like Ermenegildo Zegna and Giorgio Armani – own at least some of their own retail outlets in major cities in order to gain better control over their companies' merchandising programmes and more direct feedback from customers. In recent years such integrated retail outlets have also been important for establishing a foothold in developing markets such as China where independent retailers with a prestige image can be in short supply. Indeed, Zegna's 40 stores on the mainland were instrumental in growing China into the firm's fourth-largest market.[28] **Backward integration** occurs when a firm moves upstream by acquiring a supplier.

Integration can give a firm access to scarce or volatile sources of supply or tighter control over the marketing, distribution, or servicing of its products. But it increases the risks inherent in committing substantial resources to a single industry. Also, the investment required to vertically integrate often offsets the additional profitability generated by the integrated operations, resulting in little improvement in return on investment.[29]

**Related (or concentric) diversification** occurs when a firm internally develops or acquires another business that does not have products or customers in common with its current businesses but that might contribute to internal synergy through the sharing of production facilities, brand names, R&D know-how, or marketing and distribution skills. Thus, PepsiCo acquired Cracker Jack to complement its salty snack brands and leverage its distribution strengths in grocery stores.

The motivations for **unrelated (or conglomerate) diversification** are primarily financial rather than operational. By definition, an unrelated diversification involves two businesses that have no commonalities in products, customers, production facilities, or functional areas of expertise. Such diversification mostly occurs when a disproportionate number of a firm's current businesses face decline because of decreasing demand, increased competition, or product obsolescence. The firm must seek new avenues of growth. Other, more fortunate, firms may move into unrelated businesses because they have more cash than they need in order to expand their current businesses, or because they wish to discourage takeover attempts.

Unrelated diversification tends to be the riskiest growth strategy in terms of financial outcomes. Most empirical studies report that related diversification is more conducive to capital productivity and other dimensions of performance than is unrelated diversification.[30] This suggests that the ultimate goal of a corporation's strategy for growth should be to develop a compatible portfolio of businesses to which the firm can add value through the application of its unique core competencies. The corporation's marketing competencies can be particularly important in this regard.

#### 2.3.4.5 Expansion by Diversifying through Organisational Relationships or Networks

Recently, firms have attempted to gain some benefits of market expansion or diversification while simultaneously focusing more intensely on a few core competencies. They try to accomplish this feat by forming relationships or organisational networks with other firms instead of acquiring ownership.[31]

Perhaps the best models of such organisational networks are the Japanese *keiretsu* and the Korean *chaebol* – coalitions of financial institutions, distributors, and manufacturing firms in a variety of industries that are often grouped around a large trading company that helps coordinate the activities of the various coalition members and markets their goods and services around the world. As we have seen, many Western firms like IBM and RedEnvelope are also forming alliances with suppliers, resellers, and even customers to expand their product and service offerings without making major new investments or neglecting their core competencies.

## 2.3.5 Allocating Corporate Resources

Diversified organisations have several advantages over more narrowly focused firms. They have a broader range of areas in which they can knowledgeably invest, and their growth and profitability rates may be more stable because they can offset declines in one business with gains in another. To exploit the advantages of diversification, though, corporate managers must make intelligent decisions about how to allocate financial and human resources across the firm's various businesses and product-markets. Two sets of analytical tools have proven useful in making such decisions: **portfolio models** and **value-based planning**.

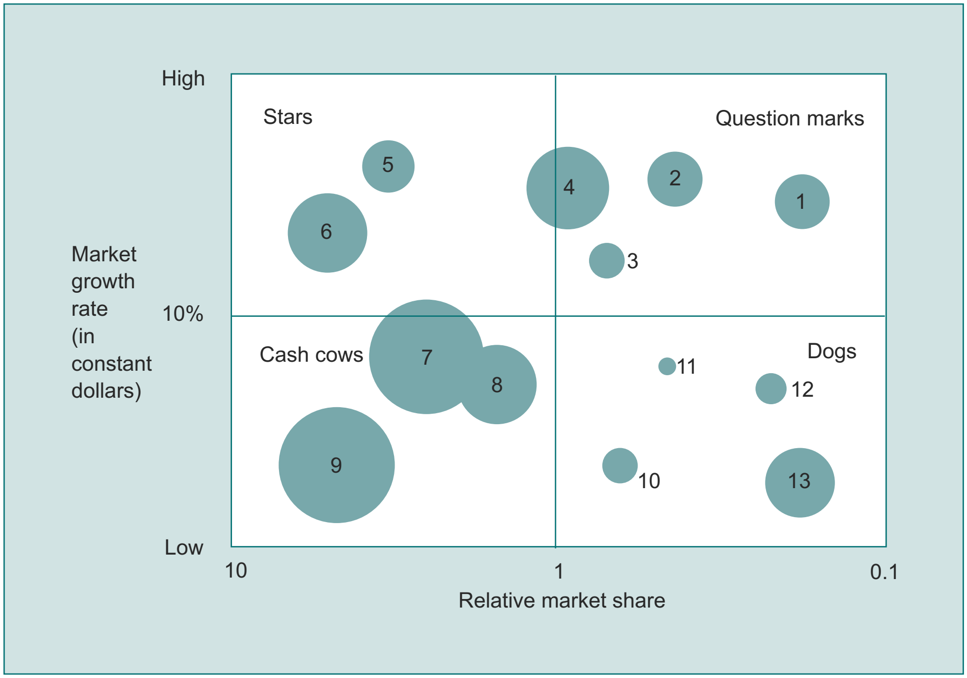
#### 2.3.5.1 Portfolio Models

One of the most significant developments in strategic management during the 1970s and 1980s was the widespread adoption of portfolio models to help managers allocate corporate resources across multiple businesses. These models enable managers to classify and review their current and prospective businesses by viewing them as portfolios of investment opportunities and then evaluating each business's competitive strength and the attractiveness of the markets it serves.

### The Boston Consulting Group's (BCG) Growth-Share Matrix

One of the first – and best-known – of the portfolio models is the growth-share matrix developed by the Boston Consulting Group in the late 1960s. It analyses the impact of investing resources in different businesses on the corporation's future earnings and cash flows. Each business is positioned within a matrix, as shown in Exhibit 2.11. The vertical axis indicates the industry's growth rate and the horizontal axis shows the business's relative market share.

**Exhibit 2.11 BCG's market growth/relative share matrix**




*Source*: Adapted from Barry Hedley, 'Strategy and the Business Portfolio,' *Long Range Planning*, 10 (February 1977).

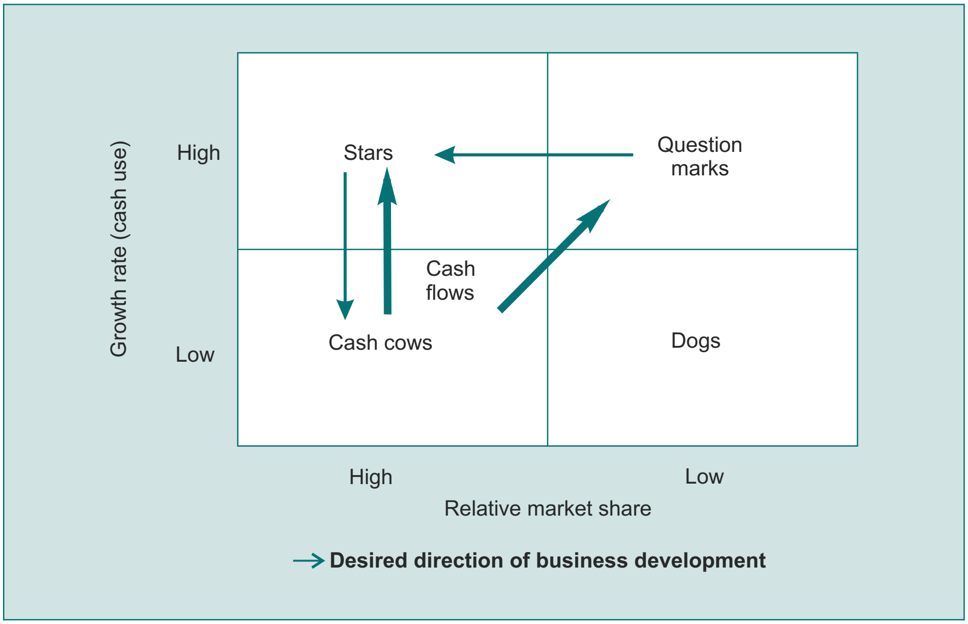
The growth-share matrix assumes that a firm must generate cash from businesses with strong competitive positions in mature markets. Then it can fund investments and expenditures in industries that represent attractive future opportunities. Thus, the **market growth rate** on the vertical axis is a proxy measure for the maturity and attractiveness of an industry. This model represents businesses in rapidly growing industries as more attractive investment opportunities for future growth and profitability.

Similarly, a business's **relative market share** is a proxy for its competitive strength within its industry. It is computed by dividing the business's absolute market share in dollars or units by that of the leading competitor in the industry. Thus, in Exhibit 2.11 a business is in a strong competitive position if its share is equal to, or larger than, that of the next leading competitor (i.e., a relative share of 1.0 or larger). Finally, in the exhibit, the size of the circle representing each business is proportional to that unit's sales volume. Thus, businesses 7 and 9 are the largest-volume businesses in this hypothetical company, while business 11 is the smallest.

## Resource Allocation and Strategy Implications

Each of the four cells in the growth-share matrix represents a different type of business with different strategy and resource requirements. The implications of each are discussed below and summarised in Exhibit 2.12.

**Exhibit 2.12 Cash flows across businesses in the BCG portfolio model**




- *Question marks*. Businesses in high-growth industries with low relative market shares (those in the upper-right quadrant of Exhibit 2.12) are called *question marks* or *problem children*. Such businesses require large amounts of cash, not only for expansion to keep up with the rapidly growing market, but also for marketing activities (or reduced margins) to build market share and catch the industry leader. If management can successfully increase the share of a question mark business, it becomes a star. But if managers fail, it eventually turns into a dog as the industry matures and the market growth rate slows.
- *Stars*. A *star* is the market leader in a high-growth industry. Stars are critical to the continued success of the firm. As their industries mature, they move into the bottom-left quadrant and become cash cows. Paradoxically, while stars are critically important, they often are net users rather than suppliers of cash in the short run (as indicated by the possibility of a negative cash flow shown in Exhibit 2.12). This is because the firm must continue to invest in such businesses to keep up with rapid market growth and to support the R&D and marketing activities necessary to maintain a leading market share.
- *Cash cows*. Businesses with a high relative share of low-growth markets are called *cash cows* because they are the primary generators of profits and cash in a corporation. Such businesses do not require much additional capital investment. Their markets are stable, and their share leadership position usually means they enjoy economies of scale and relatively high profit margins. Consequently, the corporation can use the cash from these businesses to support its question marks and stars (as shown in Exhibit 2.12). However, this does not mean the firm should necessarily maximise the business's short-term cash flow by cutting R&D and

marketing expenditures to the bone – particularly not in industries where the business might continue to generate substantial future sales.

- *Dogs*. Low-share businesses in low-growth markets are called *dogs* because although they may throw off some cash, they typically generate low profits, or losses. Divestiture is one option for such businesses, although it can be difficult to find an interested buyer. Another common strategy is to harvest dog businesses. This involves maximising short-term cash flow by paring investments and expenditures until the business is gradually phased out.

### Limitations of the Growth-Share Matrix

Because the growth-share matrix uses only two variables as a basis for categorising and analysing a firm's businesses, it is relatively easy to understand. But while this simplicity helps explain its popularity, it also means the model has limitations:

- *Market growth rate is an inadequate descriptor of overall industry attractiveness.* Market growth is not always directly related to profitability or cash flow. Some high-growth industries have never been very profitable because low entry barriers and capital intensity have enabled supply to grow even faster, resulting in intense price competition. Also, rapid growth in one year is no guarantee that growth will continue in the following year.
- *Relative market share is inadequate as a description of overall competitive strength.* Market share is more properly viewed as an outcome of past efforts to formulate and implement effective business-level and marketing strategies than as an indicator of enduring competitive strength.[32] If the external environment changes, or the SBU's managers change their strategy, the business's relative market share can shift dramatically.
- *The outcomes of a growth-share analysis are highly sensitive to variations in how growth and share are measured.*[33] Defining the relevant industry and served market (i.e., the target-market segments being pursued) can also present problems. For example, does Pepsi Cola compete only for a share of the cola market, or for a share of the much larger market for nonalcoholic beverages, such as iced tea, bottled water, and fruit juices?
- *While the matrix specifies appropriate investment strategies for each business, it provides little guidance on how best to implement those strategies.* While the model suggests that a firm should invest cash in its question mark businesses, for instance, it does not consider whether there are any potential sources of competitive advantage that the business can exploit to successfully increase its share. Simply providing a business with more money does not guarantee that it will be able to improve its position within the matrix.
- *The model implicitly assumes that all business units are independent of one another except for the flow of cash.* If this assumption is inaccurate, the model can suggest some inappropriate resource allocation decisions. For instance, if other SBUs depend on a dog business as a source of supply – or if they share functional activities, such as a common plant or salesforce, with that business – harvesting the dog might increase the costs or reduce the effectiveness of the other SBUs.

**Exhibit 2.13 The industry attractiveness–business position matrix**

| Business's competitive position | Industry attractiveness: High | Medium | Low |
|---|---|---|---|
| High | 1 | 1 | 2 |
| Medium | 1 | 2 | 3 |
| Low | 2 | 3 | 3 |

1 Invest/grow
2 Selective investment/maintain position
3 Harvest/divest

**Variables that might be used to evaluate:**

| **Business's competitive position** | | **Industry attractiveness** | |
|---|---|---|---|
| Size | Distribution | Size | Profitability |
| Growth | Technology | Growth | Technological sophistication |
| Relative share | Marketing skills | Competitive intensity | Government regulations |
| Customer loyalty | Patents | Price levels | |
| Margins | | | |

## Alternative Portfolio Models

In view of the above limitations, a number of firms have attempted to improve the basic portfolio model. Such improvements have focused primarily on developing more detailed, multifactor measures of industry attractiveness and a business's competitive strength and on making the analysis more future-oriented. Exhibit 2.13 shows some factors managers might use to evaluate industry attractiveness and a business's competitive position. Corporate managers must first select factors most appropriate for their firm and weight them according to their relative importance. They then rate each business and its industry on the two sets of factors. Next, they combine the weighted evaluations into summary measures used to place each business within one of the nine boxes in the matrix. Businesses falling into boxes numbered 1 (where both industry attractiveness and the business's ability to compete are relatively high) are good candidates for further investment for future growth. Businesses in the 2 boxes should receive only selective investment with an objective of maintaining current position. Finally, businesses in the 3 boxes are candidates for harvesting or divestiture. These multifactor models are more detailed than the simple growth-share model and consequently provide more strategic guidance concerning the appropriate allocation of resources across businesses. They are also more useful for evaluating potential new product-markets. However, the multifactor measures in these models can be subjective and ambiguous, especially when managers must evaluate different industries on the same set of factors. Also, the conclusions drawn from these models still depend on the way industries and product-markets are defined.[34]

#### 2.3.5.2 Value-Based Planning

As mentioned, one limitation of portfolio analysis is that it specifies how firms should allocate financial resources across their businesses without considering the competitive strategies those businesses are, or should be pursuing. Portfolio analysis provides little guidance, for instance, in deciding which of two question mark businesses – each in attractive markets but following different strategies – is worthy of the greater investment or in choosing which of several competitive strategies a particular business unit should pursue.

**Value-based planning** is a resource allocation tool that attempts to address such questions by assessing the shareholder value a given strategy is likely to create. Thus, value-based planning provides a basis for comparing the economic returns to be gained from investing in different businesses pursuing different strategies or from alternative strategies that might be adopted by a given business unit.

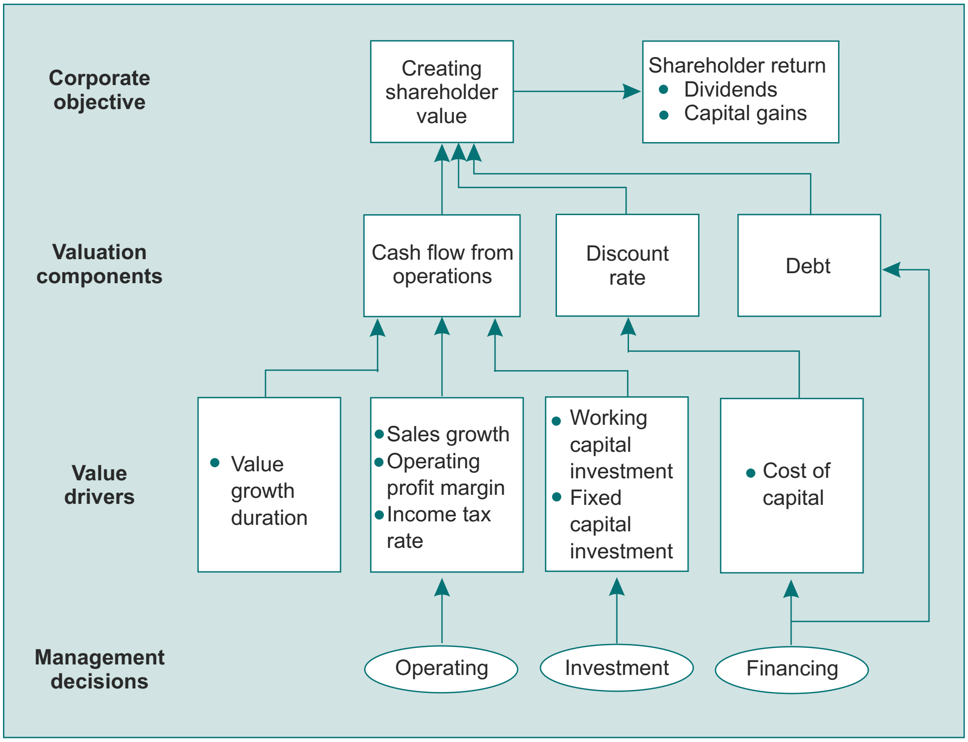
A number of value-based planning methods are currently in use, but all share three basic features.[35] First, they assess the economic value a strategy is likely to produce by examining the cash flows it will generate, rather than relying on distorted accounting measures, such as return on investment.[36] Second, they estimate the shareholder value that a strategy will produce by discounting its forecasted cash flows by the business's risk-adjusted cost of capital. Finally, they evaluate strategies based on the likelihood that the investments required by a strategy will deliver returns greater than the cost of capital. The amount of return a strategy or operating programme generates in excess of the cost of capital is commonly referred to as its **economic value added**, or EVA.[37] This approach to evaluating alternative strategies is particularly appropriate for use in allocating resources across business units because most capital investments are made at the business-unit level, and different business units typically face different risks and therefore have different costs of capital.

## Discounted Cash Flow Model

Perhaps the best-known and most widely used approach to value-based planning is the discounted cash flow model. In this model, as Exhibit 2.14 indicates, shareholder value created by a strategy is determined by the cash flow it generates, the business's cost of capital (which is used to discount future cash flows back to their present value) and the market value of the debt assigned to the business. The future cash flows generated by the strategy are, in turn, affected by six 'value drivers': the rate of sales growth the strategy will produce, the operating profit margin, the income tax rate, investment in working capital, fixed capital investment required by the strategy, and the duration of value growth.

The first five value drivers are self-explanatory, but the sixth requires some elaboration. The duration of value growth represents management's estimate of the number of years over which the strategy can be expected to produce rates of return that exceed the cost of capital. This estimate, in turn, is tied to two other management judgements. First, the manager must decide on the length of the planning period (typically three to five years); he or she must then estimate the residual value the strategy will continue to produce after the planning period is over. Such decisions are tricky, for they involve predictions of what will happen in the relatively distant future.[38]

**Exhibit 2.14 Factors affecting the creation of shareholder value**




*Source*: Adapted with permission of The Free Press, a Division of Simon & Schuster, Inc., from *Creating Shareholder Value: A Guide for Managers & Investors*, revised and updated by Alfred Rappaport. Copyright © 1986, 1998 by Alfred Rappaport.

## Some Limitations of Value-Based Planning

Value-based planning is not a substitute for strategic planning; it is only one tool for evaluating strategy alternatives identified and developed through managers' judgements. It does so by relying on forecasts of many kinds to put a financial value on the hopes, fears, and expectations managers associate with each alternative. Projections of cash inflows rest on forecasts of sales volume, product mix, unit prices, and competitors' actions. Expected cash outflows depend on projections of various cost elements, working capital, and investment requirements.

While good forecasts are notoriously difficult to make, they are critical to the validity of value-based planning. Unfortunately, there are natural human tendencies to overvalue the financial projections associated with some strategy alternatives and to undervalue others. For instance, managers are likely to overestimate the future returns from a currently successful strategy. Evidence of past success tends to carry more weight than qualitative assessments of future threats.

Some kinds of strategy alternatives are consistently undervalued. Particularly worrisome from a marketing viewpoint is the tendency to underestimate the value of keeping current customers. Putting a figure on the damage to a firm's competitive advantage from not making a strategic investment necessary to maintain the status quo is harder than documenting potential cost savings or profit improvements that an investment might generate. And, finally, value-based planning can evaluate alternatives, but it cannot create them. The best strategy will never emerge from the evaluation process if management fails to identify it.[39]

## 2.3.6 Sources of Synergy

A final strategic concern at the corporate level is to increase synergy across the firm's various businesses and product-markets. As mentioned, synergy exists when two or more businesses or product-markets and their resources and competencies, complement and reinforce one another so that the total performance of the related businesses is greater than it would be otherwise.

### 2.3.6.1 Knowledge-Based Synergies

Some potential synergies at the corporate level are knowledge-based. The performance of one business can be enhanced by the transfer of competencies, knowledge, or customer-related intangibles – such as brand-name recognition and reputation – from other units within the firm. For instance, the technical knowledge concerning image processing and the quality reputation that Canon developed in the camera business helped ease the firm's entry into the office copier business.

In part, such knowledge-based synergies are a function of the corporation's scope and mission – or how its managers answer the question, What businesses should we be in? When a firm's portfolio of businesses and product-markets reflects a common mission based on well-defined customer needs, market segments, or technologies, the company is more likely to develop core competencies, customer knowledge and strong brand franchises that can be shared across businesses. However, the firm's organisation structure and allocation of resources also may enhance knowledge-based synergy. A centralised corporate R&D department, for example, is often more efficient and effective at discovering new technologies with potential applications across multiple businesses than if each business unit bore the burden of funding its own R&D efforts. Similarly, some argue that strong corporate-level coordination and support are necessary to maximise the strength of a firm's brand franchise and to glean full benefit from accumulated market knowledge, when the firm is competing in global markets.

### 2.3.6.2 Corporate Identity and the Corporate Brand as a Source of Synergy

Corporate identity – together with a strong corporate brand that embodies that identity – can help a firm stand out from its competitors and give it a sustainable advantage in the market. *Corporate identity* flows from the communications, impressions and personality projected by an organisation. It is shaped by the firm's mission and values, its functional competencies, the quality and design of its goods and services, its marketing communications, the actions of its personnel, the image generated by various corporate activities and other factors.[40]

In order to project a positive, strong and consistent identity, firms as diverse as Caterpillar, British Airways, and Sony have established formal policies, criteria and guidelines to help ensure that all the messages and sensory images they communicate reflect their unique values, personality and competencies. One rationale for such corporate identity programmes is that they can generate synergies that enhance the effectiveness and efficiency of the firm's marketing efforts for its individual product offerings. By focusing on a common core of corporate values and competencies, every impression generated by each product's design, packaging, advertising and promotional materials can help reinforce and strengthen the impact of all the other impressions the firm communicates to its customers, employees, shareholders and other audiences and thereby generate a bigger bang for its limited marketing bucks. For example, by consistently focusing on values and competencies associated with providing high-quality family entertainment, Disney has created an identity that helps stimulate customer demand across a wide range of product offerings – from movies to TV programmes to licensed merchandise to theme parks and cruise ships.

### 2.3.6.3 Synergy from Shared Resources

A further potential source of corporate synergy is inherent in sharing operational resources, facilities and functions across business units. For instance, two or more businesses might produce products in a common plant or use a single salesforce to contact common customers. When such sharing helps increase economies of scale or experience-curve effects, it can improve the efficiency of each of the businesses involved. However, the sharing of operational facilities and functions may not produce positive synergies for all business units. Such sharing can limit a business's flexibility and reduce its ability to adapt quickly to changing market conditions and opportunities. Thus, a business whose competitive strategy is focused on new-product development and the pursuit of rapidly changing markets may be hindered more than helped when it is forced to share operating resources with other units.[41]

## Learning Summary

- Marketing perspectives lie at the heart of strategic decision making, whether at the corporate, business-unit, or product-market levels. All managers who aspire to general management roles need marketing concepts and tools in their repertoire.
- Market-oriented firms – those that plan and coordinate company activities around the primary goal of satisfying customer needs – tend to outperform other firms on a variety of dimensions, including sales growth, return on assets, and new product success.
- A clearly defined corporate mission answers the question 'What business(es) should we be in?' It provides guidance to a firm's managers concerning what alternative product categories and market segments fit best with the firm's competencies, resources and objectives. Mission statements are most useful, therefore, when they are relatively specific concerning both the customer groups and the products or technologies on which the firm will concentrate.

- Unethical behaviour by a firm's employees can damage the trust between a firm and its suppliers and customers, thereby disrupting the development of long-term relationships and reducing sales and profits over time.
- The four major paths to corporate growth – market penetration, market development, product development, and diversification strategies – imply differences in a firm's strategic scope, require different competencies and marketing actions, and involve different types and amounts of risk. Decisions about which path(s) to pursue should consider all of these factors.

## Review Questions

## Content Questions

2.1 What are the more important characteristics of a market-oriented company?

2.2 Define strategy.

2.3 What are the five components of strategy?

2.4 How do the three levels of strategy differ in terms of the issues on which they focus?

2.5 What questions should a company's mission statement answer?

2.6 What criteria should be used to define an organisation's strategic mission?

2.7 What is the value to the corporation of ethical guidelines?

2.8 What are the four components of a corporate objective?

2.9 What are the two major directions a corporation can go in seeking growth? What are the major options within each?

2.10 What is a portfolio model?

2.11 What are the two dimensions in the BCG growth share matrix? What are the assumptions concerning each of these dimensions? Describe the type of business contained in each of the model's four cells.

2.12 What are the major limitations of the BCG model?

2.13 What is value-based planning?

2.14 What are its limitations?

## Multiple Choice Questions

2.15 Components of a corporate strategy include:

A. scope.
B. goals and objectives.
C. resource allocation.
D. sources of synergy.
E. all of the above.

2.16 Starting out in an unrelated industry best illustrates which component of strategy?

A. Scope.
B. Goals and objectives.
C. Resource deployment.
D. Identification of sustainable competitive advantage.
E. Synergy.

2.17 All of the following are examples of goals and objectives within strategy development EXCEPT:

A. market share.
B. a competitor's contribution margin.
C. cost of distribution.
D. customer satisfaction.
E. unit sales.

2.18 A fundamental pattern of present and planned objectives, resource deployments and interactions of an organisation with markets, competitors and other environmental factors refers to a:

A. market orientation.
B. mission.
C. goal.
D. strategic group.
E. strategy.

2.19 The breadth of an organisation's strategic domain, including the number and types of industries, product lines and market segments it competes in or plans to enter, refers to the organisation's:

A. synergy.
B. goals and objectives.
C. resource deployments.
D. sustainable competitive advantage.
E. scope.

2.20 The desired levels of accomplishment on one or more dimensions of performance such as volume growth, profit contribution, or return on investment over specified time periods for each business and product-market, and for the overall organisation, refers to the organisation's:

A. synergy.
B. scope.
C. resource deployments.
D. sustainable competitive advantage.
E. goals and objectives.

2.21 How people and funds are obtained and allocated across businesses, product-markets, functional departments, and activities within each business or product-market, refers to:

A. goals and objectives.
B. scope.
C. resource deployments.
D. sustainable competitive advantage.
E. synergy.

2.22 A major issue in business strategy which deals with the company attempting to attain a distinctive competency is aimed at obtaining:

A. a sustainable competitive advantage.
B. low-cost leadership.
C. market-share leadership.
D. cash cow leadership.
E. market penetration leadership.

2.23 The decisions of how many and which market segments to compete in are important aspects of which aspect of business-level strategy?

A. Scope.
B. Synergy.
C. Multi-segmentation strategy.
D. Marketing matrix.
E. Cross-functional selling.

2.24 The five components of strategy are operative at the:

A. corporate level.
B. business-unit level.
C. product-market level.
D. all of the above.
E. only A and B above are correct.

2.25 The questions: 'What businesses are we in?' and 'What businesses should we be in?' are essentially focused at the:

A. horizontal level.
B. SBU level.
C. business level.
D. functional level.
E. corporate level.

2.26 A primary focus of marketing strategy is to effectively allocate and coordinate marketing resources and activities to accomplish the firm's objectives within a specific:

A. BCG quadrant.
B. SBU.
C. business.
D. product-market.
E. competitive arena.

2.27 An issue related to decisions concerning the scope of a division's marketing strategy is:

A. the changes in related production technologies.
B. the variety of marketing communications options open to the division.
C. the number of target markets the division can pursue.
D. the location of the strategic business unit on a BCG growth-share matrix.
E. the change in the demand function for a particular product, when caused by product advertising.

2.28 What type of decision is reflected in an organisation's business-level strategy?

A. Choosing suppliers.
B. Picking an advertising slogan.
C. Deciding how to compete in its industry.
D. Deciding which products to sell.
E. Defining its overall purpose.

2.29 When PepsiCo attempts to define which products, promotions, prices and distribution arrangements to include in its snacks food line, what type of strategy is it pursuing?

A. Marketing strategy.
B. Functional-level strategy.
C. Corporate strategy.
D. Operational strategy.
E. Market segmentation strategy.

2.30 'What customer needs are to be satisfied and what functions the firm must perform to satisfy them' are Levitt's definition of firm's:

A. mission.
B. culture.
C. synergy.
D. orientation.
E. marketing mix.

2.31 Components of an organisational objective include:

A. product position, market segment and cost strategies.
B. performance dimensions, measures, target levels and time frames.
C. corporate, business and functional components.
D. who, what, when, where, why and how.
E. market served, product characteristics and usage situations.

2.32 Market share is a measure of which performance criterion?

A. Growth.
B. Competitive strength.
C. Profitability.
D. Innovativeness.
E. Utilisation of resources.

2.33 $ sales from new products can be used as a measure of _____ in a company.

A. growth.
B. competitive strength.
C. profitability.
D. innovativeness.
E. utilisation of resources.

2.34 Product line extensions are part of:

A. cost leadership strategies.
B. market development strategies.
C. product development strategies.
D. diversification strategies.
E. market penetration strategies.

2.35 Making product improvements, cutting prices and outspending competitors on such things as advertising and consumer or trade promotions are tactics associated with:

A. synergy.
B. diversification.
C. expansion of existing markets.
D. demand function modification.
E. cost leadership.

2.36 When McDonald's opened a restaurant in Moscow, which of the alternative corporate growth strategies was it emphasising?

A. Diversification.
B. Product development.
C. Market penetration.
D. Market development.
E. Vertical development.

2.37 The riskiest growth strategy in terms of financial outcomes is:

A. horizontal integration.
B. backward integration.
C. forward vertical integration.
D. unrelated diversification.
E. differentiation.

2.38 When RJR Nabisco acquired General Foods Corporation, this was an example of which of the alternative corporate diversification strategies?

A. Forward integration.
B. Backward integration.
C. Unrelated diversification.
D. Related diversification.
E. Coalition building.

2.39 When Compaq Computer and Xerox joined their strengths to develop a new line of high-speed printers for computers, this was an example of:

A. market development.
B. conglomerate diversification.
C. unrelated diversification.
D. concentric diversification.
E. market penetration.

2.40 An example of forward integration is when:

A. a company that produces lumber moves into the manufacture of wood furniture.
B. a company that produces wood furniture moves into the production of lumber.
C. a company that produces wood furniture moves into the production of metal furniture products.
D. a company producing a high-technology computer starts to produce sophisticated software.
E. a company that produces baby food moves into production of other baby products, such as clothing and cribs.

2.41 An example of conglomerate diversification is when:

A. a company that produces lumber moves into the manufacture of wood furniture.
B. a company that produces wood furniture moves into the production of lumber.
C. a company that produces wood furniture moves into the production of metal furniture products.
D. a company producing a high-technology computer starts to produce sophisticated software.
E. a company producing a high-technology computer starts to produce wood furniture.

2.42 When a retailer acquires a wholesaler this is practising:

A. horizontal integration.
B. backward integration.
C. forward vertical integration.
D. unrelated diversification.
E. differentiation.

2.43 In the BCG growth share matrix, _____ is a proxy for the maturity and attractiveness of an industry.

A. relative market share.
B. growth rate.
C. market cluster.
D. absolute market share.
E. market segment.

2.44 Using the BCG portfolio model's terminology, how would Ford's Crown Victoria and Chevrolet's Caprice be classified?

A. Dogs.
B. Cash cows.
C. Stars.
D. Question marks.
E. The BCG model is used to classify businesses not products.

2.45 In terms of the BCG growth share matrix, businesses in high-growth industries with low market shares are termed:

A. stars.
B. cash cows.
C. question marks.
D. wolves.
E. dogs.

2.46 In the portfolio model developed by the Boston Consulting Group, the vertical axis indicates the _____ and the horizontal axis indicates the _____.

A. industry's growth rate; units' relative market share.
B. units' relative market share; industry's growth rate.
C. industry's relative market share; units' absolute market share.
D. units' absolute market share; industry's growth rate.
E. industry's absolute market share; industry's relative market share.

2.47 Which of the following businesses is most likely to be a 'question mark' in terms of the BCG growth share matrix?

A. A large firm, in the fast-growing pharmaceutical business, that has had erratic earnings for the past ten years.
B. A firm in a slow-growing segment of the car parts fabrication industry that is twice as big as its largest competitor, but that faces uncertain profitability during the next few years.
C. A small firm in a fast-growing segment of the car parts fabrication industry that is half the size of its largest competitor, but has a solid history of revenue performance.
D. A firm in the fast-growing pharmaceutical business that is twice the size of its largest competitor and yet faces uncertain profitability.
E. Any firm about which management has serious questions or reservations.

2.48 Which of the following businesses is most likely to be a 'cash cow' in terms of the BCG growth share matrix?

A. A small firm in the fast-growing pharmaceutical business that has had solid profitability for the past ten years.
B. A firm in a slow-growing segment of the car parts fabrication industry that is twice as big as its largest competitor, but that faces uncertain profitability during the next few years.
C. A small firm in a slow-growing segment of the car parts fabrication industry that is half the size of its largest competitor but that faces uncertain revenue performance.
D. A firm in the fast-growing pharmaceutical business that is twice the size of its largest competitor and yet faces uncertain profitability.
E. Really, any firm about which management has serious questions or reservations.

2.49 Divestiture and harvesting are strategies considered primarily for:

A. dogs.
B. question marks.
C. stars.
D. cash cows.
E. decliners.

2.50 In the BCG growth share matrix, _____ is a proxy for an SBU's competitive strength within its industry.

A. relative market share.
B. industry attractiveness.
C. market cluster.
D. absolute market share.
E. market segment.

2.51 In the Discounted Cash Flow model, shareholder value created by a strategy is determined by:

A. the cash flow it generates.
B. the business's cost of operations.
C. the market value of the debt assigned to the business.
D. all of the above.
E. none of the above.

## Application Questions and Cases

2.52 A well-known international chemical company developed a corporate responsibility code that proclaimed that the giving of gifts, loans, favours, or other services by any employee on behalf of the corporation is absolutely forbidden. Almost immediately the company's international vice president received a protest from the manager of a southwest Pacific country stating in effect that if the new code were rigorously enforced, it would put the company at a serious competitive disadvantage since some European, Japanese and American companies were more lenient in the way they handled 'local commissions.' The manager went on to say that the code was inconsistent with the company's objective of gaining market share locally. How should the international vice president answer this protest?

2.53 The Kelly Bottling Company, located in a large metropolitan area of some five million people, produced and marketed a line of carbonated beverages consisting mainly of flavoured soft drinks (not including colas), soda water and tonics. They were sold in different types of packages and sizes to a wide variety of retail accounts. How might such a company expand its revenues by pursuing each of the different expansion strategies discussed in Exhibit 2.10?

2.54 Which diversification strategy is illustrated by each of the following acquisitions? What synergies or benefits might each purchase produce?

a. A packaged food company's acquisition of a fast-food company that features hamburgers and French fries.
b. A large retailer's purchase of an interest in a company producing small appliances.
c. A tobacco company's acquisition of a beer company.
d. An oil company's acquisition of an insurance company.

2.55 A manufacturer of electrical components for industrial applications has five strategic business units (SBUs), shown in the following table. Using the Boston Consulting Group portfolio model, evaluate the strength of the company's current and potential future condition. What strategies should it consider to improve its future position?

| **SBU** | **Sales ($m)** | **Sales of top three competitors ($m)** | | | **Market growth rate (%)** |
|---|---|---|---|---|---|
| A | 1.0 | 1.4 | 1.4 | 1.0 | 15 |
| B | 3.2 | 3.2 | 3.2 | 2.0 | 20 |
| C | 3.8 | 3.8 | 3.0 | 2.5 | 7 |
| D | 6.5 | 6.5 | 1.6 | 1.4 | 4 |
| E | 0.7 | 3.0 | 2.5 | 2.0 | 4 |

2.56 Critics argue that the BCG portfolio model sometimes provides misleading advice concerning how resources should be allocated across SBUs or product-markets. What are some of the possible limitations of the model? What might a manager do to reap the benefits of portfolio analysis while avoiding at least some shortcomings you have identified?

2.57 How are the basic business philosophies or orientations of a major consumer products firm such as General Mills and a small entrepreneurial start-up in a fast-growing, high-tech industry likely to differ? What are the implications of such philosophical differences for the role of marketers in the strategic planning processes of the two firms?

2.58 As the small entrepreneurial firm described in Question 2.57 grows larger, its market matures and its industry becomes more competitive, how should its business philosophy or orientation change? Why?

2.59 State the critical issues that should be addressed at each of the following levels:

a. Corporate strategy.
b. Business-level strategy.
c. Marketing strategy.

2.60 Which role should marketing managers play in helping to formulate business-level (SBU) strategies in a large diversified firm such as General Motors? What kinds of information are marketers best able to provide as a basis for planning? Which issues or elements of business-level strategy can such information help to resolve?

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# Module 3

# Business Strategies and Their Marketing Implications

## Contents



## Business Strategies and Marketing Programmes at 3M[1]

The Minnesota Mining and Manufacturing Company, better known as 3M, began manufacturing sandpaper nearly a century ago. Today it is the leader in dozens of technical areas from fluorochemistry to fibre optics. The firm makes more than 60 000 different products, which generated $24.5 billion in global sales in 2007. The company produced $4.1 billion in operating income, for more than a 17 per cent return on invested capital.

As you might expect of a firm with so many products, 3M is organised into a large number of strategic business units (SBUs). The company contains more than 40 such SBUs or product divisions organised into six market sectors:

- The Industrial Sector makes a variety of tapes, abrasives and adhesives for industrial applications ranging from electronics to the auto industry.
- The Transportation, Graphics and Safety Sector produces such things as reflective materials for traffic signs, respirators for worker safety and materials for commercial graphics.
- The Health Care Sector markets a variety of medical, surgical, pharmaceutical and dental products and services.
- The Consumer and Office Sector offers products for homes and offices, such as Post-it brand repositionable notes and Scotch brand tapes.
- The Electro and Communications Sector supplies connecting, splicing and protective products for electronics and telecommunications markets.

- The Specialty Materials Sector provides fluorothermoplastics and fluorothermopolymers for a variety of applications from packaging to electronics.

While 3M has acquired many smaller firms over the years, its growth strategy has focused primarily on internal new product development, emphasising both improved products for existing customers and new products for new markets. One formal objective assigned to every business unit is to obtain at least 30 per cent of annual sales from products introduced within the past four years. The company supports its growth strategy with an R&D budget of more than $1.3 billion, almost 6 per cent of total revenues.

The company also pursues growth through the aggressive development of foreign markets for its many products. A seventh organisational sector is responsible for coordinating the firm's marketing efforts across countries. In 2007, 3M attained $15.4 billion in sales – 63 per cent of its total revenue – from outside the United States, and the firm expects international sales to exceed 70 per cent by 2010.

Differences in customer needs and life-cycle stages across industries, however, lead 3M's various business units to pursue their growth objectives in different ways. The Industrial Tape Division within the Industrial Sector, for example, operates in an industry where both the product technologies and the customer segments are relatively mature and stable. Growth in this group results from extending the scope of adhesive technology (for instance, attaching weather-stripping to auto doors), product improvements and line extensions targeted at existing customers and expansion into global markets.

In contrast, the firm's Drug Delivery Systems Division within the Health Care Sector develops new medical applications for emerging technologies developed in 3M's many R&D labs. It sells a variety of technologies for the delivery of medications that are inhaled or absorbed through the skin. Most of the unit's growth comes from developing new products, often through alliances with other pharmaceutical firms, aimed at new markets.

The competitive strategies of 3M's various business units also differ. For instance, the industrial tape unit is primarily concerned with maintaining its commanding market share in existing markets while preserving or even improving its profitability. Its competitive strategy is to differentiate itself from competitors on the basis of product quality and excellent customer service.

But the drug delivery systems unit's strategy is to avoid head-to-head competitive battles by being the technological leader and introducing a stream of unique new products. To be successful, though, the unit must devote substantial resources to R&D and to the stimulation of primary demand. Thus, its main objective is volume growth; and it must sometimes sacrifice short-run profitability to fund the product development and marketing efforts needed to accomplish that goal.

These differences in competitive strategy, in turn, influence the strategic marketing programmes within the various business units. For instance, the firm spends little on advertising or sales promotion for its mature industrial tape products. However, it does maintain a large, well-trained technical salesforce that provides valuable problem-solving assistance and other services to customers and informed feedback to the firm's R&D personnel about potential new applications and product improvements.

In contrast, the pioneering nature of the drug delivery unit's technologies calls for more extensive promotion to attract potential alliance partners, develop awareness among prescribing physicians and stimulate primary demand. Consequently, the unit devotes a relatively large portion of its revenues to advertising in technical journals aimed at the pharmaceutical industry, physicians and other medical professionals. It also supports a well-trained salesforce, but those salespeople spend much of their time demonstrating new technologies and building relationships with drug manufacturers who are prospective customers and partners.

While different business and marketing strategies make sense for business units facing different market and competitive conditions, they pose a dilemma for top management. Can a variety of competitive strategies and marketing programmes be consistent with, and effective under, a single corporate strategy or company policy? George Buckley had to address this issue when he took over as 3M's CEO in 2005. His predecessor had instituted a 'six sigma' programme throughout the firm. Six sigma is a quality control approach for systematically analysing a problem (e.g., high shipping costs) and then using data to solve each component of the problem. It seeks to use rigorous statistical analysis to remove variability from a process, thereby reducing defects, improving quality, and lowering costs.

Six sigma's objectives and methods make good sense for mature businesses like 3M's Industrial Tape unit where the product line is well established and improving quality and lowering costs are important means of maintaining profitability. But what about a business whose competitive strategy focuses on innovation and new product development, like the Drug Delivery Systems unit? As one management guru points out, 'The more you hardwire a company for total quality management (e.g. six sigma), the more it is going to hurt breakthrough innovation. The mind-set that is needed, the capabilities that are needed, the metrics that are needed . . . for discontinuous innovation are fundamentally different.'

Consequently, CEO Buckley has made adjustments in the firm's corporate strategy to accommodate some of the differences in objectives and competitive strategies across the firm's business units. For instance, while he has continued to emphasise six sigma goals and projects in 3M's mature businesses, he has loosened the reins a bit by de-emphasising the six sigma approach in the firm's research labs and some of its pioneering business units.

### Learning Objectives

This module examines the strategic decisions that must be made at the business level, including how business units should be designed. Particular attention is given to the question of how a business might choose to compete. What generic competitive strategies might a business pursue and in what environmental circumstances is each strategy most appropriate? The module also explore whether the same kinds of competitive strategies are relevant for small, single-business organisations and entrepreneurial start-ups as for large multi-SBU firms such as 3M and whether technological shifts, such as the growth of e-commerce, are likely to give birth to new competitive strategies or make some old ones obsolete.

The interrelationships between different business competitive strategies and elements of the strategic marketing programmes for the various products within the business are also examined. How does – or should – a particular competitive strategy influence or constrain marketing programmes for the business's product offerings? And what happens if the market positioning or specific marketing actions that would be most effective for appealing to a product's target customers do not fit very well with the competitive strategy of the larger business unit?

## 3.1 Strategic Decisions at the Business-Unit Level

The components of a firm engaged in multiple industries or businesses are typically called **strategic business units**, or **SBUs**. Managers within each of these business units decide which objectives, markets and competitive strategies to pursue. Top-level corporate managers typically reserve the right to review and approve such decisions to ensure their overall consistency with the company's mission, objectives and the allocation of resources across SBUs in its portfolio. However, SBU-level managers, particularly those in marketing and sales, bear the primary responsibility for collecting and analysing relevant information and generating appropriate strategies for their businesses. Those managers are more familiar with a given SBU's products, customers and competitors and are responsible for successfully implementing the strategy. The rationale for breaking larger firms into semi-autonomous SBUs usually stems from a market-oriented desire to move strategic decision making closer to the customers the business is trying to reach.

The first step in developing business-level strategies, then, is for the firm to decide how to divide itself into SBUs. The managers in each SBU must then make recommendations about (a) the unit's objectives, (b) the scope of its target customers and offerings, (c) which broad competitive strategy to pursue to build a competitive advantage in its product-markets, and (d) how resources should be allocated across its product-market entries and functional departments.

### 3.1.1 How Should Strategic Business Units Be Designed?

Ideally, strategic business units have the following characteristics:

- *A homogeneous set of markets to serve with a limited number of related technologies.* Minimising diversity across an SBU's product-market entries enables the unit's manager to better formulate and implement a coherent and internally consistent business strategy.
- *A unique set of product-markets, in the sense that no other SBU within the firm competes for the same customers with similar products.* Thus, the firm avoids duplication of effort and maximises economies of scale within its SBUs.
- *Control over those factors necessary for successful performance, such as production, R&D and engineering, marketing and distribution.* This does not mean an SBU should not share resources, such as a manufacturing plant or a salesforce, with one or more other business units. But the SBU should determine how its share of the joint resource is used to effectively carry out its strategy.
- *Responsibility for their own profitability.*

As you might expect, firms do not always meet all of these ideals when designing business units. There are usually trade-offs between having many small homogeneous SBUs versus large but fewer SBUs that top managers can more easily supervise.

What criteria should managers use to decide how product-markets should be clustered into a business unit? The three dimensions that define the scope and mission of the entire corporation also define individual SBUs:

1. *Technical compatibility*, particularly with respect to product technologies and operational requirements, such as the use of similar production facilities and engineering skills.
2. Similarity in the *customer needs* or the product benefits sought by customers in the target markets.
3. Similarity in the *personal characteristics* or behaviour patterns of customers in the target markets.

In practice, the choice is often between technical/operational compatibility on the one hand and customer homogeneity on the other. Frequently management defines SBUs by product-markets requiring similar technologies, production facilities and employee skills. This minimises the coordination problems involved in administering the unit and increases its ability to focus on one or a few critical competencies.

In some firms, however, the marketing synergies gained from coordinating technically different products aimed at the same customer need or market segment outweigh operational considerations. In these firms, managers group product-market entries into SBUs based on similarities across customers or distribution systems. For instance, 3M's Medical Products unit includes a wide range of products involving very different technologies and production processes. They are grouped within the same business unit, though, because all address health needs, are marketed to physicians and other health professionals and can be sold through a common salesforce and distribution system.

### 3.1.2 Business-Unit Objectives

Companies break down corporate objectives into sub-objectives for each SBU. In most cases, those sub-objectives vary across SBUs according to the attractiveness of their industries, the strength of their competitive positions within those industries and resource allocation decisions by corporate management. For example, managers may assign an SBU in a rapidly growing industry relatively high volume and share-growth objectives but lower ROI objectives than an SBU with a large share in a mature industry.

A similar process of breaking down overall SBU objectives into a set of sub-objectives should occur for each product-market entry within the unit. Those sub-objectives obviously must reflect the SBU's overall objectives; but once again they may vary across product-market entries according to the attractiveness and growth potential of individual market segments and the competitive strengths of the company's product in each market. For example, when 3M's consumer products group first introduced its Scotch-Brite Never Rust soap pads – a new form of scouring pad that will never rust or splinter because it is made from recycled plastic beverage bottles – its objective was to capture a major share of the $100 million soap pad market from well-entrenched competitive brands. 3M wanted to maximise Never Rust's volume growth and market share even if the new line did not break even for several years. Consequently, the firm's top managers approved a major investment in a new plant and a substantial introductory advertising budget. At the same time, though, the consumer group maintained high profitability goals for its other established products – such as Scotch brand Magic Transparent Tape and Post-it brand notes – to provide the cash required for Never Rust's introduction and preserve the group's overall profit level.

### 3.1.3 Allocating Resources within the Business Unit

Once an SBU's objectives and budget have been approved at the corporate level, its managers must decide how the available resources should be allocated across the unit's various product-market entries. Because this allocation process is quite similar to allocating corporate resources across SBUs, many firms use similar economic value, value-based planning, or portfolio analysis tools for both. Of course, at the SBU level managers must determine the attractiveness of individual target markets, the competitive position of their products within those markets and the cash flows each product entry is likely to generate rather than analysing industry attractiveness and the overall competitive strengths of the firm.

Unfortunately, value-based planning is not as useful a tool for evaluating alternative resource allocations across product-market entries as it is for evaluating allocations across SBUs. This is because the product-market entries within a business unit often share the benefits of common investments and the costs of functional activities, as when multiple products are produced in the same plant or sold by the same salesforce. The difficulty of deciding what portion of such common investments and shared costs should be assigned to specific products increases the difficulty of applying a discounted cash flow analysis at the product-market level. As we shall see in Module 19, some firms have adopted activity-based costing systems in an attempt to resolve such problems,[2] but many difficulties remain.

## 3.2 How Do Businesses Compete?

As mentioned, the essential strategic question at the SBU level is: how are we going to compete in this business? Thus, business strategies are primarily concerned with allocating resources across functional activities and product-markets to give the unit a sustainable advantage over its competitors. Of course, the unit's core competencies and resources, together with the customer and competitive characteristics of its industry, determine the viability of any particular competitive strategy.[3] The 3M drug delivery unit's strategy of gaining revenue growth via technological leadership and aggressive new product and market development, for instance, will continue to work only if the firm's R&D, engineering and marketing competencies and resources continue to outweigh those of its competitors. Consequently, most SBUs pursue a single competitive strategy – one that best fits their market environments and competitive strengths – across all or most of the product-markets in which they compete. The question is: what alternative strategies are available to a business unit? What are the basic, or generic, competitive strategies most SBUs choose to pursue?

### 3.2.1 Generic Business-Level Competitive Strategies

Researchers have identified general categories of business-level competitive strategies based on overall patterns of purpose, practice and performance in different businesses. Michael Porter distinguishes three strategies – or competitive positions – that businesses pursue to gain and maintain competitive advantages in their various product-markets: (1) *overall cost leadership*; (2) *differentiation* – building customer perceptions of superior product quality, design, or service; and (3) *focus*, in which the business avoids direct confrontation with its major competitors by concentrating on narrowly defined market niches. Porter describes firms that lack a distinctive strategy as being 'stuck in the middle' and predicts that they will perform poorly.[4]

Robert Miles and Charles Snow identified another set of business strategies based on a business's intended rate of product-market development (new product development, penetration of new markets).[5] They classify business units into four strategic types: *prospectors*, *defenders*, *analysers* and *reactors*. Exhibit 3.1 describes each of these business strategies briefly. As you can see, businesses pursuing a *prospector strategy* focus on growth through the development of new products and markets. 3M's drug delivery business unit illustrates this. *Defender businesses* concentrate on maintaining their positions in established product-markets while paying less attention to new product development, as is the case with 3M's industrial tape business unit. The *analyser strategy* falls in between these two. An analyser business attempts to maintain a strong position in its core product-market(s) but also seeks to expand into new – usually closely related – product-markets. Finally, *reactors* are businesses with no clearly defined strategy.

**Exhibit 3.1 Summary definitions of Miles and Snow's four business strategies**

**Prospector**

- Operates within a broad product-market domain that undergoes periodic redefinition.
- Values being a 'first mover' in new product and market areas, even if not all of these efforts prove to be highly profitable.
- Responds rapidly to early signals concerning areas of opportunity and these responses often lead to new rounds of competitive actions.
- Competes primarily by stimulating and meeting new market opportunities, but may not maintain strength over time in all markets it enters.

**Defender**

- Attempts to locate and maintain a secure position in relatively stable product or service areas.
- Offers relatively limited range of products or services compared to competitors.
- Tries to protect its domain by offering lower prices, higher quality or better service than competitors.
- Usually not at the forefront of technological/new product development in its industry; tends to ignore industry changes not directly related to its area of operation.

**Analyser**

- An intermediate type; makes fewer and slower product-market changes than prospectors, but is less committed to stability and efficiency than defenders.
- Attempts to maintain a stable, limited line of products or services, but carefully follows a selected set of promising new developments in its industry.
- Seldom a first mover, but often a second or third entrant in product-markets related to its existing market base – often with a lower-cost or higher-quality product or service offering.

**Reactor**

- Lacks any well-defined competitive strategy.
- Does not have as consistent a product-market orientation as its competitors.
- Not as willing to assume the risks of new-product or market development as its competitors.
- Not as aggressive in marketing established products as some competitors.
- Responds primarily when it is forced to by environmental pressures.

*Source*: Adapted from R. E. Miles and C. C. Snow, *Organizational Strategy, Structure and Process* (New York: McGraw-Hill, 1978).

Even though both the Porter and Miles and Snow typologies have received popular acceptance and research support, neither is complete by itself. For example, a *defender business unit* could pursue a variety of competitive approaches to protect its market position, such as offering the lowest cost or differentiating itself on quality or service. Thus, we have combined the two typologies in Exhibit 3.2 to provide a more comprehensive overview of business strategies. Exhibit 3.2 classifies business strategies on two primary dimensions: the unit's desired rate of product-market development (expansion) and the unit's intended method of competing in its established product-markets.

Each of our strategic categories could be further subdivided according to whether a business applies the strategy across a broadly defined product-market domain or concentrates on a narrowly defined segment where it hopes to avoid direct confrontation with major competitors (the focus strategy of Porter). Although this distinction is useful, it is more germane to a discussion of the business's target market strategy (as discussed in Module 9) than to its competitive strategy. Most businesses compete in a reasonably consistent way across all of their product-markets, whether their domain is broad or narrow.

**Exhibit 3.2 Combined typology of business-unit competitive strategies**

**Emphasis on new product-market growth**

**Heavy emphasis** ← → **No emphasis**

<table>
<tr><th>Competitive strategy</th><th>Prospector</th><th>Analyser</th><th>Defender</th><th>Reactor</th></tr>
<tr><td>Differentiation</td><td rowspan="2">Units primarily concerned with attaining growth through aggressive pursuit of new product-market opportunities</td><td>Units with strong core business; actively seeking to expand into related product markets with differentiated offerings</td><td>Units primarily concerned with maintaining a differentiated position in mature markets</td><td rowspan="2">Units with no clearly defined product-market development or competitive strategy</td></tr>
<tr><td>Cost leadership</td><td>Units with strong core business; actively seeking to expand into related product markets with low-cost offerings</td><td>Units primarily concerned with maintaining a low-cost position in mature markets</td></tr>
</table>

Exhibit 3.2 describes only six business strategies, rather than the eight that one might expect. We view reactor and prospector business units as two homogeneous categories.

Evidence suggests that a substantial portion of businesses fall into the reactor category. One study, for instance, found that 50 out of 232 businesses examined could be classified as reactors.[6] By definition, however, such businesses do not have well-defined or consistent approaches either to new product development or to ways of competing in existing product-markets. In other words, reactors have no clear competitive strategy. Therefore, we will largely ignore them during the rest of this discussion.

Prospectors are also shown as a single strategic category in Exhibit 3.2 because the desire for rapid new product or market development is the overriding aspect of their strategy. There is little need for a prospector business to consider how it will compete in the new product-markets it develops because it will face little or no competition – at least not until those markets become established and other firms begin to enter.

### 3.2.2 Do the Same Competitive Strategies Work for Single-Business Firms and Start-ups?

Even small firms with a single business and only a few related product offerings or start-ups with a single product must decide how they will compete. And just like an SBU in a major corporation such as 3M, their competitive strategies should be tailored to their unique resources and competencies and aimed at securing a sustainable advantage over existing or potential competitors. Therefore, the same set of generic competitive strategies is just as appropriate for small firms as for business units within larger ones. For example, New Covent Garden Soup has met with success by introducing packaged fresh soups for sale in the chiller cabinet in major supermarkets in the UK, where the typical soup offerings are canned or dry mixes: in other words by pursuing a very effective differentiated analyser strategy.

However, there is one important difference between single-business and multi-SBU organisations. In smaller single-business firms the distinction between business-level competitive strategy and marketing strategy tends to blur and the two strategies blend into one. New Covent Garden Soup's competitive strategy, for instance, is essentially the same as the market positioning for its primary product: a product that offers higher quality than competing brands because it is fresh rather than canned.

Another difference applies to entrepreneurial start-ups. Most start-ups do not have the resources to succeed by competing as a 'me-too' competitor in a well-established and highly competitive product-market. By definition they do not have an established market position to defend. Therefore, while the taxonomy of competitive strategies is still relevant to entrepreneurial firms, in reality most of them – at least those that stand a reasonable chance of success – begin life as prospectors. They compete primarily by developing a unique product or service that meets the needs and preferences of a customer segment that is not being well served by established competitors.

The critical question for a start-up firm, though, is: what happens when the new product matures and competitors arrive on the scene? This question, and similar issues related to strategic change, are examined later in this module.

### 3.2.3 Do the Same Competitive Strategies Work for Service Businesses?

What is a service? Basically, *services* can be thought of as **intangibles** and *goods* as **tangibles**. The former can rarely be experienced in advance of the sale, while the latter can be experienced, even tested, before purchase.[7] Using this distinction, a **service** can be defined as 'any activity or benefit that one party can offer to another that is essentially intangible and that does not result in the ownership of anything. Its production may or may not be tied to a physical product.'[8]

We typically associate services with nonmanufacturing businesses, even though service is often an indispensable part of a goods producer's offering. Services such as applications engineering, system design, delivery, installation, training and maintenance can be crucial for building long-term relationships between manufacturers and their customers, particularly in consumer durable and industrial products businesses. Thus, almost all businesses are engaged in service to some extent.

Many organisations are concerned with producing and marketing a service as their primary offering rather than as an adjunct to a physical product. These organisations include public-sector and not-for-profit service organisations, such as churches, hospitals, universities and arts organisations. The crucial question is this: To be successful, must service organisations employ different competitive strategies than goods manufacturers?

The framework we used to classify business-level competitive strategies in Exhibit 3.2 is equally valid for service businesses. For example, some service firms such as Super8 or Days Inn in the lodging industry attempt to minimise costs and compete largely with low prices. Other firms like Marriott differentiate their offerings on the basis of high service quality or unique benefits. Similarly, some service businesses adopt prospector strategies and aggressively pursue the development of new offerings or markets. For instance, American Express's Travel Related Services Division has developed a variety of new services tailored to specific segments of the firm's credit-card holders. Other service businesses focus narrowly on defending established positions in current markets. Still others can best be described as analysers pursuing both established and new markets. For instance, Emirates, an airline whose competitive strategy is discussed in Exhibit 3.3, might best be described as a differentiated analyser.

**Exhibit 3.3 Emirates airline – competing for business travellers while building new markets**

Habib Fekih was travelling the Middle East as a salesman for European planemaker Airbus in 1985, the year Dubai's ruling family started a small airline called Emirates to shuttle Pakistani workers between Karachi and Dubai aboard two leased planes. 'Nobody believed Emirates could be a successful airline,' recalls Fekih, who now heads Airbus's Middle Eastern subsidiary. 'It was the joke of the day.'

Emirates is a joke no longer. It has grown into the world's tenth-largest airline, earning $1.45 billion in profits in 2007 on sales of nearly $11.2 billion.

One important factor underlying Emirates' success is simply the geographic location of Dubai. It provides a convenient hub that has enabled Emirates to offer more convenient routes for business travellers shuttling between Europe or the United States and Asia. And the rapid growth of many Asian economies in recent years has, in turn, generated increased demand and new customers for Emirates' flights.

Of course, many other airlines fly between Asia and the West, so Emirates has attempted to strengthen and defend its share of that market by offering superior service. Its aggressive purchasing of new planes from both Boeing and Airbus gives it one of the youngest and most efficient fleets of any airline. And innovative services such as a 200-channel in-flight entertainment system and sumptuous travellers' lounges have helped keep Emirates' flights more than 70 per cent full. Thus, Emirates is a good example of a service firm pursuing a differentiated analyser strategy – it differentiates itself with superior service in competitive markets while developing new routes between Asia and the West to capture new customers in that rapidly growing segment of the business travel market.

*Source:* Carol Matlack, 'An Airline with a Deafening Roar,' *BusinessWeek,* March 27, 2006, p. 46; and the Emirates Group's 2007 Annual Report on the firm's website, **www.ekgroup.com.**

A study of the banking industry provides empirical evidence that service businesses actually do pursue the same types of competitive strategies as goods producers. The 329 bank CEOs who responded to the survey had little trouble categorising their institution's competitive strategies into one of Miles and Snow's four types. Fifty-four of the executives reported that their banks were prospectors, 87 identified their firms as analysers, 157 as defenders and 31 as reactors.[9]

## 3.2.4 Do the Same Competitive Strategies Work for Global Competitors?

In terms of the strategies described in Exhibit 3.2, businesses that compete in multiple global markets almost always pursue one of the two types of analyser strategy. They must continue to strengthen and defend their competitive position in their home country – and perhaps in other countries where they are well established – while simultaneously pursuing expansion and growth in new international markets.

When examined on a country-by-country basis, however, the same business unit might be viewed as pursuing different competitive strategies in different countries. For instance, while 3M's industrial tape group competes like a differentiated defender in the United States, Canada and some European countries where it has established large market shares, it competes more like a prospector when attempting to open and develop new markets in emerging economies such as China and Mexico.

This suggests that a single SBU may need to engage in different functional activities (including different strategic marketing programmes) – and perhaps even adopt different organisational structures to implement those activities – across the various countries in which it competes. For example, Huawei Technologies Co., located in Shenzhen, China, competes very effectively in its home market as a low-cost analyser. The company earned $2.4 billion in revenues in 2001 selling Internet switches and routers patterned after the equipment manufactured by Cisco Systems and Alcatel, but at prices as much as 40 per cent lower. However, only 10 per cent of those revenues came from outside China. In order to compete more effectively in the developed markets of Europe and the Americas, Huawei had to expand its product line and develop new equipment with more innovative features and greater functionality. In other words, it had to compete more like a prospector in those markets. Consequently, the firm has greatly increased its R&D spending and product development efforts. It also developed marketing programmes geared to generate brand awareness and trial among potential customers. Initially, at least, Huawei still relied heavily on alliances with established distributors and value-added resellers to develop and implement marketing programmes in developed markets. For instance, the Vierling Group has agreed to serve as Huawei's exclusive distributor in Germany. As a result of these strategic adjustments, Huawei's revenues topped $23 billion in 2008, and 75 per cent of those sales came from outside China.[10]

### 3.2.5 Will the Internet Change Everything?

Some analysts argue that the Internet will change the way firms compete. The Internet makes it easier for buyers and sellers to compare prices, reduces the number of middlemen necessary between manufacturers and end users, cuts transaction costs, improves the functioning of the price mechanism and thereby increases competition.[11] One possible outcome of all these changes is that it will be harder for firms to differentiate themselves on any basis other than low price. All the business-level competitive strategies focused on differentiation will become less viable, while firms pursuing low-cost strategies will be more successful.

While we agree that the Internet has increased both efficiency and competitiveness in many product-markets, we doubt that competition will focus exclusively on price. For one thing, innovation is likely to continue – and probably accelerate – in the future. Unique new products and services will continue to emerge and provide a way for the innovator to gain a competitive advantage, at least in the short term. Thus, firms with the resources and competencies necessary to produce a continuing stream of new product or service offerings that appeal to one or more customer segments – that is, to effectively implement a prospector strategy – should be successful regardless of whether they are the lowest-cost producers in their industries. Amazon.com, the largest e-tailer as of early 2003, is generally not the lowest priced.

In addition, the Internet is primarily a communications channel. While it facilitates the dissemination of information, including price information, the goods and services themselves will continue to offer different features and benefits. As customers gather more information from the Internet and become better informed, they are less likely to be swayed by superficial distinctions between brands. But if a firm offers unique benefits that a segment of customers perceive as *meaningful*, it should still be able to differentiate its offering and command a premium price, at least until its competitors offer something similar.

Finally, the Internet will make it easier for firms to customise their offerings and personalise their relationships with their customers. Such personalisation should differentiate the firm from its competitors in the customer's eyes and improve customer loyalty and retention. For instance, over the past few years, the Internet has played a major role in developing logistical alliances among organisational buyers and their suppliers. Consumer goods and services firms and even Internet portals also are using the Internet's interactive capabilities to acquire and communicate information and build customer relationships. For example, the My Yahoo! website allows individual consumers to personalise their Web portal in exchange for some basic demographic information. Custom-made women's jeans account for 40 per cent of Lands' End's online sales, and re-order rates for custom-clothing buyers are 35 per cent higher than for buyers of the firm's standard items.[12]

## 3.3 How Do Competitive Strategies Differ from One Another?

In Module 2 we said that all strategies consist of five components or underlying dimensions: scope (or breadth of strategic domain), goals and objectives, resource deployments, a basis for achieving a sustainable competitive advantage and synergy. But the generic strategies summarised in Exhibit 3.2 are defined largely by their differences on only one dimension: the nature of the competitive advantage sought. Each strategy also involves some important differences on the other four dimensions – differences that are outlined in Exhibit 3.4 and discussed below. Those differences provide insights concerning the conditions under which each strategy is most appropriate and about the relative importance of different marketing actions in implementing them effectively.

**Exhibit 3.4 How business strategies differ in scope, objectives, resource deployments and synergy**

| Dimensions | Low-cost defender | Differentiated defender | Prospector | Analyser |
|---|---|---|---|---|
| • Scope | Mature/stable/well-defined domain; mature technology and customer segments | Mature/stable/well-defined domain; mature technology and customer segments | Broad/dynamic domains; technology and customer segments not well established | Mixture of defender and prospector strategies |
| • Goals and objectives | | | | |
| Adaptability (new product success) | Very little | Little | Extensive | Mixture of defender and prospector strategies |
| Effectiveness (increase in market share) | Little | Little | Large | Mixture of defender and prospector strategies |
| Efficiency (ROI) | High | High | Low | Mixture of defender and prospector strategies |
| • Resource deployment | Generate excess cash (cash cows) | Generate excess cash (cash cows) | Need cash for product development (question marks or stars) | Need cash for product development but less so than do prospectors |
| • Synergy | Need to seek operating synergies to achieve efficiencies | Need to seek operating synergies to achieve efficiencies | Danger in sharing operating facilities and programmes – better to share technology/marketing skills | Danger in sharing operating facilities and programmes – better to share technology/marketing skills |

### 3.3.1 Differences in Scope

Both the breadth and stability of a business's domain are likely to vary with different strategies. This, in turn, can affect the variables the corporation uses to define its various businesses. At one extreme, defender businesses, whether low-cost or differentiated, tend to operate in relatively well-defined, narrow and stable domains where both the product technology and the customer segments are mature.

At the other extreme, prospector businesses usually operate in broad and rapidly changing domains where neither the technology nor customer segments are well established. The scope of such businesses often undergoes periodic redefinition. Thus, prospector businesses are typically organised around either a core technology that might lead to the development of products aimed at a broad range of customer segments or a basic customer need that might be met with products based on different technologies. The latter is the approach taken by 3M's drug delivery systems business. Its mission is to satisfy the health needs of a broad range of patients with new products developed from technologies drawn from other business units within the firm.

Analyser businesses, whether low-cost or differentiated, fall somewhere in between the two extremes. They usually have a well-established core business to defend and often their domain is primarily focused on that business. However, businesses pursuing this intermediate strategy are often in industries that are still growing or experiencing technological changes. Consequently, they must pay attention to the emergence of new customer segments and/or new product types. As a result, managers must review and adjust the domain of such businesses from time to time.

### 3.3.2 Differences in Goals and Objectives

Another important difference across generic business-level strategies with particular relevance for the design and implementation of appropriate marketing programmes is that different strategies often focus on different objectives. SBU and product-market objectives might be specified on a variety of criteria, but to keep things simple, we focus on only three performance dimensions of major importance to both business-unit and marketing managers:

1. *Effectiveness*. The success of a business's products and programmes relative to those of its competitors in the market. Effectiveness is commonly measured by such items as *sales growth* relative to competitors or *changes in market share*.
2. *Efficiency*. The outcomes of a business's programmes relative to the resources used in implementing them. Common measures of efficiency are *profitability* as a percentage of sales and *return on investment*.
3. *Adaptability*. The business's success in responding over time to changing conditions and opportunities in the environment. Adaptability can be measured in a variety of ways, but the most common ones are the *number of successful new products* introduced relative to those competitors or the *percentage of sales accounted for by products introduced within the last five years*.

However, it is very difficult for any SBU, regardless of its competitive strategy, to simultaneously achieve outstanding performance on even this limited number of dimensions, because they involve substantial trade-offs. Good performance on one dimension often means sacrificing performance on another.[13] For example, developing successful new products or attaining share growth often involves large marketing budgets, substantial up-front investment, high operating costs and a shaving of profit margins – all of which reduce ROI. This suggests that managers should choose a competitive strategy with a view toward maximising performance on one or two dimensions, while expecting to sacrifice some level of performance on the others, at least in the short term. Over the longer term, of course, the chosen strategy should promise discounted cash flows that exceed the business's cost of capital and thereby increase shareholder value.

As Exhibit 3.4 indicates, prospector businesses are expected to outperform defenders on both new product development and market-share growth. On the other hand, both defender strategies should lead to better returns on investment. Differentiated defenders are likely to produce higher returns than low-cost defenders, assuming that the greater expenses involved in maintaining their differentiated positions can be more than offset by the higher margins gained by avoiding the intense price competition low-cost competitors often face. Once again, both low-cost and differentiated analyser strategies are likely to fall between the two extremes.[14]

### 3.3.3 Differences in Resource Deployment

Businesses following different strategies also tend to allocate their financial resources differently across product-markets, functional departments and activities within each functional area. Prospector – and to a lesser degree, analyser – businesses devote a relatively large proportion of resources to the development of new product-markets. Because such product-markets usually require more cash to develop than they produce in the short term, businesses pursuing these strategies often need infusions of financial resources from other parts of the corporation. In portfolio terms, they are 'question marks' or 'stars.'

Defenders, on the other hand, focus the bulk of their resources on preserving existing positions in established product-markets. These product-markets are usually profitable; therefore, defender businesses typically generate excess cash to support product and market development efforts in other business units within the firm. They are the 'cash cows.'

Resource allocations among functional departments and activities within the SBU also vary across businesses pursuing different strategies. For instance, marketing budgets tend to be the largest as a percentage of an SBU's revenues when the business is pursuing a prospector strategy; they tend to be the smallest as a percentage of sales under a low-cost defender strategy. We discuss this in more detail later.

### 3.3.4 Differences in Sources of Synergy

Because different strategies emphasise different methods of competition and different functional activities, a given source of synergy may be more appropriate for some strategies than for others.

At one extreme, the sharing of operating facilities and programmes may be an inappropriate approach to gaining synergy for businesses following a prospector strategy. And to a lesser extent, this also may be true for both types of analyser strategies. Such sharing can reduce an SBU's ability to adapt quickly to changing market demands or competitive threats. Commitments to internally negotiated price structures and materials, as well as the use of joint resources, facilities and programmes, increase interdependence among SBUs and limit their flexibility. It is more appropriate for such businesses to seek synergy through the sharing of a technology, engineering skills, or market knowledge – expertise that can help improve the success rate of their product development efforts.

At the other extreme, however, low-cost defenders should seek operating synergies that will make them more efficient. Synergies that enable such businesses to increase economies of scale and experience curve effects are particularly desirable. They help reduce unit costs and strengthen the strategy's basis of competitive advantage. The primary means of gaining such operating synergies is through the sharing of resources, facilities and functional activities across product-market entries within the business unit or across related business units.[15] Emerson Electric, for instance, formed an 'operating group' of several otherwise autonomous business units that make different types of electrical motors and tools. By sharing production facilities, marketing activities and a common salesforce, the group was able to reduce the costs of both per-unit production and marketing.

## 3.4 Deciding When a Strategy Is Appropriate: The Fit between Business Strategies and the Environment

**Exhibit 3.5 Environmental factors favourable to different business strategies**

| External factors | Prospector | Analyser | Differentiated defender | Low-cost defender |
|---|---|---|---|---|
| Market characteristics | Industry in introductory or early growth stage of life cycle, many potential customer segments as yet unidentified and/or undeveloped. | Industry in late growth or early maturity stage of life cycle, one or more product offerings currently targeted at major customer segments, but some potential segments may still be undeveloped. | Industry in maturity or decline stage of life cycle; current offerings targeted at all major segments; sales primarily due to repeat purchases/ replacement demand. | Industry in maturity or decline stage of life cycle; current offerings targeted at all major segments; sales primarily due to repeat purchases/ replacement demand. |

| External factors | Prospector | Analyser | Differentiated defender | Low-cost defender |
|---|---|---|---|---|
| Technology | Newly emerging technology; many applications as yet undeveloped. | Basic technology well developed but still evolving; product modifications and improvements – as well as emergence of new competing technologies – still likely. | Basic technology fully developed and stable; few major modifications or improvements likely. | Basic technology fully developed and stable; few major modifications or improvements likely. |
| Competition | Few established competitors; industry structure still emerging; single competitor holds commanding share of major market segments. | Large number of competitors, but future shake-out likely; industry structure still evolving; one or more competitors hold large shares in major segments but continuing growth may allow rapid changes in relative shares. | Small to moderate number of well-established competitors; industry structure stable, though acquisitions and consolidation possible; maturity of markets means relative shares of competitors tend to be reasonably stable over time. | Small to moderate number of well-established competitors; industry structure stable, though acquisitions and consolidation possible; maturity of market means relative shares of competitors tend to be reasonably stable over time. |
| Business's relative strengths | SBU (or parent) has strong R&D, product engineering and marketing research and marketing capabilities. | SBU (or parent) has good R&D, product engineering and marketing research capabilities, but not as strong as those of some competitors; has either low-cost position or strong sales, marketing, distribution or service capabilities in one or more segments. | SBU has no outstanding strengths in R&D or product engineering; costs are higher than those of at least some competitors; SBU's outstanding strengths are in process engineering and quality control and/or in marketing, sales, distribution or customer services. | SBU (or parent) has superior sources of supply and/or process engineering and production capabilities that enable it to be low-cost producer; R&D, product engineering, marketing, sales or service capabilities may not be as strong as those of some competitors. |

Because different strategies pursue different objectives in different domains with different competitive approaches, they do not all work equally well under the same environmental circumstances. The question is, Which environmental situations are most amenable to the successful pursuit of each type of strategy? Exhibit 3.5 outlines some major market, technological and competitive conditions – plus a business unit's strengths relative to its competitors – that are most favourable for the successful implementation of each generic business strategy. We next discuss the reasons each strategy fits best with a particular set of environmental conditions.

## 3.4.1 Appropriate Conditions for a Prospector Strategy

A prospector strategy is particularly well suited to unstable, rapidly changing environments resulting from new technology, shifting customer needs, or both. In either case, such industries tend to be at an early stage in their life cycles and offer many opportunities for new product-market entries. Industry structure is often unstable because few competitors are present and their relative market shares can shift rapidly as new products are introduced and new markets develop.

Because they emphasise the development of new products and/or new markets, the most successful prospectors are usually strong in and devote substantial resources to, two broad areas of competence: first, R&D, product engineering and other functional areas that identify new technology and convert it into innovative products; second, marketing research, marketing and sales – functions necessary for the identification and development of new market opportunities.

In some cases, however, even though a prospector business has strong product development and marketing skills, it may lack the resources to maintain its early lead as product-markets grow and attract new competitors. For example, Minnetonka was the pioneer in several health and beauty-aid product categories with brands such as Softsoap liquid soap and Check-Up plaque-fighting toothpaste. However, because competitors such as Procter & Gamble and Unilever introduced competing brands with advertising and promotion budgets much larger than Minnetonka could match, the firm was eventually forced to change its strategy and concentrate on manufacturing products under licences from larger firms.

## 3.4.2 Appropriate Conditions for an Analyser Strategy

The analyser strategy is a hybrid. On one hand, analysers are concerned with defending – via low costs or differentiation in quality or service – a strong share position in one or more established product-markets. At the same time, the business must pay attention to new product development to avoid being leapfrogged by competitors with more technologically advanced products or being left behind in newly developing application segments within the market. This dual focus makes the analyser strategy appropriate for well-developed industries that are still experiencing some growth and change as a consequence of evolving customer needs and desires or continuing technological improvements.

Automobile manufacturing is an example of such an industry. Competitors are relatively few and well established, the market is relatively mature, but technology continues to advance. And recent changes in the industry's environment – such as rising fuel prices and concerns over the impact of auto emissions on global warming – have underscored the need for more efficient and ecologically friendly technologies. Thus, auto manufacturers around the world, including Toyota, Honda, General Motors, and many others, are investing billions in a variety of different technologies to develop a new generation of cars, as described in Exhibit 3.6.

**Exhibit 3.6 Analyser strategies in the auto industry**

Given that Toyota was already selling more than 300 000 of its Prius gas–electric hybrids annually by 2008, it was in the strongest position to respond to the double whammy of rapidly rising petrol prices and growing concerns over auto emissions and their impact on global warming that caught the auto industry off guard that year. The firm's strategy, at least for the short term, is to rapidly expand its hybrid offerings and invest in R&D to further improve their efficiency. Two new hybrid models – including one in the firm's Lexus luxury line – will be introduced to the market. And a new version of the Prius, which promises to be lighter, more fuel efficient, and available with optional solar panels on the roof, is also planned. All told, Toyota forecasts global sales of its gas–electric hybrids will reach 1 million units a year by the early 2010s.

Longer term, the company is eyeing plug-in electric cars. To that end, Toyota has created a special battery research division, complete with more than 100 dedicated engineers.

Honda also plans to beef up its hybrid offerings in the short term, but it will also offer new clean-diesel engines – which are purportedly 25 per cent more fuel efficient than conventional engines – in its larger cars, including those that carry the luxury Acura brand.

For the longer term, however, Honda is focusing on fuel cell vehicles which run on liquid hydrogen and emit only water. In 2008 the firm began production of a fuel cell model called the FCX Clarity which can go 280 miles on a tank of hydrogen and boasts better fuel efficiency than comparable four-seater gas or hybrid cars. While Honda will lease just 200 Clarities in the United States and Japan through the early 2010s, it hopes to have the technology ready for the mass market within 10 years. But since every Clarity made in 2008 cost an estimated $1 million to produce, cost reductions via economies of scale and experience will be critical for the car's future

Back in 2003, when the environment facing the auto companies was not quite so bleak, General Motors had pulled the plug on an experimental electric car – the EV-1 – and took a loss of about $1 billion. It is a bit surprising, then, that GM's strategy focuses heavily on a plug-in electric called the Chevrolet Volt. The firm increased its R&D budget for 2008 by more than $1.5 billion to speed the development of the Volt. The sedan will charge from a household electric socket in six hours and run for 40 miles before a small gas engine fires up to recharge the battery, extending the car's range to about 600 miles. Since the small engine does nothing but run a generator, the car is expected to go over 100 miles per gallon of gas.

GM says the Volt will be priced around $30 000 to $45 000 and will cost only about $300 per year for the electricity to keep it charged. Given the technical challenges involved, however, it remains to be seen whether the firm can meet its 2010 deadline and hold production costs low enough to justify such relatively modest prices.

In June 2008, Katsuaki Watanabe, Toyota's president, said, 'Without focusing on measures to address global warming and energy issues, there can be no future for our auto business.' The interesting question is which of the many new technologies being pursued by Toyota, Honda, GM, and others will prove the most effective and appealing means of addressing those issues.

*Source:* David Welch, 'GM: Live Green or Die,' *BusinessWeek,* May 26, 2008, pp. 36–41; and Ian Rowley, 'Japan's New Green Car Push,' www.businessweek.com, July 2, 2008.

The actions of Toyota and Honda illustrate one problem with an analyser strategy. Few businesses have the resources and competencies needed to successfully defend an established core business while generating new products at the same time. Success on both dimensions requires strengths across virtually every functional area and few businesses (or their parent companies) have such universal strengths. Also, defending a successful core business can produce a corporate culture and policies that are difficult to change and that may resist the kind of innovative thinking and risk-taking needed to develop radical new products. Therefore, analysers are often not as innovative in new product development as prospectors. And they may not be as profitable in defending their core businesses as defenders.

## 3.4.3 Appropriate Conditions for a Defender Strategy

A defender strategy makes sense only when a business has something worth defending. It is most appropriate for units with a profitable share of one or more major segments in a relatively mature, stable industry. Consistent with the 'constant improvement' principles of total quality management, most successful defenders initiate process improvements, product improvements, or line extensions to help protect and strengthen their established positions. But they devote relatively few resources to basic R&D or the development of innovative new products. Thus, a defender strategy works best in industries where the basic technology is not very complex or where it is well developed and unlikely to change dramatically over the short term. For instance, Pillsbury's prepared-dough products SBU – now a part of the General Mills Company – has pursued a differentiated defender strategy for years. The unit generates substantial profits from well-established refrigerated dough products such as Pillsbury Crescent rolls and Hungry Jack biscuits. But while it has introduced a number of line extensions over the years, most have been reconfigurations of the same basic dough-in-a-can technology, such as Soft Breadsticks.

### 3.4.3.1 Differentiated Defenders

To effectively defend its position by differentiation, a business must be strong in those functional areas critical for maintaining its particular competitive advantages over time. If a business's differentiation is based on superior product quality, those key functional areas include production, process engineering, quality control and perhaps product engineering to develop product improvements. The effort to develop and maintain a quality differentiation can be worthwhile, though, because evidence suggests that superior product quality has a strong impact on a business's return on investment – an important performance objective for defenders.[16]

Regardless of the basis for differentiation, marketing is also important for the effective implementation of a differentiated defender strategy. Marketing activities that track changing customer needs and competitive actions and communicate the product offering's unique advantages through promotional and sales efforts to maintain customer awareness and loyalty are particularly important.

### 3.4.3.2 Low-Cost Defenders

Successful implementation of a low-cost defender strategy requires the business to be more efficient than its competitors. Thus, the business must establish the groundwork for such a strategy early in the growth stage of the industry. Achieving and maintaining the lowest per-unit cost usually means that the business has to seek large volume from the beginning – through some combination of low prices and promotional efforts – to gain economies of scale and experience. At the same time, such businesses must also invest in more plant capacity in anticipation of future growth and in state-of-the-art equipment to minimise production costs. This combination of low margins and heavy investment can be prohibitive unless the parent corporation can commit substantial resources to the business or unless extensive sharing of facilities, technologies and programmes with other business units is possible.

The low-cost defender's need for efficiency also forces the standardisation of product offerings and marketing programmes across customer segments to achieve scale effects. Thus, such a strategy is usually not so effective in fragmented markets desiring customised offerings as it is in commodity industries such as basic chemicals, steel, or flour, or in industries producing low-technology components such as electric motors or valves.

While low-cost defenders emphasise efficiency and low price as the primary focus of their competitive strategy, it is important to keep in mind that businesses pursuing other strategies should also operate as efficiently as possible given the functional activities necessary to implement those strategies. Some of the most effective businesses are those that work *simultaneously* to lower costs and improve quality and service.[17] And operating efficiency is likely to become even more critical as the Internet makes it easier for customers to compare prices across alternative suppliers or to obtain low-price bids via 'buyers' auction' sites, such as www.MetalSite.com.

## 3.5 How Different Business Strategies Influence Marketing Decisions

Business units typically incorporate a number of distinct product-markets. A given entry's marketing manager monitors and evaluates the product's environmental situation and develops a marketing programme suited to it. However, the manager's freedom to design such a programme may be constrained by the business unit's competitive strategy. This is because different strategies focus on different objectives and seek to gain and maintain a competitive advantage in different ways. As a result, different functions within the SBU – and different activities within a given functional area, such as marketing – are critical for the success of different strategies.

There are, therefore, different key success factors inherent in the various generic business strategies. This constrains the individual marketing manager's freedom of action in two basic ways. First, because varying functions within the business unit are more important under different strategies, they receive different proportions of the SBU's total resources. Thus, the SBU's strategy influences *the amount of resources committed to marketing* and ultimately the budget available to an individual marketing manager within the business unit. Second, the SBU's choice of strategy influences both the kind of *market and competitive situation* that individual product-market entries are likely to face and the objectives they are asked to attain. Both constraints have implications for the design of marketing programmes for individual products within an SBU.

It is risky to draw broad generalisations about how specific marketing policies and programme elements might fit within different business strategies. While a business strategy is a general statement about how an SBU chooses to compete in an industry, that unit may comprise a number of product-market entries facing different competitive situations in various markets. Thus, there is likely to be a good deal of variation in marketing programmes and in the freedom individual marketing managers have in designing them, across products within a given SBU. Still, a business's strategy does set a general direction for the types of target markets it will pursue and how the unit will compete in those markets. And it does have some influence on marketing policies that cut across product-markets. Exhibit 3.7 outlines differences in marketing policies and programme elements that occur across businesses pursuing different strategies and those differences are discussed below.

**Exhibit 3.7 Differences in marketing policies and programme components across businesses pursuing different strategies**

| | Strategy | | |
|---|---|---|---|
| **Marketing policies and programme components** | **Prospector** | **Differentiated defender** | **Low-cost defender** |
| *Product policies* | | | |
| • Product-line breadth relative to competitors | + | + | – |
| • Technical sophistication of products relative to competitors | + | + | – |
| • Product quality relative to competitors | ? | + | – |
| • Service quality relative to competitors | ? | + | – |
| *Price policies* | | | |
| • Price levels relative to competitors | + | + | – |
| *Distribution policies* | | | |
| • Degree of forward vertical integration relative to competitors | – | + | ? |
| • Trade promotion expenses as percentage of sales relative to competitors | + | – | – |
| *Promotion policies* | | | |
| • Advertising expenses as percentage of sales relative to competitors | + | ? | – |
| • Sales promotion expenses as percentage of sales relative to competitors | + | ? | – |
| • Salesforce expenses as percentage of sales relative to competitors | ? | + | – |

*Key*:

Plus sign (+) = greater than the average competitor.
Minus sign (−) = smaller than the average competitor.
Question mark (?) = uncertain relationship between strategy and marketing policy or
programme component.

## 3.5.1 Product Policies

One set of marketing policies defines the nature of the products the business will concentrate on offering to its target markets. These policies concern the *breadth or* *diversity of product lines*, their *level of technical sophistication* and the target *level of product quality* relative to competitors.

Because prospector businesses rely heavily on the continuing development of unique new products and the penetration of new markets as their primary competitive strategy, policies encouraging broader and more technically advanced product lines than those of competitors should be positively related to performance on the critical dimension of share growth. The diverse and technically advanced product offerings of 3M's drug delivery systems SBU are a good example of this.

Whether a prospector's products should be of higher quality than competitors' products is open to question. Quality is hard to define; it can mean different things to different customers. Even so, it is an important determinant of business profitability.[18] Thus, Hambrick suggests that in product-markets where technical features or up-to-the-minute styling are key attributes in customers' definitions of quality, high-quality products may play a positive role in determining the success of a prospector strategy. In markets where the critical determinants of quality are reliability or brand familiarity, the maintenance of relatively high product quality is likely to be more strongly related to the successful performance of defender businesses, particularly differentiated defenders.[19]

Differentiated defenders compete by offering more or better choices to customers than do their competitors. For example, 3M's commercial graphics business, a major supplier of sign material for truck fleets, has strengthened its competitive position in that market by developing products appropriate for custom-designed signs. Until recently, the use of film for individual signs was not economical. But the use of computer-controlled knives and a new Scotch-brand marking film produce signs of higher quality and at lower cost than those that are hand-painted. This kind of success in developing relatively broad and technically sophisticated product lines should be positively related to the long-term ROI performance of most differentiated defender businesses.

However, broad and sophisticated product lines are less consistent with the efficiency requirements of the low-cost defender strategy. For one thing, maintaining technical sophistication in a business's products requires continuing investments in product and process R&D. For another, broad, complex lines can lead to short production runs and larger inventories. Some of the efficiency problems associated with broader, more-customised product lines may disappear, however, with continuing improvements in computer-assisted design and manufacturing, process re-engineering and the like.[20]

Instead of, or in addition to, competing on the basis of product characteristics, businesses can distinguish themselves relative to competitors on the *quality of service* they offer. Such service might take many forms, including engineering and design services, alterations, installation, training of customer personnel, or maintenance and repair services. A policy of high service quality is particularly appropriate for differentiated defenders because it offers a way to maintain a competitive advantage in well-established markets.[21]

The appropriateness of an extensive service policy for low-cost defenders, though, is more questionable if higher operating and administrative costs offset customer satisfaction benefits. Those higher costs may detract from the business's ability to maintain the low prices critical to its strategy, as well as lowering ROI – at least in the short term. On the other hand, even low-cost defenders may have difficulty holding their position over the long term without maintaining at least competitive parity with respect to critical service attributes.[22]

### 3.5.2 Pricing Policies

Success in offering low prices relative to those of competitors should be positively related to the performance of low-cost defender businesses – for low price is the primary competitive weapon of such a strategy. However, such a policy is inconsistent with both differentiated defender and prospector strategies. The higher costs involved in differentiating a business's products on either a quality or service basis require higher prices to maintain profitability. Differentiation also provides customers with additional value for which higher prices can be charged. Similarly, the costs and benefits of new product and market development by prospector businesses require and justify relatively high prices. Thus, differentiated defenders and prospectors seldom adhere to a policy of low competitive prices.

### 3.5.3 Distribution Policies

Some observers argue that prospector businesses should show a greater degree of *forward vertical integration* than defender businesses.[23] The rationale for this view is that the prospector's focus on new product and market development requires superior market intelligence and frequent re-education and motivation of distribution channel members. This can best be accomplished through tight control of company-owned channels. However, these arguments seem inconsistent with the prospector's need for flexibility in constructing new channels to distribute new products and reach new markets.

Attempting to maintain tight control over the behaviour of channel members is a more appropriate policy for defenders who are trying to maintain strong positions in established markets. This is particularly true for defenders who rely on good customer service to differentiate themselves from competitors. Thus, it seems more likely that a relatively high degree of forward vertical integration is found among defender businesses, particularly differentiated defenders, while prospectors rely more heavily on independent channel members – such as manufacturer's representatives or wholesale distributors – to distribute their products.[24]

Because prospectors focus on new products where success is uncertain and sales volumes are small in the short run, they are likely to devote a larger percentage of sales to *trade promotions* than are defender businesses. Prospectors rely on trade promotion tools such as quantity discounts, liberal credit terms and other incentives to induce cooperation and support from their independent channel members.

### 3.5.4 Promotion Policies

Extensive marketing communications also play an important role in the successful implementation of both prospector and differentiated defender strategies. The form of that communication, however, may differ under the two strategies. Because prospectors must constantly work to generate awareness, stimulate trial and build primary demand for new and unfamiliar products, high advertising and sales promotion expenditures are likely to bear a positive relationship to the new product and share-growth success of such businesses. The drug delivery SBU at 3M, for instance, devotes substantial resources to advertising in professional journals and distributing samples of new products, as well as to maintaining an extensive salesforce.

Differentiated defenders, on the other hand, are primarily concerned with maintaining the loyalty of established customers by adapting to their needs and providing good service. These tasks can best be accomplished – particularly in industrial goods and services industries – by an extensive, well-trained, well-supported salesforce.[25] Therefore, differentiated defenders are likely to have higher salesforce expenditures than are competitors.

Finally, low-cost defenders appeal to their customers primarily on price. Thus, high expenditures on advertising, sales promotion, or the salesforce would detract from their basic strategy and may have a negative impact on their ROI. Consequently, such businesses are likely to make relatively low expenditures as a percentage of sales on those promotional activities.

## 3.6 What If the Best Marketing Programme for a Product Does Not Fit the Business's Competitive Strategy?

What should a marketing manager do if the market environment facing a particular product or service demands marketing actions that are not consistent with the overall competitive strategy of the business to which it belongs? What if, for example, the product's target market is rapidly becoming more mature and competitive, but it is housed in a prospector business unit that does not have the cost structure or the personnel to allow the aggressive pricing or excellent customer service that may be needed for the product to compete successfully? Or what if newly emerging technology demands that a mature product category undergo an innovative redesign even though the defender SBU does not have extensive R&D and product development capabilities?

If a business unit is focused on a single product category or technological domain – as is the case with 3M's industrial tape unit – the ideal solution might be for the whole SBU to change its strategy in response to shifting industry circumstances. As the product category matures, for instance, the SBU might switch from a prospector to an analyser strategy and ultimately to one of the defender strategies.

The problem is that – as we shall see in Module 18 – effective implementation of different business strategies requires not only different functional competencies and resources but also different organisational structures, decision-making and coordination processes, reward systems and even personnel. Because such internal structures and processes are hard to change quickly, it can be very difficult for an entire SBU to make a successful transition from one basic strategy to another.[26] For example, many of Emerson Electric's SBUs historically were successful low-cost defenders, but accelerating technological change in their industries caused the corporation to try to convert them to low-cost analysers that would focus more attention on new product and market development. Initially, however, this attempted shift in strategy resulted in some culture shock, conflict and mixed performance outcomes within those units.

In view of the implementation problems involved, some firms do not try to make major changes in the basic competitive strategies of their existing business units. Instead, they might form new prospector SBUs to pursue emerging technologies and industries rather than expecting established units to handle extensive new product development efforts.

Similarly, as individual product-market entries gain successful positions in growing markets, some firms move them from the prospector unit that developed them into an existing analyser or defender unit, or even into a newly formed SBU, better suited to reaping profits from them as their markets mature. For example, a number of innovative products developed at 3M, such as Post-it repositionable notes, have enjoyed sufficient success that new divisions were formed to concentrate on defending them as their markets matured. Many successful entrepreneurial start-ups eventually reorganise into two or more business units, one to continue prospecting new products and markets and another to defend the firm's initial product offering as its market matures.

Finally, some firms that are technological leaders in their industries may divest or license individual product-market entries as they mature rather than defend them in the face of increasing competition and eroding margins. This approach is relatively common at firms such as 3M and DuPont.

Because the marketing manager responsible for a given product-market entry is usually most closely tuned-in to changes in the market environment, he or she bears the responsibility for pointing out any mismatches between what is best for the product and the capabilities of the organisational unit to which it belongs. The marketer should develop a marketing strategy that makes the most sense in light of a detailed analysis of the available customer and competitive information and present a strong case for the resources necessary to implement the plan. If those resources are not available within the business unit, or if the marketing strategy is inconsistent with the SBU's objectives or competitive strategy, top management faces a choice of moving the product to a more benign unit of the firm or rejecting the recommended strategy. If the strategy is rejected, the marketer will probably have to make compromises to the strategy to make it fit better with the competitive thrust of the SBU, even though an attractive opportunity may be lost. But if the marketer has great confidence in the recommended strategy, he or she might opt to quit the firm and pursue the opportunity elsewhere, as was the case with Jim Watkins, as discussed in Exhibit 3.8.

**Exhibit 3.8 Jim Watkins takes a hike**

When he was a product manager at the Pillsbury Company in the early 1970s, James D. Watkins became convinced that microwave technology represented a major opportunity for the packaged food industry. Consequently, he developed a marketing plan that proposed the pioneering development and aggressive introduction of a line of microwavable food products, starting with microwave popcorn. However, the business unit he worked for – and the entire Pillsbury Company at that time – was focused on defending strong positions in established markets, largely through incremental line extensions and product improvements. In other words, it was pursuing more of an analyser strategy. As a result, top management rejected Watkins's proposal as being too risky and requiring resources and -capabilities that were in short supply.

Watkins subsequently quit Pillsbury, founded a new firm called Golden Valley Microwave, attracted venture capital, hired some food scientists to do the necessary R&D, and began to market Act II microwave popcorn through large mass merchandisers such as Wal-Mart. As Watkins had predicted in his original marketing plan, the availability of microwavable foods spurred a rapid increase in consumer demand for microwave ovens, which in turn increased demand for more microwavable foods. His new company grew rapidly, and a few years later he sold it to ConAgra for many millions of dollars.

But don't be too critical of Pillsbury. Like a good analyser, the company avoided playing the risky role of the pioneer, but it eventually responded to the growing potential of microwave technology and successfully launched its own line of microwavable foods, including popcorn.

## Learning Summary

- Research suggests that a business is likely to achieve superior revenue growth, market share and profitability when there is a good fit between its competitive strategy and the strategic marketing programmes of its various product or service offerings.
- Business-level competitive strategies can be usefully categorised into (1) prospector strategies focused on growth via the development of new products and markets, (2) defender strategies primarily concerned with defending strong positions in established markets through either low prices or offering customers superior value in terms of product quality or service, and (3) analyser strategies, which are hybrids of the other two strategies.
- The generic competitive strategies described in the previous point apply equally well to services and physical products, single-product start-ups and multidivisional corporations and global and domestic operations, and they are unlikely to change dramatically due to the rise of e-commerce.
- Because the various business-level strategies focus on different objectives and seek to gain a competitive advantage in different ways, marketing may play a different role under each of the strategies and varying marketing actions may be called for.
- The marketing decision maker's job is to develop a sound, evidence-based marketing strategy for his or her offering and to make a persuasive case for its support. If that strategy does not fit the objectives or available resources and competencies of the business unit in which the product is housed, top management may choose to move the product to a more amenable unit or require adjustments to the strategy.

# Review Questions

## Content Questions

3.1 What are the basic/generic competitive strategies? Describe each briefly.

3.2 What are the characteristics of Miles and Snow's four business strategies?

3.3 How do low-cost defender, differentiated defender, prospector and analyser differ with respect to their scope, cash needs and synergy?

3.4 What are the appropriate external environment conditions for a prospector strategy? A defender strategy?

3.5 What are the marketing implications for each of the different business strategies with respect to:
- A. product policies?
- B. pricing policies?
- C. distribution policies?
- D. promotion policies?

3.6 Do service businesses require different strategies? Why? Why not?

3.7 Ideally, what characteristics should strategic business units have?

3.8 What are the objectives of a business unit?

## Multiple Choice Questions

3.9 Which criterion did General Foods Corporation emphasise when it decided to put Cool Whip and Jell-O into the same SBU?
- A. Similarity in personal characteristics of customers.
- B. Similarity in distribution patterns.
- C. Similarity in customer needs.
- D. Technical compatibility.
- E. Similar engineering skills.

3.10 Ideally, SBUs have all of the following EXCEPT:
- A. profit responsibility.
- B. related markets to serve.
- C. related technologies to use.
- D. publicly traded common stock.
- E. control over performance factors.

3.11 When all three levels of strategy (corporate, SBU, product-market) have good internal and external consistency, we say that the strategies have a good:

A. strategic fit.
B. return on investment.
C. return on sales.
D. gap strategy.
E. mission.

3.12 A strategy of competing with low prices is most likely to work if:

A. the SBU's R&D is better than that of its competitors.
B. the SBU's manufacturing operations are at least as efficient as those of competitors.
C. the product-market is relatively mature.
D. the SBU is part of a larger organisation that can subsidise low margins by the low-price unit.
E. there is a small field of competitors.

3.13 The generic business-level strategy which attempts to build customer perceptions of a superior-quality product which is supported by superior service is called:

A. a cost leader strategy.
B. a focus strategy.
C. a prospector strategy.
D. a differentiation strategy.
E. a quality strategy.

3.14 Miles and Snow identify the following four types of business strategy:

A. cost leader, differentiator, focus and stuck-in-the-middle.
B. liquidation, harvest, share maintenance and share growth.
C. leader, follower, guerrilla and flanker.
D. high price, price competitive, low price and service oriented.
E. prospector, analyser, defender and reactor.

3.15 With its limited selection of pizzas and its focus on the delivered market, Domino's Pizza is likely to be classified today as a (an):

A. prospector.
B. defender.
C. analyser.
D. reactor.
E. differentiator.

3.16 In terms of the Miles and Snow typology, the prospector strategic type:

A. is likely to be first into new product-markets.
B. attempts to locate and maintain a secure niche in relatively stable product areas.
C. attempts to maintain a stable, limited line of products.
D. lacks a well-defined strategy.
E. responds primarily when it is forced to do so by environmental pressures.

3.17 Strategic business units which have no clear strategy are termed by Miles and Snow as:

A. analysers.
B. reactors.
C. defenders.
D. prospectors.
E. cost leaders.

3.18 In terms of the Miles and Snow typology, the defender strategic type:

A. is likely to be first into new product-markets.
B. responds rapidly to early signals concerning areas of opportunity.
C. carefully follows a selected set of new developments in its industry.
D. responds primarily when it is forced to do so by environmental pressures.
E. attempts to maintain a stable, limited line of products.

3.19 In terms of the Miles and Snow typology, the analyser strategic type:

A. operates within a product-market that is regularly redefined.
B. responds early to signals concerning areas of opportunity.
C. is usually at the forefront of new-product development in its industry.
D. responds primarily when forced to do so by environmental pressures.
E. carefully follows a selected set of new developments in its industry.

3.20 In terms of the Miles and Snow typology, the reactor strategic type:

A. responds primarily when forced to do so by environmental pressures.
B. has a well-defined competitive strategy.
C. is as willing to assume the risks of new-product development as its competitors.
D. is aggressive in marketing established products.
E. anticipates environmental change.

3.21 The strategic orientations offered by Miles and Snow are applicable at which strategic decision-making level?

A. Corporate.
B. Division.
C. Product-market.
D. All of the above.
E. Only B and C above.

3.22 After combining the generic strategies of Miles and Snow and Porter, the 'prospector' strategic type is left unchanged. Why might the text authors have ignored the 'low-cost prospector' and 'differentiated prospector' classifications?

A. There are so few prospector types that making the distinction was unnecessary.
B. Since a prospector strategy is really the same as Porter's focus strategy making the distinction was not necessary.
C. The distinction is not meaningful as prospectors aren't concerned with competition.
D. The distinction would make the model too complicated, so, like Porter's focus strategy, it too was omitted.
E. While these are viable classifications, operationally the differences are too small to bother with.

3.23 When companies like 3M and McDonald's allow business units (SBUs) to follow different strategies when competing inside the USA and outside the USA it suggests that:

A. generic strategies are too generic to capture corporate reality.
B. they are not being viewed as SBUs, but as product-markets and this lower level allows for the needed flexibility.
C. these exceptions are allowed when strategic fit is poor.
D. the overseas markets are being treated like independent SBUs and over time they will either conform to the US SBUs or be split off.
E. none of the above.

3.24 The breadth of the strategic domain of an organisation is known as that organisation's:

A. depth.
B. market penetration.
C. scope.
D. direction.
E. cost leadership.

3.25 The success of an SBU's products and programmes relative to those of its competitors in the marketplace is known as that SBU's:

A. adaptability.
B. efficiency.
C. effectiveness.
D. return on sales.
E. return on investment.

3.26 Given that increased share of market is a primary objective of both company A and B, if company A increases its market share by 10 per cent during a given period, while company B increases its market share by 2 per cent, company A is said to be more:

A. efficient.
B. differentiated.
C. effective.
D. of a cost leader.
E. adaptable.

3.27 Profitability as a percentage of sales and return on investment are said to be measures of:

A. effectiveness.
B. differentiation.
C. adaptability.
D. efficiency.
E. cost leadership.

3.28 The category of businesses likely to devote the largest proportion of resources to development of new product-markets is termed:

A. defender.
B. prospector.
C. analyser.
D. reactor.
E. differentiator.

3.29 The category of businesses most likely to generate excess cash to support product and market development efforts in other business units within the firm is the:

A. reactor.
B. defender.
C. analyser.
D. prospector.
E. differentiator.

3.30 A business unit's strategic orientation usually influences:

A. the use of print rather than broadcast media.
B. the couponing redemption method followed.
C. the amount of resources committed to marketing.
D. the decision of which industry to compete in.
E. the decision of whether to diversify by growth or acquisition.

3.31 If a company, like Volvo, takes one of its car lines and adds all-wheel-drive technology to it to exploit a growing market which demands maximum traction, we can infer that it follows which strategic type:

A. prospector.
B. low-cost analyser.
C. differentiated analyser.
D. low-cost defender.
E. differentiated defender.

3.32 Which strategic orientation is well suited to unstable, rapidly changing environments?

A. prospector.
B. analyser.
C. focus.
D. differentiated defender.
E. low-cost defender.

3.33 Conditions are most likely to be favourable for a differentiated defender business strategy during:

A. the introductory stage of the product life cycle.
B. the shakeout stage of the product life cycle.
C. the early growth stage of the product life cycle.
D. the decline stage of the product life cycle.
E. the late growth stage of the product life cycle.

3.34 The business strategy most likely to have been successful when cordless telephones were first introduced and began to grow as a market was that of the:

A. differentiated defender.
B. low-cost defender.
C. prospector.
D. analyser.
E. reactor.

3.35 Which type of strategy is particularly well suited to an environment in which the industry is in the maturity or decline stage of the life cycle?

A. prospector.
B. analyser.
C. low-cost defender.
D. differentiated defender.
E. either C or D above.

3.36 Which type of strategy is particularly well suited to an environment in which the industry is in the introductory or early growth stage of the life cycle?

A. prospector.
B. mass market.
C. analyser.
D. differentiated defender.
E. low-cost defender.

3.37 All of the following are examples of the product policies of a marketing programme EXCEPT:

A. product quality.
B. service quality.
C. publicity.
D. the technical sophistication of the product.
E. the product line breadth.

3.38 Businesses following a prospector strategy should seek synergy through the sharing of:

A. technology.
B. operating facilities and programmes.
C. engineering skills.
D. market knowledge.
E. A, C and D only.

3.39 All of the following are examples of the promotion policies of a marketing programme EXCEPT:

A. advertising expenses as a percentage of sales.
B. sales promotion expenses as a percentage of sales.
C. salesforce expenses as a percentage of sales.
D. public relations expenses.
E. service quality.

3.40 'Any activity or benefit that one party can offer to another that is intangible' is a working definition of:

A. a utility.
B. a service.
C. a benefit.
D. a motive.
E. a tangible benefit.

3.41 All of the following are examples of a service EXCEPT:

A. product maintenance.
B. on-the-job training of personnel.
C. installation.
D. product repair.
E. product packaging.

## Application Questions and Cases

3.42 Compare and contrast the prospector and low-cost defender business strategies discussed in this module on each of the following strategic dimensions:

a. Scope.
b. Objectives.
c. Deployment of resources.
d. Sources of synergy.

3.43 The 3M Company's Industrial Tape SBU pursues a differentiated defender strategy in an industry where both the basic technologies and the customer segments are relatively mature and stable. Is the objective imposed by top management of obtaining 30 per cent of sales from products introduced within the last four years an appropriate objective for such an SBU? What do you think top management hopes to accomplish by imposing such an objective on the Industrial Tape SBU? What are the potential disadvantages or dangers involved in imposing such an objective?

3.44 If you were the general manager of the 3M Industrial Tape SBU discussed in Question 3.43, which objectives would you argue are most appropriate for your business unit in view of its strategy and its external environment? Why?

3.45 Historically, each division in General Motors (i.e. Chevrolet, Pontiac, Olds-mobile) competed strategically by: (a) maintaining its current position within the car market by aggressive marketing and annual improvements to its existing line of cars; and (b) simultaneously working to develop new models that would incorporate advanced technologies and designs. What strategy was each division to follow? What are the strengths and limitations of such a strategy?

3.46 Several years ago, General Motors created the Saturn division and charged it with developing an entirely new line of cars incorporating the latest advancements in product and production technology. What kind of business strategy is the Saturn division expected to pursue? How might the creation of this new division help overcome some of the limitations of GM's traditional business-unit strategy that you identified in your answer in Question 3.45?

3.47 Suppose you have been the marketing manager for 3M Company's Industrial Tape SBU as described in Question 3.43. You have just been informed that you are being transferred to a similar position within the company's Health Care SBU, a business unit that pursues a prospector strategy aimed at the rapid development of new products for newly emerging markets. Would you see the transfer as a positive step in the development of your career? How are your responsibilities and your decision-making influence likely to change as a result?

3.48 You are the marketing vice president for a small firm whose success depends on pioneering the development of new personal-care products such as soap and toothpaste. What role as marketing vice president would you play in determining the firm's success?

3.49 You are the marketing manager for a generic products division of a major pharmaceutical manufacturer. Your division uses the corporation's excess manufacturing capacity to produce generic prescription drugs – drugs whose patents have expired and which can thus be manufactured by any company that wishes to produce them. Your division is a low-cost defender that maintains its position in the generic drug market by holding down its costs and selling generic products to distributors and pharmacies at very low prices. What are the implications of this business strategy for each of the 4 Ps in the strategic marketing programme you would develop for your division?

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# PART 2

# Opportunity Analysis

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|---|---|
| **Module 4** | **Environmental Analysis: Tools to Identify Attractive Markets** |
| **Module 5** | **Industry Analysis and Competitive Advantage** |
| **Module 6** | **Understanding Consumer Buying Behaviour** |
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| **Module 8** | **Measuring Market Opportunities: Forecasting and Market Research** |
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# Module 4

# Environmental Analysis: Tools to Identify Attractive Markets

## Contents



## The Changing Menswear Market[1]

From jeans to khakis, from tailored suits to 'business casual,' clothing preferences among Western men have been changing. A trend toward casual dress in the workplace that got its start during the 1980s in high-tech firms in Silicon Valley in California became pervasive throughout the business world during the dot-com boom of the late 1990s. One day in early 2000, some 350 lawyers and staffers from the old-line New York law firm of Cadwalader, Wickersham and Taft crowded into the Polo mansion on New York's posh upper east side to get some advice on how to enter the 'business casual' era. And in the City of London, in the staid investment banking hallways of Goldman Sachs, Merrill Lynch and Morgan Stanley, business casual was the order of the day.

### *The Impact of Unfavourable Macroenvironmental Trends*

For companies serving the men's tailored clothing market, the challenges brought about by the business casual trend have been daunting. Manufacturers of tailored men's clothing have stumbled and some have attempted to reposition themselves as purveyors of more casual attire. Retailers of men's suits also have struggled and some, like the Kuppenheimer chain, a unit of Hartmarx, the leading manufacturer of tailored menswear in the United States, have closed their doors entirely.

What happens when unexpected unfavourable trends, like that toward more casual dress in the workplace, cause demand for a category of goods or services to shrink, as has happened with tailored men's clothing? First, providers of such goods feel a softening in their sales. As sales grow softer, firms find themselves having excess capacity and expense levels that cannot be supported by reduced levels of revenue. Often, the performance figures that result paint a picture that is anything but pretty. Today's Man, a 25-store menswear chain in the eastern United States was forced to reorganise under bankruptcy protection in 1998. In 1999 the bankrupt American retailer Edison Brothers liquidated its 295 Riggings stores because not a single suitor out of 250 interested parties was willing to buy the ailing chain. In 2000 Moss Brothers, the British high street menswear retailer, plunged into the red, losing £3.4 million in its year ended January 2001 compared to a £6.7 million profit the prior year. In response, the company announced plans to convert its tailored clothing stores – operating under the Savoy Taylors Guild, Suit Company, and Blazer brands – to a new casual clothing format called Code. Numerous other chains and independent men's clothiers suffered similar fates.

The widespread troubles experienced by menswear retailers and manufacturers in the 1990s and 2000s are typical of what can happen when unforeseen trends – whether social trends, as in this case, or others – cause consumer demand to drop rapidly. Simply put, the market for tailored men's apparel shrank like a cheap suit and the ensuing competitive pressures in the menswear manufacturing and retailing industries made this market and these industries far less attractive than they had once been.

### *What's Next? Will Suits Come Back?*

When the dot-com bubble burst in 2000, the time seemed right for a return to more formal business attire. The logic was that laid-off dot-com workers would be interviewing again and those who had kept their jobs would begin dressing better out of fear. But a decade later, casual dress remains firmly entrenched in many workplaces. Will suits come back, or will they simply be one option, to be worn when appropriate, for client meetings or to make one's employer think you have a job interview? Time will tell. For marketing strategists in the menswear industry, it's a question not to be ignored.

## Learning Objectives

This module addresses the second of the 4 Cs – the **environmental context** in which the business operates – that were identified in Module 1 as the analytical foundation of the marketing management process. A framework is provided to help managers, entrepreneurs and investors comprehensively assess the environment in which they operate or propose to operate, in order to assess market attractiveness and enhance their likelihood of achieving success. Thus, this module addresses three important questions for marketing strategists: Does it really matter whether we swim upstream or downstream? How can we be sure we've identified and understood the key trends? And finally, how does macro trend analysis play out in assessing markets and in making marketing decisions?

## 4.1 Swimming Upstream or Downstream: An Important Strategic Choice

Casual dress in the workplace is a social trend. The greying of the world population is a demographic one. Global warming is a trend in our physical environment. All these trends influence the fortunes of some companies, but not others. As we have seen, the influence of **macroenvironmental trends** – or **macro trends**, for short – like these can be pervasive and powerful. In general, life is better swimming downstream, accompanied by favourable trends, than upstream, running counter to such trends.

Like mosquitoes or cooling breezes on a humid summer evening, trends will always be present, whether marketing managers like them or not. The question is what managers can do about them. For some trends, marketers and other managers can do little but react and adapt. In the 1990s, manufacturers of products sold in spray containers were required to find new propellants less harmful to the ozone layer. Governments concerned about global warming mandated this change. For other trends, like the shift toward casual dress in the workplace, favourable conditions can be taken advantage of through effective marketing. Similarly, sometimes, unfavourable ones can be mitigated. But doing these things requires that important trends be noticed and understood. The sociocultural, demographic, and physical environments are but three of six major components of the **macroenvironment**. The other three are the political/legal, economic, and technological components. We deal with the competitive environment in Module 5.

## 4.2 Macro Trend Analysis: A Framework for Assessing Market Attractiveness

In this section, we examine each of the six macroenvironmental components in terms of how the dynamics of change affect the attractiveness of particular markets and influence marketing strategies and programmes. A more detailed worksheet useful in assessing market attractiveness may be found in John Mullins's *The New Business Road Test*.[2]

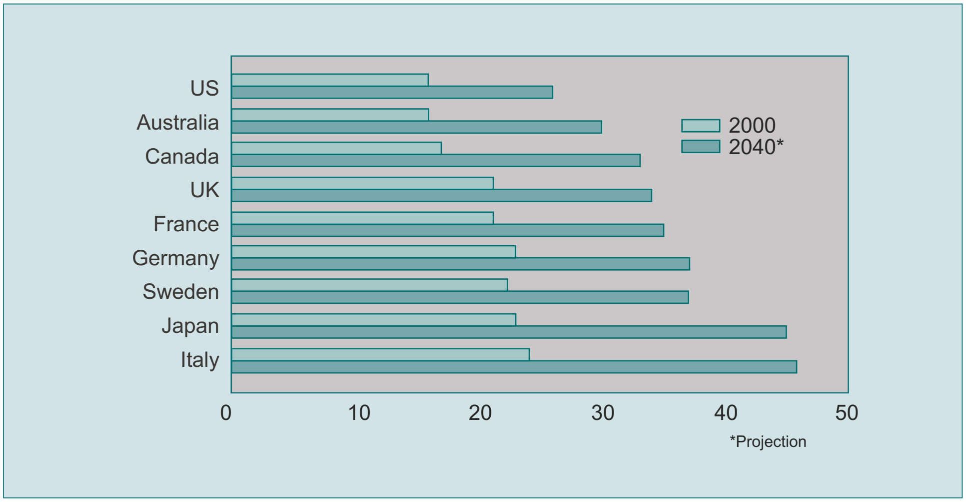
### 4.2.1 The Demographic Environment

As the saying goes, demography is destiny. All kinds of things – from sales of music CDs to the state of public finances to society's costs of health care to the financing of pensions – are governed to a significant extent by demographic changes. While the number of specific demographic trends that might influence one marketer or another is without limit, there are currently five major global demographic trends that are likely to influence the fortunes of many companies, for better or worse: the aging of the world's population, the effect of the AIDS plague on demography, the imbalance between rates of population growth in richer versus poorer countries, increased levels of immigration, and the decline in married households in developed countries.

### 4.2.1.1 Aging

Exhibit 4.1 shows the projected increase in the portion of the population aged over 60 in several of the world's most developed countries. The chart shows that in Italy, for example, about half the population will be over 60 by the year 2040, according to current projections. Providers of health care, vacation homes, life insurance, and other goods and services have taken note of the greying of the world's population and are taking steps to develop marketing strategies to serve this fast-growing market.

**Exhibit 4.1 Aging populations: % of the population aged over 60**




*Source:* Norma Cohen and Clive Cookson, 'The Planet Is Ever Greyer: But as Longevity Rises Faster than Forecast, the Elderly Are Also Becoming Healthier,' *Financial Times,* January 19, 2004, p. 15.

Doing so, however, isn't always easy. Many people do not wish to be pigeon-holed as elderly and some who are getting older may not be very attracted to goods or services that remind them of their age. One marketer dealing with this challenge is Ferrari, whose average customer is nearing 50 and getting older with each passing year. 'The profile of our customers means we have to pay attention to practicality and functionality without compromising the sportiness,' says Giuseppe Bonollo, Ferrari's strategic marketing director. 'The way the doors open on the Enzo, for example, allows part of the roof and part of the door undermoulding to come away as well, making it easier to enter the car.'[3]

The implications of the aging trend are not as clear-cut as they might appear. Surprisingly, perhaps, some 25 per cent of Apple's hot new iPhones – a 'cool,' cutting-edge product if there ever was one – have been bought by people over 50.[4] Further, there is evidence that today's elderly generation is both healthier and fitter than its predecessors. Thus, fears that health and other facilities will be swamped by hordes of ailing pensioners may be misplaced. 'New data demolish such concerns,' reports Raymond Tillis, professor of geriatric medicine at Manchester University in the United Kingdom. 'There is a lot of evidence that disability among old people is declining rapidly.'[5]

#### 4.2.1.2 AIDS

The death toll due to HIV/AIDS in Africa, the hardest hit region, was some 8 million from 1995 to 2000,[6] and the pandemic continues. In 2005, an estimated 24 million adults and children died from AIDS in sub-Saharan Africa.[7] Across Africa, grandparents are raising an entire generation of children, as the parents have died.

Pharmaceutical companies and world health organisations are struggling to develop strategies to deal with the AIDS challenge, one that presents a huge and rapidly growing market, but one in which there is little ability to pay for the advanced drug therapies that offer hope to AIDS victims.

#### 4.2.1.3 Imbalanced Population Growth

There are 6.6 billion people in the world today, a number that is growing by some 77 million each year, an annual rate of just 1.2 per cent. But five countries – India (21 per cent), China (12 per cent), Pakistan (5 per cent), Bangladesh and Nigeria (4 per cent each) – account for nearly half of that increase. Virtually all the growth in the world's population over the next half century, some 2.6 billion according to the UN forecast, will be in developing countries.[8] Of this number, 1 billion will be in the least developed countries, which only comprise 718 million people today. On the other side of the coin, 33 countries are expected to have smaller populations in 2050 than today – Japan, Italy, and Russia among them.

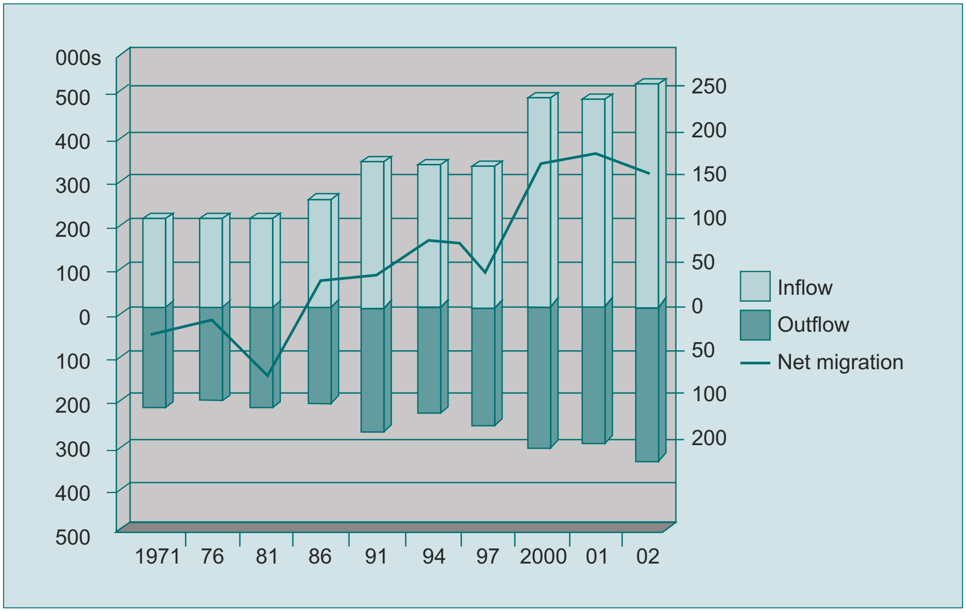
For marketers, these changes are important. For makers of capital goods, population growth in Asia and Africa means a growing need for capital goods to satisfy growing demand for manufactured goods to serve local and export markets. For Western consumer goods companies seeking to grow, Asia and Africa are where the action will be, though strategies to serve the much-lower-income customers in those markets will have to differ from those developed for richer Western markets. Procter & Gamble, for example, has become a market leader in shampoo in India by packing its products in small sachets that provide enough gel for a single shampoo, in response to the modest purchasing power of its Indian customers. No large economy size here!

#### 4.2.1.4 Increased Immigration

Not surprisingly, the increasing imbalance between the economic prospects for those living in more developed versus less developed countries is leading to increased levels of immigration. With the 2004 enlargement of the European Union from 15 to 25 countries, fears have grown that some countries in the 'old EU' will be swamped with immigrants from the accession countries in Eastern Europe, where per capita GDP is only 46 per cent of the EU 15 average.[9]

In one sense, this wave of immigration is nothing new, for melting pot countries like the United States and United Kingdom have for centuries welcomed immigrants to their shores (*see* Exhibit 4.2). In the United States, many years of immigration from Mexico and Latin America have made the Sun Belt a bilingual region, and many now view Miami as the crossroads of Latin America. The implications for marketers seeking to gain market share among Hispanic Americans are obvious.

**Exhibit 4.2 Melting Pot Britain: Past, Present, and Future**




**1600s:** About 50 000 French Protestants, known as Huguenots, admitted after religious persecution in France. The Huguenots give the word 'refugee' to the English language.
**1840s:** An estimated 1 million Irish flee famine and flock to Britain's new industrial centres.
**1890s:** About 100 000 Jews arrive in Britain from central and eastern Europe.
**1930s:** 56 000 Jews fleeing from Nazi persecution join the earlier group.
**1955–62:** 472 000 Commonwealth citizens, primarily from the Caribbean and southern Asia, move to Britain. Many were actively recruited abroad by big employers, including the London Underground.
**1970s:** 30 000 Asians who were forced out of Uganda by General Idi Amin allowed to settle in the UK by prime minister Edward Heath.

*Source:* Chart: 'Melting Pot Britain: Past, Present, and Future,' *The Sunday Times* (London), November 16, 2003, Focus, p. 16. Original source: National Statistics.

### 4.2.1.5 Declining Marriage Rates

A generation ago, a single, 30-something professional woman out with her single friends for a night on the town would have been considered an aberration. No more. Marriage in much of the Western world is on the wane. In the United States, married couples, 80 per cent of households in the 1950s, now account for just 50.7 per cent.[10] Young couples are delaying marriage, cohabitating in greater numbers, forming same-sex partnerships, and are remarrying less after a wedding leads to divorce. Later in life, they are living longer, which is increasing the number of widows and widowers.

Implications for marketers? For one, consider the implications of marrying in one's 30s, well into one's career, rather than in one's 20s. It's less likely that the parents of the bride will handle the wedding arrangements – not to mention the hefty bills that must be paid! – so couples are planning and managing their weddings themselves. In the United Kingdom a new magazine, *Stag & Groom,* hit the market in 2004 to take the fear out of the wedding process for the clueless grooms who must now play a more important role. But would anyone really buy a wedding magazine for men? Despite the hilarious publicity its launch generated, *Stag & Groom* suffered an early demise. Macro trends alone don't guarantee the success of a new venture.

## 4.2.2 The Sociocultural Environment

Sociocultural trends are those that have to do with the values, attitudes, and behaviour of individuals in a given society. Cultures tend to evolve slowly, however, so some sociocultural trends can take a generation or more to have significant impact, as people tend to carry for a lifetime the values with which they grow up. Within this broadly stable pattern, however, sociocultural trends can and do exert powerful effects on markets for a great variety of goods and services. Two trends of particular relevance today are greater interest in ethical behaviour by businesses and trends toward fitness and nutrition.

### 4.2.2.1 Business Ethics

For years, the world's leading coffee marketers, including Kraft and Nestlé, resisted calls to pay premium prices for coffee grown in a sustainable manner, on farms that pay their workers a living wage and respect the environment. In 2003, Kraft, running neck and neck with Nestlé for the number one spot in market share globally, reached agreement with the Rainforest Alliance, a nonprofit organisation that seeks to improve the working, social, and environmental conditions in agriculture in the developing world. The agreement called for Kraft to buy £5 million of Rainforest Alliance-certified coffee from Brazil, Colombia, Mexico, and Central America in 2004, paying a 20 per cent premium to the farmers.[11]

Why did Kraft take this step? 'This is not about philanthropy,' says Kraft's Annemieke Wijn. 'This is about incorporating sustainable coffee into our mainstream brands as a way to have a more efficient and competitive way of doing business.' In short, Kraft made the jump because consumers demanded it.

### 4.2.2.2 Fitness and Nutrition

Running. Working out. Fitness clubs. The South Beach and Atkins diets. These days, natural and organic foods are in (*see* Exhibit 4.3). Sugar and cholesterol – at least the bad LDL cholesterol – are out.[12] The implications of these sociocultural trends are playing out in grocery store produce departments, where entire sections are now devoted to organic produce; in the farming communities of North America and Europe, where fields formerly farmed with fertilisers are being transformed into organic ones; and on restaurant menus, where selections are being revamped to make them appeal to customers who have adopted new eating habits. The 20-ounce T-bone steak is a thing of the past, at least in some circles.

These trends are driving more than just the food business, however. Attendance at health and fitness clubs is booming. Sales of home exercise equipment are up, along with advice on how to purchase and use it to best advantage.[13]

**Exhibit 4.3 Health Trends Give Kraft a Stomach Ache**

Tracey Daugherty, a 33-year-old mother from Pittsburgh, grew up eating Kraft macaroni and cheese. Today, though, Kraft's marketing strategists have queasy stomachs because Daugherty and others won't feed it to their own children. 'Kraft's products definitely have a childhood nostalgia,' she says, 'so it's hard to completely give up on them, but they're not on my shopping list.' When she's pressed for time, Daugherty is more likely to pull an organic frozen dinner out of the freezer than boil up a batch of Kraft Mac and Cheese. On most nights, what's on her family's dinner table includes fresh produce and chicken or fish from Whole Foods, the fast-growing American grocery chain that built its reputation on natural and organic foods.

To cope with Americans' growing preference for fresh and natural foods rather than prepackaged and processed ones, the big food companies are having to rethink their businesses, find new suppliers, and augment their product lines with new, healthier versions of their longstanding best-sellers. Kraft, which owns brands such as Oscar Mayer (hot dogs, with their high animal fat content, are not exactly known as a health food!), Jell-O gelatin (mostly sugar, a no-no on today's low-carbohydrate diets), and Nabisco (whose cookies and crackers were laden with both carbs and trans-fats, the latest addition to health experts' 'avoid' lists), have struggled to meet their double-digit growth targets, as consumers increasingly shift their food dollars to healthier fare.

As Wharton Marketing Professor Patricia Williams points out, the question for the food giants is, 'To what extent is the Atkins diet and the whole low-carb thing a fad and to what extent is it a genuine shift in consumption patterns that will remain with us for a significant period of time?' The food industry cannot afford to take this question lightly.

*Sources:* Sarah Ellison, 'Finicky Shoppers Pose Problems for Kraft Foods,' *The Wall Street Journal Europe,* May 24, 2004, p. A7; and Knowledge@Wharton, 'Low-Carb, High-Carb: What's a Baker/Pasta Maker to Do?' http://knowledge.wharton.upenn.edu/index.cfm?fa=printArticle&ID=994.

## 4.2.3 The Economic Environment

Among the most far-reaching of the six macro trend components is the economic environment. When people's incomes rise or fall, when interest rates rise or fall, when the fiscal policy of governments results in increased or decreased government spending, entire sectors of economies are influenced deeply, and sometimes suddenly. As we write, with many developed economies mired in slow-growth mode, their near-term future appears to lie in the purses and wallets of their shoppers. Signs suggest that an economic rebound in the recently stagnant euro-zone and Japan, based largely on a consumer-led recovery of the kind that fuelled growth in the United States in the early years of the new millennium, remains tenuous.[14] In Ireland, where GDP grew an average of 6 per cent annually for more than a decade, the music has stopped. Unemployment has jumped, exports are down, and the real-estate bubble has burst.[15] Although Europe and the United States have sneezed, India and China have so far largely avoided catching the cold.

The implications of trends like those in consumer spending can be dramatic for marketers, to be sure, but they can be far subtler than one might imagine. Take robust economic health, for example. It's good for everyone, right? Not if you're the operator of a chain of cheque-cashing outlets or pawn shops, which thrive when times are tough and people need to turn unwanted assets into cash quickly. Or consider a new idea in franchising, brick-and-mortar stores that help people sell their unwanted goods online on eBay. California-based AuctionDrop raised $6 million in venture capital to roll out a franchised chain of such stores.[16] If the economy gets healthier, will people need such stores to help them dispose of unwanted goods? Time will tell.

Economic trends often work, to pronounced effect, in concert with other macro trends. For example, the move of the baby-boomer generation into middle age in the 1990s, a demographic trend, combined with a strong global economy and low interest rates, both economic trends, led to booming demand for condominiums and vacation homes in resort areas like the Rocky Mountains of Colorado and the sun-blessed coasts of Spain and Portugal.

## 4.2.4 The Regulatory Environment

In every country and across some countries – those that are members of the EU, for example – there is a **regulatory environment** within which local and multinational firms operate. As with the other macro trend components, political and legal trends, especially those that result in **regulation** or **deregulation,** can have a powerful impact on market attractiveness.

In September 2003, voters in Sweden resoundingly rejected the euro, preferring to maintain their own Swedish currency and thereby retain independent domestic control of their country's fiscal policy and remain freer than those in the euro-zone of what some see as stifling overregulation from Brussels.[17] For marketers involved in Swedish import or export businesses the implications may prove significant, as uncertainties inherent in predicting foreign exchange rates make trade and investment decisions more tenuous.

The power of deregulation to influence market attractiveness is now well known. Government, business, and the general public throughout much of the world have become increasingly aware that overregulation protects inefficiencies, restricts entry by new competitors, and creates inflationary pressures. In the United States, airlines, trucking, railroads, telecommunications, and banking have been deregulated. Markets also are being liberated in Western and Eastern Europe, Asia, and many developing countries. Trade barriers are crumbling due to political unrest and technological innovation.

Deregulation has typically changed the structure of the affected industries as well as lowered prices, creating rapid growth in some markets as a result. For example, the period following deregulation of the US airline industry (1978–1985) gave rise to a new airline category – the budget airline. The rise of Southwest and other budget airlines led to lower fares across all routes, and forced the major carriers to streamline operations and phase out underperforming routes. A similar story has followed in the European market, where discount airlines Ryanair, easyJet, and others have made vacation destinations places to fly to rather than drive to.

As regulatory practices wax and wane, the attractiveness of markets often follows suit. For example, the deregulation of telecommunications in Europe, following earlier deregulation in the United States, opened markets to firms seeking to offer new services and take market share from the established monopolies. The rise of Internet retailing and Internet telephony has policy makers arguing over the degree to which these Internet activities should be subject to state and federal tax in the United States. The outcome of these arguments may have considerable effect on consumers' interest in buying and selling on the Web.

## 4.2.5 The Technological Environment

In the past three decades, an amazing number of new technologies has created new markets for such products as video recorders, compact disks, ever-more-powerful and ever-smaller computers, fax machines, new lightweight materials, and highly effective genetically engineered drugs. Technological progress is unlikely to abate.

Technology can also change how businesses operate (banks, airlines, retail stores, and marketing research firms), how goods and services as well as ideas are exchanged, how crops are grown, and how individuals learn and earn as well as interact with one another. Consumers today enjoy cheque-free banking, the death of the invoice, and ticketless air travel.

Many of these innovations are the result not only of changes in computing systems but also of reduced costs in communicating (voice or data). For example, the cost of processing an additional telephone call is so small it might as well be free. And distance is no longer a factor – it costs about the same to make a trans-Atlantic call as one to your next-door neighbour. If you place the call on Skype, it can cost nothing at all![18]

At the dawn of the new millennium, developments in telecommunications and computing have led to the rapid convergence of the telecommunications, computing, and entertainment industries. Music-hungry consumers have been downloading music from legal and illegal sites thereby hammering the music industry (*see* Exhibit 4.4) and have forced the industry to change the way it distributes music. Apple's iPod led the way with an estimated 83 per cent share of legal music downloads in the fourth quarter of 2005,[19] and its music revenues have continued to grow rapidly.

Mobile phone users in Europe and Asia check sports scores, breaking news, stock quotes, and more using text messaging or SMS.[20] Smart phones like the iPhone offer even more. Savvy marketers and entrepreneurs who follow technological trends are able to foresee new and previously unheard of applications such as these and thereby place themselves and their firms at the forefront of the innovation curve, sometimes earning entrepreneurial fortunes in the process. For others, though, like the music industry, the challenges brought on by these winds of change can be daunting.

In addition to creating attractive new markets, technological developments are having a profound impact on all aspects of marketing practice, including marketing communication (ads on the Web or via email), distribution (books and other consumer and industrial goods bought and sold via the Web), packaging (use of new materials), and marketing research (monitoring supermarket purchases with scanners or Internet activity with digital 'cookies'). We explore the most important of these changes in the ensuing modules.

**Exhibit 4.4 The music industry sings the blues**

For seven years running, sales of compact discs have fallen due to the seismic shift in the way consumers obtain their music. Though CDs still account for most music sold, the sharp decline in their sales as a consequence of digital downloads has dramatically outweighed increases in CD revenues. Even the hits aren't what they used to be. Norah Jones's 'Not Too Late' sold 1.1 million copies in its first six weeks in early 2007, compared to twice that figure for her 'Feels Like Home' CD over its same postrelease period in 2004.

Music retailers are also feeling the pain, with more than 200 music stores closing in the United States in 2006 alone. Tower Records closed its 89 stores following a bankruptcy filing, and

Musicland Holding Corp., owner of the Sam Goody chain, has shuttered more than half of its 900 locations in recent years.

Pali Research analyst Richard Greenfield is not optimistic that industry conditions will get better. 'Even when you have a good release like Norah Jones,' he says, 'maybe the environment is so bad you can't turn it around.'

*Source:* Ethan Smith, 'For the Music World, the Tune Gets Sadder,' *The Wall Street Journal European Edition*, March 22, 2007, p. 16.

### 4.2.6 The Natural Environment

Everything ultimately depends on the natural environment, including marketing. Changes in the earth's resources and climate can have significant and far-reaching effects. The world's supply of oil is finite, for example, leading automakers to develop new hot-selling hybrid gas-electric vehicles such as the Toyota Prius, which can go more than 50 miles on a gallon of gas. The high price of oil has caused demand for gas-guzzling sport utility vehicles to plummet.[21]

One of the more frightening environmental scenarios concerns the buildup of carbon dioxide in the atmosphere that has resulted from heavy use of fossil fuels. This carbon dioxide 'blanket' traps the sun's radiation, which leads to an increase in the earth's average temperature. One computer model of the climate predicts a cooling of Europe; Africa, East Asia, and South America warming a lot; and less rain in East Asia, Southern Africa, most of South America, Mexico, and parts of the United States. While the evidence is increasing that greenhouse gases are changing the climate, there is considerable disagreement over the details of the warming effects and what to do about them.

In general, discussion of the problems in the natural environment has stressed the threats and penalties facing business throughout the world. But business can do a number of things to turn problems into opportunities. One is to invest in research to find ways to save energy in heating and lighting. Another is to find new energy sources such as wind farms and hydro-electric projects. A third is to seek market solutions, such as the one described in Exhibit 4.5.

### Exhibit 4.5 Europe creates a market for carbon

A new emissions trading scheme in Europe seeks to influence the behaviour of industries like electricity generation that have historically been big contributors to the buildup of greenhouse gases in the atmosphere. Under the scheme, introduced in January 2005, companies in pollution-prone industries are issued free permits for the carbon dioxide they produce, which they are then free to trade with one another. Companies that produce less carbon dioxide than their permits allow can sell their permits on an open market to other companies that exceed their allowances. Companies are fined for producing carbon dioxide in excess of the permits they hold. Through this market mechanism, the European Commission hopes that companies will be encouraged to cut their emissions by installing new and better technology or by improving energy efficiency. Will it work? Paul Newman, managing director at Icap Energy, a carbon trader, says he already sees behaviour change. 'If you are thinking of switching to coal because the gas price is high, you have to ask what is the price of carbon first.' By autumn 2005, Icap's trading volume had risen from one trade per week at the beginning of the year to 50 trades per day.

*Source:* Fiona Harvey, "Market Begins to Influence Behavior of Generators," *Financial Times,* October 10, 2005, Surveys, p. 2.

Businesses also have seen opportunities in developing thousands of **green products** (those that are environmentally friendly) such as phosphate-free detergents, tuna caught without netting dolphins, organic fertilisers, high-efficiency LED lighting, recycled paper, and clothes made from 100 per cent organic cotton and coloured with nontoxic dyes. DuPont, long synonymous with petrochemicals, is reinventing itself as an eco-conscious company. More than $5 billion of its $29 billion in revenue now comes from sustainable products, including a new corn-based fibre called Sorona, which can be used to make clothing, carpet, and other products.[22]

Trends in the natural environment are creating opportunities for companies like DuPont. On the other hand, if global warming continues, it may play havoc with markets for winter vacationers, snowmobiles, and other products and services whose demand depends on the reliable coming of Old Man Winter. Other natural trends, such as the depletion of natural resources and fresh groundwater, may significantly impact firms in many industries serving a vast array of markets. Tracking such trends and understanding their effects is an important task.

## 4.3 Environmental Analysis Guides Marketing Decision Making

Macro trends can have powerful influence on the attractiveness of markets, as well as on marketing practice. What should managers charged with strategic responsibilities do to take advantage of or cope with such trends? First, they need to prioritise trend categories, so they know what to watch for. Second, they need to identify, and then monitor, sources of relevant information about macro trends. Third, as key developments are noted, they need to anticipate impacts and be prepared to change strategies if necessary. We briefly address each of these issues in this section.

### 4.3.1 Prioritising Trend Categories

Apparel marketers closely watch sociocultural trends so as to provide garments in tune with today's changing lifestyles. For example, specialised undergarments for female athletes have become a growing market, as more and more women participate in athletic pursuits.

Real estate investors closely monitor economic trends, because changes in interest rates or income can dramatically impact demand for both commercial and residential properties. Venture capitalists and high-tech entrepreneurs watch technological trends. Food marketers study demographic and sociocultural trends to provide new food products that fit modern lifestyles and satisfy rapidly growing demand for ethnic foods. The list goes on and on. What's important is for businesspeople to understand which macro trend categories are likely to have the most impact on their fortunes and monitor those categories accordingly. Similarly, managers need to monitor changes in ethical standards and expectations, so they do not run afoul of their customers' expectations. Ethical Perspective 4.1 discusses some ethical issues that have arisen in this arena.

#### Ethical Perspective 4.1

**Ethical Issues in Macro Trend Analysis**

Because there are myriad ways in which business and the environment interact, it is not surprising that firms find it difficult to cope with social and environmental issues. More and more companies, however, are taking an active role in dealing with these issues, not only making sure they are in compliance with regulations, but also taking a strong pro-social and pro-environmental stance that includes abandoning products that are socially or environmentally harmful.

Most companies make an effort to develop a pro-environment attitude among their employees, customers, and the general public. A substantial majority have ethical codes of behaviour to guide their employees regarding the environment. Since the public demands it, more and more companies support resource conservation and recycling. McDonald's, for example, has switched from plastic and styrofoam packaging to cardboard and paper.

On the other hand, some companies have come under criticism for contracting with suppliers that use child labour or that provide unhealthy working environments and for charging high prices in developing countries for goods such as pharmaceutical drugs. Dealing with social and environmental problems can often seem intractable because of difficulty in defining their severity (e.g., the greenhouse effect), and uncertainty about how to solve them. When we think we have found a solution, we are not sure of its long-term versus short-term effects and the extent to which the solution may be dysfunctional. In some areas, however, the picture is clearer, and a positive response may even be good business.

## 4.3.2 Information Sources and Outputs of Macro Trend Analysis

There is an endless supply of information about macro trends, including the popular and business press, the Internet, supplier and customer contacts, and so on. Thus, gathering relevant data is not difficult, but it does take time and effort. A good place to start is with trade associations and trade magazines, both of which typically track and report on trends relevant to the industries they serve. Most local, state, and federal governments provide demographic data easily accessible at their websites, such as www.census.gov in the United States, and Eurostat, the statistical office of the European Union, www.epp.eurostat.ec.europa.eu. Government sources and the business press are good places to look for economic trend data. Almost all sources of information are now readily available on the Web. Search engines such as Google are a powerful tool in the quest for information.

The key outputs of a competent macro trend analysis for any market should include both quantitative and qualitative data. Quantitative data should provide evidence of the market's size and growth rate, for the overall market as well as for key segments. Qualitative data should include factors that are likely to influence these figures in the future, whether favourably or unfavourably.

## 4.3.3 Anticipating and Responding to Environmental Change

Critical changes in macroenvironmental conditions often call for changes in the firm's strategy. Such changes can be proactive or reactive, or both. To the extent that a firm identifies and effectively deals with key trends before its competitors do, it is more likely to win and retain competitive advantage. In any case, management needs systems to help identify, evaluate, and respond to environmental events that may affect the firm's longer-term profitability and position. One such approach uses an opportunity/threat matrix to better assess the impact and the timing of an event, followed by the development of an appropriate response strategy. This approach is discussed below.

### 4.3.3.1 Impact and Timing of Event

In any given period, many environmental events that could have an impact on the firm – either positively or negatively – may be detected. Somehow, management must determine the probability of their occurrence and the degree of impact (profitability and/or market share) of each event. One relatively simple way to accomplish these tasks is to use a 2 × 2 dimensional **opportunity/threat matrix** such as that shown in Exhibit 4.6. This example contains four potential environmental events that the high-speed access division of a large UK telecommunications company might have identified as worthy of concern in the early 2000s. The probability of each occurring by the year 2010 was rated as was the impact on the company in terms of profitability or market share. The event likely both to occur by 2010 and to have the greatest impact appears in the upper left-hand box. At the very least, such an event should be examined closely, including estimating with as much precision as possible its impact on profitability and market share.

**Exhibit 4.6 Opportunity/threat matrix for a telecommunications company**

| | | *Probability of occurrence* | |
|---|---|---|---|
| | | High | Low |
| *Level of impact on company* | High | 4 | 1 |
| | Low | 2 | 3 |

1. Wireless communications technology will make networks based on fibre and copper wires redundant.
2. The prices of personal computers will be reduced by 25 per cent each year, in real terms.
3. The uptake of high speed internet access technology will be 25 per cent faster than expected.
4. Cable providers will also offer comparable and competing service offerings.

The opportunity/threat matrix enables the examination of a large number of events in such a way that management can focus on the most important ones. Thus, events such as number 4 in the exhibit, with a high probability of occurring and having a high impact should be closely monitored. Those with a low probability of occurrence and low impact, such as number 3 in the exhibit, should probably be dropped, at least for the moment. Events with a low probability/high impact (number 1) should be re-examined less frequently to determine whether the impact rating remains basically sound.

## Learning Summary

- Macro trends can and often will profoundly influence the success of any business. Serving attractive markets, where trends are favourable – swimming with the current – is likely to yield more success than serving those where trends are unfavourable – swimming against the current. Thus, context, the second of the 4 Cs, matters and is central to the assessment of any opportunity.

- Taken together, the six macro trend categories constitute a useful analytical framework to ensure that all bases are covered when scanning environmental conditions.
- Paying regular and systematic attention to the highest priority macro trend categories permits timely decision making, perhaps ahead of competitors.
- Gathering hard data on macro trends is not difficult. Trade associations and trade magazines provide a good place to start.

# Review Questions

## Content Questions

4.1 What are the major problems in terms of the planet's natural environment?

4.2 What are green products?

4.3 What kinds of risk derive from a change in a country's regulatory environment?

4.4 What are some of the more important opportunities resulting from technological innovation?

4.5 What are the major trends in the world's population?

4.6 Describe what an opportunity/threat matrix is and how it can be used to help management identify, evaluate and respond to environmental events.

## Multiple Choice Questions

4.7 The major components of the macroenvironment include:

A. sociological, political, economic, geographic and psychological.
B. technological, sociocultural, demographic, regulatory, natural and economic.
C. national, cultural, subcultural, international and domestic.
D. tertiary, secondary, primary and local.
E. global, regional, national, domestic, state and local.

4.8 Given today's 'green' trend, to profit from the threats to the physical environment, firms should:

A. continue to ignore all but the legally required actions.
B. support legislation to repeal oppressive pollution laws.
C. develop products or promotional campaigns that tout their good citizenship.
D. move their offensive operations to countries that have minimal pollution laws.
E. spend whatever it takes to be a model of non-polluter.

4.9 The sudden reversal of its policies by the Mexican government to encourage foreign investment in Mexico is an example of which of the components of the macroenvironment?

A. Technological environment.
B. Regulatory environment.
C. Natural environment.
D. Demographic environment.
E. Sociocultural environment.

4.10 Was the installation of catalytic converters by US car manufacturers to reduce the pollution of car emissions into the atmosphere a:

A. voluntary action caused by concern for the natural environment?
B. voluntary action caused by pressure from the sociocultural environment?
C. voluntary action caused by advances in the technological environment?
D. involuntary action caused by changes in the regulatory environment?
E. involuntary action caused by changes in the demographic/economic environment?

4.11 The trend that started in the 1970s, with a reduction in the administrative and legal barriers to competition, is called:

A. administered competition.
B. fragmentation.
C. nationalisation.
D. deregulation.
E. deindustralisation.

4.12 A significant result of technological advancement is:

A. the replacement or decline of certain industries.
B. a change in country population.
C. an increase in country GNP.
D. an increase in attention to the physical environment.
E. an increase in attention to the political/legal environment.

4.13 By the year 2040, it is expected that the population aged _____ will represent approximately half of the world's population.

A. 20–29.
B. 30–39.
C. 40–49.
D. 50–59.
E. 60+

4.14 The economic performance of a country is measured by the:

A. consumer price index.
B. national trade balance.
C. foreign trade balance.
D. net national product.
E. gross domestic product.

4.15 What kind of purchases do interest rates effect?

A. Alcohol.
B. Food.
C. House and car.
D. Gas.
E. Beauty supplies.

4.16 Economic trends influence the level of demand in most markets, but are particularly important in:

A. markets targeting baby boomers.
B. markets sensitive to interest rates.
C. import markets.
D. markets targeting generation X.
E. export markets.

4.17 The devaluation of the Japanese yen over the US dollar allows Japanese automakers to offer better deals in selling and leasing their cars. This an example of which of the components of the environment?

A. Interest rates.
B. Currency exchange rates.
C. Unemployment rates.
D. Technological change.
E. Discount rates.

4.18 The decrease in lag time between ideas, invention and commercialisation relates to the _____ environment.

A. economic.
B. technological.
C. political.
D. sociocultural.
E. physical.

4.19 In order for a pharmaceutical company to continue developing new drugs, which environment should they be most concerned with?

A. Demographic.
B. Sociocultural.
C. Economic.
D. Technological.
E. Physical.

4.20 Technological developments are having a profound impact on what marketing practice?

A. Marketing communications.
B. Distribution.
C. Packaging.
D. Marketing research.
E. All of the above.

4.21 All of the following are examples of green products, except:

A. phosphate-free detergent.
B. low-fat foods.
C. organic fertilisers.
D. high-efficiency light bulbs.
E. recycled paper.

4.22 For a real estate investor, the most important trend to monitor would be:

A. demographic.
B. sociocultural.
C. economic.
D. technological.
E. natural.

4.23 All of the following are examples of macroenvironmental trends, EXCEPT:

A. casual dress in the workplace.
B. the graying of America.
C. failing of dot-com companies.
D. global warming.
E. increase in Internet traffic.

4.24 All of the following are examples of sociocultural trends, EXCEPT:

A. the aging population.
B. the popularity of natural foods.
C. increase in exercise for both genders.
D. the lowering of fat and cholesterol.
E. casual dress in the workplace.

4.25 Which of the following might be the best place to find demographic information?

A. Trade associations.
B. Trade magazines.
C. The census.
D. Government sources.
E. The business press.

4.26 Which area of the opportunity/threat matrix should a company focus the majority its attention?

A. Bottom right.
B. Bottom left.
C. Top right.
D. Top left.
E. All of the above.

## Application Questions and Cases

4.27 Drinking water pollution (contamination) has become a serious problem in many countries. What opportunities does this present for a variety of industries, in terms of both products and equipment?

4.28 Over the last few decades, more and more countries have deregulated an increasing number of industries, including the airline industry. How did deregulation affect the structure of such an industry? How was the role of marketing affected in this industry? What elements of the marketing mix have become more or less important as a result of this deregulation?

4.29 Suppose you have been hired as a marketing consultant by Stouffer's Foods, the manufacturer of the Lean Cuisine line of low-calorie frozen entrées. How might the demographic trends and the changes in family structure discussed in this module affect each of the 4 Ps in Stouffer's strategic marketing programme? What adjustments should the company be prepared to make in its marketing programme?

4.30 The president of a large manufacturer of household appliances (such as dishwashing machines, refrigerators, washers and dryers that are manufactured and sold in the United States, Japan, Mexico and Europe) has asked you to develop a system for monitoring and evaluating the impact of major environmental trends on his company's strategies and programmes. Briefly describe your proposed system in terms of how you would organise your scanning activities, identify environmental issues and evaluate the impact of each.

4.31 Falling birth rates in many communities have caused declining revenues for the paediatric medicine departments of local hospitals. Because most hospitals must offer a full range of services, however, they cannot close their paediatrics departments. If you were a hospital administrator, what alternative strategies might you pursue concerning your paediatrics department?

4.32 A large international fast-food chain has been considering changing its plastic take-away food containers to one that is easier (environmentally) to dispose of. Its primary concern is its units in the developed countries. It hires you to provide advice on what kinds of information it should seek before making a decision to undertake such a change.

4.33 What new product opportunities does the changing family structure provide for consumer companies?

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# Module 5

# Industry Analysis and Competitive Advantage

## Contents



## The Cellular Telephone Business: Increasing Competition in a Growing Market[1]

From London to Tokyo to Nairobi to Chicago, cell phones have become a 'can't do without it' tool of time-pressed businesspeople, hip teenagers, and just about anyone else who wants to stay in touch. The market for mobile telephone service is growing rapidly. In 1983, when the first cellular phone system began operations, it was projected that by 2000, fewer than 1 million people would subscribe. As a result of dramatic growth among both business and household users, however, by 2005, the number of cell phone users had reached more than 2 billion worldwide. In Finland and Taiwan, the number of cell phone subscribers is higher than the total population of the country; and other countries are expected to join them soon.

The continuing growth in demand for mobile telephone services generates numerous opportunities in the cell phone manufacturing and cell phone service industries, among others. Prospective entrants and current players considering additional investments should consider, however, just how attractive these markets and industries really are.

### *The Mobile Telephony Market*

By all accounts, the *market* for mobile telephony has been an attractive one. In 2003, cell phone sales hit 500 million units worldwide, surpassing analysts' most optimistic projections. New features such as colour screens, built-in cameras, and Web browsers attracted new users and encouraged existing users to upgrade their phones. As a result, the penetration of the newest third-generation (3G) phones has risen sharply, especially in Asia. Users of 3G services represented 30 per cent of all mobile phone users in Japan and a whopping 93 per cent in Korea in 2005, compared to only 5 per cent in Italy and the United Kingdom.

In the developing markets, Asia and Africa in particular, rising per capita incomes are fuelling even faster growth in cell phone penetration. In India, now the world's fastest-growing cell phone market, penetration passed 200 million in 2007, with new subscribers coming on stream at 8 million per month in 2008. Even so, only 21 per cent of the Indian population has a handset, so there's still room for plenty of growth. Indeed, in the first quarter of 2008, the combined revenues of India's four largest mobile telecom players soared by 37.8 per cent over the previous year, fuelled by robust subscriber growth and higher average minutes of use (MOU) per customer. Arun Sarun, CEO of Vodafone, the world's largest mobile operator by revenue, says, 'Seventy-five per cent of all the incremental customers, revenues, and profits are coming from emerging markets – everybody is racing and rushing towards that.' With this kind of growth, most observers would agree that the *market* for mobile phone service and mobile phones themselves is attractive indeed. But how attractive are the *industries* that serve this market?

### *Mobile Phone Manufacturing*

Rapid-fire technological advances from Qualcomm, Ericsson, Nokia, and others have brought countless new features to the market, including software to access the World Wide Web, the ability to send and receive photographic images, and various location-based services that take advantage of global positioning technology. Today's phones enable mobile users to check the weather forecast, their email, stock quotes, and more. Finland's Nokia has rocketed to world leadership in mobile phones, leaving early and longtime leader Motorola in the dust. From year to year, market share figures for mobile phone manufacturers can double or be halved, though, depending on whose latest technology catches the fancy of users. To investors' joy or dismay, stock prices follow suit. Qualcomm's shares soared 2600 per cent in 1999, only to fall back by more than 60 per cent by mid-2000, and a further 50 per cent by mid-2002. Nokia, though its stock price, too, was buffeted in the industry turbulence, has often been able to fly largely above the clouds. Its global market share grew to 40 per cent in 2007, based on its continuing strength in established markets and its growing dominance of the market for low-priced handsets in the developing world. As industry analyst Neal Mawston noted, 'Nokia has a world-class product portfolio and very few rivals can compete with that. They are now enjoying huge economies of scale that success conveys. Anybody who tries to get in a handset war with them is going to get hurt.'

This recent history in the hotly competitive mobile phone manufacturing industry suggests that a rapidly growing market does not necessarily provide a smooth path to success. Growing markets are one thing, but turbulent industries serving those markets are quite another.

### *Mobile Phone Service Providers*

Industry conditions for service providers have run wild as well. The race to win global coverage has led to mergers of large players such as Europe's Vodafone with America's AirTouch in 1999. Vodafone did not stop there, however, going on to acquire Germany's Mannesmann in 2000. All over Europe, market-by-market battles for market share raged. Prices for mobile phone service slid, given the competitive pressures. To make matters worse, the cost of obtaining new government licences to support new 3G services skyrocketed. Britain's auction in early 2000 of 3G licences wound up raising some £20 billion in licence fees, roughly 10 times what was expected. Other European governments took notice and followed in the UK's path, and operators eventually shelled out more than €100 billion in licence fees.

Unfortunately for operators, however, 3G technology proved harder to implement and more difficult to sell than was expected. The result? Massive write-downs of 3G investments, a whopping €10 billion for European wireless operator mmO2 alone. Moreover, as a result of the fierce competitive pressure in Western telecom markets and declining opportunities for growth therein, valuations of Western operators slid in 2008 to enterprise values of about six times earnings before interest, tax, depreciation and amortisation (EBITDA) compared to valuations more than double that figure in some emerging markets.

Thus, while the rapidly growing market for mobile telephone service is clearly an attractive one, the industries that serve this market face significant challenges.

### Learning Objectives

In this module, an analytical frameworks is provided to enable prospective entrepreneurs and marketing strategists in established firms to address four critical questions pertinent to such an examination: How can we assess the attractiveness of an industry? If we aim to compete on the basis of innovation, how can we determine how quickly our innovation is likely to win market acceptance? What does the overall attractiveness of the market and industry context imply for chances for future success? Finally, how can we establish and then sustain competitive advantage over the duration of our product's life cycle? First, however, we clarify the difference between two oft-confused terms: **market** and **industry**.

## 5.1 Markets and Industries: What's the Difference?

In Module 1, we defined a market as being comprised of individuals and organisations who are interested and willing to buy a good or service to obtain benefits that will satisfy a particular need or want and who have the resources to engage in such a transaction. One such market consists of college students who get hungry in the middle of the afternoon and have a few minutes and enough spare change to buy a snack between classes.

An industry, on the other hand, is a group of firms that offer a product or class of products that are similar and are close substitutes for one another. What industries serve the student snack market? At the producer level, there are the salty snack industry (makers of potato and corn chips and similar products); the candy industry; the fresh produce industry (growers of apples, oranges, bananas, and other easy-to-eat fruits); and others too numerous to mention. Distribution channels for these products include the supermarket industry, the food service industry, the coin-operated vending industry, and so on. Clearly, these industries are different and offer varying bundles of benefits to hungry students.

The distinction between markets and industries is an important one. Markets are comprised of buyers. Industries are comprised of sellers. Sellers who look only to others in their own industry as competitors are likely to overlook other very real rivals and risk having their markets undercut by innovators from other industries. Should Kodak be more concerned with Fuji, Agfa, and other longtime players in the film and photoprocessing industries, or should it be worrying about Hewlett-Packard, Sony, and others whose digital technologies have made photography's century-old silver halide chemistry resemble the horse and carriage? Only time will tell.

### 5.1.1 Defining Markets and Industries

Assessing the attractiveness of markets and industries requires clarity about which consumers and which of their needs or which sellers of which products are to be included in the assessment. Confusion between market and industry can result since consumer needs are often thought of in product terms – 'I'm hungry. I need a candy bar.' – in the same way that industries are typically described by the products they sell. Thus, *markets* are often defined both in demographic and/or geographic terms (who and/or where the customers are) and in terms of a particular good or service demanded by the consumer, expressed at the generic category, product class, or product type level.

### 5.1.2 Challenges in Market and Industry Definition

Markets and industries can be defined at several **levels of analysis**: **generic category**, **product class** and **product type** are most common. The level chosen for a particular analysis can have important implications for strategic and marketing planning. Defining a market or industry at too broad a level can cause the analyst to overlook important market industry interactions in a particular market segment or for a particular product class or type. But defining the market or industry too narrowly can cause the analyst to miss potentially important competitive developments.

The problem with using the **generic category level** is that it typically includes an array of noncompeting products. For example, within the motor vehicle market, is a Toyota Corolla in competition with a BMW or a Mack truck? Within chemical markets, do polymers that substitute for natural materials compete with gasoline additives, dyestuffs, and industrial coatings? Probably not. For an entrepreneur seeking to market a new chemical compound that enhances the depth of colour when cotton yarns are dyed, understanding the state of the overall chemical industry is probably less important than understanding dyestuffs competitors.

Using **product class** as one's level of analysis suffers from this same type of problem since the products involved may serve diverse markets or market segments. The more generic the definition of a product class, the higher the aggregation level of products (for instance, all cars versus convertibles) and the more stable is market demand, as well as the product life cycle curve, a concept we explore later in this module. Thus, basic needs for automobiles (at least, in developed countries) typically change slowly, though demand patterns for convertibles or pickup trucks or compact cars may be more volatile. The more generically the product class is defined, the less useful it is for strategic planning, which seeks to identify opportunities and threats for specific product-market relationships.

**Product types** are subsets of a product class and contain items that are technically similar, although they may vary in such aspects as appearance and price. In the case of cereals, for example, the product types could be defined as hot or cold cereals. Hot cereals would include at least two subtypes: regular and instant. Cold cereals would include regular, presweetened, natural, and fortified. Regular could be broken down into such categories as corn flakes, raisin brans, and shredded wheat. Other examples of product hierarchies abound, especially when different processing technologies are involved – frozen, canned, fresh, dehydrated, and freeze-dried fruits and vegetables, for example.

Most marketers select product type as their level of analysis for marketing planning because, while products within a product type may serve different subsets of needs, they are typically close substitutes for one another. The product-type level of aggregation is considerably more sensitive than the other levels to environmental changes – such as those driven by macro trends, as discussed in Module 4 – that create opportunities or threats for individual product-market entries. The danger in restricting one's market and competitive analysis to a particular product type is that other product types, such as bagels or a trip through the drive-through at McDonald's in the breakfast market, may be overlooked. Focusing on the true **consumer need** (i.e., a fast breakfast, rather than cereal, a product) can help avoid this problem.

Doing so appears to be uncommon, however. A recent study found that managers tended to rely on supply-based attributes (i.e., what companies sell) in identifying competitors, rather than demand- or customer need-based attributes (i.e., what customers need).[2] Further, managers tend to identify too few firms as competitors and are especially likely to omit new firms or potential competitors. Stories of experienced managers who 'know their business' and are surprised by the sudden emergence of a new competitor that operates in a different way are legion.[3] For an example of how firms create new market space not bound by old industry definitions, *see* Exhibit 5.1.

**Exhibit 5.1** **Creating new market space**

Chan Kim and Renée Mauborgne argue that one way to avoid cutthroat, head-to-head competition, in rapidly growing markets as well as those that are flat or growing slowly, is to find new 'market space,' as they call it, that defies conventional boundaries of industry competition. By looking across substitute industries or to complementary product and service offerings that go beyond what an industry has traditionally offered, companies can rethink the functional and emotional orientation of their industry and help shape industry trends to their own advantage. Cisco Systems created new market space in this way when it recognised that the doubling of the number of Internet users every 100 days was creating demand for high-speed data exchange that was not being adequately served by existing industries. By 1999, more than 80 per cent of all traffic on the Internet flowed through Cisco's routers, switches, and other network devices, on which Cisco earned margins in the 60 per cent range. Creating new market space can be attractive, indeed!

*Source*: W. Chan Kim and Renée Mauborgne, 'Creating New Market Space,' *Harvard Business Review*, January–February 1999, pp. 83–93.

Notwithstanding its intuitive appeal, defining markets or industries based on consumer needs – instead of based on generic category, product class, or product type – brings its own difficulties. For example, should airlines view themselves as being in the business of facilitating human contact? If they did, they might be tempted to enter the video conferencing business (as American Airlines did with a brief and unsuccessful foray in the 1990s) or the telecommunications business, industries where they are probably poorly equipped to compete.

The best way to avoid ill-advised temptation or confusion over how broadly or narrowly to define one's market and industry is to carefully examine *both* one's market (using the frameworks in Module 4) *and* one's industry (as we'll address in this module). It's also important to take the time to think *both* broadly (motor vehicles, food processing) and narrowly (pickup trucks, fortified cold cereals) in defining and examining the attractiveness of one's industry and one's immediate competitive environment, as the remainder of this module will illustrate.

## 5.2 The Market Is Attractive: What About the Industry?

As consumers and businesspeople have become hooked on mobile phones, the market for mobile communication has grown rapidly. By most measures, this is a large, growing, and attractive *market*. But are mobile phone manufacturing and cellular services attractive *industries*? An industry's attractiveness at a point in time can best be judged by analysing its driving forces, its critical success factors and the degree to which a management team can perform on these factors, and especially the five major competitive forces: rivalry among present competitors, potential competitors, the bargaining power of suppliers, the bargaining power of buyers, and the threat of substitute products.

### 5.2.1 Driving Forces

Just as macroenvironmental trends are important in shaping market attractiveness, they are similarly important in shaping the attractiveness of industries. Michael Porter calls these trends driving forces.[4] These include (1) changes in the industry's long-term growth rate, which directly affect investment decisions and intensity of competition; (2) changes in key buyer segments, which affect demand and strategic marketing programmes; (3) diffusion of proprietary knowledge, which controls both the rate at which products become more alike and the entry of new firms; (4) changes in cost and efficiency, derived from scale and learning effects, which have the potential of making entry more difficult; and (5) changes in government regulations, which can affect entry, costs, bases of competition, and profitability.

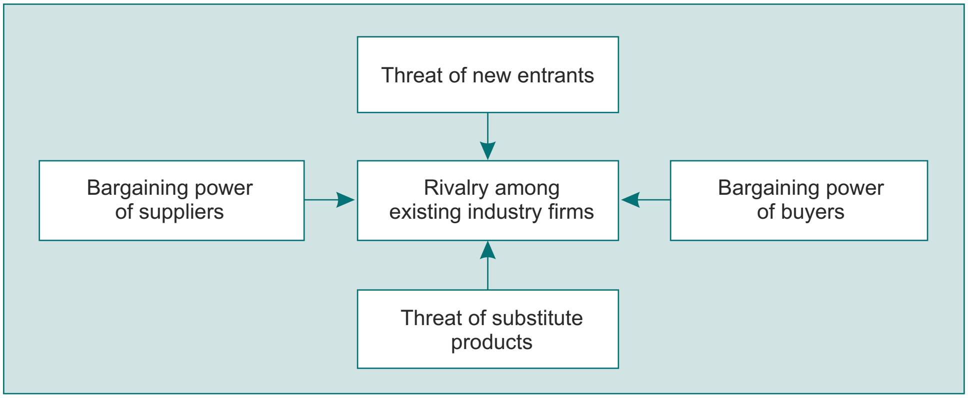
Collecting and examining trend data in each of these areas helps an entrepreneur or marketer determine whether an industry is sufficiently attractive to enter or remain in and helps shape strategic marketing decisions that enable the firm to compete effectively. The profusion of data now available on the Internet has made the gathering of these data much easier than was true several years ago.

### 5.2.2 Porter's Five Competitive Forces

Five interactive competitive forces collectively determine an industry's long-term attractiveness: present competitors, potential competitors, the bargaining power of suppliers, the bargaining power of buyers, and the threat of substitute products (*see* Exhibit 5.2).[5] This mix of forces explains why some industries are consistently more profitable than others and provides further insights into which resources are required and which strategies should be adopted to be successful. A useful way to conduct a five forces analysis of an industry's attractiveness is to construct a checklist based on Porter's seminal work.[6]

The strength of the individual forces varies from industry to industry and, over time, within the same industry. In the fast-food industry the key forces are present competitors (for example, Wendy's versus Burger King versus McDonald's), substitute products (neighbourhood delis, salad bars, all-you-can-eat buffet restaurants, and frozen meals), and buyers who are concerned about health and nutrition and who see fast foods as a symbol of a throw-away society. The growing popularity of healthier fast food alternatives has brought new entrants like Pret A Manger in the UK and Panera in the US.

**Exhibit 5.2 The major forces that determine industry attractiveness**




*Source*: Adapted from Michael E. Porter, 'How Competitive Forces Shape Strategy,' *Harvard Business Review*, March–April 1979, p. 6. © 1979 Harvard Business School Publishing Corporation, all rights reserved.

### 5.2.2.1 Rivalry among Present Competitors

Rivalry occurs among firms that produce products that are close substitutes for each other, especially when one competitor acts to improve its standing or protect its position. Thus, firms are mutually dependent: What one firm does affects others, and vice versa. Ordinarily, profitability decreases as rivalry increases. Rivalry is greater under the following conditions:

- *There is high investment intensity; that is, the amount of fixed and working capital required to produce a dollar of sales is large.* High intensity requires firms to operate at or near capacity as much as possible, thereby putting strong downward pressure on prices when demand slackens. Thus, high investment-intensity businesses are, on average, much less profitable than those with a lower level of investment. Bob Crandall, the former CEO of American Airlines, once described the airline business as being 'intensely, vigorously, bitterly, savagely competitive.'[7]
- *There are many small firms in an industry or no dominant firms exist.* The restaurant industry is a good example.
- *There is little product differentiation* – for example, major appliances, TV sets, and passenger-car tyres.
- *It's easy for customers to switch from one seller's products to those of others* (low switching cost for buyers).

The greater the competitive rivalry in an industry, the less attractive it is to current players or would-be entrants. The cellular service industry is capital intensive. And, though there are several dominant firms whose products are differentiated through rapid technological change, consumers' switching costs to change mobile phone service providers or handsets are low. Thus, rivalry among service providers, as well as for mobile phone manufacturers, is brutal (*see* Exhibit 5.3).

**Exhibit 5.3 Five forces analysis of the worldwide mobile phone service industry in 2010**

| Five Forces | Score | Rationale |
|---|---|---|
| Rivalry among present competitors | Rivalry is high leading to high customer churn: unfavourable | Products are differentiated through new features and services, customer switching costs are low. |
| Threat of new entrants | Threat of new entrants is low: moderately favourable | While rapid pace of techno-logical change may bring new entrants based on new technologies (e.g. packet switching, satellites), new service providers must purchase a bandwidth licence by spending billions. |
| Supplier power | Supplier power is high: moderately unfavourable | Governments in developed markets have raised the price of additional bandwidth through auctions. |
| Buyer power | Buyer power is low: very favourable | Even large customers have little power to set terms and conditions in this industry. |
| Threat of substitutes | Threat of substitutes is high: moderately unfavourable | PDAs and laptops using WiFi networks to access the Web could cannibalise expected sales of 3G wireless network mobile phones. |

Overall conclusion. Only two of the five forces are favourable, while three are unfavourable. Thus, the cellular phone service industry, at least in developed markets, is not very attractive at this time. In emerging markets, supplier power and threat of substitutes are more favourable, as governments are more welcoming of telecom development, and substitutes are not likely to enter any time soon. Thus industry attractiveness is brighter therein.

### 5.2.2.2 Threat of New Entrants

For cellular telephone operators, licence requirements and the huge cost of obtaining bandwidth in government auctions make threat of entry into the cellular service industry relatively low. The greater the threat of new entrants, the less will be an industry's attractiveness, so this is good news for cellular operators. Entry is more difficult under the following conditions:

- *When strong economies of scale and learning effects are present*, since it takes time to obtain the volume and learning required to yield a low relative cost per unit. If existing firms are already vertically integrated, entry becomes even more expensive. Also, if the existing firms share their output with their related businesses, the problem of overcoming the cost disadvantage is made even more difficult.
- *If the industry has strong capital requirements at the outset.*

- *When strong product differentiation exists.*
- *If gaining distribution is particularly difficult.*

A recent study suggests, however, that establishing entry barriers may be overrated as a mechanism for sustaining one's competitive advantage.[8] Entry barriers may well deter me-too entries, but they are less likely to deter more innovative entries. The results of this study suggest that a combination of effectively managing innovation cycles while building entry barriers through cost advantages or proprietary technologies can enhance incumbents' ability to sustain competitive advantage over time.

### 5.2.2.3 Bargaining Power of Suppliers

The bargaining power of suppliers over firms in an industry is the third major determinant of industry attractiveness. It is exercised largely through increased prices or more onerous terms and conditions of sale. Its impact can be significant, particularly when a limited number of suppliers service several different industries. Their power is increased under the following conditions:

- *If the cost of switching suppliers is high.*
- *If prices of substitutes are high.*
- *If suppliers can realistically threaten forward integration.*
- *When the supplier's product is a large part of the buyer's value added* – as is the case with metal cans, where the cost of tin plate is over 60 per cent of the value added.

In recent years, the bargaining power of suppliers in many industries has changed dramatically as more companies seek a partnership (just-in-time) relationship with their suppliers. What was once an arm's-length adversarial relationship has turned into a cooperative one resulting in lower transaction costs, improved quality derived primarily from using a supplier's technological skills to design and manufacture parts, and decreased transaction time in terms of inventory replenishments through just-in-time procurement systems.

The greater the bargaining power of the key suppliers to an industry, the less will be the overall attractiveness of the industry. The newly discovered power that governments worldwide have begun to exert by auctioning bandwidth for new cellular services has raised the bargaining power of the suppliers of bandwidth to the cellular industry. This change has reduced the attractiveness of this industry.

### 5.2.2.4 Bargaining Power of Buyers

An industry's customers constantly look for reduced prices, improved product quality, and added services and thus can affect competition within an industry. Buyers play individual suppliers against one another in their efforts to obtain these and other concessions. This is certainly the case with some large retailers, such as Walmart, Tesco, and Carrefour, in their dealings with many of their suppliers.

The extent to which buyers succeed in their bargaining efforts depends on:

- *the extent of buyer concentration*, as when a few large buyers that account for a large portion of industry sales can gain concessions (automakers' power over suppliers of tyres is a good example);

- *switching costs that reduce the buyer's bargaining power*;
- *the threat of backward integration*, thereby alleviating the need for the supplier;
- *the product's importance to the performance of the buyer's product* – the greater the importance, the lower their bargaining power; and
- *buyer profitability* – if buyers earn low profits and the product involved is an important part of their costs, then bargaining will be more aggressive.

The greater the power of the high-volume customers served by an industry, the less attractive will be that industry. One attractive dimension of the cellular phone service industry is that its customers have relatively little power to set terms and conditions for cellular phone service. Buyers are numerous and not very concentrated and their mobile phone costs are typically not of great importance or expense, relatively speaking.

#### 5.2.2.5 Threat of Substitute Products

Substitutes are alternative product types (not brands) that perform essentially the same functions, as plastic bottles versus aluminium cans, oleomargarine versus butter, and the faxing of documents versus overnight express delivery. Substitute products put a ceiling on the profitability of an industry by limiting the price that can be charged, especially when supply exceeds demand. Aluminium cans are a substitute for plastic bottles and conversely. The price of each constrains the price that can be charged for the other. For cellular phone service providers, possible substitutes include personal digital assistants (PDAs) such as the ubiquitous Blackberry, tablet devices like Apple's iPad, and possible new multimedia devices from the likes of Sony, Matsushita, and Samsung, or new mobile digital products not yet imagined.[9]

### 5.2.3 A Five Forces Analysis of the Cellular Phone Service Industry

A useful way to summarise a five forces industry analysis is to construct a chart like that shown in Exhibit 5.3. There, we summarise one analyst's judgement of the favourability of the five forces for the cellular phone service industry in the year 2010. This analysis indicates that, consistent with the preceding discussion, compared to earlier in the industry's history when there were fewer players (thus, less rivalry), no threatening substitutes on the horizon, and a cosier relationship with governments to provide bandwidth, the industry in 2010 was probably less attractive than some industries, for which four or five of the forces might be favourable.

Thus, strategists who must decide whether to enter or continue to invest in this industry must make a judgement as to whether the rapid growth of the *market – a favourable environmental context* – is sufficient to offset the deteriorating attractiveness of the *industry – the not-so-favourable competitive situation*. Given this mixed outlook, strategists would consider other factors, including the degree to which they believe they are likely to be able to establish and sustain competitive advantage. We further develop this theme later in this module.

### 5.2.4 Changing Competition and Industry Evolution

As we shall see later in this module, most products and product categories pass through a series of stages in their life cycles: introduction, growth, shakeout, maturity, and decline. All five competitive forces just discussed are affected by the passage of time; therefore, their strength varies as the industry passes from its introductory stage to its growth stage and on to maturity, followed by decline. Competitive forces are apt to be weakest during the fast-growth period; thus, there are substantial opportunities for gaining market share. During the shakeout period, competitive forces are at their strongest, and many competitors are forced to exit the industry. During maturity, competition typically slackens, but only if the industry leader holds a strong relative share position. An industry will experience more price competition during maturity if the leader holds a weak *relative* share position. Kellogg and General Mills have for many years held two-thirds of the US domestic cereal market, but because Kellogg does not hold a dominant relative share, the industry experiences considerable price competition. A declining industry usually witnesses considerable rivalry, the extent of which depends on the strength of the exit barriers and the rate of decline.

### 5.2.5 Critical Success Factors: Who Wins *Within* an Industry?

The **critical success factors** that differentiate between the success and failure of firms *within* an industry differ from industry to industry. These factors often are concerned with one or more of the elements in the marketing mix – product (e.g., the capability to generate successful new products), price (be a low-cost producer), place (obtain widespread product distribution), and promotion (strong relationships with large customers). As the old saying goes in the retailing industry, only three things are critical to success: location, location, and location. Thus, location, a potentially powerful source of competitive advantage, often makes the difference between which retailers are successful and which are not.

Assessing the fit between an industry's critical success factors and the presence of those factors in a firm or a proposed management team is a good way to assess whether an industry is attractive to that particular firm or management team and to determine whether that firm or team is likely to be attractive to investors or other suppliers of resources. Thus, before deciding whether or not to invest in a start-up, most venture capitalists want to know whether the start-up team has the necessary competencies to be successful in the industry it proposes to enter.

## 5.3 Industry Analysis Locally: How Intense Is the Immediate Competition?

As we have seen, assessing an industry's driving forces and Porter's five forces and understanding its critical success factors are important to industry analysis. These are macro-level issues, similar to the macro trends we examined in Module 4. To most firms, immediate product class and product type competitive conditions are equally if not more important. Such conditions are particularly salient for firms, such as retailers, that operate on a local basis.

If an entrepreneur wants to open a fly-fishing shop near a blue-ribbon trout stream in the Canadian Rockies, he or she will be pleased that fly-fishing is on the rise, that consumers have adequate income to pursue such a sport, and that leisure activities are becoming more important to many people. But it also matters if there are already a couple of fly-fishing shops serving the local market, and whether those shops serve their customers effectively. If so, the overall trends and industry conditions probably do not matter much, for the local fly-fishing pie can be sliced only so many ways! Thus, assessing an industry must typically be done locally, and at the product class and product type level, as well as more globally, and relevant information about specific competitors must be obtained.

In Module 8, we address the market knowledge systems that many firms use to gather competitive information, as well as other relevant market and industry data. As we shall see, gathering this information is important, and ethical issues having to do with how competitive information is obtained are likely to arise. For a discussion of ethical issues in gathering information to perform competitive analyses, see Ethical Perspective 5.1.

## Ethical Perspective 5.1

### SCIP: Setting Standards for Gathering Competitive Intelligence

SCIP, the Society of Competitive Intelligence Professionals (www.scip.org), is an organisation of consultants and businesspeople whose job it is to monitor the competitive environment for their firms. Competitive intelligence (CI) enables senior managers in companies of all sizes to make informed decisions about everything from marketing, R&D, and investing tactics to long-term business strategies. Effective CI is a continuous process
involving the legal and ethical collection of information, analysis that doesn't avoid un-welcome conclusions, and controlled dissemination of actionable intelligence to decision makers. SCIP's code of ethics provides a useful guide for anyone charged with gathering information about competitors.

### SCIP Code of Ethics for CI Professionals

- To continually strive to increase the recognition and respect of the profession.
- To comply with all applicable laws, domestic and international.
- To accurately disclose all relevant information, including one's identity and organisation, prior to all interviews.
- To fully respect all requests for confidentiality of information.
- To avoid conflicts of interest in fulfilling one's duties.
- To provide honest and realistic recommendations and conclusions in the execution of one's duties.
- To promote this code of ethics within one's company, with third-party contractors, and within the entire profession.

- To faithfully adhere to and abide by one's company policies, objectives, and guidelines.

*Source*:
www.scip.org. Reprinted by permission.

## 5.4 Rate of Diffusion of Innovations: Another Factor in Assessing Opportunity Attractiveness

Before entrepreneurs or established marketers invest in the development and introduction of an innovation, they should evaluate how rapidly the innovation is likely to be adopted by the target market. The faster the adoption rate, the more attractive an innovative good or service is to the marketer, as competitors are caught short while consumers build loyalty to the new product. **Diffusion of innovation** theory seeks to explain the adoption of a product or service over time among a group of potential buyers. Lack of awareness and limited distribution typically limit early adoption. As positive word about the product spreads, the product is adopted by additional consumers. Diffusion theory is useful to managers in predicting the likely adoption rate for new and innovative goods or services.

### 5.4.1 The Adoption Process

The **adoption process** involves the attitudinal changes experienced by individuals from the time they first hear about a new product, service, or idea until they adopt it. Not all individuals respond alike; some tend to adopt early, some late, and some never. The five stages in the adoption process are awareness, interest, evaluation, trial, and adoption:

1. *Awareness*. In this stage, the person is only aware of the existence of the new product and is insufficiently motivated to seek information about it.
2. *Interest*. Here the individual becomes sufficiently interested in the new product but is not yet involved.
3. *Evaluation*. This is sometimes referred to as the mental rehearsal stage. At this point, the individual is mentally applying the new product to his or her own use requirements and anticipating the results.
4. *Trial*. Here the individual actually uses the product, but, if possible, on a limited basis to minimise risk. Trial is not tantamount to adoption; only if the use experience is satisfactory will the product stand a chance of being adopted.
5. *Adoption*. In this stage, the individual not only continues to use the new product but also adopts it in lieu of substitutes.

### 5.4.2 The Rate of Adoption

If plotted on a cumulative basis, the percentage of people adopting a new product over time resembles an S curve. Although the curve tends to have the same shape regardless of the product involved, the length of time required differs among products – often substantially.

The time dimension is a function of the rate at which people in the target group (those ultimately adopting) move through the five stages in the adoption process. Generally, the speed of the adoption process depends heavily on the following factors:

- the risk (cost of product failure or dissatisfaction);
- the relative advantage over other products;
- the relative simplicity of the new product;
- its compatibility with previously adopted ideas;
- the extent to which its trial can be accomplished on a small-scale basis; and
- the ease with which the central idea of the new product can be communicated.[10]

Some new products move quickly through the adoption process (a new breakfast cereal), while others take years. Risk minimisation via guarantees and reliable and prompt service can be critical, as can be the ability to demonstrate the product's uniqueness in meeting the customer's needs. Source credibility is also important.

The rate at which a product passes through the adoption process is also a function of the actions taken by the product's supplier. Thus, the diffusion process is faster when there is strong competition among members of the supplier group, when they have favourable reputations, and when they allocate substantial sums to R&D (to improve performance) and marketing (to build awareness).[11] The cellular phone industry should score high on these adoption factors.

### 5.4.3 Adopter Categories

Early adopters differ from later adopters. Using time of adoption as a basis for classifying individuals, five major groups can be distinguished: innovators, early adopters, early majority, late majority, and laggards. (Note that these are different from the five stages of adoption for a given individual just discussed.) *See* Exhibit 5.4 for the approximate size and characteristics of each group.[12] Because each category comprises individuals who have similar characteristics and because individuals differ substantially across categories, these adopter groups can be considered market segments. Thus, one would use a different set of strategies to market a new product to the early adopter group than to market it to the late majority group. For a discussion of the challenges in transitioning marketing efforts from group to group, *see* Exhibit 5.5.

### Exhibit 5.4 Size and characteristics of individual adopter group

- **Innovators** represent the first 2.5 per cent of all individuals who ultimately adopt a new product. They are more venturesome than later adopters, more likely to be receptive to new ideas and tend to have high incomes, which reduces the risk of a loss arising from an early adoption.
- **Early adopters** represent the next 13 to 14 per cent who adopt. They are more a part of the local scene, are often opinion leaders, serve as vital links to members of the early majority group (because of their social proximity) and participate more in community organisations than do later adopters.
- The **early majority** includes 34 per cent of those who adopt. These individuals display less leadership than early adopters, tend to be active in community affairs (thereby gaining respect from their peers), do not like to take unnecessary risks and want to be sure that a new product will prove successful before they adopt it.
- The **late majority** represents another 34 per cent. Frequently, these individuals adopt a new product because they are forced to do so for either economic or social reasons. They participate in community activities less than the previous groups and only rarely assume a leadership role.
- **Laggards** comprise the last 16 per cent of adopters. Of all the adopters, they are the most 'local'. They participate less in community matters than members of the other groups and stubbornly resist change. In some cases, they adopt a product so late that it has already been replaced by another new product.

### Exhibit 5.5 Crossing the chasm: a difficult transition in the diffusion process

In his classic book on the marketing of high-technology products, Geoffrey Moore explores the challenges of crossing the 'chasm,' as he calls it, in the diffusion process between the early adopters and the early majority. For many high-tech products, innovators and early adopters have quite different needs from early majority customers. Innovators and early adopters are often willing to adopt a revolutionary new product that is not yet very user-friendly or whose product features have not yet been fully developed. Their own technical skill enables them to adapt such a product to their needs and resolve some of the uncertainties inherent in the product's perhaps still-unclear potential. Their self-perception as an innovator gives them comfort in trying new products before others do. Early majority buyers, on the other hand, typically require easier-to-use products, whose benefits are clearly defined, and for which there is proof that the product will perform. Taking a product from the first group of buyers to the second is a difficult challenge, one that is compounded by the fact that buyers in the innovator and early adopter groups are not likely to associate or talk with buyers in the early majority group.

*Source*: Geoffrey Moore, *Crossing the Chasm* (New York: Harper-Business, 1995)

The differences cited in Exhibit 5.4 and Exhibit 5.5 are important because they help in the development of strategic marketing programmes. In organisational markets, suppliers can identify innovative firms by reputation, profitability, size, and the suppliers' experiences in dealing with them. As evident from earlier discussion, information alone about the product or service is not usually a sufficient reason to adopt. Commercial sources of information (such as salespeople and mass media advertising) are important at the outset, but less-commercial and more-professional sources are sought to validate the proclaimed merits of the new product, especially during the evaluation stage. Advice from opinion leaders is more critical as a legitimising agent than as a source of information. A classic study of how doctors reacted to the introduction of a new 'miracle drug' found that only 10 per cent adopted on the basis of data provided by their initial source of information, indicating that data alone will not cause adoption.[13]

Thus, commercial sources are most important at the awareness stage in the adoption process, while personal influence is most important at the evaluation stage. In the interest stage, both are important. In the trial stage, marketers should attempt to make it relatively easy for a prospect to try a product under conditions that minimise risk. Therefore, strategic marketing programmes should accommodate the various stages in the adoption process as well as the different adoption audiences.

### 5.4.4 Implications of Diffusion of Innovation Theory for Forecasting Sales of New Products and New Firms

Optimistic entrepreneurs or new product managers sometimes wax euphoric about the prospects for the innovations they plan to bring to market. They naively forecast that their innovations will capture 10 per cent or 20 per cent of the market in its first year. How likely is it that a truly innovative new product, even a compellingly attractive one, will win all of the innovators plus most of the early adopters in its first year on the market? History suggests that such penetration levels are rare at the outset. More typically, first-year penetration levels include some but not all of the innovators, well under 2.5 per cent of those who, it is hoped, will ultimately adopt!

A good way to estimate how quickly an innovation is likely to move through the diffusion process is to construct a chart that rates the adoption on the six key factors influencing adoption speed, as shown in Exhibit 5.6. An innovation that is risky for the prospective user to try or buy, has little competitive advantage, is complex or incompatible with current user behaviour, and is difficult or expensive to try or to understand its benefits is likely to face tough criticism, regardless of the attractiveness of the industry. Personal robots, introduced in the early 1980s with great fanfare following the introduction of personal computers, were such an innovation. Thus, introducing a new product that delivers no real benefits or lacks competitive advantage into *any* industry, regardless of its high-tech profile, is likely to be an unpleasant experience.

## 5.5 Sustaining Competitive Advantage over the Product Life Cycle

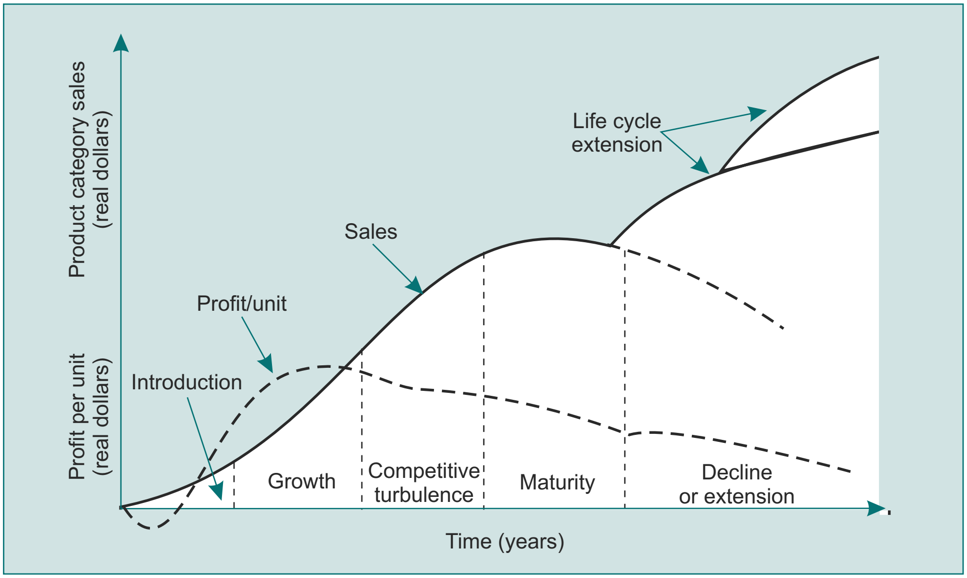
The product life cycle is concerned with the sales history of a product or product class. The concept holds that a product's sales change over time in a predictable way and that products go through a series of five distinct stages: introduction, growth, shakeout, maturity, and decline (*see* Exhibit 5.7). Each of these stages provides distinct opportunities and threats, thereby affecting the firm's strategy as well as its marketing programmes. Despite the fact that many new products do not follow such a prescribed route because of failure, the concept is extremely valuable in helping management look into the early future and better anticipate what changes will need to be made in strategic marketing programmes.

**Exhibit 5.6 Comparison of rate of adoption of cellular phones and personal computers for home use**

| Adoption factor | | Mobile phones | | Home computers |
|---|---|---|---|---|
| Risk | +/− | Moderate risk: Mobile phones were given away to attract early adopters who agreed to one year's usage. | – | An expensive investment wasted, if it turned out not to be useful. |
| Relative advantage | + | Enabled people to make and receive phone calls from anywhere – in the car or at the beach! | – | It was not clear, in the early days of personal computing, what the advantages of a PC were in the home. |
| Relative simplicity | + | Early mobile phones were easy to use. | – | Early PCs were inordinately complex to use. |
| Compatibility with current behaviour | + | Just like making or receiving a phone call at home or office. | – | Lots of learning required to use. |
| Ease of small-scale trial | + | Contracts required only modest minutes of use. | +/− | One could visit a store for hands-on trial, but couldn't understand the 'bits, bytes and RAM.' |
| Ease of communication of benefits | + | 'Make or receive calls anywhere' is easy to understand. | – | Benefits were not clear, thus not communicable. |

Key: + Favourable for rapid adoption − Unfavourable for rapid adoption

**Exhibit 5.7 The generalised product life cycle**



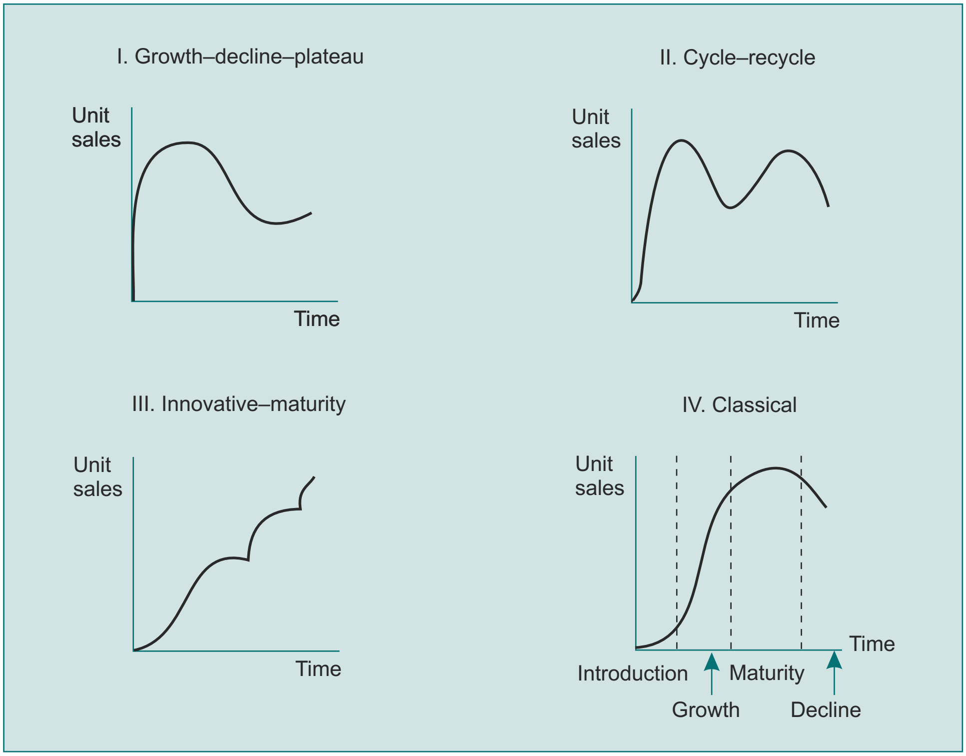

*Source*: Reprinted with permission from George Day, *Analysis for Strategic Market Decisions*, p. 60. Copyright © 1986. Reprinted with permission of South-Western College Publishing, a division of Thomson Learning. Fax 800-730-2215.

## 5.5.1 Life Cycle Curves

Many products do not go through the product life cycle curve shown in Exhibit 5.7 because a high percentage is aborted after an unsatisfactory introductory period. Other products seemingly never die (Scotch whisky, TVs, automobiles). The shape of the life cycle curve varies considerably between and within industries but is typically described as 'S'-shaped. One study identified 12 different types of curves.[14]

In general, however, only one or a very few curves typify an industry (*see* Exhibit 5.8 for the common types).

**Exhibit 5.8** **Common product life-cycle curves**




*Source*: Adapted from J. E. Swan and D. R. Rink, 'Effective Use of Industrial Product Life Cycle Trends', in *Marketing in the '80s* (New York: American Marketing Association, 1980), pp. 198–99. Reprinted by permission from the publisher, American Marketing Association.

## 5.5.2 Market and Competitive Implications of Product Life Cycle Stages

The various stages of the product life cycle present different opportunities and threats to the firm. By understanding the characteristics of the major stages, a firm can do a better job of setting forth its objectives and formulating its strategies as well as developing its action plans (*see* top half of Exhibit 5.9). Our discussion here is generalised; in later modules, we present a comprehensive examination of specific marketing-strategy programmes and do so for both leaders and followers.

**Exhibit 5.9 Expected characteristics and responses by major product life-cycle stages**

| | Stages in product life cycle | | | | |
|---|---|---|---|---|---|
| **Stage characteristics** | **Introduction** | **Growth** | **Shake-out** | **Mature** | **Decline** |
| Market growth rate (net of inflation) | Moderate | High | Levelling off | Insignificant | Negative |
| Technical change in product design | High | Moderate | Limited | Limited | Limited |
| Segments | Few | Few to many | Few to many | Few to many | Few |
| Competitors | Small | Large | Decreasing | Limited | Few |
| Profitability | Negative | Large | Low | Large for high-market-share holders | Low |
| **Firm's normative responses** | | | | | |
| Strategic marketing objectives | Stimulate primary demand | Build share | Build share | Hold share | Harvest |
| Product | Quality improvement | Continue quality improvement | Rationalise | Concentrate on features | No change |
| Product line | Narrow | Broad | Rationalise | Hold length of line | Reduce length of line |
| Price | Skimming versus penetration | Reduce | Reduce | Hold or reduce selectively | Reduce |
| Channels | Selective | Intensive | Intensive | Intensive | Selective |
| Communications | High | High | High | High to declining | Reduce |

### 5.5.2.1 Marketing Mix Decisions in the Introductory Stage

The length of the product line in the introductory stage typically should be relatively short to reduce production costs and hold down inventories. Efforts to establish competitive advantage are typically focused on differentiating the new product or product line from solutions customers previously employed to satisfy the targeted want or need. Many early PCs were purchased to perform spreadsheet analyses on the computer, instead of running the calculations by hand, with all the potential for error and difficulty in making changes that the previous manual procedures entailed.

Where service is important, the firm must be able to provide it promptly (as in postpurchase service and spare-parts availability).

Pricing in the introductory stage is strongly affected by a variety of factors: the product's value to the end user; how quickly it can be imitated by competitors; the presence of close substitutes; and the effect of price on volume (elasticity) and, in turn, on costs. Basic strategy choices involve skimming and penetration. **Skimming** is designed to obtain as much margin per unit as possible. This enables the company to recover its new product investments more quickly. Such a strategy is particularly appropriate in niche markets and where consumers are relatively insensitive to price, as was the case in the sale of cellular phones to business executives early in the product life cycle. **Penetration pricing** enables the firm to strive for quick market development and makes sense when there is a steep experience curve, which lowers costs; a large market; and strong potential competition.

**Distribution** decisions can vary widely, depending in part on whether the new product is intended for consumer or industrial markets, and whether with a mass market or niche focus. Achieving distribution is particularly important with consumer goods because of the large amounts sometimes spent on promotion to make consumers aware of the product, and to induce trial of the product. Distribution is easier to obtain if the company enjoys established channels for its other products and has a successful track record with new product introductions.

During the introductory period, **promotion** expenditures involving advertising and salesforce are typically a high percentage of sales, especially for a mass-market, small-value product. Some dot-coms spent themselves to failure for promotional purposes. For industrial goods, personal selling costs are apt to be much higher than advertising costs.

The communications task at the outset is to build awareness of the new product's uniqueness, which is typically an expensive undertaking. Further, the promotional expenditures (such as in-store displays, premiums, coupons, samples, and off-list pricing) required to obtain product availability and trial are substantial. For industrial products, the time required to develop awareness of the product's uniqueness is often extensive due to the number of people in the buying centre and the complexity of the buying systems.

### 5.5.2.2 Marketing Mix Decisions in the Growth Stage

In the growth stage of the PLC, the *product line* often expands to attract new market segments. It does so by offering an array of prices and different product features, as we have seen in the fast-growing market for mobile phones. The quest for competitive advantage now shifts to differentiation from other entrants in the product class.

*Prices* tend to decline during the growth period (the average cost of servicing cellular subscribers has been dropping by about 20 per cent annually), and price differences between brands decrease. The extent of the decline depends on cost–volume relationships, industry concentration, and the volatility of raw material costs. If growth is so strong it outpaces supply, there is little or no pressure on price; indeed, it may enable sellers to charge premium prices.

During this period sellers of both industrial and consumer goods strive to build a channel or a direct-sales system that provides maximum product availability and service at the lowest cost. If this can be accomplished, rivals are placed at a disadvantage, even to the extent of being excluded from some markets. This is particularly the case with some industrial goods for which the number of intermediaries in any one market is limited. A brand must attain some degree of distribution success in advance of the mature stage, because channel members then tend to disinvest in less-successful brands.

*Promotion costs* (advertising and personal selling) become more concerned with building demand for a company's brand (selective demand) than demand for the product class or type (primary demand). Firms strive to build favourable attitudes toward their brand on the basis of its unique features. Communications are also used to cultivate new segments. Even though promotion costs remain high, they typically decline as a percentage of sales.

#### 5.5.2.3 Marketing Mix Decisions in the Shakeout Stage

The advent of this period is signalled by a drop in the overall growth rate and is typically marked by substantial price cuts. As weaker competitors exit the market, the stronger firms gain shares. Thus, major changes in the industry's competitive structure occur. During shakeout the firm must *rationalise* its product line by eliminating weaker items, emphasise creative promotional pricing, and strengthen its channel relationships. At the turn of the millennium, the global personal computer industry became mired in a global price war in its efforts to adjust to a slowing market. The entire industry was experiencing higher inventories and simultaneously intensifying competitive environment. Dell was eating its competitors' lunch.[15] Several firms have dropped out of the retail computer market. To a considerable extent, what happens during a shakeout has been predetermined by how well each brand has been positioned in relation to its targeted segments, its distribution system, and its relative costs per unit.

#### 5.5.2.4 Marketing Mix Decisions in the Mature Stage

Because of technical maturity, the various brands in the marketplace become more similar as the PLC evolves; therefore, any significant breakthroughs by R&D or engineering that help to differentiate the product or redirect its cost can have a substantial payout. Not all innovations achieve their goals, however, as Exhibit 5.10 demonstrates. One option is to add value to the product that benefits the customer by improving the ease of use (voice-activated dialling with cellular phones), by incorporating labour-saving features, or by selling systems rather than single products (adding extended service contracts). Increasingly, in many product classes, *service* becomes a way of differentiating the offering.

*Promotion* expenditures and *prices* tend to remain stable during the mature stage. But the nature of the former is apt to change; media advertising for consumer goods declines and in-store promotions, including price deals, increase. The price premium attainable by the high-quality producer tends to erode. The effect of experience on costs and prices becomes smaller and smaller. Competition may force prices down, especially when the two leading competitors hold similar shares. For consumer goods, distribution and in-store displays (shelf facings) become increasingly important, as does effective cost management.

**Exhibit 5.10 What the bicycle industry needs is innovation**

In the early 1980s mountain bikes gave the bicycle industry a much-needed boost in sales. But the demand for such bikes peaked and most firms in the industry have experienced flat or declining sales. Clearly what the industry needs, and is attempting to do, is reinvent the bike. An attempt to do so via the use of a battery-powered motor to propel the bike failed, but one entrepreneur was working on a foldable bike that weighed less than 3.5 pounds.

*Source*: 'Reinventing the Bicycle,' *The Economist*, 18 November 1995, p. 76.

#### 5.5.2.5 Marketing Mix Decisions in the Decline Stage

Eventually most products enter the decline stage, which may be gradual (canned vegetables/hot cereals) or extremely fast (some prescription drugs). Products often enter this stage because of technologically superior substitutes (jet engines over piston engines) or a shift in consumer tastes, values and beliefs (cholesterol-free margarine over butter).

Marketing expenditures, especially those associated with promotion, usually decrease as a percentage of sales in the decline stage. *Prices* tend to remain stable if the rate of decline is slow, there are some enduring profitable segments and low exit barriers, customers are weak and fragmented, and there are few single-product competitors. Conversely, aggressive pricing is apt to occur when decline is fast and erratic, there are no strong unique segments, there are high exit barriers, a number of large single-product competitors are present, and customers have strong bargaining power. For consumer goods, marketing activity centres on distribution – persuading intermediaries to continue to stock the item even though they may not promote it. For industrial products the problem may centre around maintaining the interest of the salesforce in selling the item.

As the decline stage unfolds, some brands find it necessary to harvest any limited value that remains in the brand or even withdraw from the market (*see* Exhibit 5.11). **Harvesting** or withdrawal has as its objective an increase in cash flow that can be accomplished by milking (making only the essential investments), internal transfer of assets, and sales of the business or its assets. In any milking operation, management looks for ways to reduce assets, costs, and the number of items in the product line.

**Exhibit 5.11 GM sinks its big boats**

General Motors decided in 1995 to stop producing its Chevrolet Caprice Classic – a large, rear-wheel-drive car that had long been the favourite of police departments and taxis – and its gargantuan Cadillac Fleetwood, which was the model of choice for stretch limos and hearses. The factory where the cars were built was used to assemble a more trendy line of cars and pickup trucks. In dropping this duo, GM turned their markets over to Ford, which had been considering abandoning its big rear-wheel-drive Crown Victoria, but reconsidered its decision. Not everyone at GM agreed with the company's decision. Some wanted to continue these models 'as is,' while others argued for small-volume production, even if it required an outside contractor. These product-line challenges were forerunners of the much more serious plight GM suffered more than a decade later, when only a government bailout saved it from extinction.

*Source*: Gabriella Stern and Neal Timplin, 'GM Turns Away from Cop-Car, Limo Markets,' *Wall Street Journal*, May 16, 1995, p. B1. Copyright 1995 by Dow Jones & Co. Inc. Reproduced with permission of Dow Jones & Co. Inc. via Copyright Clearance Center.

### 5.5.3 Strategic Implications of the Product Life Cycle

The product life cycle model is a framework that signals the occurrence of opportunities and threats in the marketplace and the industry, thereby helping the business better anticipate change in the product's strategic market objective, its strategy, and its marketing programme. By considering the stage in which a product sits in the PLC, one can identify the most typical responses that marketing decision makers make to the changing circumstances faced by the product (*see* bottom half of Exhibit 5.9).

Note, however, that generalising from such typical responses to those necessary in a particular situation is fraught with risk. The product life cycle model's major weakness lies in its normative approach to prescribing strategies based on assumptions about the features or characteristics of each stage. It fails to take into account that the product life cycle is, in reality, driven by market forces expressing the evolution of consumer preferences (the market), technology (the product), and competition (the supply side).[16] Mary Lambkin and George Day argue strongly that greater emphasis on competitive issues helps to better understand the evolution of a product-market. This is especially the case in understanding the dynamics of competitive behaviour in evolving market structures.[17]

## Learning Summary

- Companies are more likely to be successful in generating sales and profits if the opportunities they pursue are blessed with the following conditions:
  - Driving forces for the industry are favourable.
  - The industry's five forces are, on balance, favourable.
  - The capabilities of the firm and/or the management team are sufficient to perform with respect to the industry's critical success factors.
  - Local competitive conditions are favourable.

In other words, choosing an attractive industry, as well as a growing market, is important!

- An innovation is more likely to be successful if it will diffuse at a rate rapid enough to quickly establish customer loyalty and advantage over competitors. This module provides a framework for assessing this likelihood.
- Regardless of the nature of the playing field, developing and regularly updating winning marketing strategies are important, too! In developing strategies to build and sustain competitive advantage, marketing decision-makers are more likely to win the competitive war by adjusting their strategies as the markets and industries in which they compete evolve through the stages of the product life cycle. Specific tools and frameworks for managing this task are provided in the balance of this book.

## Review Questions

### Content Questions

5.1 What are the major forces driving the competitive environment?

5.2 What are the various levels at which products can be defined?

5.3 Describe what is meant by the product life-cycle concept.

5.4 What are the characteristics and their implications of each of the product life-cycle stages?

5.5 What are the strategic implications of the product life cycle?

5.6 What are the major limitations of the product life-cycle concept?

5.7 Describe the adoption process.

5.8 What is the adoption rate a function of?

5.9 What are the various adopter categories?

5.10 What are the major forces which determine industry competition?

## Multiple Choice Questions

5.11 Which of the following driving forces affect demand and strategic marketing programmes?

A. Changes in the industry's long-term growth rate.
B. Changes in key buyer segments served by the industry.
C. Diffusion of proprietary knowledge.
D. Changes in cost and efficiency.
E. Changes in government regulations.

5.12 Which of the following is an example of a product definition at the *product-class* level?

A. Food.
B. Restaurant-prepared fast food.
C. Hamburgers from fast-food restaurants.
D. Wendy's fast-food restaurants.
E. The Wendy's single.

5.13 Which of the following is an example of a product definition at the *product-type* level?

A. Food.
B. Restaurant-prepared fast food.
C. Hamburgers from fast-food restaurants.
D. Wendy's fast-food restaurants.
E. The Wendy's single.

5.14 All of the following are driving forces with the potential to shape the attractiveness of industries EXCEPT:

A. changes in the industry's long-term growth rate.
B. changes in key buyer segments served by the industry.
C. diffusion of proprietary knowledge.
D. marketing mix elements.
E. changes in government regulations.

5.15 Which of the following conditions is the biggest threat in the cellular phone industry in terms of new entrants?

A. Strong economies of scale and learning effects are present.
B. The industry has strong capital requirements at the outset.
C. Strong product differentiation exists.
D. Gaining distribution is difficult.
E. Buyer incurs switching costs in moving from one supplier to another.

5.16 The x-axis of the Product Life Cycle represents:

A. adopter categories.
B. life-cycle stages.
C. discrete units of time.
D. cumulative profits.
E. cumulative time.

5.17 All of the following are stages of the normal product life-cycle curve EXCEPT:
A. growth.
B. maturity.
C. introduction.
D. decline.
E. monopoly.

5.18 What is the most common product life-cycle curve?
A. Growth-decline-plateau.
B. Cycle–recycle.
C. Innovative–maturity.
D. Classical.
E. Fad.

5.19 When nylon was first used in parachutes, then in nylons and then in car tyres, what characteristic of this surge in demand for this product did this pattern represent?
A. Plateau.
B. Maturity.
C. Recycling.
D. Classical development.
E. Cycle-half-cycle development.

5.20 At which stage of the normal product life cycle is purchase of the product limited because consumers in the target market are unaware of the product's existence or because of its lack of availability?
A. Growth.
B. Maturity.
C. Decline.
D. Introduction.
E. Shakeout.

5.21 In which stage of the product life cycle do prices tend to decline and price differences between leading brands decrease?
A. Introduction.
B. Growth.
C. Maturity.
D. Shakeout.
E. Decline.

5.22 A drop in the overall growth rate first occurs during the _____ period of the product life cycle.
A. decline.
B. shakeout.
C. introduction.
D. growth.
E. maturity.

5.23 The shakeout phase of the product life cycle is often marked by:

A. substantial price increases designed to skim margin from the market.
B. high levels of technical change in product design intended to appeal to volatile customer taste at this stage.
C. an increasing number of competitors throughout the period.
D. selective distribution in marketing channels.
E. substantial price cuts designed to move excess inventories at manufacturer and dealer levels.

5.24 During the maturity stage of the product life cycle, media advertising for consumer goods typically _____ and in-store promotions, such as price deals, typically _____.

A. increases; increase.
B. increases; decline.
C. declines; increase.
D. declines; decline.
E. increase; stay the same.

5.25 Prices tend to be set aggressively, even below cost, when the decline stage of the product life cycle:

A. is slow, there are no unique segments and exit barriers are high.
B. is fast, there are multiple unique segments and exit barriers are low.
C. is fast, there are no unique segments and exit barriers are high.
D. is slow, there are no unique segments and exit barriers are low.
E. is slow, there are multiple unique segments and exit barriers are high.

5.26 Harvesting can be accomplished through:

A. concentration on features, intensive distribution and desegmentation.
B. branding, concentration on features and extensive distribution.
C. milking, internal asset transfer or sale of the business.
D. leveraged buyout, recapitalisation and merger.
E. resegmentation, milking and concentration on features.

5.27 In the decline phase of the product life cycle, _____ has as its objective to increase cash flow by _____ the assets of the business.

A. harvesting; milking.
B. phase-out; increasing.
C. harvesting; increasing.
D. phase-out; stabilising.
E. runout; increasing.

5.28 Milking implies:

A. selectively squeezing products from some product markets while feeding others.
B. taking out of the business all but the most essential investments over time.
C. sale of the business.
D. moving the assets of the business to another area of the corporation.
E. rapid disintegration of the strategic business unit.

5.29 The objective of harvesting is to:

A. increase short-term cash flow.
B. generate a tax write-off.
C. increase the reputation of the brand among consumers.
D. diminish the reputation of the brand among consumers.
E. increase long-term cash flow.

5.30 During the awareness stage of the adoption process:

A. consumers use the product on a continued basis.
B. consumers actually use the product – preferably on a limited basis – to minimise risk.
C. consumers mentally rehearse the use of the product and the results obtained.
D. consumers are motivated to find out more about the product but remain uncommitted in assessing its value.
E. consumers are exposed to the new product but lack full information about it.

5.31 The stage of the product adoption process during which consumers mentally research the uses of the product and the results obtained is termed the:

A. adoption stage.
B. awareness stage.
C. trial stage.
D. evaluation stage.
E. interest stage.

5.32 During which stage of the adoption process does the consumer actually use the product for the first time?

A. Awareness.
B. Adoption.
C. Interest.
D. Trial.
E. Evaluation.

5.33 During which stage of the adoption process does the consumer continue to purchase the product instead of purchasing substitutes for the product?

A. Adoption.
B. Interest.
C. Evaluation.
D. Trial.
E. Awareness.

5.34 Early adopters tend to be _____ active in community activities and are _____ likely to act as opinion leaders than are later adopters.

A. less; more.
B. more; more.
C. more; less.
D. less; less.
E. more; equally.

5.35 In terms of the rate of diffusion of a product, the _____ complex and _____ expensive the product, the _____ the rate of diffusion.

A. more; more; slower.
B. more; more; faster.
C. less; more; slower.
D. less; less; slower.
E. more; less; slower.

5.36 Which of the following five forces best describes the relationship of personal digital assistants to cellular phones?

A. Threats of new entrants.
B. Threat of substitute products.
C. Bargaining power of supplier.
D. Bargaining power of buyers.
E. Rivalry among existing industry firms.

5.37 In the case of rivalry among firms, the similarity of passenger car tyres between different producers has resulted in:

A. high switching costs.
B. high investment intensity.
C. many small firms.
D. little product differentiation.
E. little need for working capital.

5.38 What type of industry-shaping force would Internet-based virtual universities be to a campus-based university?

A. Competition among existing rivals.
B. Threat of a new entrant.
C. Threat of a substitute.
D. All of the above are plausible.
E. Only A and B above are plausible.

5.39 When a major department store chain, such as Marks & Spencer, makes strong demands on its suppliers to reduce their costs so that Marks & Spencer can reduce its need for clearance sales, which force among competitors does this represent?

A. Threat of new entrants.
B. Bargaining strength of suppliers.
C. Threat of substitute products.
D. Bargaining strength of buyers.
E. Little rivalry.

## Application Questions and Cases

5.40 What are some examples of product types from the following product classes?

a. Ready-to-eat cereals.

b. Automobiles (not including pickup trucks).

c. Television sets.

d. Men's dress shirts.

5.41 What are the advantages in using the product life cycle? What are the concept's limitations?

5.42 A few years ago, pet rocks were a fad and basic Levi's or Wranglers blue jeans were a fashion among younger customers. Graph the life-cycle curves of the two products on the same chart. How do the two curves differ from one another? What are the major marketing implications for each product?

5.43 Growth in the UK cellular phone market seems to be slowing. If you were the marketing manager for a large UK cellular phone company, what would you do to stimulate sales of your brand and position your company for increased competition?

5.44 Although Levi's basic blue jeans experienced a period of increased popularity and sales growth a few years ago, the product's life-cycle curve had undergone several 'cycle-recycle' phases throughout its history. Which factors might account for this life-cycle pattern?

5.45 Suppose you are the product manager for a new aseptic packaging material, which preserves milk and other dairy products without refrigeration. The product is in the introductory stage of its life cycle. What are the implications of this position in the decisions you must make about each of the 4 Ps when designing a strategic marketing programme for this product? When (and if) this product reaches the growth stage, what changes will you have to make in your marketing plan, including its objectives?

5.46 Suppose you are the product manager responsible for General Electric's line of trash compactors. After more than 10 years, the product has yet to gain acceptance by many consumers. Use the diffusion of innovations theory discussed in the text to explain why trash compactors have achieved such poor market penetration. What does this imply concerning the shape of the rest of the trash compactor's life-cycle curve? What action might you consider taking to increase the market penetration for this product?

5.47 Taking into account the major forces driving industry competition, what do you think lies ahead for the worldwide automobile industry?

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# Module 6

# Understanding Consumer Buying Behaviour

## Contents



## Cruise Ships – Not Just for Grandma and Grandpa Anymore[1]

Not too long ago, a sea cruise was widely viewed as a rather dull and sedate vacation alternative, appealing mostly to well-to-do elderly people who enjoyed playing shuffleboard, sipping tea, and dressing for dinner. But that perception began to change in the 1980s. As a result, the global cruise industry experienced rapid growth in both revenues and profits during the 1990s and into the new century. Due to concerns about terrorism, rising energy costs, increased pollution of harbours, and the like, industry growth slowed a bit after 2002. Nevertheless, Carnival Corporation, the industry's market share leader and parent of several lines – including Carnival, Princess, Holland America, and Seabourn in North America, P&O Cruises, Cunard and Ocean Village in the United Kingdom, AIDA Cruises in Germany, and Costa Cruises in Asia and South America – served over 7.7 million passengers in 2007. The firm made $2.4 billion in net income on revenues of 13.03 billion. Nearly half the firm's revenues, and over one-third of its passengers, came from outside the United States.

### *Savvy Marketing Helped Fuel Industry Growth*

A number of factors helped change consumer perceptions and build demand for cruise vacations. Some were fortuitous events beyond the companies' control. For instance, Royal Caribbean experienced the largest volume of bookings in its history during the month following the release of *Titanic,* a somewhat surprising impact for a movie about a passenger ship that sank. More importantly, the major players in the industry strengthened all aspects of their marketing programmes to appeal to a wider variety of customer segments.

First, firms invested heavily in improving their physical facilities. Many new ships were built that were not only much bigger and steadier than their predecessors, but also incorporated amenities such as casinos, shopping arcades, theatres, health spas, Internet access in every stateroom, suites with private balconies, and even a skating rink and a water park. Shorter and cheaper cruises were added to attract more price-sensitive customers. Ships were located in more ports around the world – from Southampton in the United Kingdom to Hong Kong, Majorca, Australia, Dubai, and even Galveston, Texas – to draw passengers from a wider geographic area. And major sums were devoted to advertising and promotion programmes.

**Exhibit 6.1 Types of cruises, benefits offered and major competitors**

| Type of cruise | Rates | Amenities/benefits | Major competitors |
|---|---|---|---|
| Contemporary/ Resort class | \$150 to \$300 (per person per day) | Value-oriented cruises of 3–7 days; casual environment; newer or recently renovated ships; lots of open deck and pool space; organised activities, sports, etc.; 'Vegas'- or 'Broadway'-style productions, dancing, etc.; both sit-down and buffet-style meals. | Carnival, Royal Caribbean, Norwegian Cruise Line |
| Premium | \$250 to \$600 | Semiformal, premium-quality cruises of 7 days or longer; ships designed to offer more space per passenger; more attentive service; theme lounges, theatres, cigar bars, etc.; supervised activities, games, fitness facilities; premium food and beverage offerings. | Holland America, P&O Princess |
| Luxury | \$600 to \$1500 | Cruises emphasise greater choice of food, beverage, and entertainment options in a more formal atmosphere; more spacious and luxurious accommodations; more exotic itineraries. | Cunard Line; Crystal Cruises |
| Exclusive | \$1000 plus | Exclusive, yacht-like environment with only 100–200 passengers; high staff-to-customer ratio allows highly individualised service | Seabourn Cruise Line, Silversea Cruises, Swan Hellenic |

*Source:* 'Cruises by Cruise Line,' The Cruise Company, www.cruisecompany.net.

Perhaps the biggest factor underlying the industry's growth, however, was the ability of the major competitors to understand and cater to the differing needs, desires, and purchase criteria of different customer segments. Ship designs, onboard amenities and activities, food and beverage options, itineraries, and prices were all tailored to specific demographic, social, and lifestyle groups. For instance, P&O Princess launched 'Ocean Village' cruises in the Mediterranean. They are targeted at younger couples who enjoy sports and educational activities and offer passengers the chance to participate in such things as scuba diving, gourmet cooking, and wine tasting. Some lines offer 'romantic' cruises targeted at honeymooners; others appeal to the singles crowd; and many lines, including the ships launched by Disney, focus on families with young children by offering multiroom suites and lots of supervised activities for various age groups. Even within the traditional target audience for cruises – relatively upscale retirees in their 50s and 60s – lines offer cruises with unique benefits to appeal to subsegments with different interests and preferences. At one extreme, for instance, Hapag-Lloyd Cruises offers a 165-day excursion that leaves Dubai in November, visits islands in the Indian Ocean and South Pacific, South Africa, Patagonia, Australia and Asia, and returns to Dubai in April. Rates start at $86 570. Some categories of cruises, the benefits they promise, and major lines that offer them, are summarised in Exhibit 6.1.

### *Future Challenges*

In spite of its past success, however, the global cruise industry may face some icebergs on the horizon. Political unrest around the world disrupted industry revenues in 2002 and may do so again in the future, and rising energy costs are likely to squeeze industry profits. Indeed, Carnival Corporation forecast that higher fuel costs would increase its operating costs by $400 million in 2008. One of the industry's biggest potential challenges, though, is over-capacity. You might think that the extensive capital investment required to launch a new cruise ship would raise substantial barriers to entry and restrain industry competitiveness, but the substantial growth and profits cruise lines have enjoyed spurred them to build more and bigger ships at an increasing rate. Carnival alone is scheduled to bring 22 new ships into service by 2012, raising its total to 107.

The primary challenge, then, is for firms in the industry to increase the growth in passenger bookings to fill the growing capacity and recoup the huge investment in new ships. One way to do this is to develop long-term relationships with past customers in the hopes of generating more repeat business. Carnival, for instance, offers substantial discounts to past customers. Given that the vast majority of vacationers around the world have never gone on a cruise, however, the greatest potential for growth involves converting nonusers into new customers. As Micky Arison – Carnival's CEO – points out, 'In Germany they sell 80 million packaged holidays a year, but only 250 000 of them are cruises.' But attracting new customers will require an even better understanding of what those people want from a vacation and how they make their leisure purchase decisions.

### Learning Objectives

This module provides a framework to help organise an analysis of the mental processes individual consumers go through when making purchase decisions and the individual and environmental factors affecting those decisions.

Not all purchase decisions are equally important or psychologically involved. The decision to spend several thousand dollars on a cruise is a bigger deal for most people than the decision to add yogurt to their shopping cart. The first question explored in this module is whether consumers' mental processes are different when they purchase high-involvement goods or services than when they buy more mundane, low-involvement products. If so, what are the implications of those decision-making differences for the marketing manager or entrepreneur charged with developing the strategic marketing plan for a particular product or service?

Regardless of their involvement with a particular purchase decision, different people often choose different products or brands. This fact raises two important questions that we'll explore later. How do a person's psychological processes and traits – such as perception, memory, attitudes, and lifestyle – affect his or her buying behaviour? And what impact do social influences – like culture, social class, reference groups, and the family – have on purchase decisions?

## 6.1 The Psychological Importance of the Purchase Affects the Decision-Making Process

From an individual consumer's point of view, some purchase decisions are more important, and therefore more psychologically involving, than others. **High-involvement** purchases involve goods or services that are psychologically important to the buyer because they address social or ego needs and therefore carry social and psychological risks (e.g., the risk of looking foolish to one's family or friends). They may also involve a lot of money and therefore financial risk. Because a consumer's level of involvement with a particular purchase depends on the needs to be satisfied and the resources available, however, a high-involvement product for one buyer may be a low-involvement product for another.

The decision processes involved in purchasing high- and low-involvement products and services are quite different. As Exhibit 6.2 indicates, the decision process pursued by a given consumer can be classified into one of four categories depending on whether (1) the consumer has a high or low level of product involvement, and (2) he or she engages in an extensive search for information and evaluation of alternative brands or makes the decision routinely.[2]

**Exhibit 6.2 Types of consumer decision making**

| Extent of decision making | Extent of involvement: High | Extent of involvement: Low |
|---|---|---|
| Extended (information search; consideration of brand alternatives) | Complex decision making (cars, homes, vacations) | Limited decision making, including variety seeking and impulse purchasing (adult cereals and snack foods) |
| Habit/routine (little or no information search; focus on one brand) | Brand loyalty (athletics shoes, adult cereals, cologne, deodorant) | Inertia (frozen vegetables, paper towels) |

## 6.1.1 How Do Consumers Make High-Involvement Purchase Decisions?

When purchasing high-involvement products or services, consumers go through a problem-solving process involving five mental steps: (1) problem identification, (2) information search, (3) evaluation of alternatives, (4) purchase, and (5) postpurchase evaluation. These five steps are diagrammed in Exhibit 6.3 and discussed in the context of buying a Caribbean cruise by a hypothetical person – Paul MacDonald, who is 33 years old and single.

### 6.1.1.1 Problem Identification

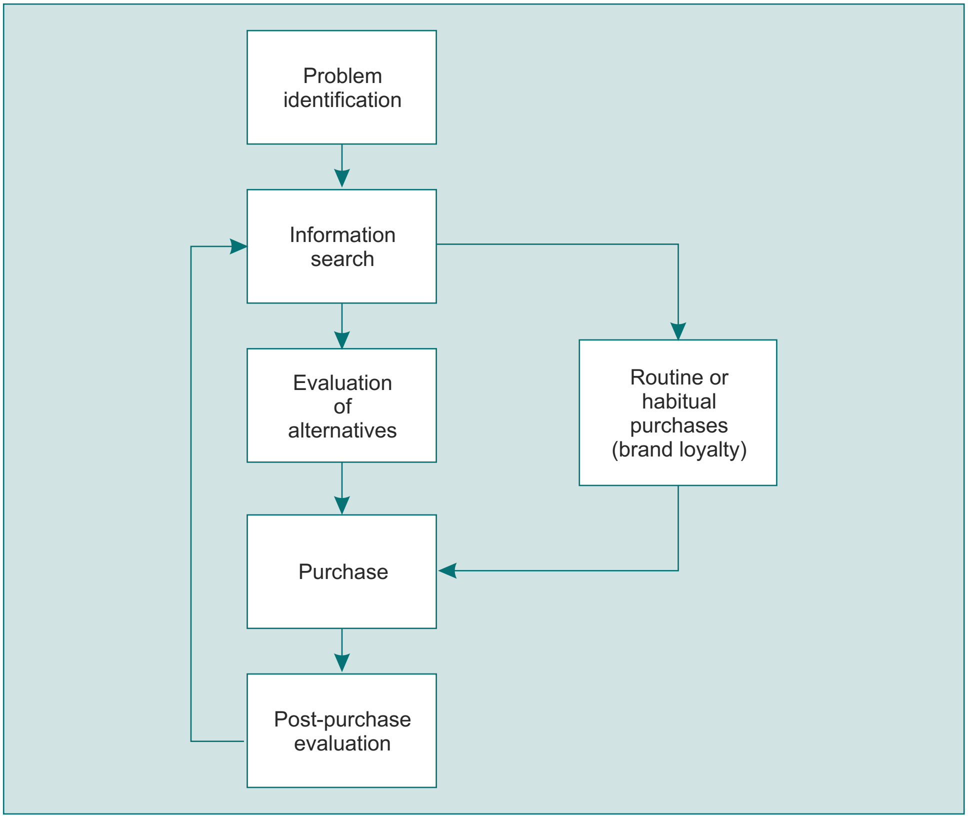
Consumers' purchase-decision processes are triggered by unsatisfied needs or wants. Individuals perceive differences between ideal and actual states on some physical or sociopsychological dimension. This motivates them to seek products or services to help bring their current state more into balance with the ideal.

Given that most of us have limited time and financial resources, it is impossible for us to satisfy all our needs at once. Instead, we tend to focus on those that are strongest. The size of the gap between our current and our desired state largely determines the strength of a particular need. A need can become stronger and be brought to our attention by a deterioration of our actual state or an upward revision of our ideal state.

A change in a consumer's actual state can occur for several reasons:

- For physical needs, a natural deterioration of the actual state occurs all the time. A person's body burns energy and nutrients. Thus, periodically we get hungry and tired and are motivated to find something to eat and go to sleep.
- A person's actual state may change as the result of the depletion of the current solution to a need. Our hypothetical consumer might be motivated to buy a cruise package because the condo in Florida he usually rents for his winter vacation is not available this year.

**Exhibit 6.3 Steps in the high-involvement, complex decision-making process**




- In some cases consumers can anticipate a decline in their actual state. If Paul MacDonald knew that the condo owner was trying to find someone to lease the condo for the entire season, he might decide to investigate alternatives for his winter vacation.

Similarly, a change in a consumer's desired state may occur for several reasons:

- The desired state may be revised upward because of new information or the development of an old need. Thus, MacDonald may have seen an ad showing how much fun a person can have on a cruise for a small amount of money or received such information from a friend.
- As one need is satisfied, the desired state on other need dimensions increases and becomes more demanding.

### 6.1.1.2 Information Search

Having recognised that a problem exists and might be satisfied by the purchase and consumption of a product or service, the consumer's next step is to refer to information gained from past experience and stored in memory for possible later use. To continue with our example, MacDonald's knowledge about cruises derives primarily from advertising, his mother and father who recently took a cruise, and friends – most of whom are married. Since he has no firsthand knowledge of cruises, he will need to seek additional information, especially regarding accommodations, schedules, and fares. For a listing of the factors that are likely to increase the information search, *see* Exhibit 6.4.

**Exhibit 6.4 Factors that are likely to increase prepurchase search**

**Product factors**

Long interpurchase time (a long-lasting or infrequently used product); frequent changes in product styling; frequent price changes; volume purchasing (large number of units); high price; many alternative brands; much variation in features.

**Situational factors**

*Experience*

First-time purchase; no past experience because the product is new; unsatisfactory past experience within the product category.

*Social acceptability*

The purchase is for a gift; the product is socially visible.

*Value-related considerations*

Purchase is discretionary rather than necessary; all alternatives have both desirable and undesirable consequences; family members disagree on product requirements or evaluation of alternatives; product usage deviates from important reference group; the purchase involves ecological considerations; many sources of conflicting information.

**Personal factors**

*Demographic characteristics of consumer*

Well-educated; high income; white collar occupation; under 35 years of age.

*Personality*

Low dogmatic (open-minded); low-risk perceiver (broad categoriser); other personal factors, such as high product involvement and enjoyment of shopping and search.

Because services are intangible, difficult to standardise, and their production and consumption inseparable, they are more difficult to evaluate than products. Thus, most services are hard to assess until they are being consumed after purchase (cruises and restaurant meals). Some services are difficult to assess even after they have been consumed (legal services, medical diagnosis, etc.). These assessment difficulties can force consumers to rely on different cues, such as the provider's credentials or reputation, when evaluating services.[3]

### How Much Information Will a Consumer Seek?

People seek additional information about alternative brands until they perceive that the *costs* of obtaining more information are equal to the additional *value* or *benefit* derived from the information. Information is valuable to consumers to the extent that it helps make a more satisfying purchase and avoids the negative consequences associated with a poor choice. Thus, consumers are likely to place a higher value on – and seek more – information when the purchase is important. This importance derives from *(a)* the strength of a person's need for the product; *(b)* the person's ego-involvement with the product; and *(c)* the severity of the social and financial consequences of making a poor choice. This is why people tend to seek more information about high-priced, socially visible products that reflect their self-image (cars, home, clothing, and, for some, cruises) than for lower-priced products that other people seldom notice, such as furnace filters or paper towels.

Even when products are very expensive and ego-involving, some consumers are unlikely to conduct an exhaustive search for information before making a decision because of the costs involved. Perhaps the biggest cost for most people is the **opportunity cost** of the time involved in seeking information. They give up the opportunity to use that time for other, more important or interesting activities, such as working or taking trips. For some people, however, the opportunity costs of shopping are low because they enjoy wandering through stores or scanning newspaper ads or websites for bargains. Also, as we'll see later, the Internet is reducing the opportunity costs of obtaining at least some kinds of product information.

There are also **psychological costs** involved in searching for information. Collecting information can be a frustrating task, often involving crowded stores, rude salespeople, or slow websites. Also, some consumers become frustrated and confused when they have a lot of complex information to evaluate before making a choice. Consequently they cut their information search short.

Because services, more than products, are associated with greater perceived risk, the individual involved is likely to use more information sources in the attempt to better cope with the risk. This often leads to an extended information-acquisition process, which may include purchase postponement. It also means that consumers are less likely to make a trial purchase than with some products.[4]

### Sources of Information

Assume that switching from renting a condo to a cruise is important and costly enough for Paul MacDonald to seek additional information before doing so. Which sources can he use? The three broad categories of information sources are personal, commercial, and public. **Personal sources** include family members, friends, and members of the consumer's reference group.

**Commercial sources** refer to various information disseminated by service providers, marketers, and manufacturers and their dealers. They include media advertising, promotional brochures, package and label information, salespersons, and various in-store information, such as price markings and displays. **Public sources** include noncommercial and professional organisations and individuals who provide advice for consumers, such as doctors, lawyers, governmental agencies, consumer-interest groups, and Web journals (blogs).

Consumers are usually exposed to more information from commercial sources than from personal or public sources. However, many consumers are influenced more by personal sources when deciding which service, product, or brand to buy. Consumers use information from different sources for different purposes and at different stages within the decision process. In general, commercial sources perform an **informing function** for consumers. Personal and public sources serve an **evaluating and legitimising function**. Thus, MacDonald might rely on advertising and discussions with his travel agent to learn what cruises are available, what the schedules are for each, the kind and size of ship used, how much each cruise costs, and the details concerning the various types of entertainment offered. It is highly likely that MacDonald would also seek the opinions of friends in deciding whether to take a cruise and in selecting a particular one. In doing so, he is consistent with the general proposition that consumers choose more personal sources for services than for goods because service consumption is highly personal and must be experienced to be understood.[5]

## How Is the Web Affecting Consumers' Search for Information?

The Internet is reducing the opportunity costs of information gathering, thus making it easier for people to make informed decisions. Many manufacturers and service providers have established their own sites. Some of these sites not only provide information about product options and characteristics, but also offer tutorials about how to use the product, help lines, and other information geared to helping customers obtain full value from their purchases. For instance, the outdoor gear retailer REI provides 45 000 pages of product use information and tips, such as a clinic on backpacking, on its site, www.rei.com.

More important, many new sites have taken over much of the search for information about alternative offerings in a product category in exchange for a small fee from the consumer or advertising from manufacturers or dealers in the category. For example, www.cruisecompany.net provides detailed information on cruises organised by type of cruise, itinerary, or cruise line, in exchange for a commission on any cruise a consumer books through the site.

While such sites facilitate the consumer's search for information about high-involvement products and services, they do not solve all the consumer's problems. Most of the information provided by such sites is obtained from commercial and public, rather than personal, sources. Therefore, some consumers may not consider it very useful for evaluating alternative choices, particularly when it comes to choosing intangible services. Also, sensory information such as touch and smell, which can be important for evaluating foods, fashion items, and similar products, cannot be displayed on the Web. These shortcomings help explain why some sites, such as iTunes and www.amazon.com, publish product reviews and evaluations submitted by individual customers.

A more recent development has blurred the distinction between public and personal information sources. Blogs provide a way for individuals to share their own experiences and opinions with a large public audience, and for potential customers to obtain personal insights from a vast number of product users.

The potential impact of blogs on buyer behaviour is illustrated by the experience of the Kryptonite division of Ingersoll-Rand. On 12 September 2004, someone with the moniker 'unaesthetic' posted in a group discussion site for bicycle enthusiasts the observation that the ubiquitous U-shaped Kryptonite bike lock could be easily picked with a ballpoint pen. Within days, a number of blogs posted a video demonstrating the problem. Kryptonite responded with a bland statement arguing that the locks remained a 'deterrent to theft,' but more and more bloggers began writing about the issue and their experiences. By 19 September, according to one Internet measurement firm, about 1.8 million people saw postings about the lock's shortcomings in a single day. Finally, on 22 September, Kryptonite was forced to announce it would exchange a new, redesigned product for any affected lock for free, a move that was estimated to cost the firm 100 000 new locks and more than $10 million (about 40 per cent of the division's annual revenue).[6]

The impact of blogs on buyer behaviour and firms' marketing programmes is growing rapidly since an estimated 23 000 new Web logs are started around the world every day. And other disgruntled consumers are posting videos to YouTube and similar sites illustrating their problems and frustrations with products or service providers. For instance, more than 340 000 people have watched Michael Whitford smash his nonfunctioning Apple Mac-book with a sledgehammer. It is important to note, though, that even very dissatisfied customers can be salvaged if the company takes quick and positive action. After Apple replaced his laptop, for example, Mr Whitford wrote on his blog 'I'm very happy now. Apple has regained my loyalty.'

Consequently, one authority advises that 'there should be somebody at every company whose job is to put into Google and blog search engines the name of the company [or one of its brands], followed by the word "sucks," just to see what customers are saying.' Of course, firms might also try to take advantage of the growing influence of blogs by creating one of their own, but this can raise some ethical issues.

#### 6.1.1.3 Evaluation of Alternatives

Consumers find it difficult to make overall comparisons of many alternative brands because each brand might be better in some ways but worse in others. Instead, consumers simplify their evaluation in several ways. First, they seldom consider all possible brands; rather, they focus on their **evoked set** – a limited number they are familiar with that are likely to satisfy their needs.

Second, consumers evaluate each of the brands in the evoked set on a limited number of **product dimensions or attributes**. They also judge the *relative importance* of these attributes, or the minimum acceptable performance of each. The set of attributes used by a particular consumer and the relative importance of each represent the consumer's **choice criteria**. In the case of our cruise example, the dates of the cruise, the ports of call, the entertainment offered, and the costs are examples of MacDonald's choice criteria for selecting a specific cruise.

Third, consumers combine evaluations of each brand across attributes, taking into account the relative importance of those attributes. This multi-attribute assessment of a brand results in an overall **attitude** toward that brand. The brand toward which consumers have the most favourable attitude is the one they are most likely to buy.

## Product Attributes and Their Relative Importance

Consumers use many dimensions or attributes when evaluating alternative products and services. Thus, in addition to the above service attributes, MacDonald might also use the newness and size of ship, types of food served, availability of an exercise room, and kinds of gambling as additional ways of comparing his options. Usually, however, consumers base their evaluations on half a dozen dimensions or less. Exhibit 6.5 contains a general list of product attributes consumers might use to evaluate alternatives.

**Exhibit 6.5** **Selected attributes consumers use to evaluate alternative products or services**

| Category | Specific attributes |
|---|---|
| Cost attributes | Purchase price, operating costs, repair costs, cost of extras or options, cost of installation, trade-in allowance, likely resale value. |
| Performance attributes | Durability, quality of materials, construction, dependability, functional performance (acceleration, nutrition, taste), efficiency, safety, styling. |
| Social attributes | Reputation of brand, status image, popularity with friends, popularity with family members, style, fashion. |
| Availability attributes | Carried by local stores, credit terms, quality of service available from local dealer, delivery time. |

Different consumers may use different sets of attributes to evaluate brands within the same product category. But even when two people use the same set of attributes, they may arrive at different decisions because they attach varying degrees of importance to the attributes. Paul MacDonald is primarily interested in entertainment, demographics of those taking the cruise, and cost, whereas another traveller might attach greater importance to gambling, ports of call, and food.

A consumer's personal characteristics and social influences – needs, values, personality, social class, and reference groups, among other things – help determine which attributes are considered and their relative importance. Environmental factors and the usage situation can also affect the perceived importance of various product benefits. For instance, some people buy more prestigious and expensive brands of beer or wine for their party guests than for their own everyday consumption.

### Forming Attitudes toward Alternative Brands

Even if two consumers use the same attributes and attach the same relative importance to them when evaluating product offerings, they may not necessarily prefer the same brand. They might rate the various brands differently on specific attributes. Differences in brand perceptions are based on past experience, the information collected, and how that information is perceived and processed. And as we shall see later, technology is making it increasingly possible for consumers to interact with manufacturers and suppliers during the production process so that product and service offerings can be customised to meet a customer's preferences on important attributes.[7] Consequently, brand attitudes may also depend on which manufacturer can be most flexible in customising its product.

## 6.1.1.4 Purchase

Even after a consumer has collected information about alternative brands, evaluated them, and decided which is the most desirable, the decision process still is not complete. The consumer must now decide where to buy the product. Choosing a source from which to buy the product involves essentially the same mental processes as does a product-purchase decision. The source is usually a retail store but may also be a mail-order catalogue or a website like RedEnvelope.com. Consumers obtain information about alternative sources from personal experience, advertising, comments of friends, and the like. Then they use this information to evaluate sources on such attributes as lines of merchandise carried, services rendered, price, convenience, personnel, and physical characteristics. Consumers usually select the source they perceive to be best on those attributes most important to them. If their experiences with a source are positive over time they may develop patronage loyalty and routinely shop that source – similar to the way consumers develop brand loyalties.

Consumers shopping in a retail store intent on purchasing one brand sometimes end up buying something different. MacDonald, for example, could be switched from one cruise to another by the travel agent. This happens because the consumer's ultimate purchase can be influenced by such factors as out-of-stocks (no outside cabins on a particular cruise), a special display, or a message from a salesperson ('I can get you a better deal on a similar cruise if you can go two weeks later').

## 6.1.1.5 Postpurchase Evaluation

Whether a particular consumer feels adequately rewarded following a purchase depends on two things: (1) the person's **aspiration or expectation level** – how well the product was expected to perform (delivery of a quality pizza while it is hot) – and (2) the consumer's evaluation of how well the product actually did perform (the pizza arrived cold).

Consumers' expectations about a product's performance are influenced by several factors. These include the strength and importance of each person's need and the information collected during the decision-making process. In the case of MacDonald, a persuasive ad or an enthusiastic endorsement of a given cruise by a friend who is a frequent cruise-goer may have caused him to expect more from his cruise than he would have otherwise. He may, however, attribute part of any dissatisfaction to his own actions – an unwillingness to participate in some of the entertainment. The fact that consumers are part of the service production process makes self-blame a real possibility.[8] Nevertheless, even with services there is a danger for marketers in using exaggerated claims in product advertising. Such claims can produce inflated expectations the product cannot live up to – resulting in dissatisfied customers.

It is important to note that, as the diagram in Exhibit 6.3 indicates, the consumer's evaluation of a purchase feeds back into memory where the information can be recalled for a similar purchase decision. Stored information about one or more negative past experiences with a brand or supplier will reduce the odds that the consumer will make the same purchase again. Consistent positive experiences can ultimately lead to **brand loyalty** – the routine repurchase of the same brand with little consideration of any alternatives.

Some experts argue that consumers more often develop loyalty to service providers than to physical products because of the difficulty of evaluating alternatives before actually experiencing the service. Also, repeated patronage can bring additional benefits, such as discounts, or more customised service as the provider gains more insights into the customer's preferences.[9] This helps explain why about 25 per cent of all cruise passengers are repeat customers.

### 6.1.2 Low-Involvement Purchase Decisions

Because low-involvement products are not very important to consumers, the search for information to evaluate alternative brands is likely to be minimal. As a result, decisions to buy products such as cookies or cereals often are made within the store, either *impulsively* on the basis of brand familiarity, or as a result of comparisons of the brands on the shelf. The consumers' involvement and their risks associated with making poor decisions are low for such products. Therefore, consumers are less likely to stay with the same brand over time. They have little to lose by switching brands in a search for variety. Even so, many consumers develop loyalty to a given brand, as in the continued popularity of such low-involvement products as Wrigley Doublemint chewing gum and Pillsbury baking flour, which have been around for years.

Most purchase decisions are low in consumer involvement – the consumer thinks the product or service is insufficiently important to identify with it. Thus, the consumer does not engage in an extensive search for information for such a purchase. Information involving such products is received passively as in, for example, seeing an ad for Green Giant frozen vegetables, which is neither interpreted nor evaluated, but simply noticed and filed away in memory.

Later, the consumer identifies a need to buy some frozen vegetables. On the next trip to the supermarket, the consumer sees the Green Giant brand in the frozen-foods section and buys several packages. The familiarity generated by exposure to earlier advertising (and/or word-of-mouth information) was sufficient to stimulate the purchase of Green Giant though the consumer does not have a strong, positive brand association.

After buying and using the product, the consumer may decide Green Giant vegetables are either good or bad. This attitude will be likely to affect future purchases of frozen vegetables. However, such brand evaluations occur only *after* an initial purchase has been made. This is the opposite of complex decision making.

#### 6.1.2.1 Inertia

As Exhibit 6.2 indicated, there are two low-involvement buying decisions. When there are few differences between brands and little risk associated with making a poor choice, consumers either buy brands at random or buy the same brand repetitively to avoid making a choice. Marketers must be careful not to confuse such repeat *inertial* purchasing with brand loyalty because it is relatively easy for competitors to entice such customers to switch brands by offering money-off coupons, special promotions, or in-store displays. Highly brand-loyal customers, on the other hand, resist such efforts on account of their strong brand preference.

#### 6.1.2.2 Impulse Purchasing and Variety Seeking

The second low-involvement purchase process is **impulse buying**, when consumers impulsively decide to buy a different brand from their customary choice or some new variety of a product. The new brand is probably one they are familiar with through passive exposure to advertising or other information, however. Their motivation for switching usually is not dissatisfaction but a desire for change and variety.

### 6.1.3 Understanding the Target Consumer's Level of Involvement Enables Better Marketing Decisions

The preceding discussion clearly indicates that consumers employ different decision-making processes and may be influenced by different psychological, social, and situational factors, depending on their level of involvement with the product or service they are buying. These differences between high- and low-involvement consumer behaviour are summarised in Exhibit 6.6.

**Exhibit 6.6 High-involvement versus low-involvement consumer behaviour**

| High-involvement consumer behaviour | Low-involvement consumer behaviour |
|---|---|
| • Consumers are information processors. | • Consumers learn information at random. |
| • Consumers are information seekers. | • Consumers are information gatherers. |
| • Consumers represent an active audience for advertising. | • Consumers represent a passive audience for advertising. |
| • Consumers evaluate brands before buying. | • Consumers buy first. If they do evaluate brands, it is done after the purchase. |
| • Consumers seek to maximise expected satisfaction. They compare brands to see which provides the most benefits related to their needs and buy on the basis of a multi-attribute comparison of brands. | • Consumers seek an acceptable level of satisfaction. They buy the brand least likely to give them problems and buy on the basis of a few attributes. Familiarity is the key. |

| High-involvement consumer behaviour | Low-involvement consumer behaviour |
|---|---|
| • Personality and lifestyle characteristics are related to consumer behaviour because the product is closely tied to the person's self-identity and belief system. | • Personality and lifestyle are not related to consumer behaviour because the product is not closely tied to the person's self-identity and beliefs. |
| • Reference groups influence consumer behaviour because of the importance of the product to group norms and values. | • Reference groups exert little influence on consumer behaviour because products are not strongly related to their norms and values. |

*Source*: Adapted from Henry Assael, *Consumer Behavior and Marketing Action* (Boston: PWS-Kent Publishing Company, 1995), p. 157.

Such behavioural differences have a major implication for marketers. A given marketing strategy, or decisions concerning any of the 4 Ps in a marketing plan, will not be equally effective for both high- and low-involvement products. Even though consumers may have differing degrees of psychological involvement with a given product category, the marketer needs to determine whether the majority of potential customers in his or her target segment are likely to be highly involved with the purchase decision or not. The various elements of the strategic marketing plan can then be tailored to the overall level of involvement of people in the target market. Exhibit 6.7 summarises some major differences in marketing actions appropriate for high- versus low-involvement product or service offerings. These differences are briefly discussed in the following sections.

**Exhibit 6.7** **Marketing decisions for high-involvement versus low-involvement products or services**

| Marketing mix element | Marketing decisions where the consumer exhibits high involvement | Marketing decisions where the consumer element exhibits low involvement |
|---|---|---|
| Product decisions | For long-term success, one or more compelling product benefits are necessary, regardless of the level of consumer involvement. | For long-term success, one or more compelling product benefits are necessary, regardless of the level of consumer involvement. |
| Pricing decisions | Price, unless substantially lower, is likely to be of secondary importance to performance criteria. High price may suggest high quality or status, to the seller's benefit. Demonstrable consumer benefits are more likely than price to drive consumer choice. | Price offers can be effective in gaining trial. A sustained low price, compared to competitors (such as for private-label goods in supermarkets), may provide sufficient inertia for repeat purchase. |

| Marketing mix element | Marketing decisions where the consumer exhibits high involvement | Marketing decisions where the consumer element exhibits low involvement |
|---|---|---|
| Promotional decisions | Consumers *are* interested in the information that sellers provide. Promotional vehicles that communicate in greater detail (e.g., print advertising, Internet, infomercials, personal selling) are likely to be effective. | Consumers *are not* interested in the information that sellers provide. Large advertising budgets and a clear focus on a single demonstrable consumer benefit are probably necessary to get the message across. |
| Distribution decisions | Consumers will be relatively *less* concerned with convenience in purchasing. Relatively less extensive distribution is necessary. | Consumers will be relatively *more* concerned with convenience in purchasing. Relatively more extensive distribution is necessary. |

### 6.1.3.1 Product Design and Positioning Decisions

Consumers evaluate both high- and low-involvement products on criteria that reflect the *benefits* they seek. Both types of products and services must offer at least one compelling and valued benefit to continue to win acceptance in the market. Because consumers tend to evaluate high-involvement products and services *before* purchasing, however, it is particularly important that such offerings be designed to provide at least some benefits that are demonstrably superior to those offered by major competitors, and that marketing communications are effective in making potential customers aware of those benefits.

For low-involvement goods and services, on the other hand, much brand evaluation occurs *after* the purchase is made. Consumers tend to be most positive about – and more likely to repurchase – brands that don't disappoint them or cause unexpected problems. Consequently, firms that market low-involvement products or services need to pay particular attention to basic use-related attributes, such as consistent product quality, reliability, convenient packaging, and user-friendliness.

### 6.1.3.2 Pricing Decisions

Highly involved consumers generally buy the brand they believe will deliver the greatest value. They are willing to pay a higher price for a brand if they believe it will deliver enough superior benefits relative to cheaper competitors to justify the difference. They may even use high price as an indicator of a brand's superior quality or prestige, particularly in categories where quality is hard to evaluate objectively before purchase, such as professional services.

Many consumers buy low-involvement products largely or solely on the basis of low price. Therefore, special sales or coupon offers can be effective in gaining trial of such goods and services. If no problems are experienced during consumption, consumers may continue to buy the brand out of inertia, at least until a competitor offers an attractive price promotion.

### 6.1.3.3 Advertising and Promotion Decisions

Highly involved consumers typically seek at least some information about alternative brands, retail outlets, and so on, before making a purchase decision. Therefore, promotional vehicles that communicate in greater detail – such as print advertising, company websites, infomercials, or a salesperson – are more likely to be attended to and be effective in marketing high-involvement goods and services.

On the other hand, because low-involvement customers are usually passive information gatherers, advertising needs to focus on only a few main points and to deliver the message frequently in order to make it easy for consumers to gain familiarity and positive associations with a brand. Television is often the primary medium for low-involvement products because it facilitates passive learning. Distinctive package design is also important for such products since it helps consumers recognise brands they've seen advertised.

### 6.1.3.4 Distribution Decisions

Extensive retail distribution is particularly important for low-involvement products because most consumers are unwilling to search for, or expend extra effort to obtain, a particular brand. Thus, the larger the proportion of available retail outlets, including websites, vending machines, and the like, a marketer can induce to carry a brand, the larger that brand's market share is likely to be.

Because consumers are more willing to spend some time and effort to acquire their favourite brand in a high-involvement category, extensive retail coverage is less critical for such products. The marketer may be better off being relatively choosy in selecting retailers to carry a brand, particularly if those retailers will play an important role in promoting the product or servicing it after the sale. The value of some exclusive, prestigious brands is clearly enhanced by the fact they are *not* available from every mass merchandiser in town.

### 6.1.3.5 Strategies to Increase Consumer Involvement

In some cases, a firm may try to increase consumers' involvement with its brand as a way to increase revenues. Increased customer involvement can be attempted in several ways. *The product might be linked to some involving issue*, as when makers of bran cereals associate their products with a high-fibre diet that may reduce the incidence of colon cancer. Of course, the involving issue might be social rather than personal. Thus, *cause-related marketing* is the practice of designating a portion of a brand's profits to a nonprofit cause – such as the Special Olympics or breast cancer research – and aggressively publicising it.[10] However, as cause-related marketing has become more popular, its effectiveness as a tool for increasing consumer involvement and brand preference may be declining, as discussed in Exhibit 6.8. Or *the product can be tied to a personally involving situation*, such as advertising a sleeping aid late in the evening when insomniacs are interested in finding something to help them sleep. Finally, *an important new feature might be added to an unimportant product* as when Revlon introduced its ColorStay Lipcolor, which promised a miracle for women – unsmeared lipstick all day long. Despite being double the price of other lipsticks, women responded to the claim that it 'won't smear off on your teeth, your glass, or him' so well that ColorStay became the number-one-selling brand in drugstores and other mass merchandisers.[11]

**Exhibit 6.8 Is cause-related marketing losing its impact?**

In recent years, many consumer products manufacturers and retail chains have sponsored marketing campaigns linking their brands or stores to a social issue. These caused-related campaigns include multicompany programmes – such as (product) Red for the benefit of African AIDS Victims – as well as efforts by individual firms, like Avon's breast cancer crusade. The popularity of such programmes has grown partly because they often fit well with the social objectives detailed in corporate mission statements, but mostly because they are effective at increasing consumers' involvement with and preference for the sponsoring brand or retail chain.

Unfortunately, the popularity of cause-related marketing may be eroding its effectiveness, at least within the US market. In a survey of 1066 adults polled by a commercial research firm in 2007, 36 per cent said they had bought a product in the previous 12 months after learning of its maker's commitment to some social issue, but that figure was down from 43 per cent in a similar survey in 2004. Only 14 per cent said they paid more for a product because of its support for a cause, down from 28 per cent. And just 30 per cent told a family member or friend about a brand's commitment to a cause, compared to 43 per cent three years earlier. Carol Cone, whose brand strategy firm conducted the survey, speculates that so many brands are now linked to worthy causes that American consumers may be suffering from 'cause fatigue.'

*Source:* Conrad Wilson, 'Shoppers without a Cause,' *BusinessWeek,* July 9, 2007, p. 14.

## 6.2 Why People Buy Different Things: Part 1 – The Marketing Implications of Psychological and Personal Influences

Even when two consumers have equal involvement with a product, they often purchase different brands for varying reasons. The information they collect, the way they process and interpret it, and their evaluation of alternative brands are all influenced by psychological and personal characteristics. Some of the important psychological, or thought, variables that affect a consumer's decision-making process include *perception, memory, needs* and *attitudes*. The consumer's personal characteristics, such as *demographic and lifestyle variables*, influence these psychological factors.

### 6.2.1 Perception and Memory

**Perception** is the process by which a person selects, organises, and interprets information. When consumers collect information about a high-involvement service such as a cruise, they follow a series of steps, or a hierarchy of effects. **Exposure** to a piece of information, such as a new product, an ad, or a friend's recommendation, leads to **attention**, then to **comprehension**, and finally to **retention** in memory. Once consumers have fully perceived the information, they use it to evaluate alternative brands and to decide which to purchase.

The perception process is different for low-involvement products. Here, consumers have information in their memories without going through the sequence of attention and comprehension. Exposure may cause consumers to retain enough information so that they are familiar with a brand when they see it in a store.

Two basic factors – *selectivity* and *organisation* – guide consumers' perceptual processes and help explain why different consumers perceive product information differently. **Selectivity** means that even though the environment is full of product information, consumers pick and choose only selected pieces of information and ignore the rest. For high-involvement purchases, consumers pay particular attention to information related to the needs they want to satisfy and the particular brands they are considering for purchase. This **perceptual vigilance** helps guarantee that consumers have the information needed to make a good choice. For low-involvement products, consumers tend to selectively screen out much information to avoid wasting mental effort. The average consumer is exposed to over 1000 ads every day plus information from other sources such as catalogues, websites, and friends. Consumers must be selective in perceiving this information to cope with the clutter of messages.

Consumers also tend to avoid information that contradicts their current beliefs and attitudes. This **perceptual defence** helps them avoid the psychological discomfort of reassessing or changing attitudes, beliefs, or behaviours central to their self-images. For example, many smokers avoid antismoking messages, or play down their importance, rather than admit that smoking may be damaging to their health.

#### 6.2.1.1 Memory Limitations

Even though consumers are selective in perceiving product information, they remember only a small portion of it. This limitation of the human memory concerns marketers since much marketing activity deals with communicating information to potential consumers to improve their attitudes toward a given brand. What can marketers do – if anything – to improve the memorability of their messages?

There are different theories of how the human memory operates, but most agree that it works in two stages. Information from the environment is first processed by the **short-term memory**, which forgets most of it within 30 seconds or less because of inattention or displacement of new incoming information. Some information, however, is transferred to **long-term memory**, from which it can be retrieved later. Long-term memory has a nearly infinite storage capacity, but the amount of product information actually stored there is quite limited. For information to be transferred to long-term memory for later recall, it must be *actively rehearsed and internalised*. It takes from 5 to 10 seconds of rehearsal to place a chunk of information in long-term memory. This is a long time relative to the fraction of a second necessary to perceive that piece of information. Therefore, new pieces of information swamp the old one before it can be transferred unless consumers find it sufficiently relevant to warrant focusing their attention.

This is why print media and interactive electronic media, such as websites, are good for communicating complex or technical information about high-involvement products. Consumers can control the pace at which such information is received and can take the time necessary to comprehend, rehearse, and remember it. Similarly, this explains why television advertising for low-involvement products should focus on a few simple pieces of information, such as brand name, symbol, or key product attributes, and be repeated frequently. Otherwise, the information will never make it into the consumer's long-term memory.

### 6.2.1.2 Perceptual Organisation

Another mental factor determining how much product information consumers remember and use is the way they organise the information. People do not view and remember each piece of information they receive in isolation. Instead, they organise information through the processes of categorisation and integration. **Categorisation** helps consumers process known information quickly and efficiently: 'I've seen this ad before so I don't have to pay much attention.' It also helps people classify new information by generalising from past experience. An ad for a new cereal with a high vitamin and mineral content, for instance, is interpreted in light of consumers' experience with other nutritional cereals. This can cause a problem if consumers' experiences have not been very favourable.

**Integration** means that consumers perceive separate pieces of related information as an organised whole. For example, the picture, headline, copy, and location of a magazine ad interact to produce a single overall reaction to the ad and the brand advertised. Similarly, consumers integrate information about various characteristics of a brand, such as its price and the retail stores that carry it, to form an overall image of the brand.

### 6.2.1.3 Effects of Stimulus Characteristics on Perception

Consumers' personal characteristics – such as their particular needs, attitudes, beliefs, and past experiences with a product category – influence the information they pay attention to, comprehend, and remember. The characteristics of the message itself and the way it is communicated also influence consumers' perceptions. The ad's colour, size, and position within a magazine or a TV programme influence consumers' attention to the message and the brand image the ad produces in consumers' minds. We examine these factors in Module 14 when we discuss advertising and promotion decisions.

## 6.2.2 Needs and Attitudes

An **attitude** is a positive or negative feeling about an object (say, a brand) that predisposes a person to behave in a particular way toward that object. Attitudes derive from a consumer's evaluation that a given brand provides the benefits necessary to help satisfy a particular need. These evaluations are multidimensional; consumers judge each brand on a set of dimensions or attributes weighted by their relative importance.

### 6.2.2.1 Fishbein Model

Martin Fishbein pioneered a model that specified how consumers combine evaluations of a brand across multiple attributes to arrive at a single overall attitude toward that brand. His model is expressed as follows:

$$\text{Attitude}_A = \sum_{i=1}^{k} B_i I_i$$

where:

| | | |
|---|---|---|
| $\text{Attitude}_A$ | = | Consumer's overall attitude toward Brand A. |
| $B_i$ | = | Consumer's belief concerning the extent to which attribute *i* is associated with Brand A. |
| $I_i$ | = | The importance of attribute *i* to the consumer when choosing a brand to buy. |
| *k* | = | The total attributes considered by the consumer when evaluating alternative brands in the product category. |
| *i* | = | Any specific product attribute. |

Exhibit 6.9 applies the Fishbein model to Paul MacDonald's evaluation of alternative cruises. This application is **compensatory** because it assumes that MacDonald's overall attitude toward a given cruise is determined by the weighted sum of the ratings for that cruise on all relevant attributes. Thus, a poor evaluation on one attribute is compensated for by a strong evaluation of another attribute. It also assumes that the cruise with the highest total score is the one MacDonald is predisposed to buy.

### 6.2.2.2 Noncompensatory Attitude Models

As suggested by Exhibit 6.9, the mental processes involved in forming an attitude are quite complex because consumers must evaluate each alternative brand on every attribute. In some purchase situations, particularly with low-involvement products, consumers may adopt a simpler approach and evaluate alternative brands on only one attribute at a time. Such an approach is **noncompensatory** because a poor evaluation of a brand on one attribute cannot be offset by a strong evaluation on another. For instance, one noncompensatory model, the lexicographic model, suggests that consumers evaluate brands on the most important attribute first. If one brand appears clearly superior on that dimension, the consumer selects it as the best possible choice. If no brand stands out on the most important attribute, the consumer evaluates the alternative brands on the second most important attribute, and so forth.[12]

### 6.2.2.3 Marketing Implications of Attitude Models

Although the different attitude models provide insights into the ways consumers evaluate competitive product offerings, their implications for marketers are similar. The models suggest that to design appealing product offerings and structure effective marketing programmes, marketers must have information about (1) the attributes or decision criteria consumers use to evaluate a particular product category; (2) the relative importance of those attributes to different consumers; and

(3) how consumers rate their brand relative to competitors' offerings on important attributes.

**Exhibit 6.9 A compensatory multi-attribute model of attitudes towards alternative cruises**

Our hypothetical consumer, Paul MacDonald, is interested in taking a Caribbean cruise lasting not more than seven days some time during the months of January or February at a reasonable price. As the table indicates, he uses five attributes (choice criteria) to make a comparison between three alternative cruises. On the basis of information gathered from advertising, travel agents, promotional materials received from a number of cruiselines, and friends, he rates the three different cruises on each of the five attributes as follows:

| | | Ratings | | |
|---|---|---|---|---|
| **Service attribute** | **Importance weight (0–10)** | **A** | **B** | **C** |
| Demographics – other passengers | 10 | 8 | 8 | 8 |
| Entertainment | 10 | 8 | 10 | 9 |
| Ports of call | 8 | 8 | 9 | 9 |
| Low fares | 7 | 9 | 8 | 8 |
| Size/steadiness of ship | 6 | 9 | 8 | 8 |

Using the formula in the text, MacDonald calculates that an overall attitude score for Cruise A equals $(10 \times 8) + (10 \times 8) + (8 \times 8) + (7 \times 9) + (6 \times 9) = 341$. His overall attitude scores for the other two cruises: Cruise B = 356 and Cruise C = 346. Consequently, MacDonald prefers and will be predisposed to buy Cruise B, the cruise towards which he has the most positive attitude. Although the demographics of other passengers was one of the most important attributes, it played no significant role in determining which cruise he would buy because there were no significant differences between the three cruises on that attribute. Instead the *determinant attribute* – that which had the biggest impact on which cruise MacDonald would prefer – was *entertainment.*

Multi-attribute models are especially helpful in formulating marketing strategies. They do so by showing the consumer's ideal combination of product/service attributes, each of which is weighted as to its relative importance. Clustering those respondents with similar 'ideals' enables the marketer to better understand not only what different sets of consumers want, but also how they perceive the various brands relative to the ideal brand. The firm can then decide which segments to target and how best to position its product-market entries.

### 6.2.2.4 Attitude Change

The multi-attribute attitude models of consumer choice suggest various ways marketers might change consumer attitudes favourably for their brands versus competing brands. These are discussed briefly below.

1. *Changing attitudes toward the product class or type to increase the total market* – thereby increasing sales for a particular brand. For example, a frozen-orange-juice seller once attempted to make its product acceptable as a refreshing drink throughout the day. This type of attitude change involves primary demand and is difficult to accomplish.
2. *Changing the importance consumers attach to one or more attributes.* For instance, a number of food manufacturers have spent large sums warning about the dangers of high cholesterol. After increasing the importance consumers attach to lowering their cholesterol, they can then promote their brands as an appropriate part of a low-cholesterol diet.
3. *Adding a salient attribute to the existing set.* For instance, Colgate-Palmolive added triclosan, an antibiotic that fights gingivitis, to its Total brand of toothpaste and promoted it heavily.
4. *Improving consumers' ratings of the brand on one or more salient attributes via more extensive or effective advertising and promotion.* This is the most common attempt, particularly during a brand's introduction to the market or after product improvements have been made.
5. *Lowering the ratings of the salient product characteristics of competing brands.* This can be attempted via comparative advertising, which has increased in recent years. For example, one nutritional cereal regularly compares the amount of vitamins and minerals its brand provides in an average serving with those provided by specific other brands.

## 6.2.3 Demographics and Lifestyle

### 6.2.3.1 Demographics

Demographics influence (1) the nature of consumers' needs and wants, (2) their ability to buy products or services to satisfy those needs, (3) the perceived importance of various attributes or choice criteria used to evaluate alternative brands, and (4) consumers' attitudes toward and preferences for different products and brands. For example, older consumers spend more on medical care and travel and less on home furnishings and clothing than do younger groups; the presence of young children obviously affects the purchasing of a variety of goods and services; and better-educated people spend more on reading materials and foreign travel than do those with less education.

### 6.2.3.2 Personality and Self-Concept

A consumer's buying behaviour is also influenced by his or her *personality* – the set of enduring psychological traits that lead a person to make distinctive and consistent responses to factors in his or her environment. An individual's personality is usually described in terms of traits such as sociability, self-confidence, dominance, adaptability, introversion, and the like.

Personality can be useful for explaining why different people buy different things because brands are also perceived to have personalities, and consumers are likely to choose brands whose personalities match their own. In a classic study, the following traits were commonly used to define *brand personalities* in the United States:

- Sincerity (honest, wholesome, down-to-earth, cheerful)
- Excitement (imaginative, spirited, daring, up-to-date)
- Competence (reliable, successful, intelligent)
- Sophistication (upper-class, charming)
- Ruggedness (tough, outdoorsy).

Brand personalities in other countries are defined with some of these same traits, but other traits are unique to specific cultures. For instance, a 'peacefulness' dimension replaces 'ruggedness' in both Japan and Spain, and 'competence' is overshadowed by 'passionate' in Spain.[13]

Many well-known brands are perceived to be strong on one dimension, though some are seen as having multidimensional personalities. For instance, MTV is associated with excitement and Campbell's soup with sincerity, while Levi's jeans are seen as rugged, youthful, and authentic. Consumers tend to choose brands with personalities that match either their own *self-concept* (the way they actually see themselves) or their *ideal self-concept* (the kind of person they would like to be), but this tendency is probably stronger for high-involvement, publicly consumed goods and services than for low-involvement items.

### 6.2.3.3 Lifestyles

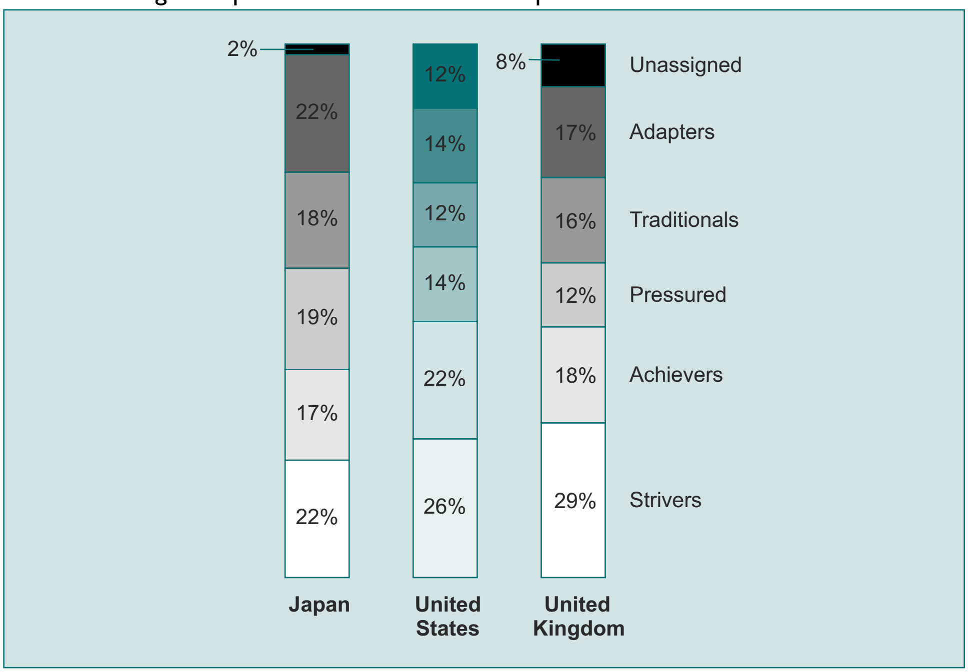
Two people of similar age, income, education, and even occupations do not necessarily live their lives in the same way. They may have different opinions, interests, and activities. As a result, they are likely to exhibit different patterns of behaviour – including buying different products and brands and using them in different ways and for different purposes. These broad patterns of activities, interests, and opinions – and the behaviours that result – are referred to as **life-styles**. To obtain lifestyle data, consumers are asked to indicate the extent to which they agree/disagree with a series of statements having to do with such things as price consciousness, family activities, spectator sports, traditional values, adverture-someness, and fashion.

Lifestyle typologies or psychographic profiles have been developed by several advertising agencies and market research firms. Global Scan, developed by Backer Spielvogel & Bates ad agency, measures a variety of consumer attitudes, activities, and values among a sample of 3500 consumers in the United States and 1000 respondents from other countries.[14] These measures are then matched against respondents' media viewing habits, product use, and purchase patterns. With this survey data, Global Scan has identified five lifestyle segments, summarised in Exhibit 6.10. The exhibit also shows the proportion of consumers that fall into each segment in the United States, the United Kingdom, and Japan. The size of the various segments varies across countries. For instance, Japan's more traditional and stable culture includes a larger proportion of 'Traditionals' and 'Adapters' than the United States.

An alternative lifestyle typology, called VALS 2, has been developed by the research firm SRI International. We will examine the lifestyle profiles identified by these various typologies, and their usefulness for defining and understanding market segments, in greater detail in Module 9.

**Exhibit 6.10 Global scan's lifestyle psychographic segments and the proportion of people in each segment across three countries**

- Strivers: Young people (median age 31) who live hectic, time-pressured lives. They strive hard for success. They are materialistic, seek pleasure, and demand instant gratification.
- Achievers: They have achieved some of the success that strivers aim for. They are affluent, assertive, and upward bound. They are very status conscious and buy for quality and are slightly older than strivers.
- Pressured: This group cuts across age groups and is composed mainly of women who face constant financial and family pressure. They do not enjoy life as much as they could and feel generally downtrodden.
- Adapters: These are older people who maintain time-honoured values but keep an open mind. They live comfortably in a changing world.
- Traditionals: They hold onto the oldest values of their countries and cultures. They resist change and prefer routines and familiar products.




*Source*: *Going Global: International Psychographics* (Ithaca, NY: American Demographics Books, 1991).

## 6.3 Why People Buy Different Things: Part 2 – The Marketing Implications of Social Influences

Information and social pressures received from other people influence a consumer's needs, wants, evaluations, and product or brand preferences. Social influences are particularly apparent when consumers purchase high-involvement, socially visible goods or services. The social influences affecting consumers' purchase decisions include culture, subculture, social class, reference groups, and family. These five categories represent a hierarchy of social influences, ranging from broad, general effects on consumption behaviour – such as those imposed by the culture we live in – to more specific influences that directly affect a consumer's choice of a particular product or brand. For a simplified view of this hierarchy of social influences, *see* Exhibit 6.11.

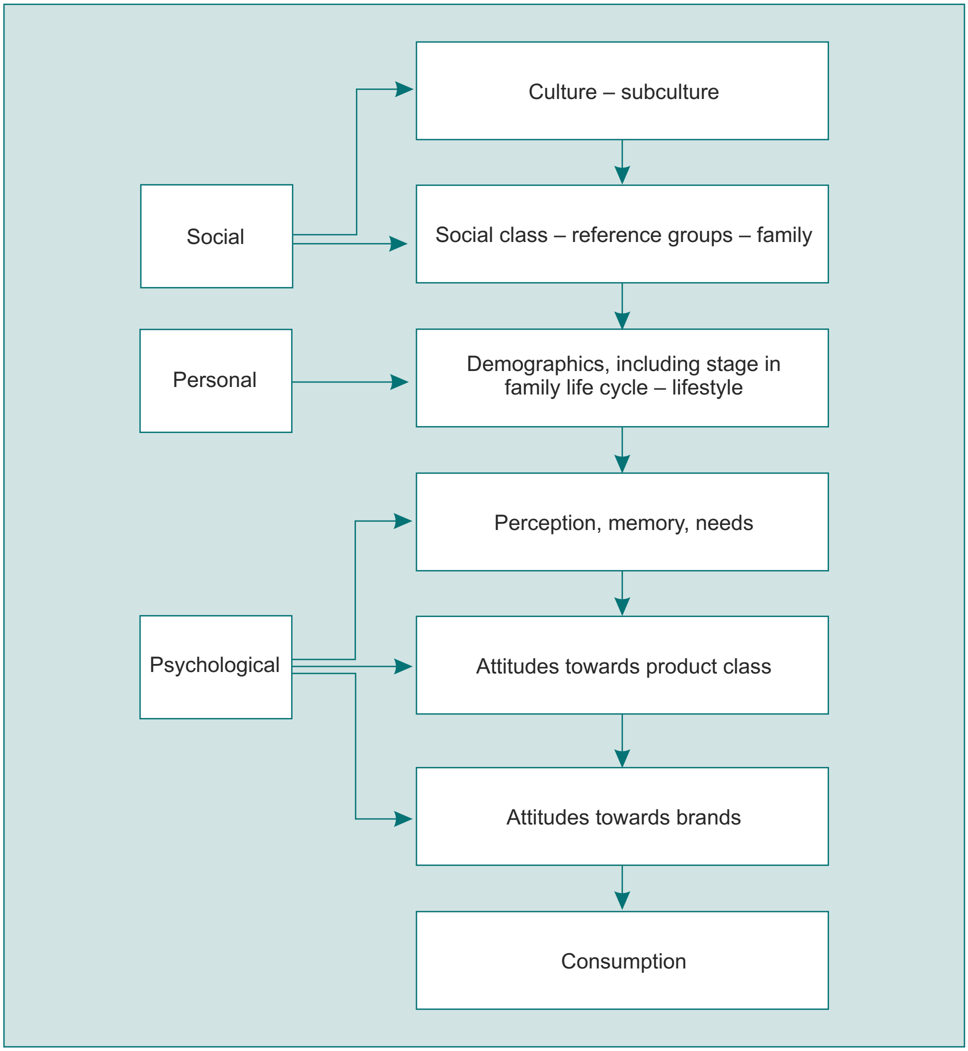
### 6.3.1 Culture

**Culture** is the set of beliefs, attitudes, and behaviour patterns (customs and folk-ways) shared by members of a society and transmitted from one generation to the next through socialisation. Cultural values and beliefs tend to be relatively stable over time, but they can change from one generation to the next in response to changing conditions in society. For example, the baby boomers born in the United States between 1946 and 1960 have somewhat different values and behaviour patterns from those of their parents. They tend to live a more health-conscious lifestyle, (e.g., to eat less red meat) and to concern themselves more with personal grooming than did their parents at the same age.

And as the boomers approach retirement age, they appear even more committed to maintaining healthy, active lifestyles – and less likely to fully retire at an early age – than previous generations of senior citizens.[15]

Cultural differences across countries create both problems and opportunities for international marketers. For example, Pillsbury wanted to take advantage of the cultural evolution concerning working women in Japan. About 50 per cent of married women in Japan now work outside the home. Consequently, they represent an attractive market for convenience foods, such as Pillsbury's Green Giant frozen vegetables. The problem is that many feel guilty about using such products because they seem inconsistent with traditional cultural values. Therefore, in addition to touting the convenience of Green Giant vegetables, Pillsbury's advertising also stressed the nutrition and flavour benefits of freezing vegetables at the peak of ripeness. As a result, Green Giant's Japanese sales increased 50 per cent in the first year of the ad campaign.[16]

**Exhibit 6.11 Simplified hierarchy of social forces affecting consumer behaviour**




## 6.3.1.1 Subculture

There are many groups of people in the United States who share common geographic, ethnic, racial, or religious backgrounds. They continue to hold some values, attitudes, and behaviour patterns that are uniquely their own. Such groups are referred to as **subcultures**. For example, the average American family now has two wage earners who probably share decisions relating to vacations, car, financial instruments, and major furniture items. In contrast, Korean-Americans as a subculture in America are much more inclined to favour the male in almost all decisions, including food.[17]

### 6.3.2 Social Class

Every society has its status groupings largely based on similarities in income, education and occupation. Because researchers have long documented the values of the various classes (typically thought of as five – upper, upper-middle, middle, working, and lower), it is possible to infer certain behaviour concerning products and services, including class members' reactions to advertising. For example, higher-status people are more critical of advertising, react better to more individualised messages, appreciate humour and sophistication, and look down a bit on ads that stress economy. Lower-status people respond to ads that are strongly visual and show practical solutions to their everyday problems.

### 6.3.3 Reference Groups

These include a variety of groups that affect consumer behaviour through normative compliance, value-expressed influence, and informational influence. The first is most effective when there are strong normative pressures (for instance, from a college fraternity or exclusive club); when social acceptance is important (serving of certain foods to guests); and when the use of a product is conspicuous (women's fashion clothing). Value-expressive influence involves conforming to gain status within one's group.

Informational influence involves the use of influential people to help assess the merits of a given product/service. The opinions of such individuals often legitimise the purchase of a certain product or service. For instance, one study shows that over 40 per cent of Americans seek the advice of family or friends when shopping for doctors, lawyers, and auto mechanics. Word of mouth is also important with respect to restaurants, entertainment, banking, and personal services. And young adults are more willing to seek referrals than are older people.[18]

### 6.3.4 The Family

The family is a reference group, but because of its importance, we discuss it separately. First, it serves as the primary socialisation agent, helping members acquire the skills, knowledge, and attitudes to function as consumers in the marketplace. Consequently, it has a great and lasting influence on its younger members' attitudes toward various brands and stores. It is likely that many of the product-purchase decisions by a given generation are influenced by parents, even grandparents. Crest toothpaste, Tide laundry detergent, various brands of cars, and various insurance companies are examples of long-lived preferences that can be handed down. Children can also socialise their parents by introducing them to new products such as food, personal care items, and the personal computer. For example, nearly half of all young people age 12 to 19 sometimes cook meals for their family.[19]

Family members tend to specialise in the purchase of certain products either because of their interest or expertise or the role structure of the family. Wives, in most marriages, have the most say in the purchases of food and household products, children's clothes and toys, and over-the-counter drugs. In a similar vein, joint decisions apply on the purchase of cars, homes, vacations, major appliances, furniture, home electronics, and long-distance telephone carriers. As education increases, more joint decision making occurs.

The influence of various family members varies substantially across countries. Generally, the more traditional the society, the more men hold the power. In the more egalitarian countries, such as the Scandinavian nations, decisions are more likely to be made jointly. As women become better educated and more influential as wage earners in developing nations, more joint decision making will happen.

#### 6.3.4.1 Family Life Cycle

When people leave home and start their own households, they progress through distinct phases of a **family life cycle**. The traditional cycle in the most industrialised nations includes young singles, young marrieds without children, young marrieds with children, middle-aged marrieds with children, middle-aged marrieds without dependent children, older marrieds, and older unmarrieds.

Each phase of the life cycle brings changes in family circumstances and purchasing behaviour. For example, young singles' purchases tend to concentrate on nondurable items, including food away from home, clothing, and entertainment. Young marrieds without children are typically more affluent because both spouses usually work away from home. They are a major market for such durables as automobiles, furniture, and appliances. Young marrieds with children probably have the least disposable income, but they are the major market for single family dwellings, infant products and clothing, and child care services. Middle-aged couples without children usually have the most discretionary income. They are a major market for many luxury goods and services, such as expensive cars and international travel. Finally, the older marrieds and unmarrieds typically have less disposable income but are nevertheless an important market for medical products and services as well as hobby and craft items.

Of course, there are exceptions to and elaborations of the traditional family life cycle, especially the growing number of single-parent families and affluent seniors. These groups are of increasing importance to marketers.[20]

## Learning Summary

- Not all purchase decisions are equally important or psychologically involving for the consumer. People engage in a more extensive decision-making process, involving a more detailed search for information and comparison of alternatives, when buying high-involvement goods and services than when purchasing more mundane, low-involvement items.
- Because of the differences in the decision-making process, a given marketing strategy will not be equally effective for both high- and low-involvement products. The consumer marketer's first task, then, is to determine whether the majority of potential customers in the target segment are likely to be highly involved with the purchase decision or not.
- Because consumers are generally unwilling to spend much time or effort evaluating alternative brands in a low-involvement product category before making a purchase, marketers need to focus their promotional messages on only a few fre-

quently repeated points and to distribute such products extensively to make them convenient for customers to buy.

- Regardless of the consumer's level of involvement with a product category, consumers often prefer different brands because of differences in their psychological or personal characteristics, such as their perceptions, memories, attitudes, and lifestyles. Understanding how such characteristics influence consumers' decisions in a product category provides an important foundation for marketing decisions concerning the definition of market segments, the selection of target markets, and the design of marketing programmes to appeal to those markets.
- Regardless of the consumer's level of involvement with a product category, consumers often prefer different brands because of differences in their social relationships, such as their culture, social class, reference groups, and family circumstances. Understanding how such social influences impact consumers' decisions in a product category provides an important foundation for marketing decisions concerning the definition of market segments, the selection of target markets, and the design of marketing programmes to appeal to those markets.

# Review Questions

## Content Questions

6.1 Describe each of the four types of purchasing decision.

6.2 Describe briefly the five steps consumers go through when purchasing high-involvement products or services.

6.3 How does low-involvement purchase behaviour differ from high-involvement purchase behaviour?

6.4 What are the marketing implications of low-involvement purchasing?

6.5 Describe the Fishbein model by using an example.

6.6 What is the difference between a compensatory and a non-compensatory model?

6.7 How do demographics and lifestyle have an impact on buying behaviour?

6.8 Identify the major social influences on consumers' decision-making processes.

## Multiple Choice Questions

6.9 The decision process pursued by a consumer can be classified by:

A. the product price level and the extensiveness of the consumer's information search.
B. the level of product involvement and the extensiveness of the consumer's information search.
C. the extent to which the product is differentiated and the product price level.
D. the level of product involvement and of consumer satisfaction.
E. the extent to which the consumer searches both internally and externally for relevant product information.

6.10 Brand loyalty is accomplished when consumers are _____ in the purchase process but search for _____.

A. highly involved; brand alternatives.
B. highly involved; better retail prices.
C. somewhat involved; little or no information.
D. somewhat involved; better retail prices.
E. highly involved; little or no information.

6.11 Generally, which of the following is a low-involvement purchase?

A. A car.
B. A DVD player.
C. A computer.
D. Cereal.
E. Clothing.

6.12 The consumer decision-making approach associated with high product involvement and extended search is known as:

A. complex decision making.
B. brand loyalty.
C. limited decision making.
D. inertia.
E. noncompensatory decision making.

6.13 The consumer decision-making approach associated with low product involvement and routine information search is known as:

A. brand loyalty.
B. complex decision making.
C. compensatory decision making.
D. inertia.
E. variety seeking/impulse purchasing.

6.14 When consumers purchase a particular brand frequently with little thought about alternative brands, they are said to be:

A. compensating.
B. impulse buyers.
C. variety averse.
D. brand loyal.
E. complex decision makers.

6.15 In which step of the complex decision-making process for high-involvement purchases is the consumer's purchase-decision process triggered by unsatisfied needs?

A. Information search.
B. Problem identification.
C. Evaluation of alternatives.
D. Purchase.
E. Post-purchase evaluation.

6.16 The size of the _____ between the current state of a consumer and the desired state of that consumer largely determines the _____ of a particular need.

A. gap; strengths.
B. gap; integration.
C. strength; gap.
D. strength; integration.
E. exposure; comprehension.

6.17 The reason why we regularly recognise, or identify, problems is because:

A. our wants never change.
B. our wants are never met.
C. our needs are never met.
D. our needs are only met temporarily.
E. A above is true, but only for low-involvement purchases.

6.18 What determines the effort to which people will go to seek additional information about alternative brands?

A. They will keep looking until they find a product with which they are satisfied.
B. They will seek additional information so long as the cost in time and trouble equals their perception of the additional benefits they will receive by conducting the search.
C. Basically, people will keep seeking information about alternatives until they finally believe looking further will not result in finding more alternatives.
D. Most people will keep looking until they cannot find a lower purchase price.
E. Typically, people will keep looking for a certain period of time because they are expected to by family and friends.

6.19 The frustrations involved in searching for product information in often crowded stores with rude salespeople are referred to as the:

A. delay costs of search.
B. psychological costs of search.
C. opportunity costs of search.
D. commercial-contact costs of search.
E. interpersonal costs of search.

6.20 Professional organisations and individuals who provide advice for consumers, such as doctors, lawyers, government agencies and consumer interest groups, are referred to as:

A. commercial sources.
B. personal sources.
C. public sources.
D. nominal sources.
E. normative sources.

6.21 The limited number of products consumers are familiar with that are likely to satisfy their needs are termed the:

A. product group.
B. choice set.
C. evoked set.
D. salient set.
E. intention set.

6.22 All of the following are examples of commercial sources of information EXCEPT:

A. media advertising.
B. promotional brochures.
C. lawyers.
D. salespersons.
E. package and label information.

6.23 The set of attributes used by a particular consumer and the relative importance of each represent the consumer's:

A. choice criteria.
B. evoked set.
C. salient set.
D. intention qualifiers.
E. qualifiers.

6.24 The evaluative attributes of repair cost and service quality can explain why most people:

A. prefer to lease new vehicles.
B. prefer to pay cash for new vehicles.
C. do not buy exotic cars that are more than ten years old.
D. do not like to buy used domestic cars from national dealers.
E. do all of the above.

6.25 The attributes (price, convenience, personnel) of the source where a product can be purchased is considered when the consumer is:

A. identifying a problem.
B. performing product information search.
C. evaluating product alternatives.
D. ready to make the purchase.
E. making a past purchase evaluation.

6.26 When a consumer notices a special ski vacation package to the French Alps for a low price during a television programme, what type of change in this consumer's desired state has occurred?

A. The desired state is revised upward because of new information.
B. As one need is satisfied, the desired state of another need increases.
C. A natural deterioration of physical needs occurs.
D. The state changes as the result of depletion of the current solution.
E. The consumer anticipates a decline in his actual state.

6.27 Which of the following is an example of a cost attribute which consumers use to evaluate alternative products?

A. Trade-in allowance.
B. Reputation of the brand.
C. Status image of the product.
D. Delivery time.
E. Credit terms.

6.28 Which of the following is an example of a performance attribute which consumers use to evaluate alternative products?

A. Likely resale value.
B. Credit terms.
C. Delivery time.
D. Quality of materials.
E. Repair costs.

6.29 A shopper who notices different brands of cookies on the shelf of a supermarket and who purchases a package on the basis of a cursory comparison of other brands on the shelf has made what type of purchase?

A. Complex decision making.
B. Inertia.
C. Impulse.
D. High-involvement.
E. Integrated.

6.30 The statement, 'Unfavourable attitudes must change before a purchase will be made,' is:
A. always true.
B. always true for high-involvement products.
C. always true for low-involvement products.
D. generally true for high-involvement products, but not for low-involvement products.
E. none of the above.

6.31 A key difference between the low- and high-involvement purchase-decision processes is:
A. there are more steps in the low- than in the high-involvement process.
B. there are more steps in the high- than in the low-involvement process.
C. more time is spent at each step of the low- than the high-involvement process.
D. more time is spent at each step of the high- than the low-involvement process.
E. There are no significant differences.

6.32 What types of brands are consumers most likely to seek when they are making a low-involvement product choice?
A. Usually, they will look for products with the kinds of features they want in terms of the importance of those features.
B. Typically, they will accept only known brands.
C. Consumers will seek the simplest brands available, so that they do not have to do a lot of mental 'processing.'
D. It is impossible to predict what consumers will do, because they often pick these types of products at random.
E. They are likely to pick the brand that is perceived to be the least likely to give them problems.

6.33 Television, rather than print, should be the primary advertising medium for:
A. products requiring complex decision making.
B. infrequently purchased products.
C. products with salient features.
D. low-involvement products.
E. products for which no clear segments can be identified.

6.34 The process of _____ allows us to select, organise and interpret information.
A. perception.
B. exposure.
C. attention.
D. comprehension.
E. retention.

6.35 Starting to notice an abundance of Volkswagen Jettas during your daily commute most likely indicates that you:
A. need a vacation.
B. need a new car.
C. are in the market for a new car.
D. are considering buying a Jetta.
E. are very pleased with the performance of the Jetta you bought last year.

6.36 The sequential steps in the consumer's perceptual learning process are:
A. identification, awareness, trial and adoption.
B. identification, awareness, comprehension and action.
C. exposure, attention, comprehension and retention.
D. perception, identification, attention and action.
E. exposure, awareness, attention and retention.

6.37 When consumers perceive separate pieces of related information as an organised whole they are:
A. coagulating.
B. categorising.
C. combining.
D. separating.
E. integrating.

6.38 When Quaker Oats promoted a link between Cheerios and health problems they were:
A. in need of a new advertising agency.
B. trying to increase consumer involvement.
C. re-segmenting the breakfast cereal market.
D. about to be fined by the FDA.
E. attempting to improve the health of their customers.

6.39 All of the following are examples of high-involvement consumer behaviour EXCEPT:
A. changing attitudes toward the product class or type.
B. changing importance of an attribute.
C. adding an attribute.
D. more extensive or effective advertising and promotion.
E. lowering ratings of competing brands.

6.40 The decision to buy a BMW car is most influenced by:
A. cultural factors.
B. social class factors.
C. reference group factors.
D. lifestyle factors.
E. Any of the above could be the most influential factor.

6.41 Throwing rice at a newly married couple reflects which type of social influence on behaviour?

A. Cultural.
B. Subcultural.
C. Social class.
D. Reference groups.
E. Family.

## Application Questions and Cases

6.42 Assume you are the marketing manager for a cruiseline. For most consumers, taking a cruise represents a high-involvement purchase. What are the implications of high involvement for decisions relating to the product and its features, its price, and its promotion?

6.43 How would you classify the following products/services in terms of the extent of involvement? How would your 'classification' affect your recommendations regarding what pricing, distribution, and promotion decisions to make?

a. Frozen vegetables.
b. Banking services.
c. Tennis racquet.
d. Toothpaste.
e. Colour television sets.
f. Lawn service.

6.44 Think back to a recent purchase you made involving a product or service costing more than $100 (e.g., a major article of clothing or an MP3 player). Using the framework outlined in Exhibit 6.3 and discussed in the module, describe the decision process involved in making your purchase. What motivated your purchase? What were your thoughts at each stage in the decision process? What activities were involved? For discussion of this issue, consider the purchase of a new colour printer for use with your computer.

6.45 With regard to the purchase of a new colour printer, what kinds and sources of information would you use? If others seek out similar kinds and sources of information, what are the implications of your information search process in the design of a marketing programme for a colour printer?

6.46 As a marketing manager for a soft-drink company, you know that such a drink is a low-involvement purchase for most consumers. How might you try to increase consumers' involvement with your product (brand) to increase their loyalty and reduce brand switching?

6.47 Based on the attitudes toward the three different cruises summarised in Exhibit 6.9 and assuming that a major segment of consumers hold attitudes similar to those of Paul

MacDonald, what actions could you, as marketing manager for Cruise A, take to improve consumers' attitudes toward your cruise?

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# Module 7

# Understanding Organisational Markets and Buying Behaviour

## Contents



## DHL Exel Supply Chain: Building Long-Term Relationships with Organisational Buyers[1]

In 2005, the Exel Company – a global leader in supply chain management services headquartered in the United Kingdom – was acquired in a 'friendly' merger by Deutsche Post World Net, the German logistics behemoth that is also the parent of DHL express freight. Exel was incorporated as a separate business unit within Deutsche Post's Logistics Division labelled DHL Exel Supply Chain.

The business unit's primary focus is on providing warehousing and ground-based transport services to contractual customers in more than 170 countries from the company's 2500 distribution centres around the world. In recent years, however, the DHL Exel Supply Chain competitive strategy has concentrated on differentiating the operation by offering customers a broader range of integrated and efficient logistics services than its competitors. To that end, it has invested to build capabilities in packaging, integrated information management, e-commerce support, and recycling services. The firm's salespeople attempt to convince large potential customers in target industry segments – such as the retailing, automotive, life sciences, electronics, and technical equipment industries – that some or all of their necessary supply chain management activities could be performed more effectively or efficiently if outsourced to DHL Exel. Account teams work closely with customers to design custom-tailored programmes of integrated services, monitor the performance of those programmes, and suggest areas for improvement and expansion.

### *Building Long-Term Relationships with Customers*

Key aspects of DHL Exel's competitive and marketing strategies, and of the development of its relationships with customers over time, are illustrated by the firm's long-running association with the Dutch printing systems manufacturer Océ. The relationship began in the 1970s when Exel transported a consignment of printing systems to a customer in the Netherlands. In the intervening years the relationship has expanded dramatically. Today, the services DHL Exel performs for Océ include freight management, inventory control, technical and customer service support, and recycling.

DHL Exel transports new printing systems from Océ's manufacturing plant to a distribution centre in Veghel in the Netherlands, where systems are configured, tested, and then shipped to Océ's customers as they are sold. When a new printing system is delivered, a DHL Exel technical driver gives on-site instruction on how to use the machine and perform simple maintenance tasks. Also, the firm's mobile technicians are available to perform equipment testing and repair on customer premises.

Finally, DHL Exel developed a 'reverse logistics' service for Océ after a customer asked the firm to take back its old printing system when a new one was delivered. The firm's technicians examine all returned systems and, with approval from Océ, undertake an appropriate course of action, from cleaning, to refurbishing, to recycling of the machine's component materials.

### *Long-Term Relationships Enhance Long-Term Performance*

DHL Exel Supply Chain's success at building lucrative long-term logistics relationships with organisational customers has contributed greatly to its revenue and market share in recent years. The unit generated revenues of over €13 billion in 2007, making it by far the market share leader with over 6.5 per cent of the €193 billion global market for supply chain services (the next leading competitor had only a 3 per cent share).

But perhaps more important for the unit's future, the experience and competencies it has developed working with customers over the years is helping it win new clients. For instance, DHL Exel recently announced the signing of a three-year contract worth over €130 million per year with Jaguar and Land Rover. Under the contract, DHL Exel will be managing Jaguar and Land Rover suppliers to ensure they are shipping the right materials and components to the right plants at the right time, as well as overseeing in-plant logistics. As Bruce Edwards, the unit's CEO, points out, 'This contract is . . . testament to the expertise that DHL Exel has established within the automotive sector. Our global network, extensive experience within the automotive market and our ability to collaborate with other DHL business units to provide a seamless service means we have an extremely strong proposition to offer automotive manufacturers.'

## Learning Objectives

In this module the question of 'who is the customer?' is considered by comparing organisational markets to consumer markets and pointing out differences between the two types of customers, differences that often dictate varying marketing approaches. One of those differences is simply the number of participants in the purchase decision. While consumers are influenced by family and friends, they often decide what to buy – and make the actual purchase – on their own. That is typically not the case in organisational purchasing, especially when the product or service involved is relatively complex and expensive. Also discussed are the different kinds of participants in organisational purchase decisions, the roles they play, and the different kinds of marketing messages and activities appropriate for each group.

Next, the module examines the process that organisational customers go through in deciding what to buy and from whom. As with individual consumers, this process varies depending on the past experience the organisation has in buying the particular product or service and with a given supplier. The module considers these issues and their implications for marketing programmes, as well as the impact the Internet and other information technologies are having on firms' strategies for strengthening customer relationships.

Finally, organisational purchasing processes also vary depending on the kinds of goods or services being purchased. Therefore, this module concludes with an examination of how organisational purchasing processes differ across various categories of goods and services and the implications of those differences for designing effective marketing programmes.

# 7.1 Who Is the Customer?

## 7.1.1 A Comparison of Organisational versus Consumer Markets

Organisations – including manufacturing firms, service producers, wholesalers, retailers, farms, and nonprofit organisations such as churches and museums, and governments – all buy things. They buy many of the same goods and services as households, such as computers, office supplies, cars, airline tickets, and telephone service. Thus, what distinguishes organisational markets from consumer markets is often not the kinds of products being purchased. Instead, the crucial differences from a marketing viewpoint are (1) the motivations of the buyer: what the organisation will do with the product and the benefits it seeks to obtain, (2) the demographics of the market, and (3) the nature of the purchasing process and the relationship between buyer and seller. Some of these differences are summarised in Exhibit 7.1 and discussed below.

**Exhibit 7.1 Differences between organisational and consumer markets**

**Demand characteristics**

The demand for industrial goods and services is:

1. Derived from the demand for consumer goods and services.
2. Relatively inelastic – price changes in the short run are not likely to affect demand drastically.
3. More erratic because small increases in consumer demand can, over time, strongly affect the demand for manufacturing plants and equipment.
4. More cyclical.

**Market demographics**

Organisational buyers, when compared with buyers of consumer goods, are:

1. Fewer in number.
2. Larger.
3. Geographically concentrated.

**Buyer–seller relationships**

Organisational markets are characterised by the following when compared with the markets for consumer goods:

1. The use of professional buying specialists following prescribed procedures.
2. Closer buyer–seller relationships.
3. The presence of multiple buying influences.
4. More apt to buy on specifications.

#### 7.1.1.1 Purchase Motives – Derived Demand

Individual consumers and households buy goods and services for their own personal use and consumption. Organisational buyers purchase things for one of three reasons: (1) to facilitate the production of another product or service, as when Toyota buys sheet steel, engine components, or computerised welding machines; (2) for use by the organisation's employees in carrying out its operations (office supplies, computer software, advertising agency services); or (3) for resale to other customers, as when a retailer such as Target buys a truckload of towels to be distributed to its many stores and sold to individual consumers.

Given these reasons for purchasing, organisational demand for goods and services is in many cases **derived** from underlying consumer demand. Océ's demand for DHL Exel's logistics services, for example, depends on the number of copiers purchased by its customers. Fluctuating economic conditions in an industry can change a firm's production schedule, plant and equipment utilisation, and materials and parts inventories. These changes affect the firm's demand for materials, components, equipment, logistics services, and more. In other words, derived demand tends to be relatively erratic and cyclical, making accurate sales forecasting and planning more difficult.

#### 7.1.1.2 Market Demographics

Another major difference between consumer and organisational markets is the number, size, and geographic dispersion of customers. Organisational markets tend to have fewer potential customers, but on average they buy much larger volumes than consumers do. In many industries, the largest organisations also tend to cluster in one or a few geographic areas, as with the concentration of major banks and financial service firms in New York, London, Frankfurt, Zurich and Tokyo.

#### 7.1.1.3 Purchasing Processes and Relationships

Because of the complexity of many of the goods and services and of the large volumes typically involved, organisational purchase decisions often involve evaluation processes focused on detailed, formally specified criteria. These processes are typically carried out by specialised purchasing managers with a great deal of input and influence from other members of the organisation.

### 7.1.2 What Do the Unique Characteristics of Organisational Markets Imply for Marketing Programmes?

The fact that the demand for many organisational goods and services is derived from underlying consumer demand not only makes it harder to forecast sales, but it also limits the marketer's ability to influence demand among organisational buyers. Toyota's demand for steel is unlikely to be increased in the short term by price cuts, persuasive advertising messages, or quantity discounts and other kinds of promotions. Until consumer demand for the firm's cars and trucks expands, increasing steel purchases would simply produce bigger materials inventories, tie up more working capital, and lower profitability.

Therefore, the forward-looking company selling to organisational markets needs to keep one eye on possible changes in organisations' buying behaviour for its product and another eye on trends in the underlying consumer markets. Some firms even engage in marketing actions aimed at stimulating demand in those consumer markets in hopes of increasing demand from their organisational customers. For instance, Monsanto aggressively promoted its warranty for Wear-Dated carpets made from its high-quality synthetic fibres in hopes of stimulating consumers' selective demand for such carpets. The bottom line is that even organisational marketers need a solid understanding of consumer behaviour.

The complexity of many of the goods and services organisations buy, the extensive decision process involved, and the demographics of organisational markets also have marketing implications. These factors facilitate the use of **direct selling**, with its emphasis on personal communications through company salespeople and vertically integrated distribution channels. Organisational marketers also tend to be heavy users of 'high-involvement' media, such as trade journals, product brochures, and websites.

Another upshot of the derived nature of demand in organisational markets, as well as of the complex products and large dollar values involved, is that interdependence between buyers and sellers tends to be greater. The economic success of the marketer depends greatly on the economic success of the organisational customer. The marketer is part of the customer's **supply chain** and is therefore relied on for services such as coordinated delivery schedules, maintenance, spare parts availability, and efficient order handling. This high level of mutual interdependence encourages the development and maintenance of long-term relationships and alliances between the parties.[2] It also demands that supplier firms be customer-oriented and have all their functional activities – including production, R&D, finance, logistics, and customer service – focused on providing superior customer value. As one authority argues, 'By its very nature, [organisational] marketing requires that all parts of the business be customer-oriented and that all marketing decisions be based on a complete and accurate understanding of customer needs.'[3]

## 7.1.3 The Organisational Customer Is Usually a Group of Individuals

Organisations are social constructions. Organisations do not buy things. Rather, individual members, usually more than one, make purchase decisions on the organisation's behalf. Similarly, organisations do not form relationships with other organisations. Relationships are built and maintained among their individual members. Consequently, to understand how organisational purchasing decisions are made, the marketer must first understand the roles performed by different individuals within the organisation and their personal interests and concerns.

### 7.1.3.1 Participants in the Organisational Purchasing Process

Organisational purchasing often involves people from various departments. These participants in the buying process can be grouped as users, influencers, gatekeepers, buyers, and deciders.[4]

*Users*: The people in the organisation who must use or work with the product or service often have some influence on the purchase decision. For example, drill-press operators might request that the purchasing agent buy a particular brand of drills because they stay sharp longer and reduce downtime in the plant.

*Influencers*: Influencers provide information for evaluating alternative products and suppliers. They are usually technical experts from various departments within the organisation. Influencers help determine which specifications and criteria to use in making the purchase decision.

*Gatekeepers*: Gatekeepers control the flow of information to other people in the purchasing process. They primarily include the organisation's purchasing agents and the suppliers' salespeople. Gatekeepers influence a purchase by controlling the information that reaches other decision makers. An organisation does not decide to buy a new product, for example, unless information about its existence and advantages over alternatives is brought to the decision makers' attention.

*Buyers*: The buyer is usually referred to as a **purchasing agent** or **purchasing manager**. In most organisations, buyers have the authority to contact suppliers and negotiate the purchase transaction. In some cases they exercise wide discretion in carrying out their jobs. In other cases, they are tightly constrained by specifications and contract requirements determined by technical experts and top administrators.

And more recently, as we shall see, technology has enabled some firms to automate parts of the buyer's role in the form of computerised reorder and logistics management systems and Web auctions.

*Deciders*: The decider is the person with the authority to make a final purchase decision. Sometimes buyers have this authority, but often lower-level purchasing managers carry out the wishes of more powerful decision makers.

### 7.1.3.2 The Organisational Buying Centre

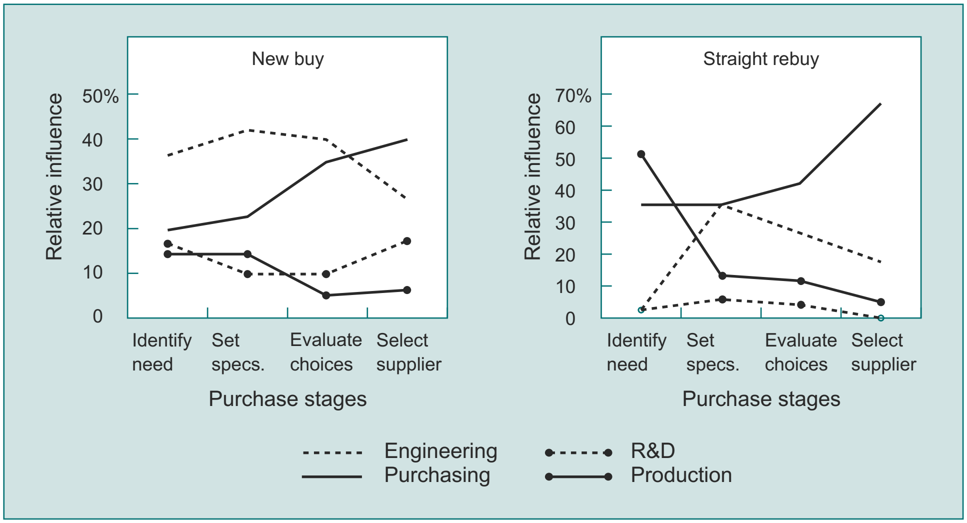
For routine purchases with a small dollar value, a single buyer or purchasing manager may make the purchase decision. For most high-value organisational purchases, several people from different departments participate in the decision process. The individuals in this group, called a **buying centre**, share knowledge and information relevant to the purchase of a particular product or service.

A buyer or purchasing manager is almost always a member of the buying centre. The inclusion of people from other functional areas, however, depends on what is being purchased. When the purchase is a major new installation, the high dollar value of the purchase usually dictates that the firm's chief executive and its top financial officer actively participate in the final decision. For purchases of key fabricating parts for the manufacture of the final product, R&D, engineering, production, and quality-control people are likely to be added. For accessory equipment, such as new office equipment, an experienced user of the equipment (say, a secretary or office manager) might participate in the decision.

Different members of the buying centre may participate – and exert different amounts of influence – at different stages in the decision process. For example, people from engineering and R&D often exert the greatest influence on the development of specifications and criteria that a new component must meet, while the purchasing manager often has more influence when it comes time to choose among alternative suppliers. The makeup of the buying centre also varies with the amount of past experience the firm has in buying a particular product or service. The buying centre tends to be smaller – and the relative influence of the purchasing manager greater – when reordering items the firm has purchased in the past than when buying a new product.[5]

These variations in the relative influence of different members of the buying centre across types of purchase decisions and stages in the buying process are illustrated in Exhibit 7.2. The exhibit summarises the results of a survey of 231 manufacturing firms where managers were asked to indicate the relative influence of various functional departments at different stages in the procurement of component parts. The influence of each department not only varied across stages in the buying process but also depended on whether the purchase was a new buy or a reorder.

**Exhibit 7.2 The relative influence of various functional departments at different stages in two types of organisational purchase decision**




*Source*: Based on E. Naumann, D. J. Lincoln and R. D. McWilliams, 'The Purchase of Components: Functional Areas of Influence,' *Industrial Marketing Management*, May 1984, pp. 113–22. Reprinted by permission of the publisher. Copyright 1984 by Elsevier Science Publishing Co., Inc. *See also* R. D. McWilliams, E. Naumann and S. Scott, 'Determining Buying Center Size,' *Industrial Marketing Management*, 21 (February 1992), pp. 43–50.

### 7.1.3.3 Marketing Implications

Because employees of a customer's firm may be active at different stages of the purchase process and have different interests and concerns, an important part of planning a marketing programme aimed at organisational customers involves determining which individuals to target, how and when each should be contacted, and what kinds of information and appeals each is likely to find most useful and persuasive. Fortunately, in many cases the roles played by various members of the buying centre are sufficiently consistent across similar types of firms in an industry that a marketing manager can tailor different promotional messages and sales policies for specific members. For example, in smaller firms in the construction industry (those with sales volumes under $25 million) presidents and vice presidents exert significantly more influence at all stages in the decision process than do purchasing agents or construction engineers, while the situation is reversed in large firms, reflecting increasing job specialisation and decentralisation of purchasing in bigger companies.[6] A manager marketing to this industry might develop account management policies directing the salesforce to seek appointments with top executives when calling on smaller firms, but to initiate contacts through the purchasing department in larger organisations. Another example involving the development of different advertising appeals and the use of different media to reach buying centre members is summarised in Exhibit 7.3.

Similarly, customers' buying centres are likely to involve a wider variety of participants when they are considering the purchase of a technically complex, expensive product, such as a computer network, than when the purchase involves a simpler product or service. Consequently, firms such as IBM selling technically complex capital equipment often deploy multifunctional sales teams or utilise 'multilevel' selling, with different salespeople calling on different members of the buying centre to give each the kinds of information that person will find most relevant.[7]

**Exhibit 7.3 Communicating value to different members of a buying centre with tailored advertisements**

Different members of a firm's buying centre value different things when choosing suppliers and products. At Honeywell's MICRO SWITCH Division, the marketing staff responsible for fibre-optic products develop customised advertisements for the different members of customers' buying centres – design engineers, production engineers, engineering managers and purchasing agents. Design and production engineers see value in leading-edge technologies and products that are easy to design, install and use. Engineering management is concerned with supplier capabilities, including a proven track record and good service. Purchasing agents see value in low cost and reliable delivery.

Recognising that different business and technical functions value different things, Bob Procsal, marketing manager for fibre-optic products, carefully chooses different messages and media to communicate to each buying centre member. For instance, advertisements stressing the products' advanced technical features and high performance levels run in technical magazines aimed at design and production engineers, while messages emphasising Honeywell's years of experience and position as a worldwide leader in advanced switching technology are targeted at engineering managers.

Does the added effort and expense of customised advertisements pay off? Bob Procsal thinks it does. He reports that inquiries about the company's line of fibre-optic products increased 50 per cent after this practice was implemented.

*Source*: Adapted from Eric N. Berkowitz, Roger A. Kerin, Steven W. Hartley and William Rudelius, *Marketing*, 5th ed. (Burr Ridge, IL: Richard D. Irwin, 1997), pp. 190–91.

## 7.2 How Organisational Members Make Purchase Decisions

Organisational purchase decisions often involve extensive information search and evaluation processes similar to those consumers use when buying high-involvement items. As with individual consumers, however, the way specific organisational purchase decisions are made can vary with the firm's level of past experience and other aspects of the buying situation.

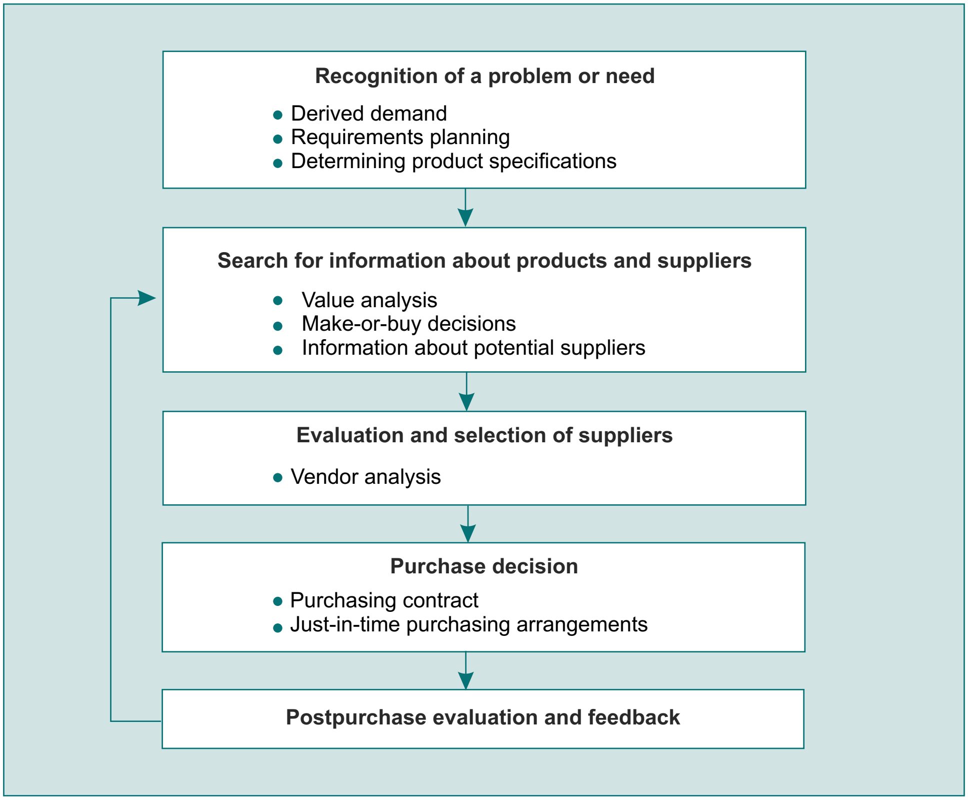
## 7.2.1 Types of Buying Situations

Organisations encounter three kinds of buying tasks or situations: the straight rebuy, the modified rebuy, and new-task buying.[8]

A **straight rebuy** involves purchasing a common product or service the organisation has bought many times before. Such purchases are often handled routinely by the purchasing department with little participation by other departments. Such purchases are almost automatic, with the firm continuing to purchase proven products from reliable, established vendors. In straight rebuy situations, all phases of the buying process tend to be short and routine. Even so, when large quantities are involved, the need for quality assurance, parity pricing, and on-time delivery to minimise inventory requires a competent salesforce to help the supplier maintain a continually satisfying relationship with the buyer over time. The rapid spread of computerised reordering systems, logistical alliances, and the like have made the development and maintenance of long-term relationships between suppliers and their customers increasingly important in the purchase of familiar goods and services. We shall examine the nature of such relationships, and how recent technological developments have facilitated their development, in a later section.

A **modified rebuy** occurs when the organisation's needs remain unchanged, but buying centre members are not satisfied with the product or the supplier they have been using. They may desire a higher-quality product, a better price, or better service. Here buyers need information about alternative products and suppliers to compare with their current product and vendor. And as we'll see, Web-based technology – such as business-to-business auctions organised by firms like FreeMarkets, Inc. (www.FreeMarkets.com.) or by industry sites like e-Steel.com (www.e-Steel.com) or PlasticsNet.com (www.PlasticsNet.com) – is making it easier for organisational buyers to make such comparisons, at least on the price dimension. Therefore, modified rebuys present good opportunities for new suppliers to win the organisation's business if they can deliver better value than the firm's current vendor.

**Exhibit 7.4 The organisational decision-making process for new-task purchases**




**New-task buying** occurs when an organisation faces a new and unique need or problem – one in which buying centre members have little or no experience and, thus, must expend a great deal of effort to define purchasing specifications and to collect information about alternative products and vendors. Each stage of the decision process is likely to be extensive, involving many technical experts and administrators. The supplier's reputation for meeting delivery deadlines, providing adequate service, and meeting specifications is often a critical factor in selling a product or service to an organisation for the first time. Because the buying centre members have limited knowledge of the product or service involved, they may choose a well-known and respected supplier to reduce the risk of making a poor decision.

### 7.2.2 The Purchase Decision-Making Process

As Exhibit 7.4 suggests, the stages in the organisational purchase decision-making process – at least for modified rebuy and new-task purchases – correspond quite closely with consumers' high-involvement purchases. However, the exhibit also suggests that some activities at each stage and their execution differ. More people are involved in organisational purchase decisions; the capability of potential suppliers is more critical; and the postpurchase evaluation process is more formalised. We examine other unique features of each stage of the organisational purchase decision process next.[9]

### 7.2.2.1 Recognition of a Problem or Need

The organisational purchasing process starts when someone in the firm recognises a need that can be satisfied by buying some good or service. As we have seen, though, while consumers may buy things impulsively to satisfy psychological or social needs, most of an organisation's needs are derived from the demand for the goods or services they produce or resell to their own customers. In other words, most organisational purchases are motivated by the needs of the firm's production processes and its day-to-day operations.

In some cases, need recognition may be almost automatic, as when a computerised inventory system reports that an item has fallen below the reorder level or when a piece of equipment wears out. In other cases, a need arises when someone identifies a better way of carrying out day-to-day operations. Océ has expanded the range of logistics services it buys from DHL Exel over the years, for instance, as it has discovered activities that DHL Exel can perform more effectively or efficiently.

Finally, changes in the organisation's operations can create new needs; for instance, top management may decide to produce a new product line that requires new components or raw materials. Or there may be changes in the firm's objectives, resources, market conditions, government regulations, or competition. Needs, then, may be recognised by many people within the organisation, including users, technical personnel, top management, and purchasing agents.

#### Requirements Planning

Instead of simply monitoring inventories and reordering when they run low, some firms attempt to forecast future requirements so as to plan their purchases in advance. Requirements planning governs the purchase of raw materials and fabricating components as well as supplies and major installations. One result of such planning is often the signing of long-term purchase contracts, particularly for products projected to be in short supply or to increase in price. Requirements planning can also lead to lower costs and better relations between a purchaser and its suppliers.

#### Determining Product Specifications

The need for particular goods and services is usually derived from a firm's production or operation requirements and, therefore, must meet specific technical requirements. Technical experts from the firm's R&D, engineering, and production departments are often involved early in the purchase decision. When the firm needs a unique component or piece of equipment, it might even seek help from potential suppliers in setting the appropriate specifications. For example, automobile manufacturers consult their parts suppliers before finalising specifications for a new model. Increasingly, suppliers are active participants in the design and development of new components or systems.

### 7.2.2.2 Search for Information about Products and Suppliers

Once specifications for the desired product/service are developed, purchasing (and possibly other departments) performs a **value analysis**. This systematic appraisal of an item's design, quality, and performance requirements helps to minimise procurement costs. It includes an analysis of the extent to which the product might be redesigned, standardised, or processed using less-expensive production methods. A cost analysis that attempts to determine what the product costs a supplier to produce is also part of a value analysis. Such information helps the purchasing agent better evaluate alternative bids or negotiate favourable prices with suppliers.

#### Make-or-Buy Decisions

Sometimes a firm has the option of producing some components and services internally (advertising, marketing research) or buying them from outside suppliers. Economic considerations typically dominate such decisions, although in the long run other factors may be important (for instance, overdependence on a single supplier).

#### Information about Potential Suppliers

Because many firms evaluate a supplier's performance on a regular basis, there is often considerable information about that supplier's quality of performance on file. Where new suppliers are involved, the purchasing department typically engages in an in-depth investigation before qualifying that firm as a potential supplier. An investigation would include such information as the firm's finances, reputation for reliability, and the ability to meet quality standards, information that can be obtained from personal sources (such as salespersons, trade shows, other firms, and consultants) and nonpersonal sources including catalogues, advertising, and trade literature.

### 7.2.2.3 Evaluation and Selection of Suppliers

Like individual consumers, organisational buyers evaluate alternative suppliers and their offerings by using a set of **choice criteria** reflecting the desired benefits. The criteria used and the relative importance of each attribute vary according to the goods and services being purchased and the buyer's needs. The supplier's ability to meet quality standards and delivery schedules is always important. Price is critical for standard items such as steel desks and chairs, but for more technically complex items, such as computers, a broader range of criteria enters the evaluation process.

#### Vendor Analysis

Some purchasing departments construct quantitative ratings of potential suppliers to aid in the selection process. These ratings look very much like the multiattribute, compensatory attitude model we discussed for individual consumers. The procedure involves selecting a set of salient attributes and assigning to each a weight reflecting its relative importance. Suppliers are then rated by summing their weighted scores across all attributes.

Such ratings serve several useful purposes, including facilitating the comparison of alternative suppliers, providing a basis for discussions with suppliers about their performance, and controlling the number of qualified suppliers. The end result of a vendor analysis is typically the development of a list of approved suppliers. General Electric, for example, works only with vendors that are top-rated in an analysis of quality, technology, price, and other factors. The company finds regular vendor analysis a more efficient way to ensure the quality of the components it buys than waiting to inspect parts when they are received.[10]

This step in the buying process, along with the previous steps, seems to imply that the individuals making up the buying centre respond only to economic arguments. But industrial buyers are social entities *in addition* to being interested in the economics of the situation. For example, producers of marine diesel engines for large boats understand the need to make such engines aesthetically appealing since the owners of such craft take pride in opening an engine hatch to reveal a sleek, chromed engine. In general, the more similar the suppliers and their offerings, the more likely it is that social factors will affect the buying decision.

## What If the Customer Makes Unethical Demands of Its Suppliers?

As we saw in Module 2, a supplier's ethics can have a direct effect on its success in the marketplace because organisational buyers are more likely to purchase from firms they consider ethical.[11] Ethical behaviour plays a crucial role in establishing the trust and cooperation necessary for the development and maintenance of long-term relationships with customers. But what if members of the buying organisation engage in or demand unethical practices?

One questionable practice that some buyers engage in is **reciprocity**, which occurs when an organisation favours a supplier that is also a customer or potential customer for the organisation's own products or services. Although this situation is relatively common, it can cause serious problems, including undermining the morale of purchasing and sales personnel who are constrained in the way they do their jobs. Also, reciprocal buying is illegal when it substantially injures free competition among alternative suppliers.

Another unethical practice that causes headaches for many suppliers – particularly in global markets where there are great differences in cultural values and legal restrictions – is the demand for bribes as a precondition for winning a purchase. Exhibit 7.5 examines this issue.

Even in the United States, buyers and merchandise managers for some large chain retailers have been known to pressure smaller suppliers to deposit into the buyer's private Swiss bank account a few pennies per item purchased, say, socks, packages of Easter candy, or whatever. The would-be seller faces a difficult decision whether to report such behaviour to the buyer's superiors – some of whom may also engage in and therefore condone such behaviour – or whether to simply refuse to play ball and thereby walk away from that chain's business. Building relationships at multiple levels in the customer organisation can offer some level of protection against this problem.

**Exhibit 7.5 Bribery in Organisational Purchasing**

Bribery can take many forms ranging from small-value Christmas gifts to large sums of money. In the United States, gifts of high value are typically condemned. Most organisations do not want the decisions of their purchasing personnel unduly influenced by large gifts from a prospective supplier. Bribery is not officially condoned anywhere in the world. Most countries' laws concerning bribery are not as restrictive as those in the United States, however, nor are they always so rigorously enforced.

US laws, on the other hand, have real teeth, including hefty fines and prison sentences. Consequently, most US firms avoid paying major bribes to foreign customers and have sought other ways to influence people and win contracts. Some take foreign officials on junkets to Disney World. Others use local agents or distributors who – known to them or not – do the dirty work. And most multinationals do make small 'facilitation' payments to hasten building inspections, telephone installations, customs clearances, and the like.

Despite such actions, the ethics of US suppliers and the strict US antibribery laws appear to leave American firms at a competitive disadvantage in many countries around the world. One recent government report indicates that bribes were allegedly offered by foreign competitors on 294 international contracts worth $145 billion between 1994 and 1999, and that is probably just the tip of the iceberg.

However, commercial bribery – especially the bribing of government officials – is getting riskier. More than 30 countries have passed antibribery laws in recent years, and US officials have stepped up enforcement of the Foreign Corrupt Practices Act (FCPA). The number of open FCPA investigations is at an all-time high, and penalties are up.

*Source*: Dana Milbank and Marcus Brauchli, 'How US Concerns Compete in Countries Where Bribes Flourish,' *The Wall Street Journal*, September 25, 1995, p. A1; and Robert Greenberger, 'Foreigners Use Bribes to Beat US Rivals, New Report Concludes,' *The Wall Street Journal*, October 12, 1995, p. B1; and *Addressing the Challenges of International Bribery and Fair Competition* (Washington DC: US Department of Commerce, July 1999).

### 7.2.2.4 The Purchase

The purchase agreement between a supplier and an organisational customer can take several forms, ranging from individual spot contracts on the open market, to long-term purchasing contracts covering a year or more, to ongoing informal relationships based on cooperation and trust rather than legal agreements. In the past, long-term purchasing contracts were popular because they enabled an organisation to concentrate its purchases with one or a few suppliers, reduce transaction costs, and gain scale economies through quantity discounts and the like. For example, an **annual requirements contract** obligated a supplier to fill all of a buyer's needs for a specific product at a consistent, usually discounted, price over a year.

One problem with long-term legal contracts, though, is that they must precisely specify all the details of a purchase agreement, including technical specifications, prices, credit terms, and so on. But in today's rapidly changing economic and technical environments, it can be difficult for the parties to foresee what their needs and market conditions will be like months or years into the future. It can be difficult to adjust the terms of a formal contract in response to unforeseen technical improvements, cost changes, or market conditions. This inflexibility of long-term contracts is a major reason their popularity has declined in favour of increased reliance on spot market contracts, or auctions, on one hand, and less formal long-term relationships between customers and suppliers on the other.[12] The increased reliance on both of these approaches has been facilitated by a common factor: the growth of telecommunications technology and the Internet.

## One Impact of Technology: The Growth of Auctions or E-exchanges

Over the past few years, a number of Internet firms have emerged to help organisations cut their purchasing costs. The earliest entrants, such as Commerce One and Ariba, focused on improving the efficiency of organisations' search for information and evaluation of alternative products and suppliers. They developed electronic catalogues that reduced clients' transaction costs by automating the collection of product information, orders, and payments.

More recently, sellers' auction websites have emerged in a number of industries. These provide lively global spot markets for standard processed materials such as steel, chemicals, and plastics. For example, ChemConnect (www.chemconnect.com) is an exchange for buyers and sellers of bulk chemicals such as benzene. The site's user-friendly design attracted a large number of potential buyers and sellers. As a result ChemConnect is now the largest online spot market for chemical trading, with over a million barrels traded daily.[13]

The websites that may have the greatest future impact on organisational purchasing behaviour, however, are those that facilitate buyers' auctions. Such auctions invite qualified competing suppliers to submit bids to win a contract where the buyer has specified all of the purchase criteria in great detail, except the price. By enabling all suppliers to see what the competition is bidding in real time, these auctions have the potential to greatly increase price competition and lower buyers' acquisition costs in some cases by as much as 30 or 40 per cent.[14]

However, because buyers' auctions are feasible only when the buyer is able to specify *all* its requirements except price – including all technical and performance attributes of the good or service, delivery schedules, inventory arrangements, payment schedules, and the like – they work best for purchases where the buyer has experience to draw upon, and where those requirements are unlikely to change rapidly. One service offered by auction sites such as FreeMarkets (www.FreeMarkets.com) is to help clients examine their needs and clearly spell out every aspect of their request for quotes (RFQs) so potential suppliers will know exactly what they're bidding for. Thus, buyers' auctions are like 'modified rebuy' situations where the buyer knows the physical requirements of the purchase but wants to see whether an alternative supplier might offer a better price.

Because auctions throw every purchase up for grabs among alternative suppliers, they work against the development of a cooperative long-term relationship with a given supplier. And they are unlikely to replace such relationships where the product or service being purchased is very technically complex or innovative, is highly customised to the buyer's unique requirements, or requires specialised equipment or other investments to produce. Auctions are also unlikely to replace long-term cooperation between a buyer and a trusted supplier where there are substantial savings to be gained from logistical alliances, as discussed in the next section. Consequently, while the proportion of global business-to-business online sales volume accounted for by auctions or e-exchanges is predicted to increase steadily for the foreseeable future, other forms of purchasing arrangements, including long-term alliances and partnerships, will continue to dominate.[15]

## Logistical Alliances

Technology also has changed organisational purchasing over the past decade by facilitating logistical alliances involving the sharing of sales and inventory data and computerised reordering. Initially, such systems involved electronic data interchange through dedicated telephone or satellite links and were mainly limited to large firms. More recently, software for developing such systems on the Web and protecting the security of proprietary data has improved substantially, thereby lowering costs and increasing their availability to smaller firms.

**Exhibit 7.6 Japanese department store uses radio frequency identification tags to improve inventory control purchasing and customer satisfaction**

Mitsukoshi, one of Japan's leading luxury department stores, began using radio frequency identification (RFID) tags to track individual inventory items in its ladies' shoe departments in 2005. Each pair of shoes on display and every box in the stockroom (or 'backyard' as the Japanese refer to it) carries a tiny radio transmitter tag with a unique ID number whose signal can be received anywhere in the department. Sales associates are equipped with PDAs capable of reading the RFID signals, and a customer kiosk housing an RFID reader is installed on the selling floor. Customers can scan through – or the salesperson can display – a full range of styles and colours, and determine whether a particular shoe is available in the right size, without the sales associate making endless trips to the stockroom. As a result, salespeople are able to service more shoppers and suggest more options. The average Mitsukoshi customer tries on 70 per cent more shoes in roughly the same amount of shopping time as before the new system was installed.

Ongoing analysis of the detailed RFID data concerning every pair of shoes sold in each store provides clues to managers about what is selling quickly and where there may be size or colour gaps in the assortment. Mitsukoshi's suppliers also receive automatic notification when a store's inventory of a specific stock-keeping unit (SKU) falls below a reorder threshold, thus speeding up replenishment and reducing stockouts.

In the first year, the new item-level RFID system enabled Mitsukoshi to achieve a 10 per cent increase in year-over-year sales volume. About one half of that increase is attributed to improved cooperation with suppliers leading to faster replenishment and fewer stockouts, and the other half to improved customer service. The programme has been so successful that it is being expanded to other fashion items, such as designer jeans.

*Source:* Susan Reda, 'Stepping Up the RFID Effort,' on the stores.org website, **www.stores.org/archives/2006/3/cover.asp,** March 2006.

Consumer package goods manufacturers such as Procter & Gamble have formed **supply chain management alliances** with mass merchandisers such as Wal-Mart and Target. Sales information from the retailer's checkout scanners is shared directly with the supplier's computers, which figure out when to replenish the stock of each item and schedule deliveries to appropriate distribution centres or even individual stores. Such paperless exchanges reduce sales and purchasing expenses, cut mistakes and billbacks, minimise inventories, decrease out-of-stocks, and improve cash flow. Recent technological enhancements – such as item-level radio frequency identification (**RFID**) tags – help such alliances deliver even more benefits to both organisational buyers and their retail customers, as illustrated by the experience of Mitsukoshi department stores described in Exhibit 7.6.

#### 7.2.2.5 Performance Evaluation and Feedback

When a purchase is made and the goods delivered, the buyer's evaluation of both product and supplier begins. The buyer inspects the goods on receipt to determine whether they meet the required specifications. Later, the department using the product judges whether it performs to expectations. Similarly, the buyer evaluates the supplier's performance on promptness of delivery and postsale service.

In many organisations this process is done formally through reports submitted by the user department and other persons involved in the purchase. This information is used to evaluate proposals and select suppliers the next time a similar purchase is made.

### 7.2.3 The Marketing Implications of Different Organisational Purchasing Situations

The extensive purchasing process we have been talking about applies primarily to new-task purchases, where an organisation is buying a relatively complex product or service for the first time. Buyers in such circumstances tend to collect a lot of information about alternative products and suppliers and to engage in extensive comparisons before making a final purchase decision. Such situations are relatively favourable to potential new suppliers who have never sold to the organisation. Such newcomers can win the organisation's business *if* they can provide superior product benefits, superior customer service, or better prices – in other words, better customer value – *and if* they can convince the customer of their superiority through an effective sales pitch, a user-friendly website, or other promotional efforts. (Good value means nothing if nobody knows about it.) Potential new suppliers may even be able to engage in product development efforts aimed at winning the new customer. This is why entrepreneurial start-ups tend to prosper in emerging categories where product designs are still in flux and there are few entrenched competitors with close ties to potential customers; they are more likely to get a full hearing and have a better chance to differentiate themselves from other suppliers.

One major reason for establishing long-term cooperative relationships with major customers is to become an active partner in designing – and setting the specifications for – the next generation of the customer's products. In the process, the supplier may have a major influence on the purchase criteria for major materials and components of the new product, thereby gaining the inside track on winning the purchase contract for those new-task purchases.

At the other extreme is the straight rebuy, where the customer is reordering an item it has purchased many times before. These purchases tend to be more routine and computerised. From the seller's viewpoint, being the established or 'in' supplier in such purchase situations provides a major competitive advantage because the customer spends little or no effort evaluating alternatives. Therefore, established suppliers should develop procedures to maintain and enhance their favoured position with current customers. For instance, many firms have developed 'key account' policies and appoint cross-functional teams to service major customers to help ensure their satisfaction and retention. New technologies have made it easier for established suppliers to strengthen their ties to customers through supply chain management systems and logistical alliances.

For 'out' suppliers who do not have well-established relationships with an organisational customer, however, the marketing challenge is more difficult. Such competitors must try to move the buyer away from the relatively routine reordering procedures of the straight rebuy toward the more extensive evaluation processes of a modified rebuy purchase decision. They must attempt to interest the buyer in modifying the purchase criteria either by promising superior product performance, better service on one or more dimensions, or an equivalent package at a better price.[16] Historically, 'out' suppliers – particularly small, unknown start-ups with few marketing resources – had a hard time surmounting this challenge. But the emergence of Web-based auctions may help level the playing field for such suppliers, at least for those efficient enough to compete largely on price.

#### 7.2.3.1 Developing Long-Term Buyer–Supplier Relationships

From a supplier's perspective, developing logistical alliances and computerised reorder systems can help tie major customers to the firm and increase the proportion of purchases they make from the supplier. But as DHL Exel's evolving relationship with Océ illustrates, long-term relationships between suppliers and their organisational customers often involve much more than merely linking their computer systems and sharing inventory data. DHL Exel often gets involved in improvement projects aimed at developing customised services to meet Océ's specific needs.

#### 7.2.3.2 Trust between Supplier and Customer Develops Person-to-Person

Such complex relationships not only involve a great deal of cooperation between the parties, but they also require *mutual trust*. Before making a substantial investment in training its employees to perform pre-installation testing of Océ's copiers, DHL Exel had to trust Océ to continue purchasing its services long enough to recoup that investment. Similarly, Océ had to trust DHL Exel to measure up to its own high standards when servicing its copier customers. In other words, both parties must trust one another to avoid opportunistic behaviours that would advance their own short-term self-interest at their partner's expense.[17]

Organisations develop trust through the actions of individual members of the firm. Therefore, company salespeople, account teams, logistics managers, and customer service personnel often play crucial roles in winning customer trust and loyalty. Unfortunately, this can make buyer–supplier relationships vulnerable to personnel turnover. Suppliers can minimise such problems by (1) developing effective corporate policies and performance standards with respect to customer service, (2) instituting training programmes and succession planning for customer contact personnel, and (3) fostering and rewarding a strong customer orientation within the corporate culture.[18]

#### 7.2.3.3 Conditions Favouring Trust and Commitment

While mutual trust is important for the development and maintenance of long-term commitments between suppliers and their organisational customers, it is not always easy to develop. First, trust tends to build slowly. Thus, the parties must have some history of satisfying experiences with one another to provide a foundation for trust. It also helps if each party brings an established reputation for fair-dealing within its industry.[19]

From the customer's perspective, a firm is more likely to trust and develop a long-term commitment to a supplier when that supplier makes dedicated, customer-specific investments, as DHL Exel has done in developing customised services for individual customers. Such investments send a powerful signal about the vendor's credibility and commitment to the relationship since the assets are not easily deployable elsewhere.

There are many other actions a firm can take to initiate, build, and maintain long-term relationships with organisational customers. Such actions become even more important as a product-market matures, sales growth slows, and competition becomes more intense. Consequently, we will examine **customer relationship management** programmes in more detail in Module 17, when we discuss marketing strategies for mature markets.

In markets characterised by complex and uncertain technical environments, such as where competing technologies are emerging simultaneously, as in the networking software industry, customers are less likely to develop a long-term orientation toward a single supplier. Because firms in such circumstances cannot tell which supplier's technology will eventually become the industry standard, they are more likely to keep their options open by spreading their purchases across multiple suppliers if it is economically feasible to do so.[20]

### 7.2.4 Purchasing Processes in Government Markets

Federal, state, and local governments and their various agencies are major buyers of many goods and services. However, a government's purchasing processes tend to be different in some respects from those of a business organisation. For one thing, government organisations tend to require more documentation and paperwork from their suppliers because their spending decisions are subject to public review. Thus, although most governments provide would-be suppliers with detailed guides describing their procedures and requirements, some suppliers complain about excessive bureaucracy, costly paperwork, and red tape.

Another difference is that government organisations typically require suppliers to submit bids, and contracts are usually awarded to the lowest bidder who meets the minimum standards specified in the contract. In some cases, though, a government unit will make allowances for a supplier's superior product quality or customer service. They also sometimes purchase on a negotiated or 'cost-plus' contract basis, particularly when the product being purchased will require a lengthy development period (a hydroelectric dam) or major and uncertain R&D investments (a new weapons system), or when there are few alternative suppliers to compete for the contract.

These differences in governmental purchasing processes make many standard marketing strategies and tools less relevant and effective than in other organisational markets. For example, since a government purchase contract usually describes the desired product specifications in great detail, and since contracts are usually awarded to the lowest bidder, a strategy of product differentiation via superior features or performance would be not likely to be successful, particularly if it resulted in higher costs. For the same reason, comparative advertising appeals or personal sales demonstrations have little impact. Nevertheless, many organisations – such as Rockwell, Goodyear and 3M – have created separate government marketing departments or sales teams. Their task is to anticipate government needs and projects, participate in or influence the development of product specifications, gather competitive intelligence, carefully prepare bids, and expedite postsale activities and services.[21] The lessons learned in selling to governments may become much more relevant in private-sector markets as Web-based buyers' auctions for standardised materials and components proliferate.

## 7.3 Selling Different Kinds of Goods and Services to Organisations Requires Different Marketing Programmes

Organisational buying processes tend to vary dramatically depending on what is being bought. Different types of goods and services require sellers to employ varying marketing strategies and actions to be successful in organisational markets. Marketers commonly classify industrial goods according to the uses made of the product by organisational purchasers. With this in mind, *six categories of industrial goods and services* can be identified: raw materials, component materials and parts, installations, accessory equipment, operating supplies, and business services. Exhibit 7.7 describes these categories and their major characteristics and marketing implications.

**Exhibit 7.7 Categories, characteristics and marketing implications of goods and services bought by organisations**

| Category | Description | Characteristics |
|---|---|---|
| Raw material | Relatively unprocessed goods that become a portion of a final product. | Limited supply, few producers; distribution is a key function, price is a critical competitive variable. |
| Component parts and materials | Processed goods that become a portion of a final product (engines, microchips, etc.). | High-volume purchases, long-term contracts; fierce competition among suppliers, requires good service and nurturing of relationships with buyers; Web auctions also important for standard components. |

| Category | Description | Characteristics |
|---|---|---|
| Installations | Major capital goods used to produce a final product, but not part of the final product (plant installations, production machinery, etc.). | Long-lasting; involved in production of many units of the final product over several years; involve large monetary outlays; capital budgeting committee involved in purchase decision; sold directly from manufacturer; personal selling and system design services are crucial. |
| Accessory equipment | Finished goods that facilitate production of a final product. | Enduring but less so than installations; more standardised, more frequently purchased and less costly than capital equipment; less complex buying; intermediaries may be involved. |
| Operating supplies | Finished goods that facilitate repair, maintenance and ongoing operations (office supplies, repair parts, etc.). | Analogous to consumer convenience goods, frequently purchased and consumed in a short time; standardised; broad market; heavy use of channel intermediaries; Web-based wholesalers and catalogue sites becoming important. |
| Business services | Provide special expertise to facilitate ongoing operations (law firms, adv. agencies, etc.). | Long-term relationships with customers; supplier's qualifications, experience and reputation critical to success; purchase decision often made by top executives. |

## 7.3.1 Raw Materials

Raw materials are goods receiving little or no processing before they are sold, except what is necessary for handling and shipping. Purchased primarily by processors and manufacturers, they are inputs for making other products. The two types of raw materials are *natural products* (fish, lumber, iron ore, and crude petroleum) and *farm products* (fruits, vegetables, grains, beef, cotton, and wool). Processors and manufacturers purchase nearly all natural products and about 80 per cent of all farm products. Retailers or consumers buy the remaining 20 per cent directly without any processing.

### Implications for Marketing Decision Makers

The supply of most natural products is limited; in recent decades, there have been some shortages. Often only a few large firms produce particular natural products, and in some countries those producers have been nationalised. These supply conditions give producers the power to limit supplies and administer prices, as with the Organisation of Petroleum Exporting Countries (OPEC). Such supply conditions encourage processors and manufacturers to seek ways to ensure adequate supplies for the future by negotiating long-term purchase contracts (often at premium prices) or by purchasing the raw materials sources.

For example, many large steel manufacturers own iron ore mining and processing operations.

Natural materials are generally bulky and low in unit value; therefore, producers try to minimise their handling and transportation costs. Distribution channels for natural materials tend to have few middlemen; most materials are marketed directly to processors and manufacturers.

The marketing problems associated with natural products are quite different from those of agricultural products, which are produced by many relatively small farms located far from consumer markets. Also, many of these products are produced seasonally. Thus, the distribution channels for most agricultural materials involve many middlemen who buy products from a large number of farmers, collect them in a central location (such as a grain elevator), and store them for shipment throughout the year to processors and exporters. Since there is little difference among the products grown by different farmers, branding is relatively unimportant. There is usually little promotional activity, except for cooperative advertising campaigns funded by trade groups to stimulate primary demand for a product. An example is a promotional campaign to persuade health-conscious adults to drink more milk.

## 7.3.2 Component Materials and Parts

As with raw materials, component materials and parts are purchased by manufacturers as inputs for making other products. *Component materials* differ, though, in that they have been processed to some degree before they are sold (for instance, flour bought by a baker). *Component parts* are manufactured items assembled as part of another product without further changes in form (electric motors for washing machines, batteries for new cars).

### Implications for Marketing Decision Makers

Manufacturers buy most component materials and parts in large quantities; therefore, they are usually sold direct, without the use of middlemen. However, wholesale distributors sell to smaller manufacturers in some lines of trade.

To avoid disrupting production runs, sellers must ensure a steady, reliable supply of materials and parts, especially when a JIT management system is being used by the buyer. This system's objective is to eliminate inventories at the customer's manufacturing site, which requires the delivery of 100 per cent quality (zero-defect) products. This relieves the customer of any incoming inspection. A vendor's failure on quality or delivery can close a customer's operation so the resulting penalties are usually severe.

A JIT system is costly to set up and cannot be effectively implemented without a continuing and close working relationship between buyer and seller. This may explain why a growing proportion of the purchases of component materials and parts, particularly in situations where the components are standardised and the buyer is able to specify all requirements in detail, are being made through electronic buyer auctions such as FreeMarkets, Inc.[22] (www.FreeMarkets.com).

Competitive bidding by suppliers can provide some of the cost-saving benefits of JIT systems without the time and effort necessary to build close cooperation.

### 7.3.3 Installations

Installations are the buildings and major capital equipment that manufacturers and service producers use to carry out their operations. They are expensive and long-lived; examples are factory buildings constructed for a manufacturer, office buildings built for government agencies, computers used by the Inland Revenue Service, presses used by an automobile manufacturer, and aircraft purchased by Ryanair.

#### Implications for Marketing Decision Makers

The marketing of installations presents a real challenge because there are few potential customers at any one time, and the average sale is very large. Many installations are custom-made to fit a particular customer's needs; therefore, sellers must provide some engineering and design services before making a sale. Often a long period of negotiation precedes the final transaction. Firms selling installations must usually provide many postsale services, such as installing the equipment, training the customer's personnel in its use, providing maintenance and repair services, and sometimes financing.

Because of the small number of buyers, the large dollar volume of each sale, and the custom engineering involved, distribution is usually direct from producer to customer. Sometimes wholesale distributors provide replacement parts and repair services for equipment already in operation. For similar reasons, promotional emphasis is usually on personal selling versus advertising. High-calibre, well-trained salespeople are critically important in the marketing of installations.

### 7.3.4 Accessory Equipment

As with installations, **accessory equipment** includes industrial machines and tools that manufacturers, services producers, and governments use to carry out their operations. The difference is that although installations determine the scale of operations of the firms that buy and use them, accessory equipment has no such impact since it consists of tools and machines with relatively short lives and small price tags. They consist of such goods as personal computers, desks, file cabinets, and hand tools.

#### Implications for Marketing Decision Makers

Because this product category includes a wide range of specific items, it is hard to generalise about the most common or appropriate marketing strategies for accessory equipment. In some cases, as with Hyster forklifts and Xerox office equipment, the producers sell accessory equipment directly. Their presale and postsale service requirements are substantial, but the dollar value of the average sale is high enough to justify direct distribution. When there are many different types of potential customers scattered around the country, the average order size is small, and the product does not require much technical service, producers use wholesale distributors (for instance, Black & Decker hand tools). Web-based catalogue sites, such as Ariba (www.ariba.com), are also important in this category.

Personal selling, either by the producer's or a distributor's salesforce, remains the most important promotional method for accessory equipment, but because most products in this category are standardised and not technically complex, advertising, brand name promotions, and company websites are also important.

## 7.3.5 Operating Supplies

**Operating supplies** do not become a part of the buyer's product or service, nor are they used directly in producing it. Instead, these supplies facilitate the buying organisation's day-to-day operations. They are usually low-priced items purchased frequently with a minimum of decision-making effort. Examples include heating fuel, floor wax, typing paper, order forms, paper clips, and pencils.

### Implications for Marketing Decision Makers

These supplies are purchased in small quantities by many different organisations, so wholesale middlemen, including those with extensive websites such as Office Depot, are typically used to distribute them. Price is usually the critical decision variable, and there tends to be little brand loyalty.

## 7.3.6 Business Services

Many business services producers, or facilitating agencies, have special areas of expertise used and paid for by other organisations. These include security and guard services, janitorial services, equipment repair services, public warehouses, transportation agencies, consulting and marketing research services, advertising agencies, and legal and accounting services.

### Implications for Marketing Decision Makers

Services are intangible and are purchased before they can be evaluated by the buyer. Thus, the supplier's qualifications, past performance, and reputation become critical determinants of the success of the marketing effort. Price is less important in selling business services because a lawyer or consultant with an outstanding reputation can often charge much more for a given service than one who is less well known. Also, price often serves as an indicator of quality, especially when there are no other quality cues.[23]

Because services are often tailored to the specific needs of a given customer, personal selling and negotiation are important elements in most services producers' marketing programmes. This selling is often done by high-level executives in the service producer's organisation. The negotiation process can be lengthy; for instance, an ad agency team spends months developing proposals and making presentations to a prospective client before finding out whether it has landed the new account. This selling task is often worth the effort, though, for once a relationship is established between a service supplier and a customer, it tends to be maintained over a long time, as in the case of DHL Exel and Océ.

Many companies employ the same law firm, advertising agency or logistics services firm for years or even decades.

## Learning Summary

- While organisational customers are different in some ways from consumers, marketers need to answer a similar set of questions to develop a solid foundation for their marketing plans. Who are our target customers? What are their needs, wants, and preferences? How do those customers decide what to buy and what suppliers to buy from?
- Organisations buy things for one of three reasons: (1) to facilitate the production of another product or service, (2) for use by the organisation's employees in carrying out its operations, or (3) for resale to other customers.
- Organisations are social constructions. Therefore, 'organisations' do not buy things. Rather, individual employees – usually more than one from different departments and organisational levels – make purchase decisions on the organisation's behalf. Understanding the personal motivations of these individuals, and their influence on different stages of the purchasing process, is essential for marketing success.
- The Internet is simultaneously encouraging two opposing trends in organisational purchasing: (1) the growing use of short-term spot market contracts via Web-based auctions and (2) the strengthening of long-term buyer–supplier relationships via the sharing of sales and inventory data and the development of supply chain alliances.
- The mutual interdependence of organisational buyers and their suppliers makes long-term cooperative relationships crucial for customer retention and marketing success. For firms that sell a significant portion of their output to a few large customers, the stakes are very high. Building trust and commitment at multiple levels in both firms – on an individual-to-individual basis – can be a key factor in establishing and maintaining long-term customer relationships that are profitable to both parties.

# Review Questions

## Content Questions

7.1 What are the major differences between organisational and consumer markets?

7.2 What groups of people are the participants in the buying process?

7.3 Describe briefly the organisational purchase decision-making process.

7.4 What are the marketing implications of the following categories of industrial goods and services?

- Raw materials.
- Component materials and parts.
- Accessory equipment.
- Installations.
- Operating supplies.
- Business services.

## Multiple Choice Questions

7.5 What distinguishes organisational markets from consumer markets is:

A. motivation of the buyer.
B. demographics of the market.
C. nature of purchasing process.
D. all of the above.
E. none of the above.

7.6 Organisational markets:

A. are made up entirely of companies that produce other goods, such as manufacturing firms, as well as mining and agricultural firms.
B. include manufacturers of goods as well as companies that provide a service, such as transportation firms, health care and the like.
C. include goods manufacturers, services and resellers, including both wholesalers and retailers.
D. include goods manufacturers, services, resellers and the government (including local, state and federal).
E. include goods manufacturers, services, resellers, government and households.

7.7 Organisational buyers purchase goods and services for:

A. further production, such as raw materials and components.
B. further production, for use in operations and for resale.
C. further production, but not for operations or resale.
D. production and operations, but not for resale.
E. production and for resale, but not for operations.

7.8 Organisational buyers, when compared to buyers of consumer goods, are _____ in number, geographically _____ and _____ apt to buy on specification.

A. fewer; dispersed; less.
B. fewer; concentrated; less.
C. fewer; concentrated; more.
D. greater; dispersed; more.
E. greater; concentrated; less.

7.9 Organisational marketers would most likely use which of the following medias for marketing their product?

A. Television.
B. Point-of-purchase.
C. Websites.
D. Newspaper advertising.
E. Radio.

7.10 The individual who provides information for evaluating alternative products and suppliers is termed a(n):

A. decider.
B. buyer.
C. influencer.
D. user.
E. gatekeeper.

7.11 A machine operator who asks the company's purchasing agent to buy a certain tool for his work on the assembly line acts as which type of participant in the buying process?

A. Decider.
B. Gatekeeper.
C. Influencer.
D. User.
E. Buyer.

7.12 The functional area with the greatest relative influence in the supplier selection decision is:

A. purchasing.
B. production.
C. engineering.
D. purchasing, but only for straight rebuys.
E. R&D, but only for new buys.

7.13 A modified rebuy typically involves:

A. definition of specifications and extensive collection of information about alternative products.
B. purchasing a common product or service the organisation has bought many times before.
C. comparison of alternative products and services with the current product and vendor.
D. bottom-up decisions to purchase a product for the organisation.
E. top-down decisions to purchase a product for the organisation.

7.14 A company eliminates a raw materials supplier because their products did not meet company standards for quality and delivery time and then negotiates contracts with new suppliers. This reflects which type of purchase?

A. Straight rebuy.
B. Modified rebuy.
C. New-task buy.
D. Problem recognition.
E. Post-purchase evaluation.

7.15 The fact that when Ford's car sales decrease, its demand for steel, tyres and fabrics decreases, illustrates:

A. the domino effect of economics.
B. cross-elasticity of demand.
C. derived demand.
D. world series demand.
E. serial demand.

7.16 When a sales report from a top salesperson points out that a major competitor has added a new feature to one of its products and that several of his top customers have also asked that this same feature be added to one of his company's products, which stage in the buying-decision process does this represent?

A. Information search.
B. Post-purchase evaluation.
C. Problem recognition.
D. Purchase decision.
E. Alternative evaluation.

7.17 After economic considerations a firm has decided to outsource their advertising. They have performed a:

A. make-or-buy decision.
B. vendor analysis.
C. choice criteria.
D. value analysis.
E. new-task buying.

7.18 Organisational buyers evaluate alternative suppliers and their offerings:

A. by eliminating the worst alternative first, and the successive alternatives until a final choice remains.
B. through a standardised checklist applied to all purchases.
C. in terms of choice criteria reflecting benefits the firm wants from the specific purchases.
D. primarily as a political compromise among competing departments within the organisation.
E. in terms of underlying cultural compatibility between the buyer and supplier organisations.

7.19 Vendor analysis should consider which of the following issues?

A. Price and reliability.
B. Availability and delivery time.
C. Quality and financial stability.
D. All of the above.
E. Only A and B above.

7.20 An example of reciprocity would be:

A. an agreement by a personal computer manufacturer to buy components from a source that agrees, in turn, to buy the manufacturer's personal computers.
B. an agreement by a forest products firm to buy chemical products in volume, in exchange for a price reduction.
C. an agreement to exchange key managerial personnel for the duration of a major purchase.
D. equal commitment by two firms to a joint venture, with equal division of profits.
E. a lowering of trade barriers in equal amounts by two countries that trade together.

7.21 An annual requirement contract:

A. is used for frequently purchased items like office and janitorial supplies.
B. obligates the supplier to keep a specific amount of the product always available during the course of the year.
C. covers a wide variety of products purchased by a single buyer from several suppliers at one time.
D. covers an entire trade area, obliging the supplier to offer the specified product to any buyer at a set price.
E. obligates a supplier to fill a buyer's needs for a specific product at a consistent price for a year.

7.22 If K-Mart agrees to share sales information with Coca-Cola for the purpose of keeping stock replenished, they would have a:

A. JIT system.
B. long-term purchasing contract.
C. supply chain management alliance.
D. annual requirements contract.
E. reciprocity agreement.

7.23 When regular suppliers are studied according to a formal rating system to determine their delivery performance, what stage in the organisational buying process is represented by this process?

A. Information search.
B. Performance evaluation.
C. Alternative evaluation.
D. Problem recognition.
E. Purchase decision.

7.24 For a supplier who wants to gain the business of a customer whose purchases are a straight rebuy with an established supplier, what must they attempt to do?

A. Wine and dine the customer.
B. Impress them with marketing brochures and packages.
C. Interest the buyer in modifying the purchase criteria.
D. Call the customer daily.
E. Send daily emails.

7.25 When Frito-Lay manages its snack displays, including stock levels, at Walgreen's stores, this illustrates:

A. a logistical alliance.
B. an illogical relationship.
C. a long-term relationship.
D. a merger.
E. none of the above.

7.26 In complex business relationships, mutual trust means:

A. on-time delivery.
B. delivery at the agreed-on price.
C. delivery of the quality and quantity specified.
D. all of the above.
E. not to act opportunistically.

7.27 Lumber and iron ore are examples of which type of goods?

A. Operating supplies.
B. Natural products.
C. Business services.
D. Accessory equipment.
E. Installations.

7.28 Buildings and major capital equipment that manufacturers use to conduct their operations are examples of:

A. component parts.
B. accessory equipment.
C. business services.
D. operating supplies.
E. installations.

7.29 When American Airlines purchases ten new 737 aeroplanes for its fleet, what type of industrial good do these planes represent?

A. Raw materials.
B. Component parts.
C. Component materials.
D. Operating supplies.
E. Installations.

7.30 When the marketing department of a university purchases desks, filing cabinets and personal computers for its office staff, what type of industrial good do these products represent?

A. Operating supplies.
B. Accessory equipment.
C. Installations.
D. Component parts.
E. Component materials.

7.31 All of the following are examples of business services EXCEPT:

A. advertising agencies.
B. taxi-cab firms.
C. marketing research firms.
D. trucking firms.
E. accounting agencies.

7.32 The most important marketing tool used by business services is:

A. Websites.
B. Trade journal advertising.
C. Personal selling.
D. Brochures.
E. Direct mail.

## Application Questions and Cases

7.33 Sales people from firms that manufacture office equipment often spend a good deal of their time talking with secretaries and office managers in the offices of potential customers. But those employees seldom have the authority to purchase major pieces of equipment. Is this an effective use of the sales person's time? Why or why not?

7.34 Suppose you are the vice president of marketing for a firm that makes printed circuit boards and other electronic components for manufacturers in a variety of industries. General Motors is about to choose a supplier of printed circuits and wiring assemblies for a new car model they are going to produce for the first time next year. You would like to win the contract to supply those circuits and assemblies. How are each of the following groups of people within GM likely to influence the firm's purchase decision concerning the new circuits and assemblies? At which stages in the purchasing process is each group likely to be most influential?

a. R&D managers.
b. Product design engineers.
c. Production managers.
d. Purchasing managers.

7.35 In view of your answers to Question 7.34, outline the important elements of a marketing programme that would communicate the appropriate information at the appropriate time to each group involved in the purchase decision at GM.

7.36 Purchasing managers at IBM have faced a very unstable environment in recent years. The firm has developed a variety of new component parts and materials to be purchased from suppliers. The identity of those suppliers, in turn, keeps changing over time as new entrepreneurial start-ups emerge and as established firms make rapid technological advances in the design and production of components such as microchips and disk storage. How is this rapidly changing and unpredictable environment likely to affect the organisation of IBM's purchasing function and the nature of the firm's purchasing procedures? What are the marketing implications for a firm that would like to become an approved supplier to IBM?

7.37 In the past year, companies and their suppliers have worked to reduce inventories through just-in-time programmes which closely orchestrate delivery schedules and the delivery of zero-defect products. What does each party have to do to make such a programme successful?

7.38 You are the marketing manager for an industrial robots company. What challenges would you expect to face in marketing such capital equipment? What parts of the marketing plan will be most critical in determining success?

7.39 Suppose the marketing manager in the above question decides to consider leasing the company's robotics to companies around the world. How would such a programme differ from a direct sale programme with respect to its marketing?

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# Module 8

# Measuring Market Opportunities: Forecasting and Market Research

## Contents



## African Communications Group: Bringing Modern Telecommunications to Tanzania[1]

In Tanzania in the early 1990s, many towns and villages had no access to telecommunications services. Even in the capital, Dar es Salaam, a city of almost 2 million people, on average only one telephone line had been installed per hundred residents. The waiting time to obtain service from the Tanzania Telecommunications Company Limited (TTCL) was 7 to 10 years. Monique Maddy and Côme Laguë, two recent MBA graduates from a leading US business school, saw in these and other market and industry data an opportunity not only to bring telecommunications services to Tanzania, but also long term to bring a variety of telecommunications services – pay phones, paging, voice mail, and other voice and data communications services – to sub-Saharan Africa. After three months of on-site research in late 1993, Maddy and Laguë decided that building a pay phone network in Tanzania was the most promising opportunity for entering this market. They knew that, to obtain financing as well as the necessary licences to operate in Tanzania, they would have to prepare a credible business plan. They also knew that among the most critical elements of any business plan was the sales forecast. Not only would the sales number be the starting point from which all the other numbers in the plan would be developed, but it would be a key litmus test for prospective investors. If the sales forecast were well supported and credible, Maddy and Laguë believed the rest of the pieces would fall into place. But how could such a forecast be prepared with any confidence for a largely new and underdeveloped market?

### *Market Analysis*

As a result of their research, Maddy and Laguë had concluded that the market for building a pay phone system in Tanzania was extremely attractive. In addition to those on the waiting list for phone service, there was huge 'unofficial' demand from individuals who had not bothered to apply for service. Maddy and Laguë estimated that, by 1996, there would be 500 000 potential subscribers for telephone service, and even with a planned doubling of its capacity, TTCL could satisfy only perhaps half this demand. Also, on most Tanzanian phones, it took several minutes to receive a dial tone. Once a dial tone was received, it could take 40 minutes to connect with cities in Africa or 20 minutes with Europe. Of the 300 coin-operated pay phones in Tanzania, many were inoperative, and some took only coins that no longer were in circulation and were virtually worthless due to Tanzania's high rate of inflation. The market for phone service looked promising.

### *Industry Analysis*

TTCL, Tanzania's central telephone company, was state-owned, though it was expected that TTCL would be privatised at some point. TTCL offered neither paging, fax, cellular, nor data services. There were several small private telecommunications companies, including one radio-calling service with 105 subscribers, and two high-end cellular phone companies. New licences were likely to be issued in the next couple of years for cellular services, paging, and pay phones, and Maddy and Laguë hoped to be among those who would win these licences.

Maddy and Laguë's analysis told them that industry conditions overall were attractive. The bureaucratic TTCL did not seem likely to be a very vigorous competitor. Though new competitors would be likely to enter the market, Maddy and Laguë's head start would put them in a good position. Numerous suppliers were eager to expand in the African market, and buyers currently had few options to obtain phone service of any kind. There were no substitutes other than cellular service, which was extremely expensive, due to the high cost of building the infrastructure.

### *Consumer Needs and Behaviour*

Not only was Tanzania's telecommunications infrastructure poorly developed, but the same also was true for its electricity and water services and its roads. It took three days to travel from Dar es Salaam to Mwanza, Tanzania's second-largest city, only 751 miles away.

Most telephone calls in cities were made by business people, who accounted for 70 per cent of telecommunications revenue. Because most residences had no phones, misuse of business phones was common. Employees were generally required to use pay phones for all types of long-distance calls. Most retail shops

– known as *dukas*, which were makeshift open-air stalls made of wood and tin – had no phones. Maddy and Laguë believed their pay phone network, together with the voice-mail and paging services they planned to offer, would provide more efficient ways of doing business to these small merchants who constituted the backbone of the Tanzanian economy. The biggest challenge they would face would probably be to educate Tanzanians on how to use their proposed system. Since the literacy rate in Tanzania was about 70 per cent, they felt optimistic about their ability to do so.

### *The Business Idea*

The idea for African Communications Group (ACG), their proposed venture, was innovative, but simple. Maddy and Laguë would build a network of pay phones based on wireless radio technology, with a central platform for routing calls and connecting with the TTCL network. The phones would accept prepaid cards sold in retail establishments located near the phone booths. The retailers would get a margin on the sale of the phone cards and might help watch over the phones to discourage vandalism. Paging and voice mail would soon be added to the system at low incremental cost. These features would provide quick communication to parties that did not have regular phone service. Subscribers could receive voice-mail messages and leave messages for other voice-mail subscribers. The pagers could be used to signal the subscriber that a message had been received.

### *Determining Market Potential and Preparing a Sales Forecast*

Maddy and Laguë liked the opportunity that lay before them, and they felt their business skills and contacts made them a good team to pursue it. But how could they translate all the market and industry data they had gathered into a credible estimate of market potential and an evidence-based sales forecast? Proving that the market and industry were attractive and that consumers would see benefits from using their network was one thing. Coming up with hard numbers for market potential and sales revenue was quite another.

## Learning Objectives

Module 8 considers two key issues that enable managers and entrepreneurs to bring life to their dreams. First, the module addresses the challenges in estimating **market potential** and **forecasting** sales, for both new and existing products or businesses. A menu of evidence-based forecasting methods is provided, each of which is useful in some situations, but not others, and we discuss their limitations. Also considered are informational needs of the forecasting task – as well as the tasks addressed in the earlier modules of this course that enable managers and entrepreneurs to understand their market and competitive contexts – to provide guidance on to how to gather, collect, and report data relevant to marketing decision making (i.e., **marketing research**). The portion of the module that deals with marketing research has two objectives. First, to enable every student to be an informed and critical user of marketing research since most strategic decision makers rely, in part, on such research to guide key corporate-level and business-level decisions, as was discussed in Module 2. Second, to provide student with at least a rudimentary level of competence in designing and carrying out marketing research studies of various kinds, so that they can, even on minimal budgets, obtain useful market and competitive insights to inform their decision making.

## 8.1 Every Forecast Is Wrong!

We know of no manager who has ever seen a forecast that came in *exactly* on the money. Some forecasts turn out too high, others too low. Forecasting is an inherently difficult task, because no one has a perfect crystal ball. The future is inherently uncertain, especially in today's rapidly changing markets. Consumer wants and needs shift, buffeted by the winds of ever-changing macro trends. Competitors come and go. New technologies sweep away old ones. Some forecasts are based on extensive and expensive research, others on small-scale inquiries, still others on uninformed hunches. As we have seen, however, forecasting plays a central role in all kinds of planning and budgeting in all kinds of businesses and other organisations. Given the stakes and the risks entailed in being *very* wrong with a forecast, some effort to prepare an **evidence-based forecast**, instead of a wild guess, is almost always called for, even if time and money are scarce. So forecast we must, but how?

## 8.2 A Forecaster's Toolkit: A Tool for Every Forecasting Setting

Before choosing a method to prepare a forecast, one first must know what is to be estimated or forecasted. First, there's the size of the potential market, that is, the likely demand from all actual and potential buyers of a product or product class. An estimate of **market potential** often serves as a starting point for preparing a sales forecast, which we explore in more detail later in this module. For Maddy and Laguë's venture in Tanzania, prospective investors will want to know how large the potential market for telephone services will be in the coming years, measured perhaps in several ways: in numbers of telephone users, in numbers and/or minutes of calls, and in dollars or Tanzanian shillings. This market is comprised of those consumers who are likely to have both the willingness and ability to buy and use a phone card or one of ACG's other services at one of ACG's pay phones. There's also the size of the currently **penetrated market**, those who are actually using pay phones in Tanzania at the time of the forecast. Investors will also want to know these figures – the size of the potential and penetrated markets for the market segments Maddy and Laguë intend to serve, their **target market**. They will also need a **sales forecast**, in which they predict sales revenues for ACG, for five years or so. How might Maddy and Laguë do these things?

Established organisations employ two broad approaches for preparing a sales forecast: top-down and bottom-up. Under the top-down approach, a central person or persons take the responsibility for forecasting and prepare an overall forecast, perhaps using aggregate economic data, current sales trends, or other methods we describe shortly. Under the bottom-up approach, common in decentralised firms, each part of the firm prepares its own sales forecast, and the parts are aggregated to create the forecast for the firm as a whole. For an example of how managers at Gap Inc. retailing divisions combine both methods to forecast next-year sales, *see* Exhibit 8.1.

**Exhibit 8.1 Forecasting next year's sales at Gap**

At international retailer Gap Inc., forecasting sales for the next year for each of its divisions – Gap, Banana Republic, and Old Navy – is an important process that drives a host of decisions, including how much merchandise to buy for the coming year. Both top-down and bottom-up approaches are used. At Old Navy, for example, each merchandiser generates a forecast of what level of sales his or her category – women's knit tops, men's jeans, and so on – can achieve for the next year. Group merchandise managers then provide their input and sum these numbers to create a total forecast from a merchandising perspective. A second bottom-up forecast is generated by the store operations organisation, summing stores and groups of stores. Simultaneously, a top-down figure is prepared at headquarters in California, using macroeconomic data, corporate growth objectives, and other factors. The three forecasts are then compared, differences debated, and a final figure on which to base merchandise procurement and expense budgets is determined. Though the effort to prepare such a forecast is considerable, the broad involvement in the process helps to ensure both knowledgeable input to the forecast as well as subsequent commitment to 'make the numbers.' Most important, Old Navy finds that the different processes together with the ensuing discussion lead to substantially better forecasts.

*Source*: Marshall L. Fisher, Ananth Raman, and Anna Sheen McClelland, 'Rocket Science Retailing Is Almost Here: Are You Ready?' *Harvard Business Review*, July–August 2000, pp. 115–24.

The bottom-up logic also applies to Maddy and Laguë's task. They can break their anticipated demand into pieces and sum the components to create the summary forecast. These pieces could be market segments, such as small retailers, mobile business people, consumers, and so on, or product lines, such as revenue from phone cards or individual pay phones, voice-mail fees, pager fees, and the like. Using the bottom-up approach presents numerous advantages. First, this approach will force them to think clearly about the drivers of demand for each market segment or product line, and thus better understand the real potential of their business and its parts.[2] Second, they will be forced to make explicit assumptions about the drivers of demand in each category, assumptions they can debate – and support with evidence gathered from their research – with prospective investors and which they can later verify as the business unfolds. Third, such an approach facilitates 'what if' planning. Various combinations of market segments and/or product lines can be combined to build a business plan that looks viable.

What forecasting methods, or tools, can Maddy and Laguë choose from? There are six major evidence-based methods for estimating market potential and forecasting sales: statistical methods, observation, surveys, analogy, judgement, and market tests.[3] A seventh method, not evidenced-based – the SWAG method (Silly Wild-

@*# Guess) – is not condoned here, though there is little else to support some forecasts!

### 8.2.1 Statistical and Other Quantitative Methods

**Statistical methods** use past history and various statistical techniques, such as multiple regression or time series analysis, to forecast the future based on an extrapolation of the past.[4] This method is typically not useful for ACG or other entrepreneurs or new product managers charged with forecasting sales for a new product or new business. There is no history in their venture on which to base a statistical forecast.

In established firms, for established products, statistical methods are extremely useful. When Michelin, the tyre maker, wants to forecast demand for the replacement automobile tyre market in Asia for the next year, it can build a statistical model using such factors as the number and age of vehicles currently on the road in Asia, predictions of GDP for the region, the last few years' demand, and other relevant factors to forecast market potential as well as Michelin's own replacement tyre sales for the coming year. Such a procedure is likely to result in a more accurate forecast than other methods, especially if Michelin has years of experience with which to calibrate its statistical model.

As with all forecasting methods, statistical methods have important limitations. Most important of these is that statistical methods generally assume that the future will look very much like the past. Sometimes this is not the case. US WEST (now Qwest), the then regional Bell telephone company serving the Rocky Mountain and Northwest regions of the United States, ran into trouble in the 1990s when its statistical models used to predict needs for telephone capacity failed to allow for rapidly increasing use of computer modems, faxes, and second lines for teenagers in American homes. Suddenly, the average number of lines per home skyrocketed, and there was not enough physical plant – cable in the ground, switches, and so on – to accommodate the growing demand. Consumers had to wait, sometimes for months, to get additional lines, and they were not happy about it! Similarly, if product or market characteristics change, statistical models used without adequate judgement may not keep pace. When tyre makers produce automobile tyres that last 80 000 miles instead of 30 000 to 50 000 miles, the annual demand for replacement tyres is reduced. If automobile manufacturers were to change the number of wheels on the typical car from four, the old statistical models would also be in trouble.

Other quantitative forecasting methods, especially for new product forecasting, have also been developed. These include methods to mathematically model the diffusion of innovation process for consumer durables[5] and conjoint analysis,[6] a method to forecast the impact on consumer demand of different combinations of attributes that might be included in a new product.

### 8.2.2 Observation

Another method for preparing an evidence-based forecast is to directly observe or gather existing data about what real consumers do in the product-market of interest.

Maddy and Laguë conducted a study of pay phone use in Tanzania to find out how many minutes per day the typical pay phone was used. Their study showed that an average of 150 three-minute calls were made per day at the 60 working pay phones then provided by other companies in Dar es Salaam. Revenue for most pay phones fell into the US$100 to $150 range.[7]

Like statistical methods, **observation-based forecasting** is attractive because it is based on what people actually *do*. If behavioural or usage data can be found from existing secondary sources – in company files, at the library, or on the Internet – data collection is both faster and cheaper than if a new study like the one Maddy and Laguë conducted must be designed and carried out. For new-to-the-world products, however, observation is typically not possible and secondary data are not available, since the product often does not yet exist, except in concept form. Had there been no pay phones in Tanzania or a similar country, observation would not have been possible. Market tests, which we discuss later in this section, are one way to get real purchase data about new-to-the-world products.

## 8.2.3 Surveys

Another common way to forecast sales or estimate market potential is to conduct surveys. These surveys can be done with different groups of respondents. Consumers, after being shown a statement of the product concept[8] or a prototype or sample of the product, can be asked how likely they are to buy, creating a **survey of buyers' intentions**. Buyers can also be asked about their current buying behaviour: what they currently buy, how often, or how much they use. The salespeople can be asked how much they are likely to sell, completing a **survey of salesforce opinion**. Experts of various kinds – members of the distribution channel, suppliers, consultants, trade association executives, and so on – can also be surveyed.

As part of their research in Dar es Salaam, Maddy and Laguë surveyed pay phone customers to find out more about them. A whopping 65 per cent were using a pay phone because they lacked access to another working phone – good news for the ACG concept! Sixty-three per cent were business customers, 20 per cent were students or teachers, and 17 per cent were other nonbusiness customers. Business customers spent an average of US$10 per week for 14 pay phone calls, and nonbusiness customers spent US$6 per week for 12 calls.[9] By combining these data with demographic data on the Tanzanian population, Maddy and Laguë now had what they needed to prepare an evidence-based, bottom-up forecast of market potential, market segment by market segment.

**Exhibit 8.2 A survey of buyers' intentions: what people say is not what they do**

When Nestlé's refrigerated foods division in the United States was considering whether to acquire Lambert's Pasta and Cheese, a fresh pasta maker, it wanted to forecast the likely first-year sales volume if the acquisition were completed. To do so, Nestlé used a concept test in which consumers were asked, among other things, how likely they were to *try* the fresh pasta product. The results were as shown in the first two columns in the table below:

| Purchase intent | % response | Rule of thumb reduction for forecasting purposes | Percentage of market deemed likely to actually buy |
|---|---|---|---|
| Definitely would buy | 27% | Multiply by 0.8 | 27% × 0.8 = 21.6% |
| Probably would buy | 43% | Multiply by 0.3 | 43% × 0.3 = 12.9% |
| Might or might not buy | 22% | Count as zero | |
| Probably or definitely would not buy | 8% | Count as zero | |
| Totals | 100% | | 21.6% + 12.9% = 34.5% |

Even though 70 per cent of consumers surveyed indicated they were likely to buy, Nestlé's experience indicated that these 'top two box' percentages should be cut sharply: 'Definitely' responses were reduced by 20 per cent, while 'Probably' responses were reduced by 70 per cent. 'Maybe' responses were considered as 'No.' These adjustments, shown in columns three and four, reduced the 70 per cent figure by more than half, to 34.5 per cent. Most consumer product manufacturers who employ concept tests use similar rules of thumb when interpreting purchase intent data for forecasting purposes, because they have learned that what people *say* they will buy exceeds what they will *actually* buy. Similar logic is useful in a variety of forecasting situations.

*Source*: Marie Bell and V. Kasturi Rangan, *Nestlé Refrigerated Foods: Contadina Pasta and Pizza* (Boston: Harvard Business School Publishing, 1995).

Surveys possess important limitations, however. For one, what people *say* is not always what people *do*. Consumer surveys of buyer intention are always heavily discounted to allow for this fact. For one common approach to doing so, *see* Exhibit 8.2. Second, the persons who are surveyed may not be knowledgeable, but if asked for their opinion, they will probably provide it! Third, what people imagine about a product concept in a survey may not be what is actually delivered once the product is launched. If consumers are asked if they will buy an 'old world pasta sauce with homemade flavour,' they will surely provide a response. Whether they will actually *like* the taste and texture of the sauce that the lab develops is another story! In general, statistical and observational methods, where adequate data or settings are available in which to apply them, are superior to survey methods of forecasting, because such methods are based, at least in part, on what people have *actually done* or bought (e.g., the number of old cars actually on the road, or the length of pay phone calls in Tanzania), while survey methods (Are you likely to buy replacement tyres this year? How often are you likely to use a pay phone?) are based on what people *say*, a less reliable indicator of their future behaviour.

### 8.2.4 Analogy

An approach often used for new product forecasting where neither statistical methods nor observations are possible is to forecast the sales or market potential for a new product or product class by **analogy**. Under this method, the product is compared with similar products for which historical data *are* available. When Danone, the leading marketer of yogurt in Europe, plans to introduce a new flavour, its managers will probably look at the sales history of earlier introductions to forecast the sales for the newest flavour. This method is also used for new-to-the-world high-technology products, for which product prototypes are often either not available or extremely expensive to produce. Rather than conduct surveys to ask consumers about their likelihood to buy a product they can hardly imagine (What would someone have said in 1978 about his or her likelihood to buy a personal computer?), forecasters consider related product introductions with which the new product may be compared. Early forecasts for high-definition television (HDTV) were done this way, comparing HDTV with historical penetration patterns for colour TV, videocassette recorders (VCRs), camcorders, and other consumer electronic products.[10]

As always, there are limitations. First, the new product is never exactly like that to which the analogy is drawn. Early VCRs penetrated households at a much faster rate than did colour TV. Which analogy should be used for HDTV? Why? Second, market and competitive conditions may differ considerably from when the analogous product was launched. Such conditions need to be taken into account.

### 8.2.5 Judgement

While we hesitate to call this a forecasting method of its own, since capable and informed judgement is required for *all* methods, sometimes forecasts are made *solely* on the basis of experienced **judgement**, or intuition. Some decision makers are intuitive in their decision processes and cannot always articulate the basis for their judgements. Said a footwear buyer at Nine West Group, 'Trend forecasting is a visceral thing that cannot be trained. I rely on my sense of colour and texture, but at times I cannot explain why I feel a certain way. I just know.'[11] Those with sufficient forecasting experience in a market they know well may be quite accurate in their intuitive forecasts. Unfortunately, it is often difficult for them to defend their forecasts against those prepared by evidence-based methods when they differ. Nonetheless, the importance of experienced judgement in forecasting, whether it is used solely and intuitively or in concert with evidence-based methods, cannot be discounted.

### 8.2.6 Market Tests

**Market tests** of various kinds are the last of our most commonly used methods. Market tests including **experimental test markets** may be done under controlled experimental conditions in research laboratories, or in **live test markets** with real advertising and promotion and distribution in stores.

Use of test markets has declined over the past two decades for two reasons. First, they are expensive to conduct because significant quantities of the new product must be produced and marketing activities of various kinds must be paid for. More importantly, in today's data-intensive environment, especially for consumer products sold through supermarkets and mass merchants, competitors can buy the data collected through scanners at the checkout and learn the results of the test market without bearing the expense. More diabolically, competitors can engage in marketing tactics to mislead the company conducting the test, by increasing sampling programmes, offering deep discounts or buy-one-get-one-free promotions, or otherwise distorting normal purchasing patterns in the category. Experimental test markets, on the other hand, are still commonly used.

The coming of the Internet has made possible a new kind of market test: an offer directly to consumers on the Web. Offers to chat rooms, interest groups, or email lists of current customers are approaches that have been tried. Use of such techniques has increased, due to companies' ability to carry out such tests quickly and at low cost.

### 8.2.7 Mathematics Entailed in Forecasting

Regardless of the method used, the ultimate purpose of the forecasting exercise is to end up with numbers that reflect what the forecaster believes is the most likely outcome, or sometimes a range of outcomes under different assumptions, in terms of future market potential or for the sales of a product or product line. The combination of judgement and other methods often leads to the use of either of two mathematical approaches to determine the ultimate numbers: the chain ratio calculation or the use of indices. *See* Exhibit 8.3 and Exhibit 8.4 for examples applying these mathematical calculations to arrive at sales forecasts. Both mathematical approaches begin with an estimate of market potential (the number of households in the target market in Exhibit 8.3; the national market potential for a product category in Exhibit 8.4). The market potential is then multiplied by various fractional factors that, taken together, predict the portion of the overall market potential that one firm or product can expect to obtain. In Exhibit 8.3, which shows the more detailed of the two approaches, the factors reflect the appeal of the product to consumers, as measured by marketing research data, and the company's planned marketing programme.

**Exhibit 8.3 Chain ratio forecast: trial of fresh pasta**

Once Nestlé's research on fresh pasta had been completed (*see* Exhibit 8.2), it used the chain ratio method to calculate the total number of households who would try their fresh pasta. The chain ratio calculation went like this:

| Research results for: | Data from research | Chain ratio calculation | Result |
|---|---|---|---|
| Number of households in target market | 77.4 million | | |
| Concept purchase intent: adjusted figure from Exhibit 8.2 | 34.5% will try the product | 77.4 million × 34.5% | 26.7 million households will try *if aware* |
| Awareness adjustment: based on planned advertising level | 48% will be aware of the product | 26.7 million × 48% | 12.8 million households will try *if they find product at their store* |
| Distribution adjustment: based on likely extent of distribution in supermarkets, given the introductory trade promotion plan | The product will obtain distribution reaching 70% of US households | 12.8 million × 70% | 9.0 million will try the product |

Similar chain ratio logic is useful in a variety of forecasting settings.

*Source*: Marie Bell and V. Kasturi Rangan, *Nestlé Refrigerated Foods: Contadina Pasta and Pizza* (Boston: Harvard Business School Publishing, 1995).

**Exhibit 8.4 Estimating market potential using indices**

There are several published indices of buying behaviour, including the 'Annual Survey of Buying Power' published by *Sales and Marketing Management*. The Buying Power Index (BPI) is a weighted sum of a geographical area's percentage of national buying power for the area, based on census income data (weight 0.5), plus the percentage of national retail sales for the area (weight 0.3), plus the percentage of national population located in the area (weight 0.2). If this calculation comes to 3.50 for a given state or region, one might expect 3.5 per cent of sales in a given category (toys, power tools, or whatever) to come from that geographical area.

**Category development indices** (CDIs) are similar indices that report the ratio of consumption in a certain *category* (say, restaurant sales) to population in a defined geographical area. Trade associations or trade magazines relevant to the category typically publish such indices. Ratios greater than 1.0 for a particular geographic area, say metropolitan Chicago, indicate that the area does more business than average (compared to the country as a whole) in that category. **Brand development indices** (BDIs) compare sales for a given *brand* (say, Macaroni Grill restaurants) to population. Companies that use BDI indices typically calculate them for their own use. The ratio of the BDI to the CDI for a given area is an indicator of how well a brand is doing, compared to its category overall, in that area. These various indices are useful for estimating market potential in defined geographic areas. They are, however, crude numbers, in that they do not consider differences in consumer behaviour from region to region. The CDI or BDI for snowmobiles in Minnesota is far higher than in Texas, for example. Attempting to rectify this imbalance by increasing the snowmobile advertising budget in Texas would be difficult!

# 8.3 Cautions and Caveats in Forecasting

## 8.3.1 Keys to Good Forecasting

There are two important keys to improve the credibility and accuracy of forecasts of sales and market potential. The first of these is to make explicit the **assumptions** on which the forecast is based. This way, if there is debate or doubt about the forecast, the *assumptions* can be debated, and data to support the assumptions can be obtained. The resulting conversation is far more useful than stating mere opinions about whether the forecast is too high or too low. For ACG, the combination of observational and survey forecasting methods enabled Maddy and Laguë to articulate the assumptions on which their revenue forecasts were based, and to support those assumptions with data. Their evidence-based forecast was instrumental in their obtaining US$3.5 million in start-up capital to get their venture off the ground.[12]

The second key to effective forecasting is to use multiple methods. When forecasts obtained by different methods converge near a common figure, greater confidence can be placed in that figure. The procedure used at Gap Inc., to forecast next-year sales (*see* Exhibit 8.1) is an example of such an approach. Where forecasts obtained by multiple methods diverge, the assumptions inherent in each can be examined to determine which set of assumptions can best be trusted. Ultimately, however, any forecast is almost certainly wrong. Contingency plans should be developed to cope with the reality that ultimately unfolds.[13]

### 8.3.2 Biases in Forecasting

Several sources of potential bias in forecasts should be recognised. First, forecasters are subject to anchoring bias, where forecasts are perhaps inappropriately 'anchored' in recent historical figures, even though market conditions have markedly changed, for better or worse.[14]

Second, capacity constraints are sometimes misinterpreted as forecasts. Someone planning to open a car wash that can process one car every seven minutes would probably be amiss in assuming sufficient demand to actually run at that rate all the time. A restaurant chain that is able to turn its tables 2.5 times each night, on average, must still do local market research to ascertain how much volume a new restaurant will really produce. Putting similar 80-table restaurants in two trade areas with different population makeup and density, with different levels of competition, will result in varying sales levels.

Another source of bias in forecasting is incentive pay. Bonus plans can cause managers to artificially inflate or deflate forecasts, whether intentionally or otherwise. 'Sandbagging' – setting the forecast or target at an easily achievable figure in order to earn bonuses when that figure is beaten – is common. Finally, unstated but implicit assumptions can overstate a well-intentioned forecast. While 34.5 per cent of those surveyed (after adjustments, as shown in Exhibit 8.2) may indicate their willingness to buy a new grocery product, such as fresh pasta, for such a forecast to pan out requires that consumers actually are *made aware* of the new product when it is introduced, and that the product *can actually be found* on supermarket shelves. Assumptions of **awareness** and **distribution coverage** at levels less than 100 per cent, depending on the nature of the planned marketing programme for the product, should be applied to such a forecast, using the chain ratio method (*see* Exhibit 8.3).

## 8.4 Why Data? Why Marketing Research?

In the first portion of this module, we provided several approaches to forecasting, each of which requires that data be collected. Similarly, the first seven modules of this book provided frameworks for gaining a better understanding of market and competitive conditions and of what buyers in a given market want and need – what we call **market knowledge**.[15] Obtaining market knowledge also requires data, and so far we've provided little discussion of exactly how one might best find the necessary data. Without relevant and timely data, market knowledge is generally incomplete and often ill-informed, based perhaps on hunches or intuition that may or may not be correct.

Without adequate market knowledge, marketing decisions are likely to be misguided. Products for which there is little demand may be introduced, only to subsequently fail. New markets may be entered, despite market or industry conditions that make success unlikely. Attractive product-markets may be overlooked.

Products may be marketed to the wrong target market, when consumers in another market segment would like the product better. Pricing may be too high, reducing sales, or too low, leaving money on the table. Advertising and promotion monies may be poorly spent. Second-best distribution channels may be chosen. These outcomes are all too common. Most often, they result from ill- or under-informed marketing decisions. Thoughtfully designed, competently executed marketing research can mitigate the chances of such unpleasant outcomes.

Thus, in the remainder of this module we address the challenge of obtaining market knowledge, including the development of systems to track pertinent market information inside and outside the firm, as well as the design and implementation of more targeted studies intended to collect information about a particular marketing problem. We begin by discussing the principal kinds of **market knowledge systems** used in companies large and small, and we show how such systems can improve the timeliness and quality of marketing decisions.

## 8.5 Market Knowledge Systems: Charting a Path toward Competitive Advantage

Marketing is rapidly becoming a game where information, rather than raw marketing muscle, wins the race for competitive advantage. There are four commonly used market knowledge systems on which companies rely to keep pace with daily developments: internal records regarding marketing performance in terms of sales and the effectiveness and efficiency of marketing programmes, marketing databases, competitive intelligence systems, and systems to organise client contact. Taken together, these systems lie at the heart of the systematic practice of **customer relationship management** (CRM). Effective use of CRM is likely to result in happier, higher volume, more loyal customers. Few of these systems that made modern CRM possible existed in their current form until developments in data processing and telecommunications made them cost-effective.

### 8.5.1 Internal Records Systems

Every Monday morning, each retail director at the headquarters of Nine West Retail Stores, a leading operator of shoe speciality stores, receives the 'Godzilla Report,' a tabulation of detailed sales and inventory information about the fastest-selling items in Nine West stores from the prior week.[16] By style and colour, each director learns which items in his or her stores are selling fast and need to be reordered. A similar report provides information about all other styles currently in Nine West's stores, so that slow sellers can be marked down or transferred to stores where those styles are in higher demand. Additional reports aggregate sales information by style and colour; by merchandise category (e.g., dress or casual); store, area, or region; and for various time periods. The information provided by these reports constitutes the backbone of Nine West's decision making about which shoes to offer in which of its stores. Imagine how much more difficult the retail director's job would be without today's point-of-sale systems to collect and report such data! Imagine the potential advantage Nine West has over shoe retailers who lack such information.

Every marketer, not just retailers, needs information about 'what's hot, what's not.' Unfortunately, accounting systems generally do not collect such data. Typically, such systems just track revenue, with no information about *which* goods or services were sold. Thus, marketers need **internal records systems** to track what is selling, how fast, in which locations, to which customers, and so on. Providing input on the design of such systems so that the right data are provided to the right people at the right time is a critical marketing responsibility in any company. But what constitutes critical marketing information varies from company to company and industry to industry.

**Exhibit 8.5 Designing an internal records system for marketing decision makers**

| Questions to ask | Implications for a chain footwear retailer | Implications for an infomercial marketer of kitchen gadgets |
|---|---|---|
| *What information* is key to providing our *customers* with what they want? | Need to *know* which shoes sell, in which stores and markets, at what rate | Need to *know* which gadgets sell, in what markets, at what rate |
| *What regular marketing decisions* are critical to our profitability? | *Decide* which shoes and shoe categories to buy more of, which to buy less of or get rid of, in which stores and markets to sell them | *Decide* on which specific TV stations, programmes, and times of day to place infomercials for which gadgets |
| *What data* are critical to managing profitability? | Inventory turnover and gross margin | Contribution margin (gross margin less media cost) per gadget sold |
| *Who* needs to know? | Buyers and managers of merchandise categories | Media buyers, product managers |
| *When* do they need to know, for competitive advantage? | For hottest sellers, need to know before competitors, to beat them to the reorder market. For dogs, need to know weekly, to mark them down. | Need to know daily, for prior night's ads, to reallocate media dollars |
| In what *sequence* and at what *level of aggregation* should data be reported? | Sequence of report: hot sellers first, in order of inventory turnover | Sequence of report: hot stations/programmes first, in order of contribution margin per gadget sold |
| | Aggregation: by style and colour for buyers, by category for merchandise managers | Aggregation: By stations/programmes for media buyers, by gadget for product managers |

Nine West retail directors need to know which styles and colours are selling, in which stores, at what rate. Walmart believes its key suppliers need to know its store-by-store item and category sales data, so it provides password-protected online access to such data to those suppliers. Telemarketers need to know which callers are producing sales, at what times of day, for which products. Marketers of kitchen gadgets through infomercials on late-night television need to know which ads on which stations in which cities are performing, in order to place media dollars where they will be most productive. Companies selling their wares to industrial markets through outside salesforces need to know not only which products are selling to which customers but also which salespeople are selling how much, at what margins and expense rates, to whom. The salesforce, too, needs information about status of current orders, customer purchasing history, and so on. For those charged with developing or updating internal record systems in their companies, we provide, in Exhibit 8.5, a series of questions to help marketing decision makers specify what internally generated sales data are needed, when, for whom, in what sequence, at what level of aggregation.

## 8.5.2 Marketing Databases Make CRM Possible

In the technology boom of the late 1990s, several companies launched extensive and expensive projects to help them better manage customer relationships through enhanced use of customer data. Although several large-scale customer relationship management (CRM) projects have failed to show an adequate return on investment, CRM has proved to be very successful in managing marketing campaigns. For a discussion of how one company has benefited from such tools, *see* Exhibit 8.6.

**Exhibit 8.6 Customer relationship management (CRM) projects – a campaign management success story**

Campaign Management Software allows marketers to design and execute marketing programmes that allow them greater control and accountability and to produce better results than in the past. A veterinary charity PDSA in the UK uses software to manage its database of 3.5 million supporters, its 11 million transactions and 22 million lines of previous mailing history. Because they are a charity, PDSA realises that not every supporter wishes to be permanently included in their database, and the system allows for this to be factored in. PDSA uses the database to effectively target customers for its mailshot campaigns and pulls in between £10 and £12 million in contributions per year.

The European bank ING has used a Dutch software company to implement a CRM system that allowed it to identify its customers who never respond to mailshots, thereby reducing their mailings by 30 per cent or 46 million. Other vendors help companies pinpoint customers who are most likely to defect to competitors, thereby reducing customer churn.

*Source*: 'Ringing the changes,' *Precision Marketing*, September 20, 2002; Michael Dempsey, 'FT Report – FT-IT – Getting back to basics in battle to win customers', *Financial Times*, November 6, 2002.

The purpose of CRM is to develop a unified and cohesive view of the customer from every touch point within the company, whether by telephone, over the Web, by mail, or in person; and, in so doing, to increase profitability and shareholder value. CRM, when implemented successfully, is a cross-functional process that requires coordination and broad-based strategic thinking. The goal of most CRM efforts is to profitably win a growing share of key customers' business while finding lower-cost but effective ways of serving less valuable customers. A key element in such efforts is the use of marketing databases, often in conjunction with call centres where many customer contacts occur.

Databases created for CRM purposes typically capture information about most or all of the following for each customer:17

- Transactions: Complete transaction detail, including dates, items purchased, and prices paid.
- Instances of customer contact: Whether sales calls, call centre inquiries, service requests, or whatever, a CRM system should capture the detail of each and every customer contact with the company.
- Customer demographics: Relevant descriptive data to facilitate market segmentation and target marketing are crucial.
- Customer responses: A CRM system should capture linkages between marketing activities and customer action. Did the customer respond to an email? A direct mail shot? A face-to-face sales call?

Many companies have become quite sophisticated about keeping track of their customers' purchases using marketing databases. Catalogue marketers such as Lands' End and L.L. Bean know who are their best customers and what categories they tend to buy. Online marketers like Amazon.com use 'cookies,' electronic signatures placed at a customer's personal computer, so they not only keep track of what each customer has bought, but they also recognise the customer when he or she logs on to their site. Airlines track members of their frequent flyer programmes and target some with special promotions. Supermarket chain Tesco in the UK uses its loyalty cards to track and analyse customer buying patterns, and to offer customers coupons and incentives tailored to their buying behaviour. Tesco uses their analysis in deciding product placement on shelves, managing coupon campaigns, and to tailor product portfolios to individual stores.[18]

Designing marketing databases that take effective advantage of customer data that companies are in a position to collect requires that several major issues be considered: the cost of collecting the data, the economic benefits of using the data, the ability of the company to keep the data current in today's mobile society, and the rapid advances in technology that permit the data to be used to maximum advantage.

Collecting information, then storing and maintaining it, always costs money. If a company wants to know more about the demographics and lifestyles of its best customers, in addition to their purchasing histories, it must obtain demographic and lifestyle data about them. Doing so is more difficult than it sounds; most people are unwilling to spend much time filling out forms that ask nosy questions about education, income, whether they play tennis, and what kind of car they drive. The cost of collecting such information must be weighed against its value. What will be done with the information once it is in hand?

Various commercial marketing databases are available, with varying depth and quality of information. For example, the Polk Company (www.polk.com) sells data compiled from state driver's licence records in the United States, as well as a demographic and lifestyle database compiled from questionnaires returned with warranty cards for consumer durables such as toasters, stereos, and the like.

Donnelley's DQI database (www.Donnelley.com) covers more than 150 million individual US consumers and 90 million US households and includes more than 1600 demographic, lifestyle, purchasing power, and creditworthiness variables, among others. Nielsen's PRIZM service, originally developed by Claritas (Potential Rating Index for Zip Markets, www.claritas.com/sitereports/reports/prizm-demographics-reports.jsp) classifies US consumers into one of 66 distinct demographic and behavioural clusters according to the zip code and postal carrier route where they live. For the UK market, geo-demographic databases can be purchased from CACI,[19] known for its database called ACORN, and Experian,[20] which offers its MOSAIC database. These databases are useful tools for targeting consumers based on the area they live in. An important caveat for all geo-demographic databases, however, is that the accuracy of the data goes down as the granularity of the area increases, i.e., customers may share the same Zip code or postcode, but may belong to very disparate economic segments.

Marketers planning to build their own databases need also to consider several increasingly important ethical issues, as discussed in Ethical Perspective 8.1.

For firms with deep pockets, advances in computing power and database technology, including new **data-mining** technology,[21] are permitting firms to combine databases from different sources to permit a more complete understanding of any member of the database. Keeping current with what is possible in database technology is important, as technological advances often make possible that which was only a dream a short time ago.

Building or accessing marketing databases is but a small part of any effective CRM effort, however. Implementing such an effort requires four key steps:[22]

- Gaining broad-based organisational support for creating and adopting a CRM strategy.
- Forming a cross-functional CRM team with membership from all functions that have customer contact.
- Conducting a needs analysis that identifies both customer and business needs.
- Developing a CRM strategy to guide implementation.

One of the things that CRM efforts make possible is segmenting markets according to the lifetime value of customers, rather than by more traditional means. **Customer lifetime value** (CLV) refers to the margins that a customer generates over a lifetime less the cost of serving the customer. Calculating CLV is not a trivial task; it requires both historical purchasing data and forecasting of future customer purchases which, as we've seen, are always somewhat tenuous. Nevertheless, research conducted by Deloitte Consulting found that companies that use CLV metrics are 60 per cent more profitable than firms that do not.[23]

Unfortunately, there have been many instances of CRM installations that were unsuccessful, sometimes dramatically so. All of us have experienced infuriating occasions where wading through endless levels of telephone prompts and poorly trained or soulless customer service representatives has damaged or destroyed, rather than enhanced, the customer relationship the company sought to build. Research by Bain & Co. suggests that there are four major pitfalls to watch out for:[24]

- Implementing CRM without first developing a strategy.
- Putting CRM in place without changing organisational structure and/or processes.
- Assuming that more CRM is better.
- Failure to prioritise which customer relationships are most worth investing in.

### Ethical Perspective 8.1

**Ethical Issues in Database Marketing, Internet Marketing, and Marketing Research**

New technologies relating to the gathering and use of information about consumers and their behaviour, interests, and intentions raise a host of legal and ethical questions. These new technologies have the potential to harm individuals when such information is used without their knowledge and/or consent, leading them to be *excluded from* or *included in* activities in such a way that they are harmed economically, psychologically, or physically. Examples include the improper disclosure of a person's credit rating, denying medical insurance to an individual based on confidential information, and a person's being placed on target lists for direct mail and telemarketing. The depth of privacy concerns varies from country to country, a critical issue for Internet marketers, given their global reach.

Ethical issues in marketing research stem, in large part, from the interaction between the researcher and respondents, clients, and the general public. For instance, respondents should not be pressured to participate, should have the right to remain anonymous, and should not be deceived by fake sponsorship.

Client issues involve the confidentiality of the research findings and the obligation to strive to provide unbiased and honest results regardless of client expectations. The public is very much involved when they are exposed to a sales solicitation disguised as a marketing research study or issuing from data obtained from 'volunteer surveys' using write-ins or call-ins.

In discussing the reliability of, and ethical issues involved with, marketing research studies, a *Wall Street Journal* article noted that many studies 'are little more than vehicles for pitching a product or opinion.' An examination of hundreds of recent studies indicated that the business of research has become pervaded by bias and distortion. More studies are being sponsored by companies or groups with a financial interest in the results. This too often leads to a bias in the way questions are asked.

Because of shortages in time and money, sample sizes are being reduced to the point that, when groups are further broken into subgroups, the margin of error becomes unacceptable – assuming a probability sample was used. In addition to sample size, the way the sampling universe is defined can bias the results. Thus, in a Chrysler study showing that people preferred Chrysler's cars to Toyota's, a sample of only 100 respondents was used in each of two tests, and none owned a foreign car. Thus, the respondents may well have been biased in favour of US cars.

In addition to the problems noted above, subjective sampling procedures are often used, data analysis may be flawed, or only the best conclusions are reported. Frequently researchers are hired whose views on the subject area being researched are known to be similar to those of the client. In an attempt to regulate the marketing research industry, several codes of conduct and ethics have been developed. For the United States, these include published codes by the American Marketing Association, the American Association for Public Opinion Research, the Marketing Research Association, and the Council of American Survey Research Organizations. In the UK, the Market Research Society has developed an ethical Code of Conduct that all members are required to adhere to. Similar organisations have developed localised guidelines in other countries.

*Source*: Paul N. Bloom, Robert Adler, and George R. Milne, 'Identifying the Legal and Ethical Risks and Costs of Using New Information Technologies to Support Marketing Programs,' in *The Marketing Information Revolution*, Robert C. Blattberg, Rashi Glazer, and John D. C. Little, eds. (Boston: Harvard Business School Press, 1994), p. 294; Cynthia Crossen, 'Studies Galore Support Products and Positions, But Are They Reliable?' *The Wall Street Journal*, November 14, 1991, pp. A1 and A8; and Thomas E. Weber, 'Europe and US Reach Truce on Net Privacy, But What Comes Next?' *The Wall Street Journal*, June 19, 2000, p. B1.

### 8.5.3 Client Contact Management Systems

One good starting point for developing CRM capabilities in companies having limited resources is to put in place **salesforce automation software**. Such software helps companies disseminate real-time product information to salespeople to enable them to be more productive and more able to satisfy customer needs. Such software also allows companies to effectively capture customer intelligence from salespeople, keep track of it for use on later sales calls, and even transfer it to other salespeople in the event of a salesperson leaving the company. Several low-cost software applications that run on PCs are available to keep track of client lists and the various kinds of contacts that are made with each client. ACT and Goldmine are two of the best-known programmes in this arena. These programmes keep track of clients' names, addresses, phone and fax numbers, and so on – along with all kinds of personal tidbits, such as their spouse's and children's names and the kind of wine the client likes to drink – and they also provide an organised way to make notes about each contact with the customer.

### 8.5.4 Competitive Intelligence Systems

In today's fast-paced business climate, keeping up with competitors and the changing macroenvironment is no easy task. Competitive intelligence (CI) is a systematic and ethical approach for gathering and analysing information about competitors' activities and related business trends.[25] It is based on the idea that more than 80 per cent of all information is public knowledge. The most important sources of CI information include companies' annual and other financial reports, speeches by company executives, government documents, online databases and trade organisations, as well as the popular and business press. The challenge is to find the relevant knowledge, analyse it, and share it with the decision makers in the organisation, so they can use it. The critical questions that managers setting up a CI system should ask are:

- How rapidly does the competitive climate in our industry change? How important is it that we keep abreast of such changes?
- What are the objectives for CI in our company?
- Who are the best internal clients for CI? To whom should the CI effort report?
- What budget should be allocated to CI? Will it be staffed full- or part-time?

In companies that operate in industries with dynamic competitive contexts, the use of full-time CI staff is growing.

### 8.5.5 Other Kinds of Market Knowledge Systems

We have covered but a few of the most common market knowledge systems, most of which are computer applications in today's increasingly sophisticated data-driven age. These tools make marketers better informed about their customers, potential customers, and competitors and help them be more productive, both of which help establish and sustain competitive advantage. New applications are being developed every day. Ultimately, the potential that many of these systems share is to enable marketers to serve target markets of one; that is, to know enough about any given customer and the competitive context that an offering can be tailored to fit each customer so well that the customer's needs are met perfectly. Doing so is many a marketer's dream!

## 8.6 Marketing Research Resolves Specific Marketing Challenges

We now turn to the **marketing research** task: the design, collection, analysis, and reporting of research intended to gather data pertinent to a *particular* marketing challenge or situation. The word *particular* is very important. Marketing research is intended to address carefully defined marketing problems or opportunities. Research carried out without carefully thought-out objectives usually means time and money down the tubes! Some marketing problems commonly addressed through marketing research include tracking customer satisfaction from unit to unit or year to year (**tracking studies**); testing consumer responses to elements of marketing programmes, such as prices or proposed advertising campaigns; and assessing the likelihood that consumers will buy proposed new products.

**Exhibit 8.7 Steps in the marketing research process: what can go wrong?**

| Steps | What frequently goes wrong? |
|---|---|
| 1. Identify managerial problem and establish research objectives | Management identifies no clear objective, no decision to be made based on the proposed research. |
| 2. Determine data sources (primary or secondary) and types of data and research approaches (qualitative or quantitative) required | Primary data are collected when cheaper and faster secondary data will do. Quantitative data are collected without first collecting qualitative data. |
| 3. Design research: type of study, data collection approach, sample, etc. | These are technical issues best managed by skilled practitioners. Doing these steps poorly can generate misleading or incorrect results. |
| 4. Collect data | Collector bias: hearing what you want to hear. |
| 5. Analyse data | Tabulation errors or incorrect use or interpretation of statistical procedures may mislead the user. |
| 6. Report results to the decision maker | Some users do not really want objective information – they want to prove what they already believe to be true. |

We begin by presenting a model of the marketing research process that sets forth the many decisions that must be made to conduct effective and actionable marketing research. The steps in the marketing research process are shown in Exhibit 8.7. As this exhibit shows, the marketing research process is fraught with numerous opportunities for error. That's why it's so important that all who play influential roles in setting strategy for their firms or who use marketing research results for decision making be well-informed and critical users of the information that results from market research studies. To this end, we now address each of the steps in the marketing research process, from a decision-making point of view.

## 8.6.1 Step 1: Identify the Managerial Problem and Establish Research Objectives

As for any other form of human endeavour, if you don't have clear objectives, any road will get you there! The same is true for conducting marketing research. A good place to start is to ask what the managerial problem or question is that a proposed programme of research might address. Maddy and Laguë's initial inquiries about starting a telecommunications business in Tanzania had numerous managerial questions to be answered. How attractive is the telephone market in Tanzania? What segments are most attractive? How large is the market, and how fast is it likely to grow? Is the industry attractive? Who are the key competitors and what competitive advantages might they have and not have if we enter? What telecommunications wants and needs are not well satisfied currently, for which groups of consumers? How likely are consumers to use the system we propose to put in place? How much might they be willing to pay? What incentives would retailers or others need to sell our phone cards or to place our pay phones on their premises? Taking each of these managerial questions, one at a time, and applying appropriate analytical frameworks to each of them – such as macro trend analysis (Module 4), Porter's five forces (Module 5), and so on – provides clear guidance for the kind of information the researcher needs. The result is a set of **research objectives** (e.g., determine market size and growth rate; assess supplier power in this industry, and so on) that will drive the research.

## 8.6.2 Step 2: Determine the Data Sources and Types of Data Required

This step is critical in determining the cost-effectiveness and timeliness of the research effort. The researcher must answer two key questions at this stage: Should I gather data from primary or secondary sources? Whichever type of data sources are called for, do I need qualitative or quantitative research to satisfy my research objectives, or both?

### 8.6.2.1 Primary or Secondary Sources?

**Primary data** are data collected from individual research subjects using observation, a survey, interviews, or whatever. The data are then gathered and interpreted for the particular research objective at hand. **Secondary data** already exist – on the Internet, in government documents, in the business press, in company files, or wherever. Someone has already done the primary data collection and placed the data where others can access it, whether easily or with difficulty, whether free or at some cost.

Which is better – primary or secondary data? *If* (and it's an important *if*) a research objective can be met using secondary data, that's usually the best course to follow. Why? First, it's usually quicker to find the data somewhere than to collect information from scratch. Imagine having to collect demographic data about Tanzania without the Tanzanian census! Second, it's usually less costly to simply find existing secondary data than to collect the information as primary data all over again. Third, secondary data are typically based on what people actually *do*, or how they actually *behave*. Surveys, a common form of primary data, are based on what people *say*. The two are not the same, as we saw earlier in the forecasting portion of this module.

**Exhibit 8.8 Some information sources for market and industry analysis**

| Type of information | Library sources | Internet sources |
|---|---|---|
| To find trade associations and trade magazines | *Gale Directory of Publications; Encyclopedia of Associations; UK Trade Association Forum; European Trade Associations* | www.gale.com<br>www.instat.com<br>www.taforum.org<br>www.eurunion.org/infores/business/trade.htm |
| Information on specific companies | *Hoover's Handbook of American Business; Ward's Business Directory; Dun and Bradstreet Million Dollar Directory; Moody's Industrial Manual* | www.hoovers.com<br>www.sec.gov/edgarhp.htm |

| Type of information | Library sources | Internet sources |
|---|---|---|
| US demographic and lifestyle data | *Lifestyle Market Analyst* | www.census.gov |
| Demographic data on a specific region or local trade area in the United States | *Sourcebook of County Demographics; Sourcebook of Zip Code Demographics;* Survey of Buying Power in *Sales and Marketing Management*; National Decision Systems, 1-800-866-6520 (fee); Urban Decision Systems, 1-800-364-4837 (fee) | |
| International demographics and world trade | *Predicasts F&S Index United States, Europe and International* | www.stat-usa.gov<br>www.odci.gov/cia/publications<br>www.census.gov/ipc<br>www.i-trade.com<br>www.epp.eurostat.ec.europa.eu/ (EU)<br>www.unescap.org/stat/ (Asia) |
| Macro trends | *Statistical Abstract of the United States; Business Periodicals Index* | www.stat-usa.gov |
| E-commerce | *Red Herring* magazine | www.thestandard.com<br>www.clickz.com<br>www.ecommercetimes.com<br>www.mediametrix.com<br>www.emarketer.com |
| Proprietary providers of research reports | | www.forrester.com<br>www.gartner.com<br>www.scarborough.com |
| Market share information | *Market Share Reporter* | |
| Average financial statements by industry | *Annual Statement Studies*, Robert Morris and Associates | www.rmahq.com/Ann_Studies/asstudies.html |

Given the rate of change on the web, some Internet addresses may change, and some print sources may add websites.

*Source*: Robert I. Berkman, *Find it Fast: How to Uncover Expert Information on Any Subject in Print or Online* (New York: HarperCollins, 1997); various web addresses as listed above.

For Maddy and Laguë, secondary data, if available, should answer several of their research questions, such as those on market and industry attractiveness, *if* Tanzania's government has made gathering and reporting such data a priority. Often, the availability and quality of a country's secondary data, from government as well as other sources, correlates closely with its degree of economic development. See Exhibit 8.8 for a list of some commonly used websites for market and industry analysis in the United States and Europe. Similar sources are available in most developed countries. To explore consumers' willingness to use the innovative system of pay phones and calling cards that Maddy and Laguë proposed to develop, primary data were necessary. It is unlikely that a study to evaluate the attractiveness of such a system to consumers had already been conducted.

#### 8.6.2.2 Qualitative or Quantitative Data and Research Approaches?

Where secondary data are to be collected, the researcher needs to decide whether qualitative data, such as that concerning sociocultural trends in Tanzania, or quantitative data, such as the number of households in a particular income group in Dar es Salaam, are required. Most secondary research studies require both qualitative and quantitative data.

If primary data are necessary, a decision must be made about whether to collect that data using qualitative or quantitative research approaches. **Qualitative research** usually involves small samples of subjects and produces information that is not easily quantifiable. Qualitative data may yield deeper insights into consumer behaviour than are available from quantitative research. For this reason, qualitative research is often conducted first and used to guide subsequent quantitative research. An important drawback of qualitative research, however, is that its generally small samples may not fairly represent the larger population. Most experienced marketing researchers would say, '*Never generalise from qualitative research*. Always follow up with a quantitative study to test the hunches developed in the qualitative study.' Such statements presume, however, that adequate research resources are available to conduct additional studies. Often, and particularly in entrepreneurial settings, such is not the case, and decision makers are forced to rely, albeit tenuously, on small-scale qualitative studies.

**Quantitative research** collects data that are amenable to statistical analysis, usually from large enough samples so that inferences may be drawn with some confidence to the population from which the subjects in the sample are drawn. The principal benefit of quantitative research lies in its measurement of a population's attitudes toward or likely response to products or marketing programmes. Because of their larger sample sizes and quantitative metrics, greater confidence can be placed in quantitative studies, when conducted properly, using appropriate sampling procedures and statistical techniques. We address these issues in more detail in subsequent sections of this module.

#### 8.6.2.3 Qualitative Research Techniques

There are seemingly as many qualitative research techniques as there are stars in the sky.[26] The most common ones, however, are focus groups and interviews of various kinds.[27] A focus group typically consists of 8 to 12 consumers from the marketer's target market brought together at a research facility to discuss a particular marketing problem, such as attitudes toward a proposed new product and various possible features. A skilled moderator conducts the focus group, records the conversation on audio and/or videotape, and writes a report of the findings. Typically two or more groups are conducted for a single research project. Focus groups have significant limitations: They are subject to data distortion caused by a dominant person in the group, their results are difficult to interpret, and they are neither representative of nor generalisable to a larger population, due to their small sample size and convenience samples. They are a good way, however, to begin a research inquiry or to gather at least some information when research budgets are tight.[28]

#### 8.6.2.4 Quantitative Research Techniques

In most quantitative research, questionnaires are used that enable the researcher to measure the subjects' responses on quantitative scales. These scales enable the researcher to compare product attributes, the responses of demographically different consumers, and other differences in order to better understand what consumers prefer, how satisfied they are with one product compared to others, and so on. Where statistically significant differences are found, managers can be relatively certain at some known level of confidence that the differences uncovered in the research reflect those actually found in the whole population. Examples of several kinds of quantitative scales commonly used in such research are shown in Exhibit 8.9. Novice researchers, or those whose budgets are limited, can sometimes obtain useful market knowledge from small-scale research that begins with some qualitative research, perhaps several interviews, and concludes with a quantitative study using measures such as those shown in Exhibit 8.9. Gaining experience with such research, even in a class project setting, provides future managers with some appreciation for the conduct of marketing research and the limitations to its interpretation.

### 8.6.3 Step 3: Design the Research

Designing secondary research is a simple matter of finding sources of information sufficient to satisfy the research objectives and ensuring that the sources are credible. For primary qualitative research, such as focus groups or interviews, detailed guides are prepared for conducting the research to specify what questions are to be asked. For primary quantitative research, research design is the most technical and most difficult step in conducting the research. The key decisions to be made in primary research design are to determine the data collection method and prepare the research instrument, determine how to contact the participants in the research, and design the sampling plan.

#### 8.6.3.1 Determine the Data Collection Method and Prepare the Research Instrument

The most common methods of collecting primary data are observation, survey, and experiment. Observation is just that: observing subjects using pay phones in Tanzania, in Maddy and Laguë's case. Typically, a form is prepared on which the observer records what is being observed, perhaps minutes of use and gender of the user, among other things. Many Japanese companies favour the use of observation to better understand not only consumers, but also salespeople and distribution channel members.[29]

Surveys involve writing a questionnaire, which will include questions and either scaled answers (such as those shown in Exhibit 8.9) or spaces for open-ended answers. Demographic information about the respondent is also usually requested to aid in market segmentation and market targeting decisions, which we address in Module 9. Constructing survey questions and formats for the answers is more difficult than one might expect and is beyond the scope of this book, but several sources cited in this module, as well as Exhibit 8.9, can help bring the reader up to speed on these tasks.[30]

**Exhibit 8.9 Some commonly used types of scales for quantitative market research**

| Type of scale | Description | Example |
|---|---|---|
| Semantic Differential Scale | A scale connecting two bipolar words or phrases | How satisfied are you with your provider of cable TV?<br>Not at all satisfied 1 2 3 4 5 6 7 Extremely satisfied |
| Likert Scale | A statement with which the respondent shows the amount of agreement/ disagreement | I am extremely satisfied with my provider of cable TV.<br>Strongly agree 1 2 3 4 5 6 7 Strongly disagree |
| Quality Rating Scale | Rates some attribute on a scale from 'excellent' to 'poor' | My cable TV service, overall, is:<br>Poor Fair Good Very Good Excellent |
| Importance Scale, using semantic differential format | Rates the importance of some attribute | How important are the following criteria to your satisfaction with your cable TV provider?<br>Not at all important ... Extremely important<br>Answers the phone quickly 1 2 3 4 5 6 7<br>Prompt repair service 1 2 3 4 5 6 7<br>Cleans up after installation 1 2 3 4 5 6 7<br>Service never goes dark 1 2 3 4 5 6 7 |
| Intention-to-Buy Scale | Measures how likely the respondent is to buy at some price | How likely are you to sign up for the new InterGalactic Channel for an extra $4.95 per month?<br>Definitely ____<br>Probably ____<br>Might or might not ____<br>Probably not ____<br>Definitely not ____ |

Experiments are studies in which the researcher manipulates one or more variables, such as price or product features, either within the context of a survey or in a laboratory or field setting, in order to measure the effect of the manipulated variable on the consumer's response. One common use of experiments is to examine the consumer's likelihood to buy a new product at different price points. Different respondents are given different prices for the product, and the researcher tests differences in consumers' likelihood to buy as the price changes. This procedure entails less bias than asking consumers what they would be willing to pay for a product, the typical answer to which is 'as little as possible!'

### 8.6.3.2 Determine the Contact Method

Once a data collection method is chosen, the researcher must decide how to contact those who will participate in the research. Common choices include face-to-face (perhaps in a shopping mall or a public place), mail, telephone, fax, email, and the Internet. Exhibit 8.10 shows some of the trade-offs among these methods. A significant problem with survey research is that those who choose *not* to participate when asked ('We're eating dinner now, and please don't call back!') may differ from those who *do* participate. This nonresponse bias may distort the results of the research. Response rate can also be a problem, since many who are asked to participate will not do so. Response rates for mail surveys generally run about 15 to 20 per cent. The other types are better or worse, as shown in Exhibit 8.10. Thus, for a mail survey, five to six times the number of surveys the researcher hopes to receive must be mailed.

Increasingly, marketing research of all kinds, especially surveys, is moving from more costly face-to-face or telephone contact methods to online approaches. Proponents argue that there are benefits in doing so. First, it's fast, easy, and in some cases free, thanks to numerous websites like **www.zoomerang.com** that offer easy-to-use online survey tools. Second, respondents can choose when to take the survey, so they may provide more thoughtful, more complete answers. And researchers can ask more sensitive questions, because the process is less intrusive.[31]

But critics have significant concerns, the main one being that it's difficult to ensure that the huge pools of online respondents are representative of the wider population. The fact that respondents are not selected randomly violates a core tenet of probability-based sampling and interpretation of the results, notes Stanford professor Jon A. Krosnick, who has studied polling for eight years. Gary Langer, Director of Polling at ABC News, says the pools of volunteer participants – lured by gifts or cash – who take some polls are simply poll-taking clubs. ABC refuses to run the results of nonrandom polling. Procter & Gamble requires that research firms it hires to run online studies demonstrate that the respondents make up a highly representative group, not simply a bunch of survey junkies.[32]

**Exhibit 8.10 Pros and cons of different contact methods for survey research**

| Method | Response rate | Cost | Timeliness | Nonresponse bias |
|---|---|---|---|---|
| Face-to-face | High | High | Slow | Low |
| Mail | Low | Low | Slow | High |
| Telephone | Moderate | Moderate | Fast | Moderate |
| Fax | Moderate | Low | Fast | High |
| Email | Low | Low | Fast | High |
| Internet | Low | Low | Fast | High |

### 8.6.3.3 Design the Sampling Plan

Selecting a sample of participants for observational, survey, or experimental research requires that three questions be answered:

- Who is the population (or universe) from which the sample of **respondents** will be drawn?
- What sample size is required to provide an acceptable level of confidence?
- By what method, probability sampling (also called random sampling) or nonprobability sampling (such as convenience sampling), will the sample be selected?

We'll discuss each of these issues briefly.[33] First, the population from which the sample is to be drawn must be clearly specified. Typically, it consists of the target market, defined in demographic or behavioural terms (e.g., users of pay telephones in Tanzania), although excluding current nonusers might not be a good idea for Maddy and Laguë if they hope to expand the market.

Second, the sample must be large enough to provide confidence that statistical data, such as mean responses to survey questions, are *truly* within some narrow-enough range, sometimes called the **margin of error**. In general, the larger the sample size, the smaller the margin of error. If Maddy and Laguë observed only three pay phones in their research, they could not be very confident that the average daily minutes of use at those phones was representative of use for the wider universe of pay phones in Tanzania. A larger sample would give them more confidence. Exhibit 8.11 provides rough approximations of the margin of sampling error associated with different sample sizes.

**Exhibit 8.11 Margin of error associated with different sample sizes**

Assume a poll of eligible voters is taken to determine which candidate is in the lead. Suppose the results are that Jones has 45 per cent of the voters in her corner, Smith has 41 per cent, and 14 per cent are undecided. Can we conclude that Jones leads Smith? It depends, in part, on the sample size of the poll.

| Sample size | Approximate margin of error for 95% confidence level | Implications for the Jones and Smith race |
|---|---|---|
| 100 | 10 percentage points | Jones has 45% plus or minus 10%, or 35% to 55%.<br>Smith has 41% plus or minus 10%, or 31% to 51%.<br>Smith could be leading by as much as 51% to 35%. |
| 500 | 4.5 percentage points | Jones has 45% plus or minus 4.5%, or 40.5% to 49.5%.<br>Smith has 41% plus or minus 4.5%, or 36.5% to 45.5%.<br>Smith could be leading by as much as 45.5% to 40.5%. |
| 1000 | 3 percentage points | Jones has 45% plus or minus 3%, or 42% to 48%.<br>Smith has 41% plus or minus 3%, or 38% to 44%.<br>Smith could be leading by as much as 44% to 42%. |

What will the headlines say? Probably that Jones leads Smith, 45 per cent to 41 per cent. If the sample size is 1000, typical in national or statewide political polls, is this a fair conclusion?

*Source*: 'What Is a Margin of Error?' American Statistical Association Section on Survey Research Methods at www.amstat.org/
sections/srms/.

Third, the idea behind **probability** or **random sampling** is that every person in the population has an equal chance of being selected. If **nonprobability samples**, such as **convenience samples**, are used, the sample may be biased. If Maddy and Laguë observe consumers using pay phones in the international departure lounge at the airport in Dar es Salaam, this sample would not reflect usage by the general Tanzanian population. Convenience samples are used quite often for marketing research because true random samples are more difficult and costly to reach. The nonresponse problem makes almost all samples potentially biased in the same way. An astute user should always ask about the sample selection method. If the method is not random, the user should inquire about how the sample was selected to look for any obvious source of bias that might distort the research results.

## 8.6.4 Step 4: Collect the Data

By now, the hardest parts of the research process are complete, though the most time-consuming parts have just begun. The data collection contributes more to overall error than any other step in the process. In some cases, especially where entrepreneurs or marketers conduct marketing research themselves instead of contracting with a third party for data collection, **collector bias** can be a problem. The person collecting the data might, in his or her enthusiasm for the product, bias the respondents so they tell the researcher what they think he or she wants to hear.

Errors in face-to-face or telephone surveys include those that derive from nonresponse by some respondents; selection errors by the interviewer (i.e., selecting respondents who are not members of the specified population); the way the interviewer asks the questions; the interviewer's interpretation and recording of answers; and even interviewer cheating. In surveys conducted by fax, email, or over the Internet, an additional problem is that the researcher does not know who actually replied to the survey.

The data collection effort can be substantial. To complete 100 surveys in the United Kingdom with randomly selected homes using random digit dialling, several hundred phone numbers will likely be required and 1000 diallings!

## 8.6.5 Step 5: Analyse the Data

When the data have been collected, the completed data forms must be processed to yield the information the project was designed to collect. The forms are checked to see that instructions were followed, that the data are complete, and that the data are logical and consistent within each respondent's form. Typically, the data are then entered into computer files, percentages and averages are computed, and comparisons are made between different classes, categories, and groups of respondents. Often, sophisticated statistical analyses are required.

### 8.6.6 Step 6: Report the Results to the Decision Maker

This is where the rubber meets the road. If the research study began with clearly defined objectives, reporting the results simply returns to those objectives and reports what was found. Where research is carried out without clear objectives, reporting can be difficult, as no clear conclusions may be available. Lots of marketing research money is wasted in some companies because of poorly specified research objectives.

## 8.7 What Users of Marketing Research Should Ask

The research process described in the preceding section makes clear where many of the potential stumbling blocks are in designing and conducting marketing research. The informed and critical user of marketing research should ask the following questions, ideally before implementing the research or if necessary subsequent to its completion, to ensure that the research is unbiased and the results are reliable.

1. What are the objectives of the research? Will the data to be collected meet those objectives?
2. Are the data sources appropriate? Are cheaper, faster secondary data used where possible? Is qualitative research planned to ensure that quantitative research, if any, is on target?
3. Are the planned qualitative and/or quantitative research approaches suited to the objectives of the research? Qualitative research is better for deep insights into consumer behaviour, while quantitative research is better for measurement of a population's attitudes and likely responses to products or marketing programmes.
4. Is the research designed well? Will questionnaire scales permit the measurement necessary to meet the research objectives? Are the questions on a survey or in an interview or focus group unbiased? ('Isn't this a great new product? Do you like it?') Do the contact method and sampling plan entail any known bias? Is the sample size large enough to meet the research objectives?
5. Are the planned analyses appropriate? They should be specified *before* the research is conducted.

## 8.8 Rudimentary Competence: Are We There Yet?

One objective we set at the outset of this module was to provide the reader with at least a rudimentary level of competence in designing and carrying out marketing research studies. Entire courses dealing with marketing research are offered in nearly every business school marketing curriculum and half a module does little justice to the detail and technical expertise involved in this important craft. Nonetheless, by reading this module and a few of the cited reference sources on particular research techniques, the reader should be able to conduct at least some useful research for a class project or even a low-budget entrepreneurial venture. Such research, despite its limitations, will give the reader an experiential base useful in assessing research done by others, and it will surely yield greater insights into the marketing problem than will hunches alone. Given the importance of marketing research in strategic decision making today, we encourage every business student from every business discipline to try his or her hand at it.

In the remaining modules in this course, we shall return from time to time to the marketing research topic and show how marketing research informs not only market and competitive analysis and customer understanding, but also the design and implementation of marketing programmes. In recent years, a wide variety of software applications have been developed to aid marketers in conducting marketing research and applying it and other data to specific marketing problems. In subsequent modules, we'll point out specific applications for which such systems are commonly used. Various trade magazines publish annual directories that list providers of these tools and other services that facilitate marketing research.[34]

## Learning Summary

- Every forecast and estimate of market potential is wrong! *Evidence-based* forecasts and estimates, prepared using the tools provided in this module, are far more credible – and generally more accurate – than hunches or wild guesses. A menu of evidence-based forecasting approaches is provided in this module.
- Forecasts have powerful influence on what companies do, through budgets and other planning procedures. Thus, forecasting merits significant management attention and commitment.
- Superior market knowledge is not only an important source of competitive advantage, but it also results in happier, higher volume, and more loyal customers. Thus, the systematic development of market knowledge is a critically important activity in any organisation.
- Much can go wrong in marketing research and often does. Becoming an informed and critical user of marketing research is an essential skill for anyone who seeks to contribute to strategic decision making. Tools for obtaining this skill are presented in this module.

## Review Questions

### Content Questions

8.1 Define the term 'market potential'.

8.2 How can one measure market potential?

8.3 What are the benefits and drawbacks of using statistical methods for estimating market potential and sales?

8.4 What other evidence-based methods might you use to estimate market potential or forecast sales?

8.5 Explain some of the biases in forecasting.

8.6 Describe marketing database systems and how they can be used.

8.7 Define what is meant by the term ‘marketing research’.

8.8 What is the difference between primary and secondary data sources?

8.9 In performing marketing research, what are some important ethical considerations to make when dealing with respondents?

8.10 What are the major differences between probability and nonprobability sampling?

8.11 What are some critical questions that managers setting up a client contact management system should ask?

8.12 Name each step of the marketing research process and explain what could go wrong at each step.

8.13 What are the major sources of error in data collection?

## Multiple Choice Questions

8.14 In a decentralised firm, when each part of the firm prepares its own sales forecast and then those are aggregated to create the forecast for the firm as a whole, what type of forecast approach is used?

A. Top-down.
B. Bottom-up.
C. Assembly.
D. Team.
E. Lateral.

8.15 The research process which recognises and notes people and actions, rather than merely asking for information, is called:

A. tracking studies.
B. observation.
C. consumer surveys.
D. focus groups.
E. mall intercept studies.

8.16 When companies adjust for the buyer's likelihood to buy in a consumer survey, they are making a(n):

A. awareness adjustment.
B. distribution adjustment.
C. concept purchase intent adjustment.
D. judgement call.
E. BPI adjustment.

8.17 When McDonald's introduces a new sandwich at some of their locations they are performing a(n)

A. survey.
B. observation.
C. analogy.
D. market test.
E. judgement.

8.18 Of the following forecasting tools, which has the tendency to be very expensive to carry out?

A. Market test.
B. Analogy.
C. Observation.
D. Statistical methods.
E. Survey.

8.19 What does the ratio of the BDI to the CDI tell us?

A. The percentage of buying power for an area in a certain category.
B. How well a brand is doing compared to its category.
C. Ratio of sales in a geographical area compared to nationwide.
D. Ratio of sales of a brand in a geographical area compared to nationwide.
E. None of the above.

8.20 Two important keys to improve the credibility and accuracy of forecasting are:

A. use census data and company historical data when available.
B. make assumptions explicit and use multiple methods.
C. apply indices and adjustments.
D. make test markets big and surveys short.
E. never use the SWAG method and avoid using judgements.

8.21 An understanding of market and competitive conditions and of what buyers in a given market want and need is called:

A. market conditions.
B. market knowledge.
C. market niche.
D. market analysis.
E. market potential.

8.22 The Nine West Retail Stores' 'Godzilla Report,' which provides detailed sales and inventory information about the fastest selling items in Nine West stores from the prior week, is an example of a(n):

A. internal record system.
B. marketing database.
C. competitive intelligence system.
D. client contact system.
E. sales report.

8.23 The question, 'In what sequence and at what level of aggregation should data be reported?' is important to ask when designing a(n):

A. competitive intelligence system.
B. client contact system.
C. marketing database.
D. sales report.
E. internal record system.

8.24 A telemarketer decides to have one particular salesperson sell only one product in his product line-up. This decision was based on information from the:

A. client contact system.
B. marketing database.
C. internal record system.
D. sales report.
E. competitive intelligence system.

8.25 An important issue to be considered when designing marketing databases is:

A. the cost of collecting the data.
B. the economic benefits of using the data.
C. the ability of the company to keep the data current in today's mobile society.
D. the rapid advances in technology that permit the data to be used to maximum advantage.
E. all of the above.

8.26 The companies Polk, Donnelley and Claritas have what in common?

A. They develop marketing database systems for other companies.
B. They sell marketing data from their commercial marketing databases.
C. They analyse what marketing data are most useful for a company to buy or collect.
D. Companies outsource their marketing department to Polk, Donnelley and Claritas.
E. None of the above.

8.27 The information in a compiled database might be collected from a(n):

A. telephone directory.
B. magazine publisher.
C. credit card issuer.
D. affinity group.
E. all of the above.

8.28 The following is a good source to get information on competitors:

A. annual reports.
B. government documents.
C. online databases.
D. trade organisations.
E. all of the above.

8.29 Marketing research is performed to:

A. determine a target market.
B. develop the best product.
C. increase sales.
D. address a particular marketing challenge or situation.
E. all of the above.

8.30 What is the first step in the marketing research process?

A. Determine data sources.
B. Collect data.
C. Analyse data.
D. Identify managerial problems and establish research objectives.
E. Design research.

8.31 A drawback of qualitative research is that:

A. it's typically not accurate.
B. the information is of little benefit.
C. the conclusions drawn are usually shallow.
D. generally the small samples may not fairly represent the larger population.
E. the data is best used for statistical purposes.

8.32 Greater confidence can be placed in quantitative studies because of:

A. their larger sample size.
B. their data collection process.
C. the type of the people sampled.
D. the statistical methods applied.
E. all of the above.

8.33 When a food manufacturer pulls ten consumers from a target market together to taste and discuss a cookie that will soon go on the market, they are performing a(n):

A. survey.
B. focus group.
C. questionnaire.
D. interview.
E. experiment.

8.34 What kind of scale is being used when a question asks the respondent to answer by stating the degree to which they are satisfied or not satisfied?

A. Semantic Differential Scale.
B. Likert Scale.
C. Quality Rating Scale.
D. Importance Scale.
E. Intention-to-Buy Scale.

8.35 What kind of scale is being used when a question asks the respondent to answer by showing their level of agreement or disagreement?

A. Semantic Differential Scale.
B. Likert Scale.
C. Quality Rating Scale.
D. Importance Scale.
E. Intention-to-Buy Scale.

8.36 The three most popular means of collecting primary data are:

A. focus groups, surveys and mall intercept studies.
B. focus groups, observation and interviews.
C. observation, surveys and experiments.
D. experiments, focus groups and observation.
E. interviews, experiments and surveys.

8.37 A common use of experiments is to:

A. examine the consumer's likelihood to buy a new product at different price points.
B. test a consumer's preference in product packaging.
C. determine the target market for a product.
D. test a consumer's satisfaction in a product.
E. determine the best means of advertising.

8.38 Of the different methods of contacting potential research participants, which has the highest response rate?

A. Telephone.
B. Mail.
C. Email.
D. Internet.
E. Face-to-face.

8.39 Of the different methods of contacting potential research participants, which is typically the most expensive?

A. Telephone.
B. Mail.
C. Email.
D. Internet.
E. Face-to-face.

8.40 A bank is trying to determine whether or not to install ATM machines at a grocery store chain. They determine this by observing the usage of an ATM at a convenience store. The bank is using:

A. probability sampling.
B. nonprobability sampling.
C. random sampling.
D. inconvenient sampling.
E. margin of error sampling.

8.41 When a person collecting data for marketing research influences the respondent, perhaps inadvertently, to tell the researcher what she wants to hear, there will be:

A. skewed results.
B. margin of error.
C. collector bias.
D. nonprobability sampling.
E. prejudiced results.

8.42 For what type of research technique is it common to have the following errors: non-response by some respondents; selection errors by the interviewer; improper questioning by the interviewer; improper interpretation and recording of answer; and interviewer cheating?

A. Telephone survey.
B. Focus groups.
C. Experiments.
D. Mail survey.
E. None of the above.

8.43 The following occurs during data analysis:

A. Check that instructions were followed.
B. Check that data is complete.
C. Check that data is consistent.
D. Compute data to determine percentages and averages.
E. All of the above.

8.44 What is the final step in marketing research?

A. Analyse the data.
B. Implement results.
C. Report results.
D. Review entire process.
E. None of the above.

8.45 What type of research is best for understanding the insights into consumer behaviour?

A. Probability.
B. Nonprobability.
C. Face-to-face.
D. Qualitative.
E. Quantitative.

8.46 What type of research is best for measuring a population's attitudes and likely responses to products or marketing programmes?

A. Probability.
B. Nonprobability.
C. Face-to-face.
D. Qualitative.
E. Quantitative.

## Application Questions and Cases

8.47 A large international rental-car company decides to develop a retention programme that would provide incentives for its heavy users to continue their loyalty to the company. You, as a consultant, are asked to design a retention programme that will accomplish this purpose.

8.48 Before putting your recommended retention programme in operation, the company asks you to design a marketing research study that will test the effectiveness of your programme.

8.49 A local theatre company wants to know whether current season ticket holders would prefer more comedies or more serious dramas next season. Because programme decisions must be made soon, the information must be collected quickly. But the research budget is limited. Which survey questioning method (i.e., mail, phone, personal interviews) would you recommend using to collect the information? What limitations might that method impose on the study?

8.50 The household detergents division of a large household products company with worldwide distribution is planning a research study among women 21 years and over to determine their attitudes toward home laundering and the products and brands used in such activities. Studies are to be carried out in a variety of countries in the Far East, Middle East, Africa, Western Europe, Eastern Europe, and South America. What data-collection problems would you expect to experience in doing this research across a variety of countries?

8.51 What are the dangers involved in using sales force estimates to forecast a product's future sales? Under which conditions are such estimates most likely to be accurate and useful?

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# Module 9

# Market Segmentation and Target Marketing

## Contents



## Blue Ribbon Sports Targets Distance Runners[1]

It was 1964. Phil Knight, a recent graduate of Stanford's Graduate School of Business and a former University of Oregon runner with a 4:10 personal best in the mile, and the legendary Bill Bowerman, Knight's former track coach at the University of Oregon, were passionate about distance running. They believed that the German-made shoes that most competitive runners wore at the time were too expensive and not designed with *distance* runners' needs in mind. They saw an opportunity to design better running shoes in the United States, have them manufactured in Asia, and sell them in America at prices lower than the German shoes.

### *The Unique Needs of Distance Runners*

Distance runners such as Knight and Bowerman had different footwear needs than other athletes. To become conditioned enough to run a 26-mile marathon or even a one-mile or two-mile race at an intercollegiate track meet, distance runners ran several miles per day and sometimes more than 100 miles in a week. Often, these miles were spent on rough trails, where rocks and other natural obstacles led to ankle sprains and other injuries, or along country roads, where the miles and miles of impact led sometimes to shin splints or even stress fractures of the bones in their legs and ankles. Bowerman, a lifelong innovator who made shoes in his garage for his runners, believed that distance runners needed lighter and more flexible shoes, not heavy leather or stiff soles. They needed shoes with better lateral stability, to protect against ankle sprains, and more cushioning, to help the runner's body cope with miles and miles of repetitive impact.

### *The Waffle Revolution*

Though real success took several years to materialise, the story of Bowerman's vision of a better shoe for distance runners is now entrepreneurial lore. With his wife's waffle iron and some latex, Bowerman invented the waffle outsole that would ultimately revolutionise the running shoe. The lightweight, yet durable and stable sole set a new standard for shoe performance for distance runners. Knight, the business person and visionary, had written in a class assignment at Stanford a plan for developing a business to sell American-designed, Asian-made shoes to distance runners. Knight and Bowerman each chipped in $500 to form Blue Ribbon Sports and found a Japanese company, Onitsuka Tiger, to manufacture the shoes they designed. For years, wherever there was running going on, Knight could be found selling his shoes out of the back of his station wagon. By 1969, Knight was able to quit his day job as an accountant and devote all of his energies to the growing business, which then had 20 employees and several retail outlets.

### *Launching and Expanding the Nike Brand*

In 1972, Blue Ribbon Sports launched its Nike brand at the US Olympic trials after a dispute between Blue Ribbon and Tiger led to a breakup of their relationship. In the 1972 Olympic marathon, four of the top seven finishers wore Nike shoes. By 1974, after 10 years of dogged effort to build the company, the Nike shoe with Bowerman's waffle sole was America's best-selling training shoe, and the Nike brand was on its way to stardom. In 1978, tennis great John McEnroe signed with the company, which had changed its name to Nike, Inc., and tennis shoes became a prominent part of the product line. In 1985, a promising Chicago Bulls basketball rookie named Michael Jordan endorsed a line of Air Jordan shoes and apparel. By 1986, Nike's worldwide sales passed the billion-dollar mark and Nike had become the acknowledged technological leader in the footwear industry. Before long, Nike extended its product lines to include athletic apparel.

### *World Cup 2002*

Among Nike's target markets by the turn of the millennium was football – soccer to Americans – the world's most-played sport. With World Cup 2002 scheduled in Korea and Japan, Nike's product developers knew that extreme heat and humidity would call for uniforms that would help players compete at top speed and still keep their body temperature down. Working for two years with the Korean team, Nike developed its new Cool Motion technology, a material with a 'two-layer structure designed to maximise thermal comfort and ventilation,' said Nike's Creative Product Designer for Football, Craig Buglass. The uniform's inner layer pulled perspiration away from the skin and spread it over a wide area for quick evaporation. Its water-repellent outer layer helped to keep the uniform dry under extreme humidity during intense aerobic activity.

Did the uniforms perform? Korea, never known as a football power, surprised many by winning third place. Their relentless pressure and unending team speed impressed many observers. The high-tech uniforms surely didn't hurt.

### Learning Objectives

Module 9 draws on the foundation of market knowledge and customer understanding established in the first eight modules to introduce what are probably the most important and fundamental tools in the marketer's toolkit: **market segmentation** and **target marketing**. Together with **brand differentiation and positioning**, which we address in Module 10, these tools provide the platform on which most effective marketing programmes are built. Learning to apply these tools effectively, however, requires addressing several important questions. How can potentially attractive market segments be identified and defined? Finally, how can these segments be prioritised so that the most attractive ones are pursued? Answering these questions should enable decisions to be made on which market segments should be targeted and which investments should be made.

## 9.1 Why Do Market Segmentation and Target Marketing Make Sense?

Market segmentation is the process by which a market is divided into distinct subsets of customers with similar needs and characteristics that lead them to respond in similar ways to a particular product offering and marketing programme. Target marketing requires evaluating the relative attractiveness of various segments (in terms of market potential, growth rate, competitive intensity, and other factors) and the firm's mission and capabilities to deliver what each segment wants, in order to choose which segments it will serve. Brand positioning entails designing product offerings and marketing programmes that collectively establish an enduring competitive advantage in the target market by creating a unique image, or position, in the customer's mind. Knight and Bowerman founded Blue Ribbon Sports in part because they saw a market segment – distance runners – whose needs were not being fully met. They chose to target this segment because running was growing in popularity and because they had particular knowledge and expertise they could bring to the party. They positioned their innovative shoes as the ones that enhanced the performance of the best runners in the world and, by implication, of anyone else who cared about his or her running.

These three decision processes – market segmentation, target marketing, and positioning – are closely linked and have strong interdependence. All must be well considered and implemented if the firm is to be successful in managing a given product-market relationship.

No matter how large the firm, however, its resources are usually limited compared with the number of alternative market segments available for investment. Thus, a firm must make choices. Even in the unusual case where a firm can afford to serve all market segments, it must determine the most appropriate allocation of its marketing effort *across* segments. But are all these analyses and conscious choices about which segments to serve really necessary?

## 9.1.1 Most Markets Are Heterogeneous

Because markets are rarely homogeneous in benefits wanted, purchase rates, and price and promotion elasticities, their response rates to products and marketing programmes differ. Variation among market segments in product preferences, size and growth in demand, media habits, and competitive structures further affect the differences and response rates. Thus, markets are complex entities that can be defined (segmented) in a variety of ways. As New York-based trend tracker Tom Vierhile notes, 'What consumers really appear to hunger for are products that fit their unique needs, wants, and desires. They want products that talk just to them and appeal to them on an emotional level.'[2]

The critical issue is to find an appropriate segmentation scheme that will facilitate target marketing, product positioning, and the formulation of successful marketing strategies and programmes. By focusing their initial efforts on high-performance distance runners, a clearly defined and very narrow market segment, Knight and Bowerman put themselves in position to design shoes especially well-suited to these runners' needs. Their segmentation scheme, arguably, played just as important a role in their early success as did Bowerman's wife's waffle iron!

## 9.1.2 Today's Market Realities Often Make Segmentation Imperative

Market segmentation has become increasingly important in the development of marketing strategies for several reasons. First, population growth has slowed, and more product-markets are maturing. This sparks more intense competition in existing markets as firms seek growth via gains in market share and encourages companies to find new markets they've not served previously. Often, as they search for faster-growing markets, their attention turns to the developing world, where the enormous diversity in demographic profiles and market conditions makes careful market segmentation and targeting essential. Nokia, for example, has targeted the fast-growing Indian market, where a majority of the population lives in rural areas. In doing so, it's had to adapt the design of its cell phones, adding dust-proof keypads and eliminating other features to make its phones affordable to India's low-income masses.

Second, such social and economic forces as expanding disposable incomes, higher educational levels, and more awareness of the world have produced customers with more varied and sophisticated needs, tastes, and lifestyles than ever before. This has led to an outpouring of goods and services that compete with one another for the opportunity of satisfying some group of consumers.

Third, there is an increasingly important trend toward microsegmentation in which extremely small market segments are targeted. For a discussion of how one company built itself into a multimillion-dollar business while serving a very small niche *see* Exhibit 9.1. This trend has been accelerated in some industries by new technology such as computer-aided design, which has enabled firms to mass-customise many products as diverse as designer jeans and cars.[2] For example, many automobile companies are using a flexible production system that can produce different models on the same production line. This enables the company to produce cars made to order and sell, as does General Motors in the United States, which used its online presence to fine tune its build-to-order process.[3]

**Exhibit 9.1 Can Under Armour become another Nike?**

Kevin Plank did not set out to create a cult around athletic underwear – he simply wanted a comfortable T-shirt to wear under his football pads that would wick moisture away from his skin and protect him from heat exhaustion during practice. After hunting through all the sporting goods shops, Kevin realised that there was not a single product on the market that met his needs. He set out to create one.

In March 1996, just before graduation, Kevin had some T-shirts sewn up in Lycra and found that he had solved a common problem for all of his teammates.

Under Armour, the company that was soon born in his grandmother's basement, made its first sale of 200 shirts for $12 a-piece to the American football team at Georgia Tech. Kevin ended his company's first year with sales of $17 000. Under Armour was marketed by word-of-mouth from happy, satisfied customers, and grew with sales to athletic teams in colleges.

The company got its big break due to a product placement in the Oliver Stone football movie *Any Given Sunday*. Buzz from the movie, and a first-time ad in ESPN magazine during the movie premiere boosted Under Armour sales to $1.35 million in 1999. Under Armour's, sales in 2001 drove triple-digit growth in its category and led industry peers at Sporting Goods Business to recognise the company as 'Apparel Supplier of the Year.' Under Armour's sales soared to $55 million in 2002 and more than $400 million in 2006.

The small underserved market segment that Kevin Plank discovered and his success have not gone unnoticed – ironically, recent entrants to this market are Nike and Reebok. Kevin Plank's reaction? 'I'll never let them see me sweat.'

*Source*: Company website www.underarmour.com; Elaine Shannon, 'Tight Skivvies; They're what everyone's wearing this season. Here's why,' *Time*, January 13, 2003, A1 Vol. 161, Issue: 2; and Stanley Holmes, 'Under Armour May Be Overstretched,' *BusinessWeek* European Edition, April 30, 2007, p. 65.

Finally, many marketing organisations have made it easier to implement sharply focused marketing programmes by more sharply targeting their own services. For example, many new media have sprung up to appeal to narrow interest groups. In the United Kingdom, these include special interest magazines, such as *Wanderlust* and *Autocar*; radio stations with formats targeted to different demographic groups, such as classical music, rock, country, and jazz, not to mention chat shows of various kinds; and cable TV channels, such as Sky Sport and the Discovery Channel. Also, more broad-based magazines, such as *The Economist* and *Hello*, offer advertisers the opportunity to target specific groups of people within their subscription base. An advertiser can target specific regions, cities, or postcodes, or even selected income groups.

## 9.2 How Are Market Segments Best Defined?

There are three important objectives entailed in the market segmentation process:

- **Identify a homogeneous segment that differs from other segments.** The process should identify one or more relatively homogeneous groups of prospective buyers with regard to their wants and needs and/or their likely responses to differences in the elements of the marketing mix – the 4 Ps (product, price, promotion, and place). For Bowerman and Knight, high-performance distance runners comprised such a segment. Differences within one market segment should be small compared to differences across various segments (most high-performance distance runners probably have athletic footwear needs that are quite similar to one another, but quite different from, say, the needs of basketball players).

- **Specify criteria that define the segment.** The segmentation criteria should measure or describe the segments clearly enough so that members can be readily identified and accessed, in order for the marketer to know whether a given prospective customer is or is not in the target market and in order to reach the prospective customer with advertising or other marketing communication messages. Knight and Bowerman might have defined their initial target market as being comprised of members of running clubs or distance runners on collegiate track and cross-country teams.
- **Determine segment size and potential.** Finally, the segmentation process should determine the size and market potential of each segment for use in prioritising which segments to pursue, a topic we address in more detail later in this module. Knight and Bowerman could easily ascertain how many such runners there were in Oregon or the western United States, and they probably knew how many pairs of shoes per year the typical distance runner bought, at what average price.

Given these objectives, what kinds of segmentation criteria, or descriptors, are most useful? Segmentation decisions are best made in one of three ways: based on *who* the customers are, based on *where* they are, or based on *how they behave* relevant to the market in question. The three approaches apply in both consumer and organisational markets. We examine each of these approaches below.

## 9.2.1 Who They Are: Segmenting Demographically

While firm demographics (age of firm, size of firm, industry, etc.) are useful in segmenting organisational markets, we usually think of demographics in terms of attributes of individual consumers, as shown in Exhibit 9.2. Some examples of demographic descriptors used to segment consumer markets are as follows:

**Exhibit 9.2 Some of the more commonly used demographic descriptors**

| Demographic descriptors | Examples of categories |
|---|---|
| Age | Under 2, 2–5, 6–11, 12–17, 18–24, 25–34, 35–49, 50–64, 65 and over |
| Sex | Male, female |
| Income | Under $15 000, $15 000–$24 999; $25 000–$74 999, etc. |
| Occupation | Professional, manager, clerical, sales, supervisor, blue collar, homemaker, student, unemployed |
| Education | Some high school, graduated from high school, some college, graduated from college |

| Demographic descriptors | Examples of categories |
|---|---|
| Geography | Regions, countries, cities, metropolitan areas, counties, Zip codes and blocks |
| Race and ethnic origin | Anglo-Saxon, African-American, Italian, Jewish, Scandinavian, Hispanic, Asian |

Others include marital status, home ownership, and presence and age of children.

*Age*: Since mobile phone penetration has reached saturation levels in Europe and the UK, mobile service providers are focusing on the 55–65 and 65+ segment to improve usage and penetration respectively. Their high disposable incomes and their ability to devote time to new habits is seen as a lucrative market opportunity.[4] At the other end of the demographic scale, Red Bull has built a following among youth worldwide (see Exhibit 9.3).

**Exhibit 9.3 Red Bull's targeted approach wins across the globe**

Austria-based Red Bull is a company with one product, an energy drink containing the amino-acid Taurine. While working for Unilever, Dietrich Mateschitz travelled often to Asia, where he tried syrups that Asian businessmen drank to revitalise them. His experience there led him to spot a market opportunity, and after modifying the drink to appeal to western palates, he launched Red Bull in 1987. Its signature, a slim, silver-coloured, 8.3 ounce can, has been an enormous hit with its target youth segment across the globe. In 2009, Red Bull sold 3.9 billion cans in 160 countries, although its momentum slowed because of 'difficulties presented by the global economic climate,' the company reported.

From Stanford University on California's west coast, to the beaches of Australia and Thailand, Red Bull has managed to maintain its hip, cool image, with virtually no mass-market advertising. It has instead opted for a grass roots campaign. 'In terms of attracting new customers and enhancing consumer loyalty, Red Bull has a more effective branding campaign than Coke or Pepsi,' said Nancy F. Koehn, professor of business administration at Harvard Business School and author of *Brand New: How Entrepreneurs Earned Consumers' Trust from Wedgwood to Dell*.[5] Red Bull used Collegiate Brand Managers to promote the drink via free samples handed out at student parties. The company also organised extreme sports events, for example, cliff diving in Hawaii or skateboarding in San Francisco, reinforcing the brand's extreme, on-the-edge image.

*Source*: Jill Bruss, 'Alternatively speaking: alternative beverages keep the industry abuzz with new products. (Category Focus),' *Beverage Industry*, November 1, 2002, ISSN: 0148-6187; Volume 93; Issue 11, p. 14; Anni Layne Rodgers, 'It's a (Red) Bull Market After All,' *FastCompany*, October 2001; 'SLIM AND TRENDY – Camouflaged in a slim new can reminiscent of Red Bull…,, *Foodweek*, December 16, 2002; Company website www.redbull.com

*Sex*: In Australia, Toyota launched an online information service aimed at women, recognising that women make up 50 per cent of Toyota's sales and directly influence 8 out of 10 vehicle purchase.[6] As many marketers are discovering, however, thinking about all men or all women as a single market segment is usually naive. Understanding segments within the male population, for example, can bring out insights previously missed.[7]

*Income*: Higher-income households purchase a disproportionate number of cellular phones, expensive cars, and theatre tickets. In 2000, Nokia started a wholly owned subsidiary, Vertu, to create an ultra-exclusive mobile telephone and services built around the phone, targeting the same customers who buy luxury watches and custom-made cars.[8]

*Occupation*: The sales of certain kinds of products (e.g., work shoes, automobiles, uniforms, and trade magazines) are tied closely to occupational type. The increase in the number of working women has created needs for specialised goods and services including financial services, business wardrobes, convenience foods, automobiles, and special-interest magazines.

*Education*: There is a strong positive correlation between the level of education and the purchase of travel, books, magazines, insurance, theatre tickets, and photographic equipment.

*Race and ethnic origin*: More and more companies are targeting these segments via specialised marketing programmes. In the United States, car companies have found ways to cater to the needs of the multi-cultural segment, which is estimated to reach 32 per cent of the US population by 2010. A distinctive trend that had already emerged by 2002 was the Asian-American's affinity for upscale cars – they accounted for 15 per cent of BMW and 9 per cent of Mercedes Benz sales.[9]

Demographic descriptors are also important in the segmentation of industrial markets, which are segmented in two stages. The first, *macrosegmentation*, divides the market according to the characteristics of the buying organisation using such descriptors as age of firm, firm size, and industry affiliation (SIC code in the US). The international counterpart of SIC is the trade-category code.

The second stage, *microsegmentation*, groups customers by the characteristics of the individuals who influence the purchasing decision – for instance, age, sex, and position within the organisation. International markets are segmented in a similar hierarchical fashion, starting with countries, followed by groups of individuals or buying organisations.

### 9.2.2 Where They Are: Segmenting Geographically

Different geographic areas vary in their sales potential, growth rates, customer needs, cultures, climates, service needs, and competitive structures, as well as purchase rates for a variety of goods. For example, more pickup trucks are sold in the southwest United States, more vans in the Northeast, and more high-priced imports in the West. More and more advertisers are taking advantage of geographic media buys, and Uni-Marts, Inc., a convenience store operator of over 400 stores, focuses on small towns and rural areas, thereby avoiding big competitors. In its first 25 years, it has never recorded a loss.[10]

Geographic segmentation is used in both consumer and organisational markets and is particularly important in retailing and many services businesses, where customers are unwilling to travel very far to obtain the goods or services they require. Thus, one way to segment retail markets is by distance or driving time from a particular location. The area included within such a geographically defined region is called a **trade area**.

#### 9.2.2.1 Geodemographic Segmentation

Marketers targeting emerging markets in the developing world must pay particular attention to market segmentation within the geographic regions they target. Virtually every developing country contains a small segment of extremely wealthy people, a rapidly growing but sometimes relatively small middle class, and large numbers of people who are poor by Western standards. The first two of these demographic groups are most often found in the cities, while many poor live in either rural areas or in urban slums. Treating the people of any developing country as a single market segment is not likely to bring success.

In emerging and developed markets alike, many segmentation schemes involve both demographic and geographic factors. Thus, retailers usually want to know something about the people who live within, say, a two-mile or five-mile radius of their proposed new store. Neiman Marcus, the upscale department store, might target one demographic group within a given trade area, and Walmart, a discounter, might target another.

Nielsen and other sources offer low-cost reports based on census data that show the demographic profile of the population residing within any given radius of a particular street corner or shopping centre location in the United States. These reports are useful in assessing the size and market potential of a market segment defined by a particular trade area. Geodemographics also attempts to predict consumer behaviour by making demographic, psychographic, and consumer information available at the block and zip code levels. Nielsen's PRIZM service classifies all US households into 66 demographically and behaviourally distinct clusters, each of which, in turn, is assigned to one of 14 social groups and 11 life stage groups.[11] Nielsen offers similar datasets for other countries as well.[11]

### 9.2.3 How They Behave: Behavioural Segmentation

There is no limit to the number of insightful ways successful marketers have segmented markets in behavioural terms. Knight and Bowerman originally targeted high-performance distance runners. Bicycle makers Specialised and Gary Fisher target bicyclists who wish to ride on single-track trails or back-country terrain. Europe's EasyJet airline targets leisure travellers. Gatorade's original target market consisted of athletes who needed to replenish water and salts lost through perspiration. This simple segmentation scheme created a whole new category of 'sports beverages,' which now includes entries from Coke (Powerade) and Pepsi (All Sport), though Gatorade still dominates the category. This onetime niche market has grown into a multibillion dollar market in the United States alone.[12] These examples all demonstrate the power of highly specific behavioural descriptors in defining sharply focused market segments, based not on *who* the target consumers are or *where* they live, but based on what they *do*.

In virtually every consumer and organisational market there are probably segments like these just waiting to be identified and targeted by insightful marketers.

Behavioural descriptors can take many forms, including those based on consumer needs; on product usage patterns; on more general behavioural patterns, including lifestyle, which often cuts across demographic categories or varies within them; and, in organisational markets, on the structure of firms' purchasing activities and the types of buying situations they encounter.

#### 9.2.3.1 Consumer Needs

Customer needs are expressed in **benefits sought** from a particular product or service. Different customers have different needs and thus attach different degrees of importance to the benefits offered by different products. In the end, the product that provides the best bundle of benefits – given the customer's particular needs – is most likely to be purchased. For an example of how targeting a distinct set of consumer needs has taken a late entrant to the top of the car rental industry, see Exhibit 9.4.

Since purchasing is a problem-solving process, consumers evaluate product or brand alternatives on the basis of desired characteristics and how valuable each characteristic is to the consumer – **choice criteria**. Marketers can define segments according to these different choice criteria in terms of the presence or absence of certain characteristics and the importance attached to each. Firms typically single out a limited number of benefit segments to target. Thus, for example, different automobile manufacturers have emphasised different benefits over the years, such as Volvo's safeness versus Jaguar's styling, quickness, and status.

In organisational markets, customers consider relevant benefits that include product performance in different use situations. For example, super computers are bought because they meet the high-speed computational requirements of a small group of customers such as governments, universities, and research labs. Other considerations in the purchase of industrial products/services include on-time delivery, credit terms, economy, spare parts availability, and training.

**Exhibit 9.4 Enterprise rent-a-car: targeting pays off**

In 1963, Jack Taylor added car rentals to his small automobile leasing business. Taylor's strategy was to serve a completely different target market than the majors, Hertz and Avis, and provide replacement cars for people involved in accidents or breakdowns and those who were grounded while their cars were being serviced. Serving this market required a completely different sort of service – delivering the car to the customer, for example – than the majors provided. 'This stuff is a lot more complicated than handing out keys at the airport,' says Andy Taylor, Jack's son and now chairman and CEO. The business grew steadily, if unexceptionally, until the 1990s, when the younger Taylor stepped on the gas and cruised past Hertz and Avis to take the number one spot in the US market, with a fleet of 500 000 vehicles and more than $6 billion in revenue for the still privately held company. Europe followed and the initial entry has begun, into the UK, Ireland, and Germany.

While Enterprise now serves target segments beyond the car-replacement market, its clear focus on a narrowly defined segment that the majors had ignored provided the beachhead and an impregnable foundation on which the company was able to grow. Equally important, the strong customer service culture and decentralised decision making that were crucial to the initial strategy have become the lynchpin of the company's wider success. Enterprise measures each of its branches each month in terms of both profitability and customer service (two questions are asked of each customer: Are you satisfied with our service? Would you come back?) and no one gets promoted from branches that have below-average customer service scores, no matter how strong their financial performance. Enterprise has found that customers who answer 'completely satisfied' on question one are three times more likely to come back.

Clear targeting. Exceptional customer service. It's a combination that's kept Enterprise rolling for more than 40 years.

*Source:* Simon London, 'Driving Home the Service Ethic,' *Financial Times*, June 3, 2003.

### 9.2.3.2 Product Usage and Purchase Influence

In addition to highly specific behavioural descriptors such as those just discussed, there are more general product-related descriptors as well. They include product usage, loyalty, purchase predisposition, and purchase influence, all of which can be used to segment both consumer and industrial markets. **Product usage** is important because in many markets a small proportion of potential customers makes a high percentage of all purchases. In organisational markets, the customers are better known, and heavy users (often called *key accounts*) are easier to identify.

Market segmentation based on sources of **purchase influence** is relevant for both consumer and organisational markets. Many products used by various family members are purchased by the wife, but joint husband–wife decisions are becoming more common. Children's products, prescription drugs, and gifts are clearly influenced by a variety of family members. In organisational markets, several individuals or units with varying degrees of influence participate in buying decisions.

### 9.2.3.3 Lifestyle

Segmentation by lifestyle, or psychographics, groups consumers on the basis of their activities, interest, and opinions. From such information it is possible to infer what types of products and services appeal to a particular group, as well as how best to communicate with individuals in the group. Even among demographic groups that might at first glance seem homogeneous, behavioural segmentation based on lifestyle is identifying new target markets for savvy marketers (see Exhibit 9.5).

**Exhibit 9.5 Marketing to baby boomers: rethinking the rules**

By 2006, more than half the baby boomers in the United States – those born between 1946 and 1964 – had turned 50 or older. And, with combined spending power of more than $1 trillion per annum among the 50- to 60-year-olds alone, this growing market simply cannot be ignored. What marketers are discovering, though, is that these aging customers aren't all the same. Demographic segmentation just won't do. Behaviour is the key. Consumers aged 50+ buy a quarter of all Vespa motor scooters in the United States. Better still for Vespa, with their empty-nester spending power, they tend to buy the top-of-the-line models. But that doesn't mean all boomers are fantasising about their younger days. Indeed, wrinkles and grey hair are in among many boomers, along with healthier diets and lifestyles to help them age gracefully.

But are these consumers counting their days until they can retire to the shuffleboard court or bingo parlour? Hardly. As a result, Del Webb, the retirement-community division of Pulte Homes Inc., is changing the way it markets its properties, with more emphasis on the varied and active lifestyles that many of tomorrow's retirees will lead. 'We have to keep up with residents,' says David G. Schreiner, vice president for active-adult business development at Del Webb. 'The War Generation was far more predictable and consistent, but this generation gives you a bunch of paradoxes.'

*Source:* Louise Lee, 'Bunch of paradoxes.' *BusinessWeek,* October 24, 2005.

Stanford Research Institute (SRI) has created an improved US segmentation service (called VALS 2), which builds on the concept of self-orientation and resources for the individual. *Self-orientation* is based on how consumers pursue and acquire products and services that provide satisfaction and shape their identities. In doing so, they are motivated by the orientations of principle, status, and action. Principle-oriented consumers are motivated by abstract and idealised criteria, while status-oriented consumers shop for products that demonstrate the consumer's success. Action-oriented consumers are guided by the need for social or physical activity, variety, and risk taking. *Resources* include all of the psychological, physical, demographic, and material means consumers have to draw on. They include education, income, self-confidence, health, eagerness to buy, intelligence, and energy level – on a continuum from minimal to abundant.

Based on these two dimensions, VALS 2 defines eight segments that exhibit distinctive behaviour and decision making – actualisers, fulfillers, achievers, experiencers, believers, strivers, makers, and strugglers. Nielsen and similar commercial organisations identify each of the respondents as to their VALS type, thereby permitting a cross-classification of VALS type with the product usage and personal information collected by such companies. Thus, users can determine what each VALS segment bought, what their media habits are, and similar data. The VALS system has been further developed in Europe and Asia.[13] Those interested in the VALS segmentation scheme can complete a short survey on the VALS website (log onto www.strategicbusinessinsights.com/vals/) and discover the VALS segment to which they belong.

### 9.2.3.4 Organisational Behavioural Attributes

Purchasing structure and buying situation segmentation descriptors are unique to organisational markets. **Purchasing structure** is the degree to which the purchasing activity is centralised. In such a structure the buyer is likely to consider all transactions with a given supplier on a global basis, to emphasise cost savings, and to minimise risk. In a decentralised situation, the buyer is apt to be more sensitive to the user's need, to emphasise product quality and fast delivery, and to be less cost-conscious. Some marketers segment their markets accordingly and target customers whose purchasing structure is similar (companies who buy centrally from one location to meet their global needs, for example).

The **buying situation** descriptor includes three distinct types of situations: straight rebuy, a recurring situation handled on a routine basis; modified rebuy, which occurs when some element, such as price or delivery schedules, has changed in a client–supplier relationship; and a new buying situation, which may require the gathering of considerable information and an evaluation of alternative suppliers. Business-to-business marketers seeking new customers often find the buying situation to be a useful way to decide which new customers to target.

### 9.2.4 Innovative Segmentation: A Key to Marketing Breakthroughs

At the beginning of this section, we identified three objectives of the market segmentation process:

- Identify a homogeneous segment that differs from others
- Specify criteria that define the segment
- Determine segment size and potential

Effective marketers, such as the creators of Nike athletic shoes and Red Bull energy drinks and Enterprise Car Rental know that following this process to an insightful and innovative market segmentation scheme is often the key to marketing breakthroughs. Often, combinations of different descriptors are used to more precisely target an attractive segment: perhaps some behavioural dimension together with a carefully defined demographic profile within some geographic region. Generally, it is useful to know the demographic profile of the target market to be pursued, even if the driving force behind the segmentation scheme is geographical and/or behavioural in nature. Understanding the demographic profile of a target market enables the marketer to better choose targeted advertising media or other marketing communication vehicles, as we shall see in Module 14.

As several examples in this section have shown, at the foundation of many a marketing breakthrough one often finds an insightful segmentation scheme that is sharply focused in a *behavioural way*. Marketers with superior market knowledge are probably more likely to generate the insights necessary to define market segments in these innovative and meaningful ways. Knight and Bowerman, as runners themselves, had the necessary market knowledge to see how distance runners, as a market segment, were underserved. Their insight, together with the development of innovative products and the creation of effective marketing programmes, led the growth of the athletic footwear market, as consumers purchased different shoes for their different athletic pursuits, and ultimately revolutionised the athletic footwear industry.

## 9.3 Choosing Attractive Market Segments: A Five-Step Process

Most firms no longer aim a single product and marketing programme at the mass market. Instead, they break that market into homogeneous segments on the basis of meaningful differences in the benefits sought by different groups of customers. Then they tailor products and marketing programmes to the particular desires and idiosyncrasies of each segment. *But not all segments represent equally attractive opportunities for the firm.* To prioritise target segments by their potential, marketers must evaluate their future attractiveness and their firm's strengths and capabilities relative to the segments' needs and competitive situations.

Within an established firm, rather than allowing each business unit or product manager to develop an approach to evaluate the potential of alternative market segments, it is often better to apply a common analytical framework across segments. With this approach, managers can compare the future potential of different segments using the same set of criteria and then prioritise them to decide which segments to target and how resources and marketing efforts should be allocated. One useful analytical framework managers or entrepreneurs can use for this purpose is the **market-attractiveness/competitive-position matrix**. As we saw in Module 2, managers use such models at the corporate level to allocate resources across businesses, or at the business-unit level to assign resources across product-markets. We are concerned with the second application here.

**Exhibit 9.6 Steps in constructing a market attractiveness/competitive position matrix for evaluating potential target markets**

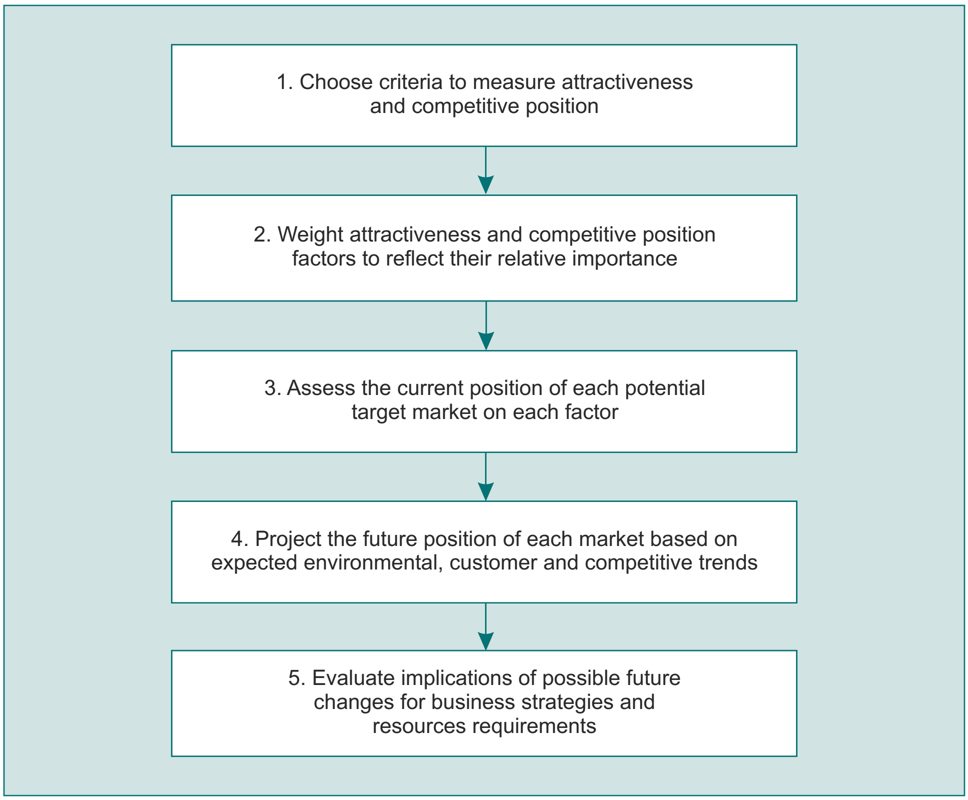



Exhibit 9.6 outlines the steps involved in developing a market-attractiveness/competitive-position matrix for analysing current and potential target markets. Underlying such a matrix is the notion that managers can judge the attractiveness of a market (its profit potential) by examining market, competitive, and environmental factors that may influence profitability. Similarly, they can estimate the strength of the firm's competitive position by looking at the firm's capabilities or shortcomings *relative* to the needs of the market and the competencies of likely competitors. By combining the results of these analyses with other consid-

erations, including risk, the mission of the firm, and ethical issues (*see* Ethical Perspective 9.1), conclusions about which markets and market segments should be pursued can be reached.

### Ethical Perspective 9.1

**Eat Chocolate, Get Fit?**

In 2003, Cadbury's, the British confectionery company, launched a 'Sports for Schools' promotion, emulating an earlier and very successful promotion that Tesco, the leading grocer in the UK, had run called 'Computers for Schools.' Cadbury's offered to buy fitness equipment for schools in exchange for tokens obtained through consumer purchases of Cadbury's confectionery.

Following howls of protest in the media, in which the programme was characterised as a perverse incentive for children to eat more of a product widely considered to be associated with child obesity, a growing problem in the UK and elsewhere, Cadbury's withdrew the programme.

As the UK's Food Commission calculated, 'Cadbury's wants children to eat 2 million kilograms of fat (more than 4 million pounds) – to get fit.' According to the Food Commission's calculations, a netball that sold for £5 in sporting goods stores would require consumer tokens from £38 worth of Cadbury products. These £38 worth of products would, in turn, involve consuming more than 20 000 calories and over 1000 grams of fat. In targeting children and families with this promotion, Cadbury's overlooked or misunderstood consumers' rising concerns over child obesity.

Empirical research by Craig Smith and Elizabeth Cooper-Martin indicates that ethical concerns such as those that arose here are particularly likely to arise over targeting strategies where the target market is perceived as vulnerable and where the products concerned are, in any sense, perceived to be harmful. Thus, it's not necessarily the products themselves that lead to ethical concerns, but targeting and market segmentation decisions to which insufficient ethical consideration is given. As Smith and Cooper-Martin note, 'Marketing managers should be alert to public disquiet over the ethics of certain targeting strategies,' especially when consumer vulnerability and product harm enter the equation.

*Sources:* N. Craig Smith, 'Out of Leftfield: Societal Issues as Causes of Failure of New Marketing Initiatives,' *Business Strategy Review*, Summer 2007; N. Craig Smith and Elizabeth Cooper-Martin, 'Ethics and Target Marketing: The Role of Product Harm and Consumer Vulnerability,' *Journal of Marketing* 61 (July 1997), pp. 1–20.

The first steps in developing a market-attractiveness/competitive-position matrix, then, are to identify the most relevant variables for evaluating alternative market segments and the firm's competitive position regarding them and to weight each variable in importance. Note, too, that Exhibit 9.6 suggests conducting a forecast of future changes in market attractiveness or competitive position in addition to, but separately from, an assessment of the current situation. This reflects the fact that a decision to target a particular segment is a strategic choice that the firm will have to live with for some time.

### 9.3.1 Step 1: Select Market-Attractiveness and Competitive-Position Factors

An evaluation of the attractiveness of a particular market or market segment and of the strength of the firm's current or potential competitive position in it builds naturally on the kind of opportunity analysis developed in Module 4 through Module 8. Managers can assess both dimensions on the basis of information obtained from analyses of the environment, industry and competitive situation, market potential estimates, and customer needs. To make these assessments, they need to establish criteria, such as those shown in Exhibit 9.7, against which prospective markets or market segments can be evaluated. Both market and competitive perspectives are necessary.

**Exhibit 9.7 Factors underlying market attractiveness and competitive position**

| Market attractiveness factors | Competitive position factors |
|---|---|
| Customer needs and behaviour<br>• Are there unmet or underserved needs we can satisfy? | Opportunity for competitive advantage<br>• Can we differentiate?<br>• Can we perform against critical success factors?<br>• Stage of competing products in product life cycle: is the timing right? |
| Market or market segment size and growth rate<br>• Market potential in units, revenue, number of prospective customers<br>• Growth rate in units, revenue, number of prospective customers<br>• Might the target segment constitute a platform for later expansion into related segments in the market as a whole? | Firm and competitor capabilities and resources<br>• Management strength and depth<br>• Financial and functional resources: marketing, distribution, manufacturing, R&D, etc.<br>• Brand image<br>• Relative market share |
| Macro trends: are they favourable, on balance?<br>• Demographic<br>• Sociocultural<br>• Economic<br>• Political/legal<br>• Technological<br>• Physical | Attractiveness of industry in which we would compete<br>• Threat of new entrants<br>• Threat of substitutes<br>• Buyer power<br>• Supplier power<br>• Competitive rivalry<br>• Industry capacity<br>• Driving forces: are they favourable, on balance? |

#### 9.3.1.1 Market-Attractiveness Factors

As we saw in Module 2, assessing the attractiveness of markets or market segments involves determining the market's size and growth rate and assessing various trends – demographic, sociocultural, economic, political/legal, technological, and physical – that influence demand in that market. An even more critical factor in determining whether to *enter* a new market or market segment, however, is the degree to which *unmet customer needs*, or needs that are currently not being well served, can be identified. In the absence of unmet or underserved needs, it is likely to be difficult to win customer loyalty, regardless of how large the market or how fast it is growing. 'Me-too' products often face difficult going in today's highly competitive markets.

#### 9.3.1.2 Competitive-Position Factors

As we saw in Module 5, understanding the attractiveness of the industry in which one competes is also important. Entering a segment that would place the firm in an unattractive industry or increase its exposure in an unattractive industry in which it already competes may not be wise. Of more immediate and salient concern, however, is the degree to which the firm's proposed product entry into the new market or segment will be sufficiently *differentiated* from competitors, given the critical success factors and product life-cycle conditions already prevalent in the category. Similarly, decision makers need to know whether their firm has or will be able to acquire the resources it will take – human, financial, and otherwise – to effectively compete in the new segment. Simply put, most new goods or services need to be either better from a consumer point of view or cheaper than those they hope to replace. Entering a new market or market segment without a source of competitive advantage is a trap.

### 9.3.2 Step 2: Weight Each Factor

Next, a numerical weight is assigned to each factor to indicate its relative importance in the overall assessment. Weights that Phil Knight and Bill Bowerman might have assigned to the major factors in Exhibit 9.7 are shown in Exhibit 9.8. Some users would rate each bullet point in Exhibit 9.7 independently, assigning a weight to each one.

### 9.3.3 Step 3: Rate Segments on Each Factor, Plot Results on Matrices

This step requires that evidence – typically both qualitative and quantitative data – be collected to objectively assess each of the criteria identified in Step 1. For Blue Ribbon Sports in 1964, the assessment of the various factors might have looked such as those shown in Exhibit 9.8. While more detailed evidence than we discuss here should have been, and no doubt was, gathered, Knight and Bowerman might have reached the following conclusions:

### Market-attractiveness factors

- Unmet customer needs for lateral stability, cushioning, and lightweight shoe have been identified. Score: 10.
- The distance runner segment is quite small, though growing, but it might lead to other segments in the future. Score: 7.
- Macro trends are largely favourable: fitness is 'in,' number of people in demographic groups likely to run is growing, global trade is increasing. Score: 8.

### Competitive-position factors

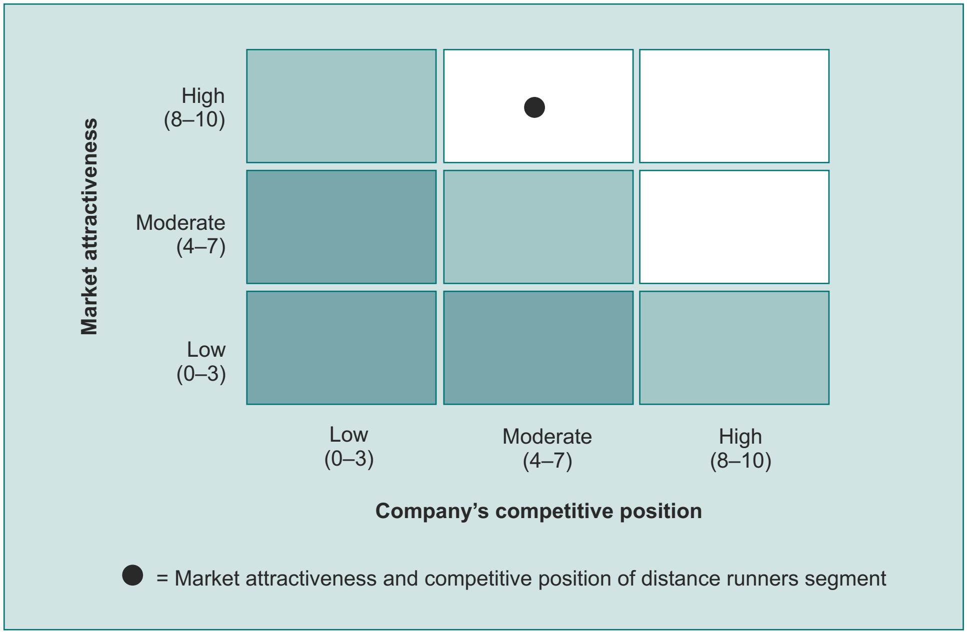
- Opportunity for competitive advantage is somewhat favourable; proposed shoes will be differentiated, but shoe category seems mature, and Blue Ribbon Sports, as a new firm, has no track record. Score: 7.
- Resources are extremely limited, though management knows runners and distance running; Bowerman has strong reputation. Score: 5.
- Five forces are largely favourable (low buyer and supplier power, little threat of substitutes, low rivalry among existing firms), driving forces attractive. Score: 7.

**Exhibit 9.8 Assessing the distance runner market segment in 1964**

| | | Rating | |
|---|---|---|---|
| | **Weight** | **(0–10 scale)** | **Total** |
| *Market attractiveness factors* | | | |
| Customer needs and behaviour: unmet needs? | 0.5 | 10 | 5.0 |
| Segment size and growth rate | 0.3 | 7 | 2.1 |
| Macro trends | 0.2 | 8 | 1.6 |
| **Total: market attractiveness** | **1.0** | | **8.7** |
| | | | |
| *Competitive position factors* | | | |
| Opportunity for competitive advantage | 0.6 | 7 | 4.2 |
| Capabilities and resources | 0.2 | 5 | 1.0 |
| Industry attractiveness | 0.2 | 7 | 1.4 |
| **Total: competitive position** | **1.0** | | **6.6** |

Mere armchair judgements about each criterion, of course, are not very credible and run the risk of taking the manager or entrepreneur into a market segment that may turn out not to be viable. It is especially important to undertake a detailed analysis of key competitors, especially with regard to their objectives, strategy, resources, and marketing programmes. Similarly, compelling evidence that a proposed entry into a new segment will satisfy some previously unmet needs, and do so in a way that can bring about sustainable competitive advantage, is called for. Both qualitative and quantitative marketing research results, as described in Module 8, are typically used for this purpose. Once these assessments have been made, the weighted results can be plotted on a **market-attractiveness/competitive-position matrix** like the one shown in Exhibit 9.9.

**Exhibit 9.9** **Matrix showing the attractiveness of a Blue Ribbon Sport's target segment based on a matching of market attractiveness and competitive position**




### 9.3.4 Step 4: Project Future Position for Each Segment

Forecasting a market's future is more difficult than assessing its current state. Managers or entrepreneurs should first determine how the market's attractiveness is likely to change over the next three to five years. The starting point for this assessment is to consider possible shifts in customer needs and behaviour, the entry or exit of competitors, and changes in their strategies. Managers must also address several broader issues, such as possible changes in product or process technology, shifts in the economic climate, the impact of social or political trends, and shifts in the bargaining power or vertical integration of customers.

Managers must next determine how the business's competitive position in the market is likely to change, assuming that it responds effectively to projected environmental changes but the firm does not undertake any initiatives requiring a change in basic strategy. The expected changes in both market attractiveness and competitive position can then be plotted on the matrix in the form of a vector (arrow) that reflects the direction and magnitude of the expected changes. Anticipating such changes may be critically important in today's Internet age.

### 9.3.5 Step 5: Choose Segments to Target, Allocate Resources

Managers should consider a market to be a desirable target only if it is strongly positive on at least one of the two dimensions of market attractiveness and potential competitive position and at least moderately positive on the other. In Exhibit 9.9

this includes markets positioned in any of the three cells in the upper right-hand corner of the matrix. However, a business may decide to enter a market that currently falls into one of the middle cells under these conditions: (1) managers believe that the market's attractiveness or their competitive strength is likely to improve over the next few years; (2) they see such markets as stepping-stones to entering larger, more attractive markets in the future; or (3) shared costs are present, thereby benefiting another entry.

The market-attractiveness/competitive position matrix offers general guidance for strategic objectives and allocation of resources for segments currently targeted and suggests which new segments to enter. Thus, it can also be useful, especially under changing market conditions, for assessing markets or market segments from which to withdraw or to which allocations of resources, financial and otherwise, might be reduced. Exhibit 9.10 summarises generic guidelines for strategic objectives and resource allocations for markets in each of the matrix cells.

**Exhibit 9.10 Implications of alternative positions within the market-attractiveness/ competitive-position matrix for target market selection, strategic objectives and resource allocation**

| Market attractiveness | Competitive position: *Weak* | *Medium* | *Strong* |
|---|---|---|---|
| *High* | Build selectively:<br>• Specialise around limited strengths<br>• Seek ways to overcome weaknesses<br>• Withdraw if indications of sustainable growth are lacking | DESIRABLE POTENTIAL TARGET<br>Invest to build:<br>• Challenge for leadership<br>• Build selectively on strengths<br>• Reinforce vulnerable areas | DESIRABLE POTENTIAL TARGET<br>Protect position:<br>• Invest to grow at maximum digestible rate<br>• Concentrate on maintaining strength |
| *Medium* | Limited expansion or harvest:<br>• Look for ways to expand without high risk; otherwise, minimise investment and focus operations | Manage for earnings:<br>• Protect existing strengths<br>• Invest to improve position only in areas where risk is low | DESIRABLE POTENTIAL TARGET<br>Build selectively:<br>• Emphasise profitability by increasing productivity<br>• Build up ability to counter competition |
| *Low* | Divest:<br>• Sell when possible to minimise cash value<br>• Meantime, cut fixed costs and avoid further investment | Manage for earnings:<br>• Protect position<br>• Minimise investment | Protect and refocus:<br>• Defend strengths<br>• Seek ways to increase current earnings without speeding market's decline |

*Sources*: Adapted from G. S. Day, *Analysis for Strategic Market Decisions* (St Paul, MN: West Publishing Co., 1986), p. 204; D. F. Abell and J. S. Hammond, *Strategic Market Planning Problems and Analytical Approaches* (Englewood Cliffs, NJ: Prentice Hall, 1979); and S. J. Robinson, R. E. Hitchens and D. P. Wade, 'The Directional Policy Matrix: Tool for Strategic Planning,' *Long Range Planning*, 11 (1978), pp. 8–15.

## 9.4 Different Targeting Strategies Suit Different Opportunities

Most successful entrepreneurial ventures target narrowly defined market segments at the outset, as did Phil Knight and Bill Bowerman, for two reasons. One, doing so puts the nascent firm in position to achieve early success in a market segment that it understands particularly well. Second, such a strategy conserves precious resources, both financial and otherwise. But segmenting the market into narrow niches and then choosing one niche to target is not always the best strategy, particularly for established firms having substantial resources. Three common targeting strategies are **niche-market**, **mass-market** and **growth-market** strategies.

### 9.4.1 Niche-Market Strategy

This strategy involves serving one or more segments that, while not the largest, consist of sufficient numbers of customers seeking somewhat-specialised benefits from a product or service. Such a strategy is designed to avoid direct competition with larger firms that are pursuing the bigger segments. For example, overall coffee consumption is down in some countries, but the sales of speciality coffees in coffee bars such as Starbucks or Coffee Republic have boomed in recent years, at least until a faltering global economy took the wind out of their sales. Whether four-dollar lattes will return to fashionability remains to be seen.

### 9.4.2 Mass-Market Strategy

A business can pursue a mass-market strategy in two ways. First, it can ignore any segment differences and design a single product-and-marketing programme that will appeal to the largest number of consumers. The primary object of this strategy is to capture sufficient volume to gain economies of scale and a cost advantage. This strategy requires substantial resources, including production capacity, and good mass-marketing capabilities. Consequently, it is favoured by larger business units or by those whose parent corporation provides substantial support. For example, when Honda first entered the American and European motorcycle markets, it targeted the high-volume segment consisting of buyers of low-displacement, low-priced cycles. Honda subsequently used the sales volume and scale economies it achieved in that mass-market segment to help it expand into smaller, more-specialised segments of the market.

A second approach to the mass market is to design separate products and marketing programmes for the differing segments. This is often called **differentiated marketing**. For example, Marriott and Accor do this with their various hotel chains. Although such a strategy can generate more sales than an undifferentiated strategy, it also increases costs in product design, manufacturing, inventory, and marketing, especially promotion.

### 9.4.3 Growth-Market Strategy

Businesses pursuing a growth-market strategy often target one or more fast-growth segments, even though they may not currently be very large. It is a strategy often favoured by smaller competitors to avoid direct confrontations with larger firms while building volume and share. Most venture capital firms invest only in firms pursuing growth-market strategies, because doing so is the only way they can earn the 30 per cent to 60 per cent annual rates of return on investment that they seek for portfolio companies. Such a strategy usually requires strong R&D and marketing capabilities to identify and develop products appealing to newly emerging user segments, plus the resources to finance rapid growth. The problem, however, is that fast growth, if sustained, attracts large competitors. This happened to Apple when IBM entered the personal computer business. The goal of the early entrant is to have developed an enduring competitive position via its products, service, distribution, costs, and its brand by the time competitors enter.

## 9.5 Global Market Segmentation and Target Marketing

The traditional approach to global market segmentation has been to view a country or a group of countries as a single segment comprising all consumers. This approach is seriously flawed because it relies on country variables rather than consumer behaviour, assumes homogeneity *within* the country segment, and ignores the possibility of the existence of homogeneous groups of consumers *across* country segments.[14]

More and more companies are approaching global market segmentation by attempting to identify consumers with similar needs and wants reflected in their behaviour in the marketplace in a range of countries. This inter-country segmentation enables a company to develop reasonably standardised programmes requiring little change across local markets, thereby resulting in scale economies. Star TV's launch of a Pan-Asian satellite television service broadcasting throughout Asia in English and Chinese is an example of such a strategy.[15]

There are many reasons – beyond mere ambitions to grow – why companies expand internationally. Some companies go international to defend their home position against global competitors that are constantly looking for vulnerability. For example, Caterpillar, through a joint venture with Mitsubishi Heavy Industries, has for the past 30 years made a substantial investment in Japan to deny its Japanese competitor, Komatsu, strength at home, thereby taking away its profit sanctuary. Had Cat not been successful in doing so, Komatsu would have been able to compete more aggressively with Cat, not only in the United States but also in other major world markets.[16]

Another reason a firm may go overseas and target a specific country is to service customers who are also engaging in global expansion. In recent years Japanese automobile companies that have created US manufacturing facilities have encouraged some of their parts suppliers to do the same. Firms also enter overseas markets to earn foreign exchange and, in some cases, are subsidised by their governments to do so.

In general, with the exception of these strategic special circumstances, the selection of overseas target markets follows essentially the same patterns as for domestic markets, although given the magnitude of economic, social, and political change in the world today, companies are paying considerably more attention to political risk.

## Learning Summary

- Marketers and entrepreneurs who find new and insightful ways to segment mature markets often uncover opportunities for uncontested market entry and rapid growth.
- Sharply focused target marketing enables marketers to differentiate from mass-market leaders by giving consumers in a narrowly defined market segment what they want.
- Focused market entry strategies conserve resources and facilitate early success.
- The five-step procedure provided in this module identifies segments having the highest potential.
- The market-attractiveness/competitive-position matrix is a useful analytical framework for deciding which markets or market segments to enter and from which to withdraw.

# Review Questions

## Content Questions

9.1 Define market segmentation.

9.2 Why is there a strong interdependency between market segmentation, market targeting and positioning?

9.3 What is the rationale for market segmentation?

9.4 Why is market segmentation of growing importance?

9.5 What are the objectives of the market segmentation process?

9.6 What are the different types of descriptors used to segment consumer goods markets? Industrial goods markets?

9.7 Describe the two-step process used to segment industrial markets.

9.8 What is geodemographic segmentation? Why is it becoming increasingly important?

9.9 What are the steps in constructing a market-attractiveness/business-position matrix for evaluating potential target markets?

9.10 What are the three most common types of market targeting strategy? Discuss each.

## Multiple Choice Questions

9.11 Dividing the market for a particular type of car into customers who seek style and customers who seek durability is an example of:

A. demographic segmentation.
B. usage segmentation.
C. product differentiation.
D. demand function modification.
E. market segmentation.

9.12 What was Knight and Bowerman's target market?

A. All runners.
B. Short-distance runners.
C. Long-distance runners.
D. Track competitors.
E. Olympic contenders.

9.13 Market segments are created to reflect differences across:

A. individual consumers.
B. groups of consumers.
C. individual products.
D. groups of products.
E. individual businesses.

9.14 When Hyatt Hotels announced a new marketing programme which featured excursions and social events for teenagers, at which descriptor was this programme aimed specifically?

A. Sex.
B. Household life cycle.
C. Education.
D. Age.
E. Income.

9.15 When a furniture retailer notes data which suggest that young married couples are heavy buyers of furniture, which descriptor is being emphasised?

A. Sex.
B. Education.
C. Income.
D. Household life cycle.
E. Geography.

9.16 When Ford notices that a large number of pickup trucks are sold in the southwest US, on which descriptor is it focusing?

A. Income.
B. Age.
C. Education.
D. Occupation.
E. Geography.

9.17 When a clothing retailer wants to target women between the ages of 25 to 55, earning an annual income of $30 000 or more, in a five-mile radius of their store, they are using which descriptor?

A. Geography.
B. Income.
C. Sex.
D. Age.
E. Geodemographics.

9.18 Customers show their degree of brand loyalty by:
- A. their demand price elasticity for the product type.
- B. the product being in their evoked set.
- C. the extent to which they can recall brand features, compared to other brands.
- D. the extent to which they have tried other brands, but use one particular brand.
- E. their successive purchases of one particular brand over time.

9.19 The degree to which a company's purchasing activity is centralised is known as:
- A. purchasing segregation.
- B. purchasing structure.
- C. product usage.
- D. purchase predisposition.
- E. purchase influence.

9.20 Knowledgeable nonusers of high-fibre cereals who state a high intention to buy this type of product are said to have a high:
- A. product usage.
- B. purchase predisposition.
- C. purchase influence.
- D. purchase structure.
- E. loyalty.

9.21 For the sports beverage market, which includes entrants such as Gatorade, Coke (Powerade) and Pepsi (All Sport), what descriptor do they use to define those target markets?
- A. Geodemographics.
- B. Behavioural.
- C. Age.
- D. Sex.
- E. Income.

9.22 The characteristics which consumers use to evaluate brand alternatives in terms of how valuable each of these characteristics is to that consumer are known as:
- A. purchase predispositions.
- B. purchase structure.
- C. choice criteria.
- D. general criteria.
- E. abstract criteria.

9.23 When firms develop unique marketing programmes for each targeted country's consumers they are segmenting on _____ and are assuming _____ among members of a market.

A. culture; homogeneity.
B. culture; heterogeneity.
C. psychographics; homogeneity.
D. psychographics; heterogeneity.
E. demographics; homogeneity.

9.24 Social class is based largely on similarities in:

A. behaviour, income and occupation.
B. geography, occupation and education.
C. age, behaviour and education.
D. race, income and geography.
E. income, occupation and education.

9.25 Regardless of the descriptor chosen to identify a target market, what descriptor is it also useful to know?

A. Geographic.
B. Demographic.
C. Geodemographic.
D. Behavioural.
E. Consumer needs.

9.26 What type of application enables the marketer to examine a customer database to identify patterns of variables that predict which customers buy or don't buy, as well as how much they buy?

A. Buying behaviour extrapolation.
B. Customer retrieval system.
C. Customer manipulation.
D. Data extraction.
E. Data mining.

9.27 The most critical factor in determining whether to enter a new market is the:

A. market size.
B. market growth rate.
C. investment required.
D. degree to which unmet customer needs can be identified.
E. demographics of target market.

9.28 All of the following are examples of competitive position factors when assessing the attractiveness of a market segment EXCEPT:

A. threat of new entrants.
B. industry capacity.
C. overall market size.
D. threat of substitutes.
E. buyer power.

9.29 All of the following are examples of competitor capability factors in assessing competitive positioning EXCEPT:

A. management strength and depth.
B. financial and functional resources.
C. brand image.
D. competitive rivalry.
E. relative market share.

9.30 What is the most critical factor in accessing competitive positioning?

A. Product differentiation.
B. Brand name.
C. Market share.
D. Company image.
E. Breadth of product line.

9.31 From a consumer's point of view, new goods and services need to:

A. be more accessible.
B. produce quicker results.
C. be better and/or cheaper.
D. have brand name recognition.
E. be acceptable by peers.

9.32 Recognising that the largest competitor in a given target market holds five times the share of the next leading competitor is an example of what market attractiveness and competitive positioning factor?

A. Macro trends
B. Customer needs and behaviour.
C. Firm and competitor capabilities and resources.
D. Opportunity for competitive advantage.
E. Market size and growth rate.

9.33 In order to determine market-attractiveness and competitive position it is recommended to:

A. evaluate top three competitors.
B. weight and rate each factor.
C. evaluate unmet customer needs.
D. evaluate new product against competitors for product differentiation.
E. determine cost for market entry.

9.34 When Marriott Hotels designed different brand name hotels for different market segments (e.g. families, businesspeople, low-budget travellers), which type of targeting strategy did it use?

A. Niche-market strategy.
B. Differentiated marketing strategy.
C. Mass-market strategy.
D. Growth-market strategy.
E. Shotgun strategy.

9.35 General Motors designs separate cars and marketing programmes for large market segments. This is an example of a(n):

A. growth market strategy.
B. differentiated market strategy.
C. undifferentiated market strategy.
D. peripheral market strategy.
E. overlapping market strategy.

9.36 A(n) _____ is designed to avoid direct competition with larger firms that are pursuing the bigger segments:

A. growth-market strategy.
B. differentiated market strategy.
C. undifferentiated market strategy.
D. peripheral market strategy.
E. niche-market strategy.

9.37 If the projected growth rate of a targeted market segment is revised from 3 per cent per year to 30 per cent per year this might suggest which of the following actions?

A. Broadening of the product lines.
B. Increase in R&D activities which is the firm's source of competitive advantage.
C. Increase promotional spending to twice that of the market leader.
D. All of the above may be appropriate.
E. Only A and C above are appropriate.

9.38 If a target market in which your firm holds a medium-strength position becomes unattractive, how might your strategic focus change?

A. Move from investment to management.
B. Move from investment to divestment.
C. Move from management to investment.
D. Move from divestment to management.
E. Move from divestment to investment.

9.39 The decision to participate in an international market may reflect the need for:

A. a more constant source of raw materials.
B. retaliation against a competitor's pricing strategy in a domestic market.
C. compliance with governmental regulations.
D. multinational distribution alliances.
E. new sources of investment capital.

## Application Questions and Cases

9.40 Extensive market segmentation is a relatively recent phenomenon. Until about the middle of the last century many firms offered a single basic product aimed at the entire mass market (such as Coca-Cola or Levi jeans). But in recent years many firms – including industrial goods manufacturers and services producers as well as consumer products companies – have begun segmenting their markets and developing different products and marketing programmes targeted at different segments. Which environmental changes have helped spark this increased interest in market segmentation?

9.41 Exactly what is the relationship between segmentation, target marketing, and positioning? What damage will be done to a company's target market and positioning efforts if markets are incorrectly segmented?

9.42 The trend is for companies to engage in microsegmentation whenever possible and then to use direct marketing to develop and retain customers. How can such segmentation be carried out by consumer goods companies? By industrial goods companies?

9.43 Can market segmentation be taken too far? What are the potential disadvantages of oversegmenting a market? What strategy might a firm pursue when it believes that the market has been broken into too many small segments?

9.44 Which variables or descriptors might be most appropriate for segmenting the market for the following consumer products and services? Explain your reasoning.

a. Lawn mowers.
b. Frozen entrees or dinners.
c. Breakfast cereals.
d. Financial services.

9.45 Which variables or descriptors might be most appropriate for segmenting the markets for the following industrial goods and services? Explain your reasoning.

a. Photocopiers.
b. Floor sweepers.
c. Truck leasing.

9.46 A camera manufacturer has hired you as a consultant to identify major *benefit segments* in the camera market. Which major benefit segments do you think might exist in this market, without actually conducting consumer research? What other information would you want to collect about the potential customers in each segment to provide a useful basis for designing camera models and marketing programmes that appeal to each segment?

9.47 What is the difference between a *growth-market* targeting strategy and a *niche* targeting strategy? What capabilities or strengths should a business have to implement to conduct a growth-market targeting strategy effectively?

9.48 In developing a targeting matrix, what dangers are incurred? How can these dangers be minimised?

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# Module 10

# Positioning

## Contents



## Repositioning French Wine[1]

In the mid-1990s, French winemakers launched a three-year campaign in America with the objective of repositioning French wine. Traditionally these wines had been positioned as upscale – something you drink when you're dining at an elegant restaurant with a French cuisine. In an effort to broaden the appeal of their wines, French vintners were 'trying to make Americans as comfortable with fumé blanc as they are with a Bud.'[1] The campaign stressed that French wines can be accessible and affordable; there are plenty of such wines between $5 and $15.

At the time, only about 12 per cent of American consumers drank wine regularly. To broaden the market the industry had to appeal to more people, especially younger people. One wine marketer said the industry had only itself to blame for creating an image problem.

> For the last 20 years, the wine industry has put up huge barriers to entry. We made people choose red or white, then pick which variety, and then which vineyard. They had to smell it and swirl it to see if it had a good mouth feel … The wine industry has this elitist and sophisticated image that doesn't fit with today's casual society.[1]

The campaign included consumer print ads, retail promotions, and a new website. One ad showed a group of young people enjoying some 'vin rouge' as they barbecue. The headline read, 'Sizzling things happen in the "oui" hours,' which is a play on the campaign's theme, 'Say yes to wines from France.' The print media schedule included ads in *The Wine Spectator* and in such general interest magazines as *The New Yorker*, *Vanity Fair* and *In Style*.

Retail outlets were targeted in an effort to teach retailers about French wines and encourage them to use the free in-store merchandising materials. These included self-talkers, case cards, gift bags, and guidebooks.

The winemakers' group also had a pocket guide to French wines that consumers could request through an 800 number or through the group's website. The latter included information on 40 brands of French wines complete with pictures and prices. Other sections provided data on France's grape-growing regions and how to link wines and foods. Users could even access help in pronouncing 'Pouilly-Fuissé.'

The campaign generated a strong response. In its first year alone, about 10 000 calls to the toll-free number were received along with 40 000 hits on the website. And despite exchange rate changes that made the import of French wines more expensive, overall sales in America increased.

### Learning Objectives

In Module 10, we take the final step in preparing the foundation on which effective marketing programmes are based. Drawing on decisions made about target markets, this module addresses the critical question, 'How should a business position its product offering – whether goods or services – so customers in the target market perceive the offering as providing the benefits they seek, thereby giving the product an advantage over current and potential future competitors?' As we shall see, the brand positioning decision is a strategic one, with implications not only for how the firm's goods or services should be designed, but also for developing the other elements of the marketing strategy. Pricing decisions, promotion decisions, and decisions about how the product is to be distributed all follow from, and contribute to the effectiveness of, the positioning of the product in its competitive space. Thus, the material in this module provides a foundation for virtually all of the decision making that follows in the balance of this course.

## 10.1 Differentiation: One Key to Customer Preference and Competitive Advantage

Why do customers prefer one product over another? In today's highly competitive markets, consumers have numerous options. They can choose from dozens of best-selling novels to take along on an upcoming vacation. They can buy the novel they choose from an online merchant such as Amazon.com, from large chain booksellers such as Barnes and Noble in the US, Waterstones in the UK or their online counterparts, from book clubs, from a local bookstore, or in some cases from their nearby supermarket or mass merchant. They can even borrow the book at their local library and not buy it at all! Whether it's goods such as books or services such as libraries, consumers make choices such as these nearly every day. In most cases, consumers or organisational customers choose what they buy for one of two reasons: what they choose is *better*, in some sense, or *cheaper*. In either case, the good or service they choose is, in some way, almost always *different* from others they could have chosen.

Differentiation is a powerful theme in developing business strategies, as well as in marketing. As Michael Porter points out, ‘A company can outperform its rivals only if it can establish a difference that it can preserve. It must deliver greater value to customers or create comparable value at a lower cost, or both.’[2] Most of the time, differentiation is why people buy. They buy the latest John Grisham novel because they know it will be a page-turner, different from the last Grisham they read, and hard to put down. They buy it from Amazon.com because they know Amazon’s selection is enormous, and its one-click ordering system takes only a minute. Or they buy it from the megastore because it’s fun to browse there or from their local bookseller because they feel good about supporting their local merchants. They buy it at the supermarket because it’s convenient. All these book-selling strategies are different, and they appeal to different consumers (i.e., different market segments) at different points in time, for different book-buying purposes. If these strategies did not vary, consumers would have no reason to use some of them, and they would buy their books where they were cheapest or most convenient, though even in such a case, the cheaper pricing or greater convenience would still constitute differences.

### 10.1.1 Differentiation in Business Strategies

Michael Porter’s classic book on competitive advantage identified three generic strategies: cost leadership, differentiation, and focus, as shown in Exhibit 10.1.[3] These strategies, which differ in the scope of the target market and market needs they serve (broad or narrow competitive scope) and on whether they base their competitive advantage on low cost (lower prices to the customer for equivalent products) or differentiation (products that are superior on some important dimensions) represent distinctly different ways in which companies can compete for the minds and wallets of customers in their target markets. Porter argues that the worst strategy is to be ‘stuck in the middle,’ to be neither different nor lower in cost than one’s competitors. Companies in such a position offer customers little reason not to take their business elsewhere. But customers don’t really buy strategies. They buy specific goods and services and effective execution: on-time delivery, proper installation, responsive customer service, and so on. Thus, strategy is implemented at the product market level, where differentiation lies at the heart of positioning.

**Exhibit 10.1 Generic competitive strategies**

| | | Competitive advantage | |
|---|---|---|---|
| | | Lower cost | Differentiation |
| Competitive scope | Broad target | **Cost leadership strategy** | **Differentiation strategy** |
| | Narrow target | **Focus strategy (cost-based)** | **Focus strategy (differentiation-based)** |

*Source*: Adapted from Michael Porter, *Competitive Advantage*. (New York: The Free Press), 1985, p.12.

### 10.1.2 Differentiation among Competing Brands

As we saw in the previous module, customers in one market segment have wants and needs that differ in some way from those of customers in other segments. Brand positioning allows the marketer to take advantage of and be responsive to such differences and position particular goods and services so as to better meet the needs of consumers in one or more of these segments. These differences are often physical. Nike's original waffle sole was such a difference, as we saw in Module 9. But differences can also be perceptual, as with Nike's later products that benefited from endorsements by John McEnroe, Michael Jordan, and other famous athletes. Creating *both* physical and perceptual differences, using all the elements of the marketing mix – product, pricing, promotion, and distribution decisions – is what effective positioning seeks to accomplish.

## 10.2 Physical Positioning

One way to assess the current position of a brand relative to competitors is on the basis of how the various offerings compare on some set of objective physical characteristics. In many cases a physical positioning analysis can provide useful information to a marketing manager, particularly in the early stages of identifying and designing new product offerings, as the example of Geox shoes in Exhibit 10.2 demonstrates.

Despite being based primarily on technical rather than on market data, physical comparisons can be an essential step in undertaking a positioning analysis. This is especially true with the competitive offerings of many industrial goods and services, which buyers typically evaluate largely on the basis of such characteristics. In addition, it contributes to a better marketing/R&D interface by determining key physical product characteristics; helps define the structure of competition by revealing the degree to which the various brands compete with one another; and may indicate the presence of meaningful product gaps (the lack of products having certain desired physical characteristics), which, in turn, may reveal opportunities for a new product entry, such as Geox's breathable shoes.

**Exhibit 10.2 Your feet want to breathe**

Nearly 20 years ago, Mario Moretti Polegato was out hiking under the hot summer sun of his native Italy. In an effort to relieve the discomfort of his sweaty feet, Polegato poked holes in the soles of his hiking shoes. 'Why doesn't anyone make shoes that can breathe?' he wondered. After trying unsuccessfully to sell his idea of breathable shoes to Nike and Adidas, he decided to strike out on his own. Polegato founded Geox in 1995, starting with children's shoes and later adding adult styles. Customers responded. In 2007, his Milan-listed company sold 21 million pairs of shoes, some $1.2 billion worth, everything from rhinestone-studded but breathable sandals fit for a night on the town to earthy moccasins to a new line of athletic footwear. Thousands of tiny holes in the sole of every Geox shoe lets air in but keeps water out.

In Polegato's view, most athletic shoe-makers focus on performance and competitive advantage. The Geox mind-set – it's all about comfort – is different, he says. 'Feet have to breathe.'

*Source*: Jennifer L. Schlenker, 'Geox Takes On the Goliaths of Sport,' *BusinessWeek* European Edition, April 14, 2008, p. 58.

### 10.2.1 Limitations of Physical Positioning

A simple comparison of only the physical dimensions of alternative offerings usually does *not* provide a complete picture of relative positions because, as we noted earlier, positioning ultimately occurs in customers' minds. Even though a brand's physical characteristics, package, brand name, price, and ancillary services can be designed to achieve a particular position in the market, customers may attach less importance to some of these characteristics than, or perceive them differently from, what the firm expects. Also, customers' attitudes toward a brand are often based on social or psychological attributes not amenable to objective comparison, such as perceptions of the brand's aesthetic appeal, sportiness, or status image (for example, in the United States, French wine has traditionally been thought of as very expensive or as an accompaniment to French food). Consequently, **perceptual positioning analysis** – whether aimed at discovering opportunities for new product entries or evaluating and adjusting the position of a current offering – is critically important.

## 10.3 Perceptual Positioning

Consumers often know very little about the essential physical attributes of the brands they buy, especially household products. The same is true for many services. Even if they did, they would not understand the physical attributes well enough to use them as a basis for choosing between competitive offerings. (For the major differences between physical and perceptual brand positioning analyses, *see* Exhibit 10.3.) Many consumers do not want to be bothered about a brand's physical characteristics because they are not buying these physical properties but rather the benefits they provide. While the physical properties of a brand certainly influence the benefits provided, a consumer can typically evaluate a brand better on the basis of what it *does* than what it *is*. Thus, for example, a headache remedy may be judged on how quickly it brings relief, a toothpaste on the freshness of breath provided, a beer on its taste, and a vehicle on how comfortably it rides.

**Exhibit 10.3 Comparison of physical and perceptual positioning analyses**

| Physical positioning | Perceptual positioning |
|---|---|
| • Technical orientation. | • Consumer orientation. |
| • Physical characteristics. | • Perceptual attributes. |
| • Objective measures. | • Perceptual measures. |
| • Data readily available. | • Needs marketing research. |
| • Physical brand properties. | • Perceptual brand positions and positioning intensities. |
| • Large number of dimensions. | • Limited number of dimensions. |
| • Represents impact of product specifications and price. | • Represents impact of product specifications and communication. |
| • Direct R&D implications. | • R&D implications need to be interpreted. |

The evaluation of many goods and services is subjective because it is influenced by factors other than physical properties, including the way brands are presented, our past experiences with them, and the opinions of others. Thus, physically similar brands may be perceived as being different because of different histories, names, and advertising campaigns. For example, some people will pay considerably more for Bayer aspirin than for an unadvertised private label even though they are essentially the same product.

## 10.4 Levers Marketers Can Use to Establish Brand Positioning

Customers or prospective customers perceive physical as well as other differences between goods or services within a product category, of course. Marketing decision makers seeking to win a particular position in customers' minds will seek to endow their brand with various kinds of attributes, which may be categorised as follows:

- *Simple physically based attributes.* These are directly related to a single physical dimension such as price, quality, power, or size. While there is a direct correspondence between a physical dimension and a perceptual attribute, an analysis of consumers' perception of products on these attributes may unveil phenomena of interest to a marketing strategy. For instance, two cars with estimated gasoline mileage of 23.2 and 25.8 miles per gallon may be perceived as having similar gasoline consumption.
- *Complex physically based attributes.* Because of the presence of a large number of physical characteristics, consumers may use composite attributes to evaluate competitive offerings. The development of such summary indicators is usually subjective because of the relative importance attached to different cues. Examples of composite attributes are the speed of a computer system, roominess of a car, and a product's or service's being user friendly.

- *Essentially abstract attributes.* Although these perceptual attributes are influenced by physical characteristics, they are not related to them in any direct way. Examples include the sexiness of a perfume, quality of a French wine, and prestige of a car. All of these attributes are highly subjective and difficult to relate to physical characteristics other than by experience.
- *Price.* A brand's price may imply other attributes, such as high or low quality.

The importance of perceptual attributes with their subjective component varies across consumers and product classes. Thus, it can be argued that consumers familiar with a given product class are apt to rely more on physical characteristics and less on perceptual attributes than consumers who are less familiar with that product class. It can also be argued that while perceptual positioning is essential for many consumer goods, such is not the case for many industrial goods.

Even though there is considerable truth in these statements, perceptual attributes must be considered in positioning most brands. One reason is the growing similarity of the physical characteristics of more and more products. This increases the importance of other, largely subjective dimensions. Consider, for example, whether Nike's Air Jordan basketball shoes would have sold as well without basketball ace Michael Jordan's endorsement and his presence in their ads.

## 10.5 Preparing the Foundation for Marketing Strategies: The Brand Positioning Process

Positioning a new brand in customers' minds or repositioning a current brand involves a series of steps, as outlined in Exhibit 10.4. These steps are applicable to goods and services, in domestic or international markets, and to new or existing brands. Thus, when we say 'brand' in the rest of this chapter and those that follow, we include both existing goods and services and planned new products – goods or services – that do not yet exist. This is not to suggest that the determinant product attributes and the perceptions of consumers of the various competitive offerings will remain constant across countries or other market segments; rather, they are likely to vary with most products. After managers have selected a relevant set of competing offerings serving a target market (Step 1), they must identify a set of critical or determinant product attributes important to customers in that target market (Step 2).

Step 3 involves collecting information from a sample of customers about their perceptions of the various offerings, and in Step 4 researchers analyse this information to determine the product's current position in customers' minds and the intensity thereof (Does it occupy a dominant position?), as well as those of competitors.

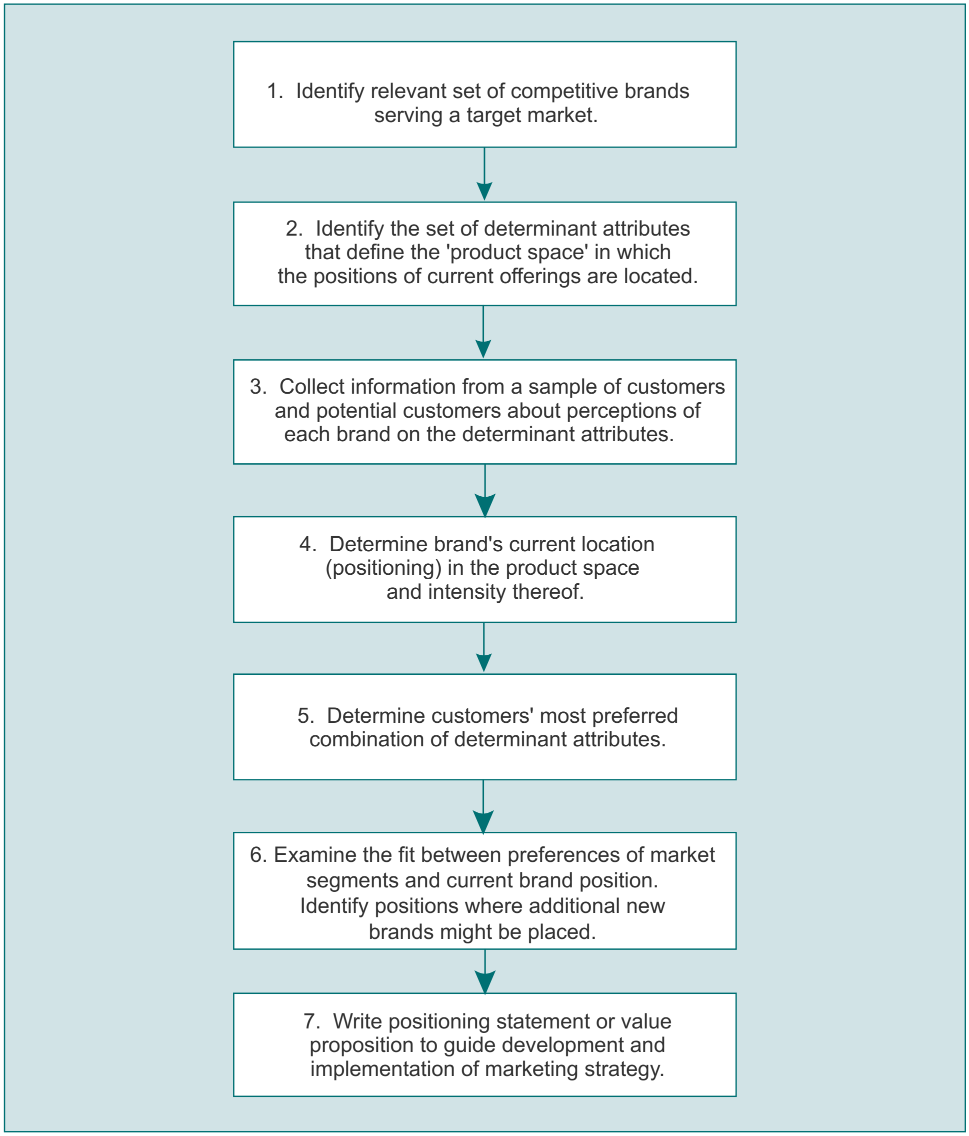
Managers then ascertain the customers' most preferred combinations of determinant attributes, which requires the collection of further data (Step 5). This allows an examination of the fit between the preferences of a given target segment of customers and the current positions of competitive offerings (Step 6). And finally, in Step 7, managers write a concise statement that communicates the positioning decision they have reached.

A discussion of these steps in the positioning process takes up the remainder of this module.

### 10.5.1 Step 1: Identify a Relevant Set of Competitive Products

Positioning analyses are useful at many levels: company, business unit, product category, and specific product line or brand. At the company or business-unit level, such analyses are useful to determine how an entire company or business unit is positioned relative to its competitors. The results of such analyses are sometimes displayed graphically by plotting competing companies or businesses in their respective quadrants of the generic strategies grid shown in Exhibit 10.1. Larger or smaller dots or circles may be used to indicate relative sizes of competing firms.

**Exhibit 10.4 Steps in the positioning process for goods and services**




At the product category level, the analysis examines customers' perceptions about types of products they might consider as substitutes to satisfy the same basic need. Suppose, for example, a company is considering introducing a new instant breakfast drink. The new product would have to compete with other breakfast foods, such as bacon and eggs, breakfast cereals, and even fast-food drive-throughs. To understand the new product's position in the market, a marketer could obtain customer perceptions of the new product concept relative to likely substitute products on various critical determinant attributes, as we describe in Steps 3 and 4 of the positioning process (*see* Exhibit 10.4).

Once competitors introduce several brands into the category, a positioning analysis at brand level can be helpful to better understand how various brands appeal to customers, to position proposed new products or brands or reposition current ones, and to identify where new competitive opportunities might be found.

At whichever level the positioning analysis is to be done, the analyst's choice of competing products (or product categories or firms) is critical. Marketers who omit important substitute products or potential competitors risk being blindsided by unforeseen competition.

### 10.5.2 Step 2: Identify Determinant Attributes

Positioning, whether for goods or services, can be based on a variety of attributes – some in the form of surrogates that imply desirable features or benefits as a positioning base. Some common bases are the following.[4]

- **Features** are often used in physical brand positioning and, hence, with industrial products. An example of its use with a consumer good US high-end home appliance maker Jenn-Air's claim, 'This is the quietest dishwasher made in America.' Amazon.com has a unique '1-click®' ordering system.
- **Benefits**, like features, are directly related to a brand. Examples here include Volvo's emphasis on safety and durability and Norelco's promising a 'close and comfortable shave.'
- **Parentage** includes who makes it (bottled by a French vintner; 'At Fidelity, you're not just buying a fund, a stock, or a bond – you're buying a better way to manage it') and prior products ('Buying a car is like getting married. It's a good idea to know the family first,' followed by a picture of the ancestors of the Mercedes-Benz S class model).
- **Manufacturing process** is often the subject of a firm's positioning efforts. An example is Jaeger-LeCoultre's statement about its watches – 'We know it's perfect, but we take another 1000 hours just to be sure.'
- **Ingredients** as a positioning concept is illustrated by some clothing manufacturers saying their sports shirts are made only of organic cotton.
- **Endorsements** are of two types – those by experts ('Discover why over 5000 American doctors and medical professionals prescribe this Swedish mattress' – Tempor-Pedic) and those via emulation as with Michael Jordan using Nike shoes.
- **Comparison** with a competitor's brand is common ('Tests prove Pedigree is more nutritious than IAMS, costs less than IAMS, and tastes great, too' – Pedigree Mealtime).
- **Proenvironment** positioning seeks to portray a company as a good citizen ('Because we recycle over 100 million plastic bottles a year, landfills can be filled with other things, like land, for instance' – Phillips Petroleum, now part of ConocoPhillips).
- **Price/quality** is used in cases such as Walmart successful positioning itself as the lowest-price seller of quality household products.

Theoretically, consumers can use many attributes to evaluate competing brands, but the number actually influencing a consumer's choice is typically small, partly because consumers can consider only attributes of which they are aware. The more variables used in positioning a given brand, the greater the chance of confusion and even disbelief on the part of the consumer. The positioning effort must be kept as simple as possible and complexity should be avoided at all costs. Thus, for most products, experienced marketers hang their hat on one, or at most two, attributes for positioning purposes.

In using one or more attributes as the basis of a brand's positioning effort, it is important to recognise that the importance attached to these attributes often varies. For example, while the brands of soap or shampoo provided by a hotel may be an attribute that some consumers use in evaluating hotels, most are unlikely to attach much importance to it when deciding which hotel chain to patronise. Even an important attribute may not greatly influence a consumer's preference if all the alternative brands are perceived to be about equal on that dimension. Deposit safety is an important attribute to consider when choosing a bank, but most consumers perceive all banks to be about equally safe. Consequently, deposit safety is not a **determinant attribute:** It does not play a major role in helping customers to differentiate among the alternatives and to determine which bank they prefer.

Marketers should rely primarily on *determinant* attributes in defining the product space in a positioning analysis. The question is, 'How can a marketer find out which product dimensions are determinant attributes?' Doing so typically requires conducting some kind of marketing research, using the marketing research process described in the previous module. This brings us to Step 3.

### 10.5.3 Step 3: Collect Data about Customer's Perceptions for Products in the Competitive Set

Having identified a set of competing products, the marketer needs to know what attributes are determinant for the target market and the product category under consideration. He or she also needs to know how different brands in the competitive set are viewed on these attributes. Typically this market knowledge is developed by first conducting qualitative research, perhaps interviews or focus groups, to learn which attributes are determinant. Then quantitative research follows, perhaps a survey of consumers about their perceptions, to gather data on how competing products score on these attributes. Later in this module, we discuss several statistical and analytical tools that are useful in this portion of the positioning process.

### 10.5.4 Step 4: Analyse the Current Positions of Products in the Competitive Set

Whether the positioning process is directed at a new brand not yet introduced or repositioning one that already exists, it is important to develop a clear understanding of the positioning of the existing brands in the competitive set (see Step 1). A useful tool for doing so is the **positioning grid**, also called a **perceptual map**.[5] The positioning grid provides a visual representation of the positions of various products or brands in the competitive set in terms of (typically) two determinant attributes. Where more than two attributes are to be considered in a positioning analysis, multidimensional grids, or multiple grids, are produced. Alternatively, a value curve, which comprises more than just two dimensions, can be generated (see below). But not all products or brands exist in the minds of most consumers.

A brand that is not known by a consumer cannot, by definition, occupy a position in that consumer's mind. Often the awareness set for a given product class is three or fewer brands even though the number of available brands is greater than 20. Thus, many if not most brands have little or no position in the minds of many consumers. Consider coffee bars, which, in recent years, have become ubiquitous in cities worldwide. In London, three major chains dominate – Starbucks, Coffee Republic, and Caffé Nero – each with its own ambience and image with consumers. There are also several smaller chains and numerous independents, most of which are largely unknown – thus with no clear positioning – to most Londoners.

With consumers having so many coffee bars to choose from already – often several shops within a few hundred metres of each other on any busy street – for a new coffee bar entrant to be successful, it must adopt a clear positioning in consumers' minds to give consumers a reason to switch. **Determining** the attributes on which the brand's positioning will be based is a key outcome of the positioning process and a driver of the marketing communication strategy, as well as the marketing strategy overall, that will ultimately be developed. Without clear guidance about the intended position of the brand, advertising agencies, salesforces, and others charged with building the awareness and recognition of the product in the marketplace will be ill-equipped to do this important job.

### 10.5.4.1 Building a Positioning Grid

An example of what can be done with data gathered in Step 3 is found in Exhibit 10.5, which shows the results obtained from a classic study done by Babson College that portrays how a sample of consumers positioned a number of women's clothing retailers in the Washington, DC area.[6] Respondents rated the various stores on the two determinant attributes of value and fashionability. Some stores, such as Nordstrom and Kmart, occupy relatively distant positions from one another, indicating that consumers see them as very different. Other stores occupy positions comparable to one another (Neiman Marcus, Saks) and thus are considered relatively alike, meaning the intensity of competition between these stores is likely to be considerably greater than for those that occupy widely divergent positions.

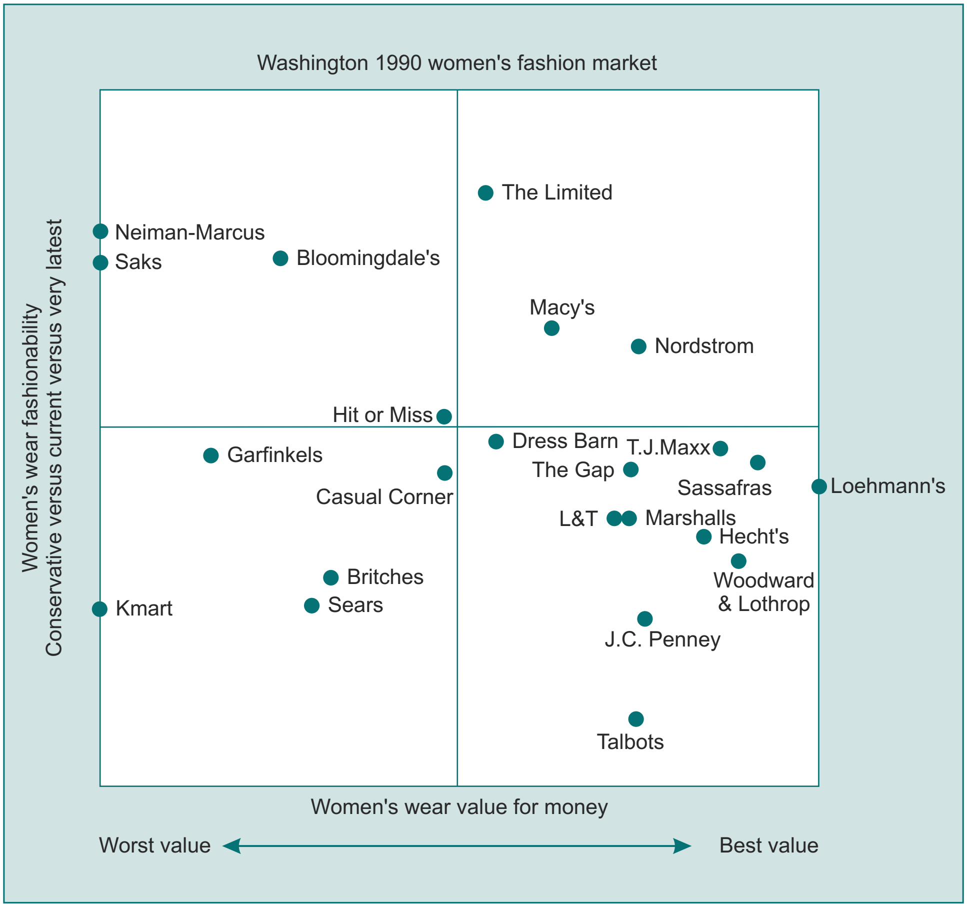
The store positioning shown in Exhibit 10.5 also provides useful information about possible opportunities for the launching of a new store or the repositioning of an existing one. Positioning for a new store could be done by examining the positioning map for empty spaces (competitive gaps) where no existing store is currently located. There is such a gap in the upper right quadrant of the 'value/fashionability' map in Exhibit 10.5. This gap may represent an opportunity for developing a new entry or repositioning an old one that is perceived to offer greater fashionability than Nordstrom at a lower price. Of course, such gaps may exist simply because a particular position is either (1) impossible for any brand to attain because of technical constraints or (2) undesirable since there are few prospective customers for a brand with that set of attributes.

#### 10.5.4.2 Building a value curve

Given that crafting strategies involves making choices – choices about what *not* to do, as well as what to do – another useful tool for positioning decisions is the value curve.[7] Value curves indicate how products within a category compare in terms of the level – high or low – of as many attributes as are relevant. Thus, unlike perceptual maps, which are most easily viewed in just two dimensions, value curves are more multidimensional.

Sometimes, value is best delivered by eliminating or reducing the level of some attributes, especially those not really desired or appreciated by the target customer, and increasing the level of others, the ones the customer really wants. Let's imagine that in addition to the data shown on the perceptual map in Exhibit 10.5, we have data about several other variables for three stores: Neiman Marcus, Sears, and JC Penney. We could build value curves for the three retailers by plotting these hypothetical data as shown in Exhibit 10.6.

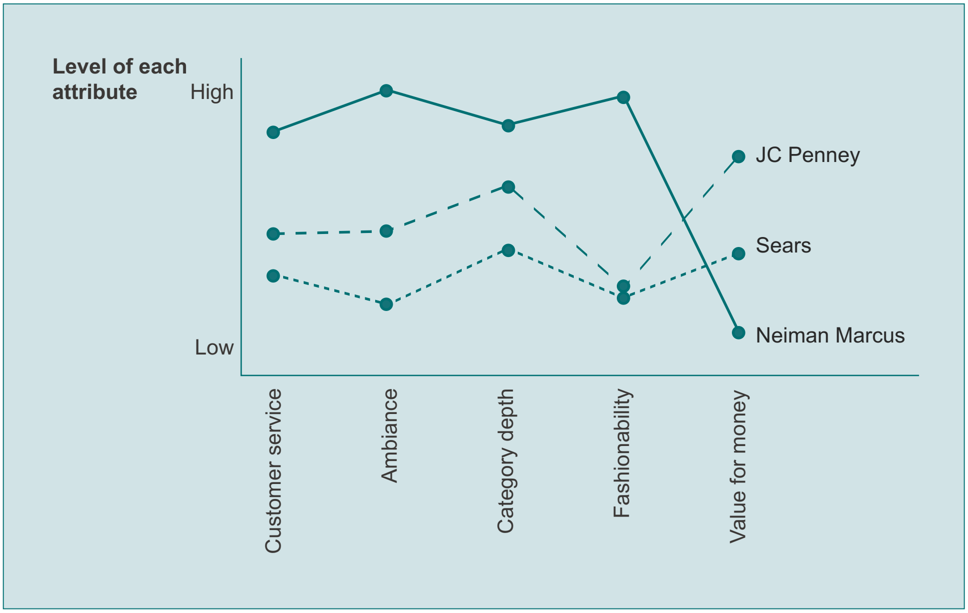
**Exhibit 10.5 Perceptual map of women's clothing retailers in Washington, DC**




*Source*: Adapted from Douglas Tigert and Stephen Arnold, 'Nordstrom: How Good Are They?', *Babson College Retailing Research Reports*, September 1990, as shown in Michael Levy and Barton A. Weitz, *Retailing Management* (Burr Ridge, IL: Richard D. Irwin, 1992), p. 205.

The value curves show that, among other things, Sears and JC Penney choose to compete by reducing their level of customer service, ambience, category depth, and fashionability, presumably in order to deliver increased value for money. Neiman Marcus offers higher levels of customer service, ambience, category depth, and fashionability, presumably because the target customer it seeks to serve is willing to pay for these attributes.

**Exhibit 10.6 Value curves for Neiman Marcus, JC Penney and Sears**




### 10.5.4.3 Marketing Opportunities to Gain a Distinct Position

In situations where one or a limited number of brands dominate a product class (or type) in the minds of consumers, the main opportunity for competitors generally lies in obtaining a profitable position within a market segment *not* dominated by a leading brand. Competing head-on against the leaders on the basis of attributes appropriated by larger competitors is not likely to be effective.

A better option is to concentrate on an attribute prized by members of a given market segment. Toyota, with its traditional baby-boomer customer base getting older, launched its new Scion brand in 2004, targeted at American youth. Instead of transitional mass marketing, the Scion team used edgy Internet-based marketing, including making virtual Scions available for virtual purchase on Second Life, a website growing in popularity with the younger set.[8] Scion's hip, youthful image has helped the new brand score with its Generation Y target market.

### 10.5.4.4 Constraints Imposed by an Intense Position

Although marketers should seek a distinctive and intense position for their brands, attaining such a position imposes constraints on future strategies. If shifts in the market environment cause customers to reduce the importance they attach to a current determinant attribute, marketers may have difficulty repositioning a brand with an intensely perceived position on that attribute. Repositioning carries with it the threat of alienating part or all of the brand's current users regardless of success with its newly targeted group. Success in its repositioning efforts may well ensure losing its current group of users.

Another concern is the dilution of an existing intense position as a result of consolidation. For example, British Leyland was formed through a series of mergers involving a number of British car manufacturers. For years, the company did not have a clear identity because it was new and manufactured a variety of brands, including Rover, Triumph, and Austin-Morris. Most Europeans had difficulty recalling spontaneously any British car manufacturer since once-strong brand names such as Austin and Morris had lost their identity and meaning. Following a long series of divestitures, buyouts, and reorganisations, British Leyland's successor company, MG Rover, went bankrupt in 2005. While there's little doubt that high-cost manufacturing contributed to the company's demise, a lack of clear positioning for many of its brands was surely a contributing factor.[9]

Another danger associated with an intensely positioned brand is the temptation to overexploit that position by using the brand name on line extensions and new products. The danger here is that the new products may not fit the original positioning and the brand's strong image is diluted. For example, for many years, the Holiday Inn Group offered travellers the choice of staying in Holiday Inn, Holiday Inn Express, Holiday Inn Select, or Holiday Inn Garden Court, each of which operated at a different price point and service offering.[10] Such diverse offering can be very confusing to consumers.

#### 10.5.4.5 Limitations of Product Positioning Analysis

The analysis depicted in Exhibit 10.5 is usually referred to as *brand positioning* because it indicates how alternative brands are positioned relative to one another in customers' minds. The problem with this analysis, though, is that it does not tell the marketer which positions are most appealing to customers.[11] Thus, there is no way to determine if there is a market for a new brand or store that might locate in an 'open' position or whether the customers in other market segments prefer brands or stores with different attributes and positions. To solve such problems it is necessary to measure customers' preferences and locate them in the product space along with their perceptions of the positions of existing brands. This is called a **market positioning analysis**. We deal with this issue in Step 5.

### 10.5.5 Step 5: Determine Customers' Most Preferred Combination of Attributes

There are several ways analysts can measure customer preferences and include them in a positioning analysis. For instance, survey respondents can be asked to think of the ideal brand within a category – a hypothetical brand possessing the perfect combination of attributes (from the customer's viewpoint). Respondents could then rate their ideal brand and existing brands on a number of attributes. An alternative approach is to ask respondents not only to judge the degree of similarity among pairs of existing brands but also to indicate their degree of preference for each. In either case, the analyst, using the appropriate statistical techniques, can locate the respondents' ideal points relative to the positions of the various existing brands on the product space map.

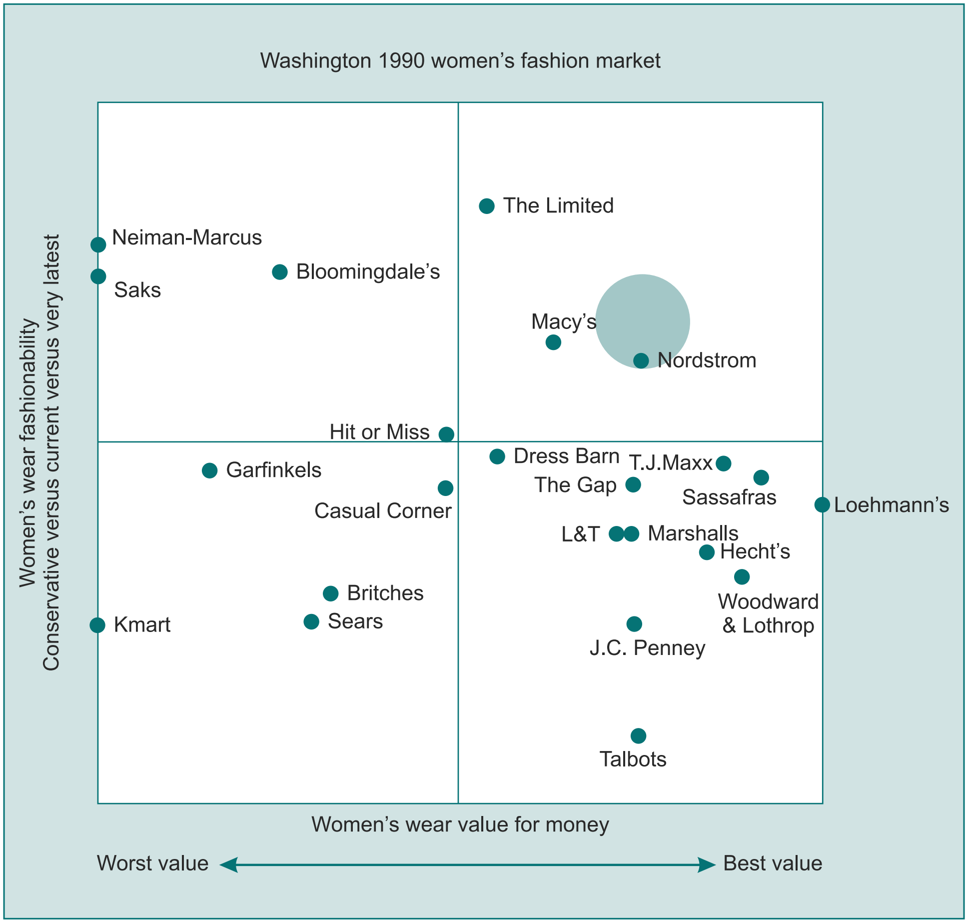
Another method of assessing customers' preferences and trade-offs among them is a statistical technique called conjoint analysis.[12] Customers are surveyed and asked their preferences among various real or hypothetical product configurations, each with attributes that are systematically varied. By analysing the resulting data, the marketer can learn which of several attributes are more important than the others. These results can then be used in positioning analyses such as those described here.

Whichever approach is used, the results will look something like Exhibit 10.7, which shows a hypothetical cluster of ideal points for one segment of women's-clothing consumers. As a group, this segment would seem to prefer Nordstrom over any other women's clothing retailer on the map.

There are, however, several reasons not all customers in this segment are likely to prefer Nordstrom. First, the ideal points of some customers are actually closer to Macy's than Nordstrom. Second, customers whose ideal point is equidistant between the two stores may be relatively indifferent in their choice of which store to patronise. And finally, customers sometimes may patronise stores somewhat further away from their ideal – particularly when buying low-involvement, nondurable goods or services – to assess the qualities of new stores, to reassess older stores from time to time, or just for the sake of variety.

Using price as one dimension of a positioning grid, or as a key dimension on which a brand is positioned, is typically not very useful unless price is a key driver of the marketing strategy. This is the case for two reasons. First, price is easily imitable by competitors. Unless the firm has a clear cost advantage over its competitors, by virtue of its processes or other sources of efficiency, using low price as a basis for positioning can be a fast road to a price war that no one (except consumers) will win. Second, claims that one's brand – whether a good or a service – is low-priced are sometimes not very credible, because so many marketers make such claims. It is often better to position around more enduring differentiators, and let price speak more subtly for itself. Walmart, an exception, has been able to sustain its low-price positioning in the United States because its costs, compared to its chief competitors, actually are lower.

**Exhibit 10.7 Perceptual map of women's clothing retailers in Washington, DC, showing the ideal points of a segment of consumers**

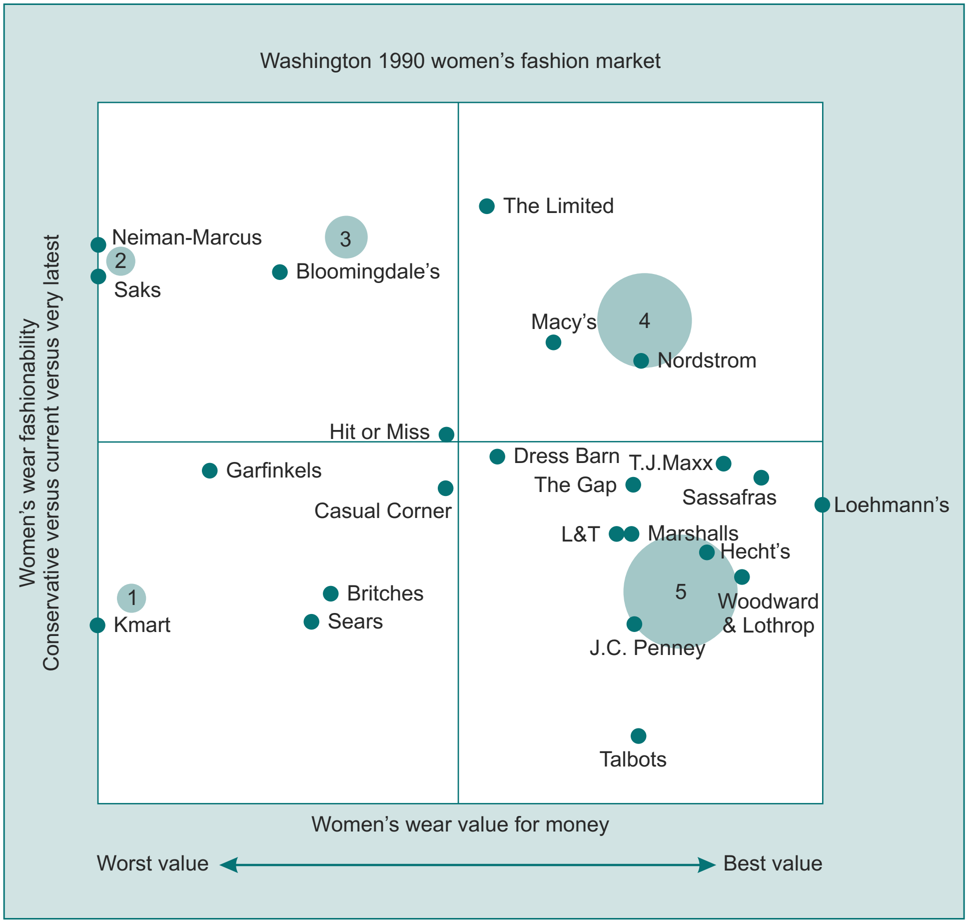



*Source*: Adapted from Douglas Tigert and Stephen Arnold, 'Nordstrom: How Good Are They?', *Babson College Retailing Research Reports*, September 1990.

## 10.5.6 Step 6: Consider Fit of Possible Positions with Customer Needs and Segment Attractiveness

An important criterion for defining market segments is the difference in the benefits sought by different customers. Because differences between customers' ideal points reflect variations in the benefits they seek, a market positioning analysis can simultaneously identify distinct market segments as well as the perceived positions of different brands. When customers' ideal points cluster in two or more locations on the product space map, the analyst can consider each cluster a distinct market segment.[13] For analytical purposes, each cluster is represented by a circle that encloses most of the ideal points for that segment; the size of the circle reflects the relative proportion of customers within a particular segment.

**Exhibit 10.8** **Perceptual map of women's clothing retailers in Washington, DC, showing five segments based on ideal points**




*Source*: Adapted from Douglas Tigert and Stephen Arnold, 'Nordstrom: How Good Are They?', *Babson College Retailing Research Reports*, September 1990.

Exhibit 10.8 groups the sample of Washington, DC respondents into five distinct segments on the basis of clusters of ideal points.[14] Segment 5 contains the largest proportion of customers; segment 1, the smallest.[15] By examining the preferences of customers in different segments along with their perceptions of the positions of existing brands, analysts can learn much about (1) the competitive strength of different brands in different segments, (2) the intensity of the rivalry between brands in a given segment, and (3) the opportunities for gaining a differentiated position within a specific target segment.

Step 6 not only concludes the analysis portion of the positioning process and crystallises the decision about the positioning a brand should hold, but it also can uncover locations in the product space where additional new brands could be positioned to serve customer needs not well served by current competitors. Thus,

Exhibit 10.8 shows that a possible side benefit of the positioning process is recognition of underserved positions where additional new products might be placed.

### 10.5.7 Step 7: Write Positioning Statement or Value Proposition to Guide Development of Marketing Strategy

The final decision about where to position a new brand or reposition an existing one should be based on both the market targeting analysis discussed in Module 9 and the results of a market positioning analysis. The position chosen should match the preferences of a particular market segment and should take into account the current positions of competing brands.

It should also reflect the current and *future* attractiveness of the target market (its size, expected growth, and environmental constraints) and the relative strengths and weaknesses of competitors. Such information, together with an analysis of the costs required to acquire and maintain these positions, allows an assessment of the economic implications of different market positioning strategies.

Most successful brands are positioned based on one or, at most, two determinant attributes, whether physical or perceptual. Using more simply confuses customers. Domino's Pizza, in the US, in its early days, focused its positioning solely on its fast delivery, since that was the principal dimension on which it established its competitive advantage. While there are many things Domino's could have said about the pizza itself, for example, it chose to focus its positioning on its key point of differentiation: fast delivery. Recently, when fast delivery became common in the pizza industry, Domino's added a heat retention device to its delivery containers and added a second positioning attribute: hot. Papa John's, a later entrant in the American pizza business, positions its offering around a single attribute, the quality of its pizza, with its promotional phrase, 'Better ingredients. Better pizza.'

Where there are no real product differences, as in so-called **me-too products**, or no differential benefits to the user, not only is success hard to achieve, but also ethical issues may arise. For an example of ethical issues involving positioning in the pharmaceutical industry, *see* Ethical Perspective 10.1.

Once the desired positioning for the brand has been determined, it's a good idea to write it down so those charged with developing and implementing the marketing strategy have a clear understanding of what is intended for the brand and where it will fit in its competitive set. Two approaches are commonly used for doing so. In the classical approach, a **positioning statement** is written. A more recent approach, one being adopted in a number of firms, involves writing a **value proposition** for the brand.

## Ethical Perspective 10.1

**Positioning in the Pharmaceutical Industry: An Ethical Quagmire**

Under constant and ever-increasing pressure to perform, the pharmaceutical industry is frequently cited for practices that are ethically questionable. An article in the British journal *The Lancet* is an assessment of advertisements in Spanish medical journals in 1997, for antihypertensive (drugs used to treat high blood pressure) and lipid-lowering (i.e., cholesterol-lowering) drugs. The advertisements studied in a 6-month period (264 different ads for antihypertensives and 23 different ads for lipid-lowering drugs) made a total of 125 referenced claims. After excluding the 23 claims that did not have published data, the researchers found that 44 per cent of the literature did not support the statements made in the ads. This study was a note of caution for doctors who prescribe medicines based on the evidence of reported research on drugs.

Is such marketing really in the best long-term interests of the shareholders?

*Source*: Pilar Villanueva, Salvador Peiró, Julián Librero, Inmaculada Pereiró, 'Accuracy of Pharmaceutical Advertisements in Medical Journals,' *The Lancet*, January 4, 2003, Volume 361, Number 9351,

www.thelancet.com/journals/lancet/article/PIIS0140673603121186/fulltext

### 10.5.7.1 Writing a Positioning Statement or a Value Proposition

A positioning statement is a succinct statement that identifies the target market for which the brand is intended and the product category in which it competes and states the unique benefit the brand offers. An example of a positioning statement that reflects Volvo's marketing strategy in the United States is shown in Exhibit 10.9.

**Exhibit 10.9 Positioning statement and value proposition for Volvo automobiles in the United States**

| Positioning statement | Value proposition |
|---|---|
| For upscale American families, Volvo is the automobile that offers the utmost in safety and durability. | • Target market: upscale American families<br>• Benefits offered: safety, durability<br>• Price range: 20 per cent premium over similar cars |

A value proposition is similarly explicit about what the brand does for the customer (and sometimes, what it does not do) and typically also includes information about pricing relative to competitors. Both positioning statements and value propositions should reflect a **unique selling proposition** that the brand embodies. In this sense, they reflect the basis on which the marketer intends to win sustainable competitive advantage by differentiating the brand from others in its competitive space. In its shortest form, a value proposition typically looks like this:

- Target market
- Benefits offered (and not offered)
- Price range (relative to competitors)

Exhibit 10.9 also provides a value proposition for Volvo. More fully developed value propositions sometimes identify the best competing alternatives available to the customer and specify the benefits, in measurable terms, that the customer can expect to receive by using the proposed brand.[16] Detailed value propositions such as these are particularly helpful in positioning industrial goods and services, where quantifiable customer benefits are often essential to make the sale.

It is important that the positioning statement or value proposition states **benefits** that the user of the product will obtain, rather than **features** or attributes of the product itself, or vague or ambiguous platitudes about high quality or excellent service. By benefits, we mean the resulting end-use measurable consequences that the user will experience through the use of the brand, in comparison to others.

The marketer generally writes positioning statements and value propositions for use internally and by others, such as advertising agencies, engaged to develop the marketing strategy. They are short and succinct, and are typically *not* written in catchy consumer language, though catchy **slogans** and **tag lines** for communication with customers often follow. They are commonly written for a product line or a brand, as is the case in our Volvo example, and sometimes for a single product or for a business as a whole. For products, they play several important roles. They provide direction for R&D and product development about what kind of attributes should be built into the product (side-door airbags, for example, in Volvo's case). They provide direction for those who create advertising campaigns about what the focus of those campaigns should be (for example, Volvo's ads almost always focus on safety or durability, even though Volvo could say other things about its cars). The value proposition provides direction for pricing decisions.

Thus, in a very real sense, the positioning statement or value proposition constitutes the foundation upon which the marketing strategy is built. More broadly, when used at the business level, as they sometimes are, these statements articulate the strategic direction toward which the company's activities in all arenas should be directed. Promising a certain sort of positioning, or value, to the target market is one thing. Delivering it is another. Clear and concise positioning statements and value propositions can play important roles in effectively executing the intended strategy.

## 10.6 The Outcome of Effective Positioning: Building Brand Equity

Brand equity is the term marketers use to refer to the value created by establishing customer preference for one's brand. It reflects how consumers feel, think, and act toward the brand, and it has implications for the prices and profits the brand can achieve in the marketplace and for the market capitalisation of the company owning the brand.[17] When companies create differences between their brands and other brands, differences that consumers view as meaningful, brand equity is the result. Effective positioning decisions that lead to effective marketing programmes are critical to this process.

Consider Procter & Gamble, arguably one of the world's most successful marketers over the past century or more. Its market capitalisation in excess of $200 billion in 2007 was due in large part to the brand equity it has built with consumers in the more than 140 countries in which it does business. As P&G's global marketing officer, James Stengel notes about consumers, 'They want to trust something. People really do care what's behind the brand, what's behind the business. They care about the values of a brand and the values of a company. We can never be complacent about that. Businesses and brands that are breaking records are those that inspire trust and affection and loyalty by being authentic, by not being arrogant, and by being empathetic to those they serve.'[18]

In India, for example, P&G sells shampoo one sachet at a time, rather than in the giant economy-size bottles found in American showers, reflecting Indian consumers' limited purchasing power. In North America, P&G has turned its trusted detergent brand, Tide, into a growth machine by adding innovative new cleaning products like the Tide Stain Stick that people can carry with them.[19]

## 10.6.1 Managing Brand Equity

While brand positioning decisions are crucial in large companies like P&G and to the development of new brands, whether goods or services, in entrepreneurial start-ups, there are two ongoing issues that are essential if whatever brand value that's been built is to be maintained and grown: brand reinforcement and brand revitalisation.

Some companies have maintained strong brands for many decades – P&G's Tide, Crest, and Pampers, for example, Wrigley's gum, Coca-Cola, Disney, and numerous others. Other brands with substantial brand equity are more recent phenomena – Nike footwear and apparel, Dell computers, Nokia cell phones, Nivea skin products, and more. All of these companies, young and old, nurture and protect their brands, ensuring that the products that bear their brands stand for something consistent, and that marketing messages reinforce the brand strategy and personality.

**Exhibit 10.10 Safeway delivers, then makes its promise authentic**

Following consistent double-digit growth in earnings throughout the 1990s, Safeway, the third-largest supermarket chain in the United States, stumbled badly in 2002 and 2003, reporting its first annual losses since going public in 1990. 'We needed some fundamental changes,' said Steven A. Burd, Safeway chair and CEO. Safeway was being squeezed by discounters like Walmart and Target, which were adding grocery sections to their stores at a rapid pace, and upmarket competitors like Whole Foods Market, where extensive assortments of prepared and organic foods and fancy store environments were luring upscale shoppers away from conventional supermarkets. Safeway was dead in the water.

Burd and his team knew they couldn't solve the problem with a few fancy slogans or marketing campaigns, as weekly shoppers could tell in an instant whether any changes were real or simply window dressing. Safeway spent three years improving its food quality and assortment – especially its perishables like meat, produce, and bakery – and invested $1.6 billion a year to remodel each and every one of its more than 1700 stores. What Safeway did best, though, was to wait until the job was done before repositioning the company. It wanted its new story to be authentic. As Liz Muller, chief creative officer at Orangetwice, the retail design firm that created Safeway's new look, says, 'What you are marketing, you'd better deliver. Otherwise you actually do more damage.'

The results were as tasty as Safeway's new artisan breads. From 2004 to 2007, Safeway's stock price doubled from $18 to $35, as same-store sales soared and profits returned. Seth Godin, author of *All Marketers Are Liars: The Power of Telling Authentic Stories in a Low-Trust World,* was impressed. 'You can make up a story, but when people visit your store, if the story is inauthentic, then people reject you and don't trust you again.' That's a mistake the Safeway team didn't make.

Sources: Justin Hibbard, 'Put Your Money Where Your Mouth Is,' *BusinessWeek* European Edition, September 2006, pp. 61–63; www.investorguide.com/stock-charts.php?ticker=SWY.

Sometimes, however, market conditions or marketing mistakes make it necessary to revitalise a brand that has lost its lustre. The emergence of new competitors or changes in consumer tastes and preferences can affect a brand's fortunes, sometimes for the worse. For an example of how Safeway, the supermarket chain, recently revitalised its brand, see Exhibit 10.10.

As we have seen in this module, brand positioning is much more than a one-time exercise. It's an ongoing, never-ending process, one in which the best marketers keep abreast of market and competitive changes in order to maintain and grow the brand equity they have built. Positioning decisions, important as they are, only set the foundation for the development and implementation of effective marketing programmes, however. It is those programmes whose job is to deliver on the brand promise. Developing and implementing marketing programmes and strategies is the focus of much of the remainder of this book. Before turning to those issues, though, we wrap up our work on positioning by identifying some of the growing array of software tools to aid in the positioning process, and we address a few caveats to which attention should be given along the way.

## 10.7 Analytical Tools for Positioning Decision Making

### Exhibit 10.11 Software tools for positioning decision making

Software tools useful for making positioning decisions include applications that identify important determinant attributes, as well as statistical applications that can plot positioning grids from market research data.

*Conjoint analysis*: As was mentioned in Step 5 of the positioning process, it is important to learn which key attributes are important to consumers. Conjoint analysis is one tool for doing so. Conjoint analysis determines which combination of a limited number of attributes consumers most prefer. The technique is helpful for identifying appealing new product designs and important points that might be included in a product's advertising. Although it can provide some insights about consumer preferences, it cannot provide information about how consumers perceive the positioning of existing products in relation to product dimensions. Conjoint analysis is one way to narrow down a set of product attributes to those most important to consider in product design and positioning decisions.

Most often, it is used with physical attributes, not perceptual ones. Several widely used conjoint analysis applications are available from Sawtooth Software, Inc. (www.sawtoothsoftware.com).

*Factor analysis and discriminant analysis*: Factor analysis and discriminant analysis are two statistical techniques useful in constructing positioning grids based on actual marketing research data. They are included in most broad-based statistical packages, such as SPSS (www.spss.com/spssmr). To employ factor analysis, the analyst must first identify the salient attributes consumers use to evaluate products in the category under study. The analyst then collects data from a sample of consumers concerning their ratings of each product or brand on all attributes. The factor analysis programme next determines which attributes are related to the same underlying construct (load on the same factor). The analyst uses those underlying constructs of factors as the dimensions for a product space map, and the programme indicates where each product or brand is perceived to be located on each factor.

Discriminant analysis requires the same input data as factor analysis. The discriminant analysis programme then determines consumers' perceptual dimensions on the basis of which attributes best differentiate, or discriminate, among brands. Once again, those underlying dimensions can be used to construct a product space map, but they are usually not so easily interpretable as the factors identified through factor analysis. Also, as with factor analysis, the underlying dimensions may be more a function of the attributes used to collect consumer ratings than of the product characteristics that consumers actually consider to be most important.

*Multidimensional scaling*: Unlike the other techniques in which the underlying dimensions identified depend on the attributes supplied by the researcher when collecting data, multidimensional scaling produces dimensions based on consumer judgements about the similarity of, or their preferences for, the actual brands. These underlying dimensions are thought to be the basic dimensions that consumers actually use to evaluate alternative brands in the product class. Multidimensional scaling programmes that use data on similarities construct geometrically spaced maps on which the brands perceived to be most similar are placed close together. Those that use consumer preferences produce joint space maps that show consumer ideal points and then position the most-preferred brands close to those ideal points.

Unfortunately, the underlying dimensions of the maps produced by multidimensional scaling can be difficult to interpret. Also, the dimensions identified are only those that already exist for currently available brands. This makes the technique less useful for investigating new product concepts that might involve new characteristics. Finally, the technique is subject to statistical limitations, when the number of alternative brands being investigated is small. As a rule, such techniques should be applied only when at least eight or more different products or brands are being examined.

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Throughout the positioning process, we have advocated collecting marketing research data so positioning decisions are anchored in solid evidence, not mere supposition or naive opinion. Advances in computing power and statistical techniques have made possible a broad range of tools to help the marketing decision maker make the best use of marketing research. We briefly outline a few of these tools in Exhibit 10.9. It is beyond the scope of this course to provide detailed instruction in the use of these and other statistical techniques. Texts on marketing research and new product development are good sources for additional depth in this area.[20]

## Learning Summary

- Clear and distinctive positioning that differentiates a brand from others with which it competes is usually essential for developing a winning marketing strategy.
- The positioning process outlined in this module helps decision makers choose a position that maximises their chance of establishing sustainable competitive advantage.
- Distinctive and intense positioning is best accomplished when based on one or at most two attributes. More are likely to be confusing to customers.
- Writing clear and succinct positioning statements or value propositions can play an important role in ensuring effective development and execution of a marketing strategy. This module provides templates for writing these materials.
- Effective brand positioning decisions establish the foundation upon which successful marketing strategies and programmes are built, thereby setting the stage for the creation of brand equity.

## Review Questions

## Content Questions

10.1 What is meant by positioning?

10.2 What are the differences between physical and perceptual positioning?

10.3 What are the limitations of physical positioning?

10.4 What are the steps in the positioning process?

10.5 What are some of the more common types of bases used to distinguish one product or service from another?

10.6 What constraints are imposed on a brand with an intense position?

10.7 What are the limitations of a product positioning analysis?

10.8 In choosing a given position for a given brand, what factors should one consider?

## Multiple Choice Questions

10.9 Designing a marketing programme and product that a segment's customers will perceive as desirable and that will simultaneously provide the firm with a differential advantage over current and potential competitors is known as:

A. market targeting.
B. marketing research.
C. product definition.
D. market exploration.
E. product positioning.

10.10 In describing a car, its width, length, weight and headroom are all examples of its:

A. physical dimensions.
B. psychological dimensions.
C. psychographic dimensions.
D. lifestyle dimensions.
E. perceptual dimensions.

10.11 A few years ago, several entrepreneurs noticed that none of the hotel chains offered room rates below $25 a night. Such prices were usually available from old, unattractive motels in inconvenient locations. Consequently, the entrepreneurs opened new franchises aimed at a price-conscious market segment. This is an example of:

A. physical product positioning analysis.
B. perceptual positioning analysis.
C. target market analysis.
D. mass-market strategy.
E. none of the above.

10.12 Physical product positioning analysis is especially useful in:

A. developing a promotion campaign aimed at consumers.
B. product modifications and extensions.
C. identifying and designing new-product offerings.
D. understanding how the customer views the product.
E. developing new target markets.

10.13 When Ford Motor Co. succeeded in convincing adult women through advertising that the Ford Explorer was safe, comfortable, and had off-the-road abilities, what did this result represent?

A. A perceptual position.
B. An anticipatory position.
C. A physical position.
D. A defensive position.
E. Both A and C above are correct.

10.14 When consumers evaluate a pickup truck on the basis of how comfortably it rides, they are evaluating it on the basis of what it:

A. should be, rather than on the basis of what it is.
B. is, rather than on the basis of what it used to be.
C. was, rather than on the basis of what it is.
D. used to be, rather than on the basis of what it is.
E. does, rather than on the basis of what it is.

10.15 Consumers view which of the following attributes as a simple physically based attribute in evaluating a new car?

A. Roominess.
B. Prestige.
C. Image.
D. Price.
E. Efficiency.

10.16 All of the following are examples of the characteristics of physical positioning analyses EXCEPT:

A. readily available data.
B. physical attributes.
C. attitudes toward the brand.
D. direct R&D implications.
E. technical orientation.

10.17 All of the following are examples of the characteristics of physical positioning analyses EXCEPT:

A. qualitative comparisons.
B. direct R&D implications.
C. physical characteristics.
D. physical brand properties.
E. a large number of dimensions.

10.18 Excitement and prestige are _____ attributes influenced by _____ characteristics which share a _____ relationship:

A. physical; concrete; direct.
B. physical; concrete; indirect.
C. perceptual; concrete; direct.
D. perceptual; concrete; indirect.
E. perceptual; physical; direct.

10.19 Consumers who evaluate a new car on the basis of an abstract attribute would use which of the following dimensions?

A. Prestige.
B. Roominess.
C. Price.
D. Headroom.
E. Horsepower.

10.20 A knowledgeable consumer who is familiar with this product class is likely to base her eye-shadow purchase on:

A. ease of application.
B. whether the eye shadow case has a mirror or not.
C. its perceived ability to captivate men.
D. the sexiness of the brand's spokesperson.
E. both A and B above are correct.

10.21 When Campbell's positions its soups for use as dips and sauces, which attribute is it stressing in its advertising?

A. Benefits.
B. Usage.
C. Features.
D. Parentage.
E. Ingredients.

10.22 At what level would a positioning analysis be taking place if Carnation was studying the possibility of developing a new type of instant breakfast and compared its concept idea to cereals, eggs and bacon and English muffins?

A. Product category.
B. Brand level.
C. Niche level.
D. Mass-market level.
E. Repositioning level.

10.23 When Volvo stresses the safety features in its cars, which attribute is it stressing in its advertising?

A. Product feature.
B. Surrogate.
C. Customer benefit.
D. Use.
E. Price.

10.24 What attribute is Pedigree stressing in advertising when they state 'Tests prove Pedigree is more nutritious than IAMS, costs less than IAMS, and tastes great too'?

A. Price/quality.
B. Product class.
C. Ingredients.
D. Benefits.
E. Comparison.

10.25 The first step in the product positioning process is to:

A. identify the set of determinant attributes that defines the product space.
B. collect information from a sample of customers and potential customers about perceptions.
C. analyse the intensity of a product's current position.
D. identify a relevant set of competitive products.
E. select positioning or repositioning strategy.

10.26 The second step in the product positioning process is to:

A. identify the set of determinant attributes that define the product space.
B. collect information from a sample of customers and potential customers about perceptions.
C. analyse the intensity of a product's current position.
D. identify a relevant set of competitive products.
E. select positioning or repositioning strategy.

10.27 The most significant danger in conducting only brand-level positioning analysis is that it can:

A. miss significant challenges from other competing brands.
B. position the firm's brand incorrectly relative to the competition.
C. miss threats from possible substitutes in other products.
D. be inappropriate in the firm's competitive environment.
E. be cost-ineffective in the sense that information gained is not justified by the cost.

10.28 Attributes that play an important role, to at least some customers, and clearly differentiate among alternatives are known as _____.

A. common attributes.
B. market/customer factors.
C. competitive position factors.
D. relevant attributes.
E. determinant attributes.

10.29 The first step in analysing the intensity of an existing brand's position is to assess its level of market _____.

A. acceptance.
B. strength.
C. relevance.
D. involvement.
E. awareness.

10.30 One key constraint to consider when trying to establish an intense position in the market is that:

A. once you have established such a position, competitors will seek to take that position away.
B. once a brand has attained an intense position, it is very difficult to change that position.
C. brand intensity is very unstable, and customers are not likely to remain loyal over time.
D. brand intensity is easy to change provided the firm is willing to spend a lot of money on new promotional campaigns.
E. none of the above.

10.31 Extending an intensely positioned brand to diverse product lines can lead to:

A. market share loss in the short term.
B. competitive responses which can do significant harm to a firm's revenues.
C. a significant increase in consumer demand for products with that brand.
D. confusion among consumers as to what the brand stands for in each case.
E. higher marketing costs.

10.32 An appropriate strategy for building an intense position, especially with low-involvement products (such as P&G has done with Crest toothpaste) is to associate the product with:

A. one determinant attribute and concentrate on that.
B. at least five salient attributes so that customers can pick one they are aware of.
C. at least five determinant attributes so any and all determinant attributes are conveyed to the customer.
D. a minimum of two salient attributes.
E. a competitor's product.

10.33 When interpreting a perceptual map, what indicates that a distinct market segment exists?

A. A cluster of brands.
B. A cluster of consumer ideal points.
C. A quadrant with three or more brands.
D. A cluster of products with the same set of shared benefits.
E. Perceptual maps cannot identify market segments.

10.34 The last step in the product positioning process is to:

A. identify the set of determinant attributes that defines the product space.
B. collect information from a sample of customers and potential customers about perceptions.
C. analyse the intensity of a product's current position.
D. identify a relevant set of competitive products.
E. write a positioning statement or a value proposition.

10.35 Perceptual maps provide information about all of the following EXCEPT:

A. the competitive strengths of different brands in different segments.
B. the intensity of the rivalry between brands in a given segment.
C. the opportunities for gaining a differentiated position within a specific targeted segment.
D. the likelihood that new attributes will become salient in the future.
E. perceptual maps provide all of the above.

10.36 Which dimension, when used alone, is not typically useful in positioning a product?

A. Ingredients.
B. Usage.
C. Price.
D. Features.
E. Benefits.

10.37 What is an important criterion for defining market segments?

A. The difference in the benefits sought by different customers.
B. Learning who the competitor's customers are.
C. Defining the company's ideal customer.
D. All of the above.
E. None of the above.

10.38 A typical positioning statement contains the following points, EXCEPT:

A. Brand Name.
B. Target Market.
C. Product Features.
D. Product Category.
E. Unique Product Benefit.

## Application Questions and Cases

10.39 What are the major differences between physical and perceptual product positioning? Under what conditions would a firm be satisfied with simply a physical-position exercise? What kinds of firms would practise this kind of positioning? What dangers are involved?

10.40 What exactly does perceptual positioning accomplish for a consumer goods firm? For an industrial goods firm?

10.41 What determines the *intensity* of a product's perceived position in the marketplace? What might be done to increase the intensity of the position of a brand that currently holds a relatively small market share, such as Saab in the automobile market?

10.42 What is meant by a *determinant attribute* for a given product? Explain why the identification of such attributes is so important. What would be an example of a determinant attribute for the following products and services?

a. A cruise line.
b. A laptop computer.
c. French wine.
d. Sportswear.
e. A hospital.
f. A liberal arts college.
g. A tractor.

10.43 Exhibit 10.5 is a perceptual map of women's-clothing retailers in Washington, DC, which shows the ideal points of a given segment of consumers. What is an *ideal point* and how is it determined? How can it be used in relation to the development of a strategic marketing plan?

10.44 For a high-quality women's-clothing retailer like Nordstrom, what would be the best market position strategy to adopt? Why?

10.45 In terms of positioning strategy, what is the rationale for the fact that Nabisco offers many different brands within the cracker category, each of which is perceived as being only slightly different from the others? What are the advantages and limitations of such a strategy?

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9. Lindsay Brooke, 'Mini: The Real Story,' *Automotive Industries,* April 2002. For more on BL's history, see also 'British Leyland Motor Corporation,' www.en.wikipedia.org/wiki/British_Leyland
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11. Existing brands' attractiveness can be inferred from current sales volumes and market shares. The position occupied by the share leader is obviously more appealing to a greater number of customers than are the positions occupied by lesser brands.
12. See Paul E. Green, J. Douglas Carroll, and Stephen M. Goldberg, 'A General Approach to Product Design Optimization via Conjoint Analysis,' *Journal of Marketing Research*, May 1985, pp. 168–84; and J. Douglas Carroll and Paul E. Green, 'Psychometric Methods in Marketing Research: Part I, Conjoint Analysis,' *Journal of Marketing Research*, November 1995, p. 385.
13. When using preference data to define market segments, however, the analyst should also collect information about customers' demographic characteristics, lifestyle, product usage, and other potential segmentation variables. This enables the analyst to develop a more complete picture of the differences among benefit segments. Such information can be useful for developing advertising appeals, selecting media, focusing personal selling efforts, and designing many of the other elements of a marketing programme that can be effective in appealing to a particular segment.
14. The size of the individual circles in Exhibit 10.8 is fictitious and designed for illustrative purposes only.
15. The map in Exhibit 10.8 shows five distinct preference segments but only one set of perceived product positions. The implication is that consumers in this sample were similar in the way they perceived existing brands but different in the product attributes they preferred. This is the most common situation; customers tend to vary more in the benefits they seek than in how they perceive available products or brands. Sometimes, however, various segments may perceive the positions of existing brands quite differently. They may even use different determinant attributes in assessing these positions. Under such circumstances, a marketer should construct a separate market-positioning map for each segment.
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# PART 3

# Marketing Programme Decisions

# Module 11

# Product Decisions

## Contents



## Product Decisions in a Services Business[1]

Almost no one likes banks. From surly tellers to long lines, from 'bankers' hours' to fees for just about everything, consumers are fed up. But Prudential, the big British insurer, was convinced things didn't have to be this way. In October 1998, Prudential launched Egg, which has gone on to become one of Europe's most successful online financial services providers. Egg, unlike many in the banking industry, believes superlative customer service is the key to growth. But can such service be delivered online? 'The aim of all Egg's communication is to make the customer feel like an individual,' says Patrick Muir, Egg's director of marketing. 'We want to make money easier to understand and easier to manage.'

Offering great customer service is easy to *say*, but is much harder to deliver consistently. Egg has succeeded by making a series of decisions about the product it offers – various **services**, in its case, rather than **goods** – and then managing its execution and service delivery very well through the use of technology. Banking with Egg is a far cry from conventional banking or most other applications of customer relationship management technology, for that matter, which often infuriate rather than please customers.

What were the product decisions that helped Egg succeed? First, Egg offers its customers a variety of channels of communication. There's the Internet, of course, but Egg doesn't stop there. Its Egg TV offers interactive access from the comfort of one's living room. Further, Egg's call centres are available round the clock to help customers who want to speak to a real person. 'You actually have a conversation with someone, rather than sticking with a rigid script,' says Muir. What Egg also does differently is to offer a wide variety of financial services. Current accounts, savings, credit cards with cash-back discounts financed out of the retailer's commission to Egg, mortgages, even insurance. Egg's wide range of financial services offers one-stop shopping to Egg customers. And each Egg customer can access a personal balance sheet that displays all his or her assets and liabilities on one screen. Even accounts with other online providers can be included.

Egg's multichannel strategy provides customers with more access points and enables them to access their money where, when, and as they wish. At home? Use Egg TV. At the office? Use the Internet. On holiday at a beach resort? Find an Internet café, and access your account. Egg says it's committed to mobile banking, too, as wireless technology deployment permits.

Egg's technology gives it a comprehensive customer-by-customer view that enables Egg to come up with suitable products and service to offer, based on each customer's own profile. 'We want to put great offers in front of our customers that we believe are right for them rather than pushing unwanted products through hard-hitting sales campaigns,' says Muir.

Egg's early results spoke for themselves. In 1999, it won 22 per cent of net new deposits in the UK banking system. Within 18 months of launch, Egg had attracted more than one million customers. By 2002, brand awareness reached 88 per cent and its customers numbered over 2.1 million.

Egg's success in the United Kingdom led management to believe it could replicate the Egg model elsewhere. But its foray across the English Channel was not à la mode. French consumers didn't respond in the same way Brits had, and by 2004, Prudential was forced to shut down the French operation, posting an overall loss for the year of £107 million. But it was not just the French business that had fared poorly, so other parts, too, were jettisoned. Prudential sold Egg's investments business to Fidelity at a small loss and put its investment wrap business, Funds Direct, up for sale.

Chastened by these setbacks, management refocused on its basic UK business, returned the company to profitability, and – with Egg's stock price in the tank – bought the company back from its public shareholders, taking it private. In May 2007, having returned the business to health, Prudential then sold Egg to CitiGroup for £546 million, or just over $1 billion.

Despite the somewhat rocky road it has travelled, Egg's service-centric focus has served it well. Whether that focus is sufficient to fuel future growth in the hotly competitive online finance industry, where just about every brick-and-mortar bank is also now online, remains to be seen. But CitiGroup's billion-dollar bet suggests that it believes Egg still has room to run.

## Learning Objectives

Module 11 addresses several critical questions that marketers face in differentiating their offerings from those of their competitors. How should our product offering, whether a good or a service, be designed to give it a chance to win sustainable competitive advantage? What product decisions must we make to deliver the benefits and value promised in our positioning statement or value proposition? How can products and product lines best be managed to satisfy the needs of different market segments, rather than simply taking market share from the firm's other products? Finally, given the importance of new products in the long-term success of most firms, how can new product development be managed, from a process perspective, to ensure a timely flow of new products that enjoy favourable reception by customers? Answering these questions thoughtfully, using evidence-based and up-to-date market knowledge as a foundation, gives the firm its best chance to offer goods and services that consumers want – as opposed to products its engineers can develop.

The first portion of the module address the *content* of product decision making: decisions about product quality and features, related services, packaging, brand names, and so on. These decisions are applicable to existing and new products alike. We then broaden our focus to decisions about **product lines**, groups of related products. Then, to complete the module, we address the *process* of **new product development**. An abundance of recent evidence indicates that *how* the **new** product development process is managed – whether for **new-to-the-world products** born in high-tech research labs or simple **product modifications** or **line extensions** – can have important implications for time to market and, ultimately, for product success or failure.

## 11.1 Product Design Decisions for Competitive Advantage

A **product** can be defined as anything that satisfies a want or need through use, consumption, or acquisition. Thus, products include goods (TVs, radios, cars), services (medical, educational), places (New York, Moscow), people (David Cameron and other politicians everywhere), activities (entering a contest or visiting a weight-loss clinic), and ideas (have you hugged your kids today?).

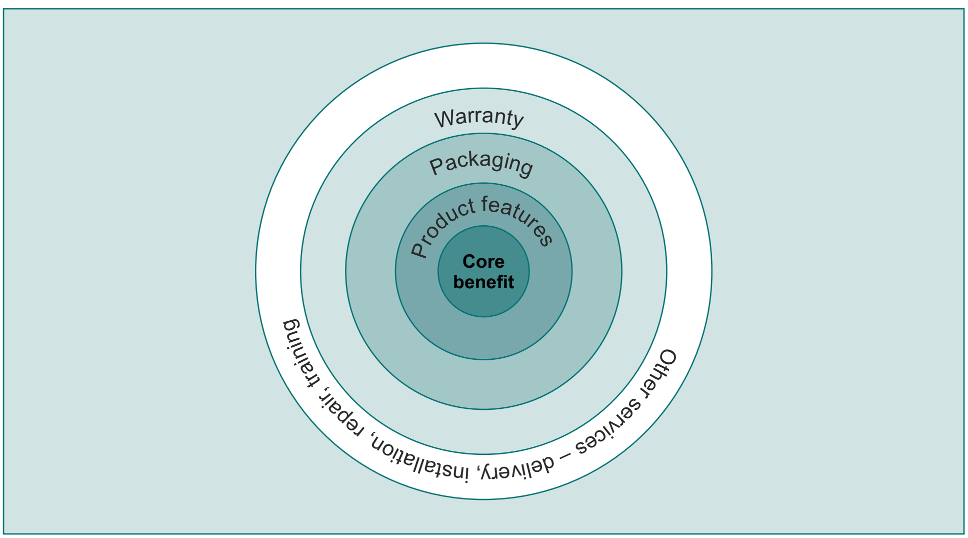
Conceptually, products should be thought of as problem solvers since they are purchased because of the core benefits they provide – not because of the product per se.[2] For example, a student who buys a handheld calculator is buying a way to quickly solve certain mathematical problems as well as to ensure accuracy of calculations. What is important is how the *consumer* perceives the product as satisfying a need, *not* how the *seller* sees the product. The seller must turn the wanted benefits into a tangible product with **features** or attributes that will provide the intended satisfaction better than competitive products. But benefits and features are not the same. **Features** are the tangible or intangible attributes given the product by its designers. **Benefits** are the solutions to customer problems or needs delivered by the product. Some of the features that Egg offers, and the benefits they deliver, are shown in Exhibit 11.1. Ultimately, most customers are far more interested in *benefits* than they are in *features*, though marketers sometimes forget this fact in designing ads or other marketing communications messages.

Well-managed marketers give explicit attention to all of the attributes of their products, choosing product features, packaging, warranties and services, and brand names that will help deliver the benefits sought by the product's target market (*see* Exhibit 11.2). We deal with what needs to be addressed in making these decisions in the first half of this module.

**Exhibit 11.1 Some features of Egg and the customer benefits they deliver**

| Feature | Benefits |
|---|---|
| Online Bank | Available to customers 24/7, i.e., longer banking hours |
| Multiple channels to serve customers | Use the Egg interactive TV to manage accounts from the comfort of your living room |
| | Access to account available while on a holiday from an Internet café, and from your PC at home or work |
| | Call centre available for customers who call over the phone |
| Online-only bank | Bank has a lower cost basis which is transferred to customers via:<br>• more competitive interest rates on credit cards<br>• higher interest rate on checking and savings accounts |
| | Able to offer customers new products faster than bricks and mortar banks |
| Account aggregation, and aggregation of accounts held with other financial institutions | Allows Egg customers to get a single snapshot of their current finances across all of their credit cards and bank accounts |
| | Allows customers to more easily see savings opportunities (i.e., moving balances to a lower interest credit card) |

**Exhibit 11.2 The augmented product concept**



### 11.1.1 Goods and Services: Are the Product Decisions the Same?

What is a service? As we discussed at the outset of the course, services can be thought of as *intangibles* versus goods as *tangibles*. Thus, services can rarely be experienced in advance of the sale, while tangible goods can be directly experienced, even tested, before purchase.

The service component of the US economy accounts for about 75 per cent of all non-farm jobs and over half the country's gross domestic product (GDP).[3] There are several reasons for the growing importance of services in the United States, as well as in Europe and Japan, but the two most important are economic growth and lifestyle changes. Given the large number of women now working outside the home, the demand for child care, housekeeping, and time-saving services has increased dramatically. Another lifestyle factor has been the growing interest in fitness, which, in turn, has increased the demand for physical fitness and recreational services. And as populations grow older, the need for health-related services expands. Finally, the increase in the number and complexity of goods has stimulated an increase in demand for repair services. Business services (maintenance, financing, marketing research, advertising) have also grown at a high rate. As we have seen with Egg, the principles entailed in product decision making apply to services as well as goods. Thus, when we say **product** in this book we mean both **goods** and **services**. As shown in Exhibit 11.3, different kinds of goods and services often call for varying marketing strategies, but the decision-making content and processes for both goods and services are similar.

**Exhibit 11.3 Marketing-strategy implications of consumer goods classification**

| | Examples | Strategy elements stressed |
|---|---|---|
| Convenience goods and services | Toothpaste, soap, razor blades, magazines, many packaged food products, haircuts | Maximum distribution (product availability), consumer advertising (awareness and brand recognition), merchandising (in-store displays) |
| Shopping goods and services | Colour televisions, cars, major appliances, homes, car repair, family doctors | Available in limited number of stores, personal selling important, limited to extensive advertising, seller often offers financing, warranties and postpurchase service |
| Speciality goods and services | Musical instruments, stereo equipment, some brands of men's clothing, college consultants | Limited distribution, high price, strong advertising to promote brand uniqueness and where available locally |
| Unsought goods and services | Certain medical services, personal liability insurance | Strong promotion, including personal selling |

## 11.1.2 Product Quality and Features Decisions

A well-developed positioning statement or value proposition plays an important role in designing products, whether goods or services. It tells the product's designers what benefits are to be delivered, so designers can imbue the product with the necessary features or other attributes, such as those we've seen at Egg, to deliver those benefits. Positioning makes clear how the product – an account with Egg – is to be differentiated from other products in its category.

As we have seen in the positioning module, products – whether goods or services – can be differentiated by both physical and perceptual means. One important dimension on which goods or services are physically differentiated is on the basis of quality – seeking to be better, in some sense, in the customers' eyes than competing products. Differentiating on quality can occur on any of the eight dimensions of quality for goods or the five dimensions of service quality, as shown in Exhibit 11.4 and Exhibit 11.5.

**Exhibit 11.4 Eight dimensions of quality for goods**

1. *Performance* has to do with a product's basic operating characteristics. For a car, this translates into such traits as acceleration, miles per gallon, ease in handling and comfort. The individual and the use environment determine what traits are important as well as how important.
2. *Features* are secondary product characteristics that are designed to enhance the product's basic functioning. In cars, examples include a rear window defroster, power steering and cruise control.
3. *Reliability* is the probability that a product will perform satisfactorily over a given period. Because of the cost of repair and downtime, reliability is an extremely important dimension for cars and heavy machinery.
4. *Conformance* is the extent to which a product's operating characteristics meet certain specifications.
5. *Durability* is a measure of the life of a product. It has both technical (replacement) and economic (repair costs) dimensions.
6. *Serviceability* is concerned with the speed and ease of obtaining competent repair.
7. *Aesthetics* has to do with how a product looks, feels, sounds, tastes and smells. These ratings are subjective and are related to how the consumer perceives quality.
8. *Perceived quality* frequently results from the use of indirect measures since the consumer may lack or not understand information about a product's attributes. Thus, perceptions may derive from such cues as price, brand name, advertising, reputation and country of origin.

*Source*: Adapted from David A. Garvin, *Managing Quality* (New York: Free Press, 1988), pp. 49–60.

**Exhibit 11.5 Five dimensions of service quality**

1. *Tangibles* are the appearance of physical characteristics associated with the service. For a dentist, tangibles include the décor of the office, the comfort and conditions

of the equipment and facilities, and the appearance of the dentist and dental assistants.

2. *Reliability* is the dependability entailed in the service performed. Does the dentist's work last over many years? Is the work pain-free once the office ordeal is over?
3. *Responsiveness* is the promptness and helpfulness of the service deliverers. Does the dentist keep patients waiting or see them on schedule? Does he or she see patients quickly in an emergency?
4. *Assurance* is the competence, courtesy, and credibility with which the service is provided. Is the dentist properly trained and certified? Is the staff courteous?
5. *Empathy* is the degree to which the service provider communicates with the customer and understands the customer's needs and concerns. Does the dentist offer and explain the merits of different treatment options? Does he or she carefully answer patients' questions?

*Source*: Adapted from Valarie A. Zeithaml, A. Parasuraman, and Leonard L. Berry, *Delivering Quality Service: Balancing Customer Perceptions and Expectations* (New York: Free Press, 1990).

So how should decisions about product features be made? Typically, consumers' choice criteria are limited to relatively few attributes or quality dimensions for a given product category. Thus, most products use only a few dimensions of quality as the basis on which they compete. Attempting to differentiate on too many features can be confusing to consumers and can lead to 'feature fatigue.'[4] Decisions about which dimensions of quality should be designed into a product are driven by earlier choices about the product's target market and positioning. When the product and product category, its users and its uses are well understood, the marketing research techniques discussed in Module 8 can be employed to determine consumer needs and assess consumer preferences for products having various features. For example, in designing the seats for its Infinity J-30 automobile to be sold in the US, Nissan tested more than 90 samples of leather before selecting three whose smells were most appealing to American consumers.[5] Some analytical techniques (and software packages for running them) commonly employed in determining the best set of features for a product are discussed in Exhibit 11.6.

**Exhibit 11.6 Marketing decision support tools for new product decision making**

| Tool or technique | Software packages | What they do |
|---|---|---|
| Brand development software | NamePro® from the Namestormers (www.namestormers.com) | Helps create distinctive, memorable brands for goods or services |
| Quality function deployment | QFD/CAPTURE (see www.qfdcapture.com) | Measures links between known customer needs, engineering characteristics, and product design features to assess product preferences |
| Conjoint analysis | Several Programmes from Sawtooth Software (see www.sawtoothsoftware.com) | Assesses consumers' preferred trade-offs among different product attributes |

In some situations, especially when the task is to design a breakthrough product that differs significantly from prior products, traditional marketing research is less likely to elicit the information needed to design a new product. For such situations, new techniques have been developed to go beyond what consumers can easily articulate and uncover needs they may not have yet identified. Empathic design, one such technique that observes customers or prospective customers in their own environments at home, at work, or wherever, is described in Exhibit 11.7. The use of techniques such as empathic design is one way to respond to critics who charge that excessively customer-led decision processes can blind companies to the needs of customers it does not currently serve.[6] Companies that adopt a true **market orientation** use techniques such as these to obtain a broader view of their markets than their current customers can provide.

## 11.1.3 Branding Decisions

**Branding** identifies and helps differentiate the goods or services of one seller from those of another. It consists of a name, sign, symbol, or some combination thereof. A **brand name** is the part that can be vocalised (BIC, Benetton, Sony). A **brand mark** is something that cannot be verbalised, such as a symbol, design, or unique packaging (Red Bull silver can, the McDonald's arches, the Pillsbury Dough Boy). A **trademark** is simply a brand or some part of a brand that legally belongs exclusively to a given seller.

Branding is important to consumers because it simplifies shopping, facilitates the processing of information concerned with purchase options, provides confidence that the consumer has made the right decision, helps to ensure quality, and often satisfies certain status needs. Branding also benefits sellers by enhancing:[7]

- The effectiveness of their marketing programmes – particularly those concerned with promotion.
- Brand loyalty, which leads to greater profitability because generally it costs less to retain customers than to acquire new ones.
- The opportunities for successfully launching brand extensions.
- Prices and margins resulting from a competitive advantage.
- Channel relationships.

**Exhibit 11.7 Empathic design uncovers new customer needs**

Empathic design, a qualitative product design and marketing research technique, observes customers in their own environments to uncover needs that they cannot or are not likely to articulate under traditional qualitative or quantitative research settings, such as focus groups, in-depth interviews, or surveys. The empathic design process includes five steps, as follows:

1. *Observation*: Decisions about whom should be observed, who should do the observing, and what the observers should be watching are critical. A team of observers each having a different perspective – a human factors specialist, an engineer, a designer, and so on – is typically employed.

2. *Capturing data*: Most data are gathered from visual, auditory, or sensual clues, sometimes using audio or video recorders, or even rough sketches, to record the data.
3. *Reflection and analysis*: The research team gathers to reflect on what they have observed and to review their visual and textual data with other colleagues.
4. *Brainstorming for solutions*: This step is used to transform the research observations into graphic or visual representations of possible solutions to customer problems or needs.
5. *Developing prototypes*: Prototypes are used to clarify the concept and gain further feedback from others, including designers and potential customers.

A complete description of the empathic design process can be found in Leonard and Rayport (1997).

*Source*: Dorothy Leonard and Jeffrey F. Rayport, 'Spark Innovation Through Empathic Design,' *Harvard Business Review*,
November–December 1997, pp. 102–13.

Through its branding efforts, a company improves its brand equity position, which consists of four major asset categories – brand name awareness, brand loyalty, perceived quality, and brand association. Thus, given the value-enhancing power of branding, it is not surprising that more and more attention is being given to managing brands, especially in terms of developing a winning brand identity. The latter will be discussed in Module 14, in which we focus on advertising.

The decision issue here, of course, is what brand to give to a new product. This decision may involve developing a new brand, as Toyota did when it introduced its upscale Lexus automobiles, or using one of the firm's existing brands, as Toyota did with the introduction of its Toyota Prius models.

### 11.1.3.1 Branding Strategies

A company has a number of branding-strategy options, one of which is to brand name each individual product or to use a family brand name. **Individual branding** requires the company to provide each product or product line with a distinctive name. This type of branding is practised by such firms as Procter & Gamble (Tide and Ariel detergents, Crest toothpaste), Diageo (Smirnoff vodka, Guinness stout, Bailey's Irish Cream, Jose Cuervo tequila), and Accor hotels (Mercure, Novotel, Motel 6).

Individual branding reduces a company's risk in that a failure of one brand is not readily associated with the firm's other products. Further, it enables a firm to compete via multiple entries, each positioned differently, within the same product class.

When developing a new brand, whether in a new or existing company, one key decision is whether to have the brand clearly indicate what the product is or stands for (*Burger* King, *Pizza* Hut, *Healthy* Choice cookies) or to develop a brand whose meaning must be built (Amazon, Nestlé, McDonald's). The former approach may make it easier and less costly to build market awareness and gain customer trial at the outset, but it can limit the flexibility to adapt to changing market conditions (witness Kentucky Fried Chicken's name change to KFC when *fried* became a negative attribute due to trends toward healthier eating). The former approach, however, is viewed by some as generic and boring and may make it harder to build an image for and differentiate one's brand. Positioning guru Al Ries argues that the latter approach, whereby a brand is based on its own distinctive name (eBay, Amazon), is probably better than the indicative approach (Auction.com, Books.com) in today's rapidly changing and highly competitive marketplace.[8]

**Family branding** uses the same brand name to cover a group of products. There are several variations of family branding including its use primarily with related items (Campbell's soups and Dyson's vacuum cleaners), its use with all company items regardless of whether they are use-related (General Electric is an example), and the use of a family name combined with individual product names (Kellogg's Raisin Bran cereal).

The major arguments for using family branding are reduced costs and transfer of customer satisfaction from one product to another bearing the same name. The latter makes it easier to launch product modifications such as new package sizes and types, or new flavours and varieties, and new products as when Nike extended its brand to cover athletic clothing. Family branding can also increase the impact of shelf facings in stores and make feasible the promotion of a product line comprising many low-volume items.

Under certain conditions, family branding is not a good strategy. For instance, when the family brand covers products that vary in quality, consumers become confused about what quality to expect. Also, extending a brand name to an inadequate product may tarnish the quality reputation of the entire line.

Other strategies include *cobranding* and *globalisation*. The former uses multiple brand names with a single product or service offering.[9] To be successful, the new product should either open another segment or add value in existing segments. Examples are the Smart car (Mercedes-Benz and Swatch), Häagen-Dazs' Bailey's Irish Cream ice cream. Cobranding is expected to grow.

Building a global brand is often difficult for a variety of reasons: the meaning of the brand name evoking negative associations in some countries; the presence of strong local brands; and the heavy investments required. Still, if successful, the scale effects can dramatically enhance sales and profits. The most successful global brands include Coca-Cola, Kellogg's, Nike, Starbucks, McDonald's, Marlboro, IBM, American Express, Sony, Mercedes-Benz, and Nescafé.[10]

### 11.1.3.2 Corporate Identity and Family Branding as a Source of Synergy

Corporate identity – together with a strong corporate brand that embodies that identity – can help a firm stand out from its competitors and give it a sustainable advantage in the market. *Corporate identity* flows from the communications, impressions, and personality projected by an organisation. It is shaped by the firm's mission and values, its functional competencies, the quality and design of its goods and services, its marketing communications, the actions of its personnel, the image generated by various corporate activities, and other factors.

In order to project a positive, strong, and consistent identity, firms as diverse as Caterpillar, Walt Disney, and The Body Shop have established formal policies, criteria, and guidelines to help ensure that all the messages and sensory images they communicate reflect their unique values, personality, and competencies. One rationale for such corporate identity programmes is that they can generate synergies that enhance the effectiveness and efficiency of the firm's marketing efforts for its individual product offerings. By focusing on a common core of corporate values and competencies, every impression generated by each product's design, packaging, advertising, and promotional materials can help reinforce and strengthen the impact of all the other impressions the firm communicates to its customers, employees, shareholders, and other audiences, and thereby generate a bigger bang for its limited marketing bucks. For example, by consistently focusing on values and competencies associated with providing high-quality family entertainment, Disney has created an identity that helps stimulate customer demand across a wide range of product offerings – from movies to TV programmes to licensed merchandise to theme parks and cruise ships.

#### 11.1.3.3 Retailer and Distributor Brands

In recent years, high-quality **store brands** have gained considerable ground versus national brands. Such labels represent over $50 billion in US supermarket sales and 20 per cent of supermarket unit sales. Private labels are enjoying even greater success in Europe, taking a 41 per cent volume share of the market in the UK, followed by Belgium with 36.4 per cent and Germany with 31 per cent.[11]

The explanation for the increasing importance of store brands is that during the 1980s and 1990s the national and global brands regularly increased their prices along with massive distributions of coupons, thereby training consumers to shop on price. They also undertook large numbers of line extensions and, in general, focused less on brand equity. Such fast-growing discounters as Walmart and France's Carrefour have moved aggressively to take advantage of the price vulnerability of many national brands. Strong retailer brands have also become very important in the soft goods trade. American retailers Gap and The Limited, and a number of European retailers such as Burberry and Laura Ashley, have built significant equity in their own brands.

But there are some countertrends to the above. A number of consumer goods companies have been acquired over the past several years at substantial multiples of their book value because of the value of their brand names (for instance, acquisition of Richardson/Vicks by Procter & Gamble and various liquor brands by Diageo). The reasoning behind such acquisitions is the high cost of creating a well-known brand and the low success rate of new products. Thus, buying popular brands can be a shortcut to growth.

### 11.1.4 Packaging Decisions

A product's package serves several functions – protecting, facilitating use of, and promoting the product, as well as providing information about the product and its use. The protection function is critical in both transport and storage. Protecting an item under a variety of temperatures and moisture conditions and against being crushed or dropped during handling is no small undertaking.

Because of increasing competition among brands within stores, packages have become an extension of the product and a way of identifying and differentiating products that can lead to increased loyalty. Packaging often facilitates use of the product, as in aerosol cans and disposable and unbreakable bottles. Packaging can also increase consumer safety, as proved by child-proof tops on drugs and tamper-resistant packages.

Packaging can give a product strong promotional support at the point of purchase. Many more potential customers may see the package than see advertising – and at more opportune times. Many more sellers are attempting to develop a common package design for their products, thereby creating a greater impact on the consumer. Because consumers purchase a high percentage of supermarket items on impulse, packaging is especially important for such items. Packaging also can play an important role in the marketing of services. The blue suits and white shirts worn by high-priced strategy consultants are an example. The distinctive store decor of the various beauty salon chains is another.

Increasingly firms such as Patagonia are recognising the need to use environmentally sensitive packaging. Given the growing concern about the disposal of solid waste, more recyclable and biodegradable materials are being used.

### 11.1.5 Services Decisions and Warranties

The service component of a product can include a variety of activities; the following are among the more common:

- Delivery reliability.
- Warranty.
- Repair and maintenance (including response time, spare parts availability, and effectiveness).
- Efficient complaint handling.
- Credit availability.
- Prompt handling of enquiries.
- Buyer personnel training.
- Prompt claim settlement.
- Fast price quotations.
- Fast order processing.

Companies that excel at providing service, such as Nordstrom department stores and online retailer Zappos, find it a substantial competitive advantage. In most markets, it is a significant part of a firm's quality rating. In many, it is more important than the product itself. Service is not just a competitive weapon; it also strongly affects the overall level of profitability since it typically costs more to get a new customer than to keep an old one. The more service-sensitive the market (the importance of service versus physical attributes), the greater the opportunity for profits. To be effective a firm's service programme must contain performance standards and be monitored regularly.

Warranties can play important roles in reducing the customer's risk of purchase and enhancing quality perceptions, thereby enhancing sales. Catalogue retailer Lands' End's slogan 'Guaranteed, period' is an example. Similarly, Dell's offer of extended three-year on-site warranties for computers sold on its website helps reduce any concerns about buying Dell products sight unseen. Warranties are only part of the story in assuring customer satisfaction, however. Sometimes, products fail to perform as planned, and customers have unsatisfactory experiences with them that take the company beyond the terms of its warranties.

The story of Bridgestone Corp., the makers of Firestone tyres, and its handling of safety problems with Firestone's Wilderness AT tyres on Ford Explorers, shows how expensive – in human lives and in financial terms – product performance and safety problems can be (*see* Ethical Perspective 11.1). This story also highlights how ethical issues that go beyond the original intent of a warranty can come into play.

### Ethical Perspective 11.1

**Bridgestone's Handling of Firestone Tyre Recall Angers Consumers,**

**Hammers Stock Price**

In August 2000, Bridgestone/Firestone Inc. recalled 6.5 million tyres that had been installed as original equipment on Ford Motor Company's hot-selling Explorer sport utility vehicles and other SUVs and light trucks. The tyres had been the subject of an inquiry into a tread separation problem as a result of nearly 300 reports of tyre failure, allegedly resulting in scores of injuries and 46 deaths in the United States plus other injuries and deaths elsewhere. What angered consumers and consumer advocates most, however, was not that the tyres appeared to be defective, since most consumers understand that product problems do occasionally occur despite manufacturers' best efforts to prevent them. What angered them was Firestone's decision to phase the recall over many months, possibly as long a year, because it lacked sufficient inventory to replace the tyres at once. If the tyres were unsafe, consumers wanted replacement tyres right away. Said Carlos Perdue, 79, a retired Ford facilities manager in Michigan, 'I'm not going to wait for a year to get my tyres replaced.'

Observers of Firestone's decision to phase the recall questioned Firestone's stance in ethical terms. If the tyres were unsafe (John Lampe, Firestone's executive vice president, finally acknowledged in September 2000 that it had made bad tyres), why was Firestone not willing to face that fact and allow consumers to replace their tyres with tyres made by any manufacturer, instead of waiting for Firestone to provide its own replacement tyres? Why had it not acted sooner, when reports of the faulty tyres began to appear six months earlier. 'It's about what they didn't do up to now,' said Stephen Greyser, a marketing professor at Harvard Business School. 'The fact that the company is just stepping up to bat tells me they've never really had the consumer as the principal focus of their thinking.' As one former Bridgestone/Firestone executive remarked, 'They just don't have a clue how to handle this.'

Shares of Bridgestone Corp. fell to 1849 yen on the heels of the furore over the recall, down from about 2500 yen before news of the tyres' problems began to surface. A poll of American consumers in September 2000 found that Firestone's handling of the tyre recall was 'extremely likely' or 'very likely' to influence decisions to purchase Firestone products for a whopping 67 per cent of consumers.

*Source*: Timothy Aeppel, 'Firestone Set to Replace 6.5 Million Tyres,' *The Wall Street Journal*, August 10, 2000, p. A3; John O'Dell and Edmund Sanders, 'Firestone Recall May Take a Year,' *Denver Post*, August 10, 2000, p. A1; Todd Zaun, 'Bridgestone to Take Charge of $345 Million,' *Wall Street Journal*, August 11, 2000, p. A6; Stephen Power and Clare Ansberry, 'Bridgestone/Firestone Says It Made "Bad Tires",' *Wall Street Journal*, September 13, 2000, p. A3; Irene M. Kunii and Dean Foust, 'They Just Don't Have a Clue How to Handle This,' *BusinessWeek*, September 18, 2000, p. 43.

## 11.2 Managing Product Lines for Customer Appeal and Profit Performance

Whether a **product line** is too short or too long depends on the extent to which the market can be segmented and how the company wants to position itself. Much also depends on what stage the product-market evolution is in. A short product line is desirable during the early stages, given the difficulties of managing a long line. It is also more profitable given the economies of scale and that it simplifies the inventories of both the company and its channel members. In the longer term, however, a short line comes under fire as competitors segment the market and develop more specialised products to meet the needs of these segments. Thus, to survive and prosper, short lines must be uniquely positioned against competitors – and the firm must be able to maintain the line's differential advantage.

In recent years more and more companies are pursuing product expansion strategies. They do so to grow by catering to more segments, to minimise competitive threats to small lines, to satisfy the demands of some customers for a variety of goods under a single brand, and as a short-term weapon to gain more control over limited shelf space, thereby making it more difficult for a competitor to expand its line.[12] The problem is that as a line increases, it becomes more difficult to position individual products to prevent cannibalisation that reduces the scale effects realised by the older product, thus affecting the net profitability of the line. Aside from the short-line/long-line strategy issue, other product-line decisions including line filling, line stretching, **line extension** and product abandonment. All but the last involve adding to the length of the present line. We discuss these product-line strategies in the following sections.

### 11.2.1 Line Filling

This strategy lengthens the product line by adding items within the present range. Its objective is to satisfy more customers, to increase sales and profits, to placate dealers who want a full-line supplier, and to ward off competitors. Most consumer goods companies increase the length of their product lines during the growth period by adding or dropping features. Thus, for example, many car manufacturers have added an off-road sport utility vehicle to their lines. Because of the temptation to add items, line filling often results in too long a line from an economic viewpoint; hence the need for a periodic product-line analysis.

### 11.2.2 Line Stretching

This strategy involves lengthening the product line beyond its current range of variables, such as size and price. Aircraft manufacturers, such as Boeing and Airbus, have typically expanded the size of their jets. Such product line stretching – literally, in this case – may be up or down or both. An upward stretch can also consist of trading up, as in the addition of higher price lines. JC Penney, the American soft lines retailer, has traded up many of its lines over the years. An upward stretch is not without its risks, however, since consumers may not believe that the company can produce a higher-quality product.

A downward stretch involves adding products to serve the lower end of the market; for instance, Mercedes added a minicar (in Europe) some three feet shorter than any of its other lines, selling for only $20 000. The risks involved with a downward stretch are primarily that the lower quality of the new product may diminish the company's overall quality image and that channel intermediaries may not support the move because of lower margins.

Firms practise two-way stretches when they have a midrange offering and seek market dominance by expanding both up and down, as Toyota has done. Both up and down line-stretching strategies are essentially incremental. Firms can thus exploit their current technological, manufacturing, and marketing resources, reducing the risks inherent in the introduction of new products.

### 11.2.3 Line Extensions

This strategy consists of introducing new products that differ significantly from those in the existing line by more than just size and price. The commercial jet airplane industry serves as an example. Boeing aborted a line-stretching strategy based on its 727 model (involving a lengthened 200-passenger version) because of a lack of interest by several major airlines. It then successfully developed its B757, B767, and B777 models. Examples of other line extensions include Gap Kids and Time's *Sports Illustrated for Kids*.

A product-line extension strategy involves greater costs and financial risks than product-line filling or stretching strategies. It provides, however, an extended technological base for the firm and is more likely to tap new market segments. It also provides a new anchor point in the product space from which product-line filling or stretching strategies can be based, thereby minimising the danger of cannibalising existing products.

### 11.2.4 Brand Extensions

**Brand extension** involves the use of a brand name established in one product class as a vehicle to enter another product class. A majority of the new products introduced to supermarkets and drugstores fall in this category.

The rationale for an extension is that the contribution of the brand name to the extension will be positive. The critical question here is the extent to which the brand name can provide a point of differentiation, including a quality association. Examples here include Arm and Hammer Carpet Deodorizer, Duracell Durabeam flashlights, and the use of the HP (Hewlett-Packard) name on thousands of items, even paper. By providing such an association, brand extensions can facilitate the acceptance of a new product by providing it with instantaneous familiarity. Bad brand extensions occur when the name adds little or no benefit to the extension and may cause confusion and, at worst, stimulate negative attribute association.

## 11.2.5 Dropping Products

Too few companies subject their product lines to a regular audit to determine which products, if any, should be dropped. Too often a firm rationalises the continuation of certain products on the basis that they are at least covering direct costs, perhaps even making a contribution to fixed costs. Such reasoning overlooks the opportunity costs of not getting rid of them, including the disproportionate amount of management time spent on weak products. Substantial profit increases can often result from the elimination of weak items. Japan's Shiseido Co, the country's largest cosmetics group moved to profitability by streamlining product lines and improving inventory control.[13]

The criteria for identifying weak products focus largely on the trend of the product's contribution to profit. Each such item should then be evaluated on such considerations as future sales of the item's product type or class, its future market share assuming no changes in the product or its marketing, future market share assuming certain product and marketing changes, anticipated changes in the marketing of competitive products (including the price), the effect of dropping the product on the company's channels of distribution, the cost of dropping the item (layoffs and inventory clearances), and the effect of dropping the product on the sales and profits of the firm's other items, because of joint costs or other factors.

## 11.2.6 Product Systems

**Exhibit 11.8 Champagne for your printer**

Hewlett-Packard, Epson, and the other makers of inkjet printers know a cash cow when they see one. At the equivalent of more than $2000 per litre, ink for your printer is far pricier than a bottle of Dom Perignon! Printer consumables – principally those little black cartridges that we cannot live without – account for half of HP's printer and imaging division's sales and most of its profits. It's no wonder that HP stuffs postage-paid envelopes into its packages so its customers will recycle their cartridges into raw materials for other plastic products, rather than refill them at one of the growing number of cartridge consumables stores. The printer companies' profits are spawning a new industry to serve those who would refill cartridges, rather than recycling or disposing of them. 'Inkjet refilling is a very lucrative market,' says Bill McKinney, CEO of InkTec Zone, a growing company that markets inkjet-filling machines to retailers wanting to cash in on these profits. Fortunately for the printer makers, though, some 86% of consumers still buy new brand-name cartridges, thereby making low prices on printers possible. Will the cartridge cash cow disappear? If so, printer prices are bound to rise.

*Sources:* Drew Cullen, 'Bring on the Empty Cartridges,' *The Register,* November 12, 2003, at www.theregister.co.uk/2003/11/12/bring_on_the_empty_cartridges/; and ClickPress, 'Liquid Gold Rush: Turning Inkjet Cartridges into Gold,' at http://www.clickpress.com/releases/Detailed/7143005cp.shtml.

This strategy consists of selling a product and providing complementary products and service as a package. For example, some airlines sell vacation packages that include airfare, rental car, hotel accommodations, meals, sight-seeing tours, and entertainment. Complex undertakings such as data processing and information retrieval also lend themselves to product systems. Many of the larger computer companies sell not only computers, but also software, operating systems, preventive maintenance (including emergency repairs), financing and employee training. Gillette sells razors and blades, selling razors at low prices to generate high-margin recurring revenue on the razor blades. Hewlett-Packard sells printers and ink cartridges. Inkjet cartridges are so lucrative for HP that they could practically give away the printers for free (*see* Exhibit 11.8).

A product-system strategy requires a strong compatibility between the various components of the system. When properly implemented, such a strategy produces scale economies (in contrast to individual consumers' attempts to put together their own systems) and a closer, more enduring relationship between buyer and seller. Implementing a product system successfully requires an in-depth understanding of customers' needs; a well-trained, high-level salesforce; and sufficient funds to finance the sale of a system, which often is a time-consuming process.

## 11.3 New Product Development Process Decisions

As the Egg example illustrates, a firm's growth and profitability is significantly influenced by how well it succeeds in making product decisions, improving present products, and adding new ones to serve new markets or market segments. But developing new products is a costly and risky undertaking as companies around the world have learned. This section examines a process by which a firm can better exploit the opportunities for new products and minimise the inherent risks. Before detailing this process, we need to discuss the role of new products in long-term profitability, new product success rates and the major reasons new products fail.

### 11.3.1 The Importance of New Products to Long-Term Profitability

An abundance of research has established that new products constitute the lifeblood of long-term firm success[14] and provide a central mechanism for firms' adaptation to rapidly changing markets and the opportunities they offer. Radical innovations, defined as those based on new technology and that offer substantial increases in customer benefits, may be particularly important but tend to come from a minority of companies, often entrepreneurial start-ups.[15]

There are a number of ways to classify new products. One of the simplest ways is to divide new products into four major classes: new to the world, new to the firm, product-line extensions, and product improvements. Only a small percentage of products are new to the world. The vast majority are either **product-line extensions** or **product improvements**. The rationale for this focus on line extensions is – Why spend a lot of time and money to introduce a new product when most fail and it's much less expensive and faster to introduce an extension or an improvement? But is this the way to go?

## 11.3.2 New Product Success and Failure

Introducing new products is a notoriously risky business, as most new products – more than half, by many estimates – fail. They don't usually fail for technical reasons, either. They fail because not enough people want to buy them.[16] Thus, a crucial factor in successful new product development is to ensure that an adequate understanding of customer needs, preferences, and requirements is developed. Doing so is not as easy as it sounds, however.

As we saw in Module 8, there is a wide array of marketing research tools that, at least in theory, should enable marketers to gain the customer understanding they require. In practice, though, it is not always easy for customers to articulate what they want, particularly with new-to-the-world products or product ideas that they can scarcely imagine. For this reason, some companies, such as Bang & Olufsen, the high-end Danish electronics maker, don't bother doing marketing research on new product ideas (*see* Exhibit 11.9). Most companies, however, work diligently to understand how large the market is for new products, how fast that market is growing (using approaches and frameworks such as those discussed in Module 4), and to understand what customers really want and will pay for. For some – like Hewlett-Packard, 3M, and Intel – these efforts have led to consistent new product success over many years and well-deserved reputations for their product innovation prowess.

**Exhibit 11.9 At Bang & Olufsen, designers rule the roost**

CEO Torben Ballegaard Sorensen, of Bang & Olufsen, says it's often the case that consumers don't really know what they want. Thus, B&O doesn't engage in extensive marketing research or follow an exhaustive new product development process. Instead, B&O's ideas and the sometimes revolutionary products that flow from them arise not as the result of market analysis, 'but rather a deep understanding of how our consumers live,' he says. And who has that understanding at B&O? A half dozen or so highly creative designers, not B&O managers.

Depending on the instincts of quirky designers is not for everyone, however. And counting on the ability of managers to manage such individuals raises additional complications. But B&O wants its designers, none of whom are even employees, to call the shots, even when that means telling the engineers that a standard 2-inch screen with a black plastic frame simply won't do for its new high-end mobile phone. An elegant, frameless 2.1-inch screen is what designer Torsten Valeur had in mind. Samsung, the supplier, simply had to cancel its $2 million order and get what Valeur wanted in the first place.

But, thanks to Valeur's snazzy design, B&O's Serene phone sells nicely at its $1275 price point. More generally, its designers' ability to intuit what B&O's luxury customers want and will pay for means its BeoLab 5 stereo speakers, cranking out a thumping 2500 watts per speaker, fetch $19 700 a pair. Its 50-inch BeoVision 9 plasma TV swivels to adjust itself to where you are sitting, a nice feature, for those who already have everything else money can buy. It's a mere $19 900. Just think, for under $50 000, you can outfit the family with designer phones, a great sound system, and the TV, too!

*Source:* Jay Greene, 'Where Designers Rule,' *BusinessWeek* European Edition, November 5, 2007, pp. 46–51.

### 11.3.3 Organising for New Product Development

At the outset of the development process, the firm must decide whether to keep its development activities in-house or go outside, as does Bang & Olufsen, via subcontracting, outsourcing or some form of joint venture. The rationale for the latter is that large integrated bureaucratic companies find it difficult during times of rapid technological changes to compete against smaller, more focused companies that are highly flexible and can motivate their employees using stock incentives and bonuses. As a result, companies like Procter & Gamble, British Telecom, and IBM are building innovation networks with other companies to open up their innovation processes (*see* Exhibit 11.10).

Other companies are using another prime source to spur innovation – the customer.[17] A new trend toward **cocreation** is bringing customers or prospective customers directly into the product development process.[18] The idea underlying cocreation is that rather than inventing new goods or services on their own, companies engage their customers in the process. Facebook, for example, benefits from the more than 20 000 software applications that have been developed by Facebook users. Under the cocreation mantra, companies don't bother to imagine, create, or deliver many of the new products. Instead, they provide a platform on which customers can do so. Cocreation defies the conventional organisational logic of having to own and protect one's new goods and services, and calls for new skills and mind-sets to make such product development methodologies possible.

**Exhibit 11.10 'Not invented here' no longer rules at IBM**

IBM's CEO Sam Palmisano knows that, inevitably, even for a huge company like IBM, there are more smart people outside the company than can possibly work on its own payroll. So IBM has abolished its 'not invented here' mentality and opened its doors to a variety of R&D partners. 'We are the most innovative when we collaborate,' says Palmisano.

Take IBM's alliance in chip manufacturing, for example. At IBM's chip fabrication plant in the Hudson River Valley in New York State, 2000 IBM staffers and hundreds of others working for AMD, Freescale, and other partners scurry around in their white coveralls keeping the factory humming. 'We don't work in silos,' says John Pellerin, AMD's top manager at the East Fishkill plant. 'We're a fully cross-mixed team.'

There are several keys to building such alliances and making them work effectively. One is agreeing on common goals from the outset. Another is setting clear rules of engagement. Who talks to whom, and about what do they and don't they talk?

When alliances fall apart, as sometimes they do, it's often for one of two reasons: goals have diverged, or cultural barriers make it difficult for people from different companies – or different parts of the world – to work effectively together. But practice makes perfect, and companies like IBM that work at innovation alliances soon learn how to manage them productively. 'This is not IBM's first rodeo,' says Freescale's Gregg Bartlett. 'They have a lot of experience and there won't be any surprises.'

*Source:* Steve Hamm, 'Radical Collaboration,' *BusinessWeek Inside Innovation,* September 2007, pp. 17–22.

Another new customer-driven approach is **collective customer commitment.**[19] Under this approach, companies systematically solicit new product ideas from customers and ask for purchase commitments *before* going into production. While this idea is not a new one – indeed, business-to-business marketers, real estate developers, and others have long done so – it helps avoid expensive failures by ensuring demand before large production investments are made. This approach is now being extended into consumer markets, aided by the highly efficient customer engagement possibilities that the Internet brings.

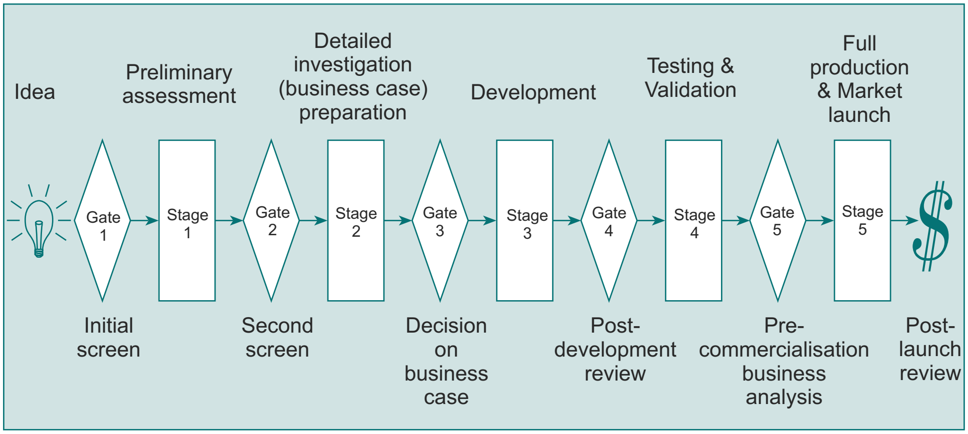
For many companies, though, product innovation still happens largely internally, where customer insight is developed concurrently with product and process engineering to speed new products to market. Empirical research indicates that the way product development is best organised depends, in part, on the nature of the product under development. For line extensions and product improvements, where the degree of innovation is minor, relatively bureaucratic procedures appear to be better at getting products to market quickly. For more radical innovations, cross-functional teams are more efficient, both for **time-to-market** and cost considerations.[20]

A reduction in time to market can have a strong, positive effect on the product's profitability, especially in fast-cycle industries in which product life cycles are short. Improved profitability results from extending the product's sales life, creating opportunities to charge a premium price, providing for development and manufacturing cost advantages, and reducing the risks of a marketing shift since the development process started.

### 11.3.4 Key Decisions in the New Product Development Process

Given the importance of new products – whether goods or services – in long-term firm success, much attention has been paid in recent years to the generation and assessment of new product ideas and to improving the process of getting new products to market.[21] One result of this attention has been the development of so-called **stage-gate systems** for managing new product development from **idea generation** to **product launch**.[22] A diagram of the stage-gate system is shown in Exhibit 11.11.

**Exhibit 11.11 Stage-gate new product development system**




*Source*: Paul O'Connor, 'Implementing a Stage-Gate Process: A Multi-Company Perspective,' *Journal of Product Innovation Management* 11 (1994), p. 185.

In a stage-gate system an idea for a new product must pass through a series of gates at each of which its merit is examined before it is allowed to continue its journey toward market introduction. Between each gate, various analyses and development activities are conducted. The point is to 'kill' ideas that lack strategic or market potential early in the process, before significant resources are spent on these ideas, as well as to pave the way for high-potential ideas so that they not only get to market quickly but also have the 'right' attributes to enhance their likelihood of market success. Simple new products, such as line extensions or product improvements, sometimes skip stages in the process, going directly from idea status to stage 2, 3, or 4, for example. More innovative products whose market acceptance is unclear or whose product performance is uncertain typically must pass muster at each gate. Similarly, stages in the process are sometimes conducted concurrently, and backward loops in the process are common when the results of the analysis at a given stage do not support passing the product to the next stage.

### 11.3.4.1 Managing the Stage-Gate Process

Though the stage-gate process may appear lengthy and tedious, a principal goal of using such processes is to improve the speed with which a firm brings new products to market.[27] This is accomplished in three principal ways. First, clear milestones are set at each gate to encourage new product teams to move quickly through the necessary activities to get through the next gate. Second, resource commitments are made along the way to ensure that inadequate resources, whether human or financial, do not delay promising products. Third, concurrent engineering is employed, whereby both market analyses and technical progress proceed concurrently.

Previously, it was common for R&D to develop a product and 'throw it over the wall' to marketing, who were asked to sell it. Marketing would then throw it back, asking for changes to make the product more acceptable to customers, and so on, through several iterations. By the time the tossing ended, a competitor's product may have won the race to market. Thus, here, as with most other business processes, implementation is critical. In some fast-moving markets, firms seek **first-mover advantage**, whereby theirs is the first entrant in a new product category. There is much talk, especially in high technology and Internet marketing circles, about the importance of first-mover advantage. As is discussed in Exhibit 11.12, however, bringing the *right* product to market and updating it to keep it ahead of competing products are far more important in the long run than being first to market, especially with a product that does not offer what customers really want or need.

**Exhibit 11.12 Best beats first**

There is much talk in business school classrooms and in the pages of business plans about first-mover advantage. Indeed, many aspiring entrepreneurs are so enamoured with being first to market that they seem to feel that little else matters.

But how important is first-mover advantage? A candid look at business history in the 20th century indicates that being *best* in market is far more important than being *first* to market, notwithstanding the benefits that being first can bring to early leaders in any category. A 1999 review by Lambert and Slater of recent studies of first-mover advantage, as well as an abundance of anecdotal evidence (see sources) makes it clear that first movers are often successfully leapfrogged by later competitors, who benefit from the ability to observe and improve upon the market offerings of the early entrants. Where is VisiCalc, the first personal computer spreadsheet, today? Where is Osborne, the first portable personal computer? Why did Palm Pilots become ubiquitous, and then get superseded by the Blackberry, while Apple's earlier Newton failed? Thus, while faster time to market can provide a competitive edge, entrants who fail to introduce the right product or improve on their early offerings risk being overtaken by followers whose offerings are more attractive. As business researcher and best-selling author Jim Collins observes, being best is typically far better than being first.

*Sources:* Constantinos C. Markides and Paul A. Geroski, *Fast Second: How Smart Companies Bypass Radical Innovation to Enter and Dominate New Markets* (San Francisco: Jossey-Bass, 2004); Jim Collins, 'Best Beats First,' *Inc.,* August 2000, pp. 48–51; Denis Lambert and Stanley F. Slater, 'First, Fast, and On Time: The Path to Success. Or Is It?' *Journal of Product Innovation Management,* 1999, pp. 427–38.

### 11.3.4.2 Deciding Who Staffs the Gates and How Many Gates

In most companies or business units using stage-gate systems, a cross-disciplinary team is appointed to staff the gates. As new product ideas pass through the process, this team considers market, technical, and manufacturing or service deliverability criteria in deciding which ideas should pass through to the next stage. At minimum, marketing, R&D, and production perspectives are necessary, as is the presence of someone having the clout to commit resources needed for further development. One study showed that selecting gatekeepers who score high on measures of creativity, such as the MBTI® Creativity Index, enhances both the speed and productivity of the new product development process.[23]

The number of gates employed in the process varies in different firms, as some steps shown in Exhibit 11.11 can be combined or broken into additional steps.

### 11.3.4.3 Gate 1: Idea Generation and Initial Screening Decisions

To have an effective new product strategy, a firm needs to establish objectives for its new product effort. In what customer markets does it wish to grow? What capabilities does it have? What product lines should be expanded? In a large multidivisional firm, which divisions should get greater R&D and new product funds? These decisions, which were addressed from a strategic perspective in Module 2, provide guidance for idea generation. Typically, a substantial number of new product ideas must be generated to get one successful product. Ideas for new products can come from customers; from the company's own staff, R&D people, the salesforce, product managers, marketing researchers; from members of its distribution channels; even from competitors.

Whatever the source, at Gate 1, an initial screening is made to determine the idea's **strategic fit**. Does the idea align with the company's mission, does it take advantage of or strengthen its competencies, and are the resources needed to develop and market the product available? If the answer to any of these questions is, No, the idea will likely be rejected. Some ethical considerations in making these decisions are discussed in Ethical Perspective 11.2.

## Ethical Perspective 11.2

**Issues in Idea Generation and Screening**

Business is often criticised for excessive production of me-too products, which leads to waste in the economic system. This is a difficult criticism to refute except to note that under certain conditions the development of a me-too product is justified, such as when it can be produced at a lower price or made available to more people. Some consumers argue that business produces too many wasteful products. But what is such a product? Also, companies don't create the desire for wasteful products; it already exists.

There is also reverse criticism that business fails to produce products that are needed, such as products for people with unusual physical attributes (too tall, too short). In the medical field the development of new drugs is inhibited by risk (vaccines for children) and the uneconomic size of the market. In the latter case, the US government provides federal funds for the development and marketing of so-called *orphan drugs* having only a very limited application.

It seems clear that sellers need to design safety into their products, but to what extent? Often consumers are not willing to pay the price of the added safety, as was initially the case with flame-resistant children's pyjamas and auto seat belts. Both were finally mandated by government. How a product is positioned and communicated affects how a product is used and, thus, can relate to safety (car acceleration and braking power). And what should a company do when one of its products is designed for an innocent use but contributes to violence, like a high-powered toy water gun that shoots a variety of liquids, some not so pleasant to the person on the receiving end?

In recent years societies around the world have become increasingly concerned about the impact of products and their packaging on the environment. There are several ways in which both new and old products can harm the environment – through the use of destructive raw materials (asbestos and lead), the use of a manufacturing process that pollutes (use of chemicals in the production of paper), the use of the final product (automobiles and air pollution), and the disposal of the used product (tyres, motor oil, beverage containers).

Firms vary in their response to the ecological problem. Some largely ignore the problem, while others go so far as to disinvest in businesses that may harm the environment. Since being ethically right is not always the most profitable position, firms face the question of how best to trade off the environmental benefits versus profits. Small businesses (some of which account for considerable pollution) in particular are often hard pressed to take even a reasonable environmental point of view because of their lack of funds and technological know-how.

*Source*: Philip R. Cateora, *International Marketing*, 7th ed. (Burr Ridge, IL: Richard D. Irwin, 1990), pp. 149–54.

#### 11.3.4.4 Gate 2: Secondary Screening Decisions

In Stage 1, prior to reaching Gate 2, managers are typically asked to undertake preliminary assessments of the idea's technical and market feasibility. First, can the product be developed and delivered? For a high-technology product, will the technology pan out? Second, how large is the market, and what is the estimated market potential for the proposed product? Will customers like it? This screening is typically based largely or entirely on secondary data and on the market and technical know-how resident in the company. The tools presented in Module 8 for estimating market potential are useful at this stage. A 'classic' qualitative scoring model used by some companies at Gate 2 is shown in Exhibit 11.13. To invest new product development resources wisely, it is necessary to 'kill' weak ideas at Gate 2, because significant resources in marketing research and in product development are likely to be incurred for products that pass this gate. Thus, a weak screening process can waste resources on obvious losers or misfits and can lead to a creeping commitment to the wrong projects. An overly rigid process, on the other hand, can lead to lost opportunities.

**Exhibit 11.13 NewProd scoring model**

| (1) | (2) | (3) Very good (10) | | (4) Good (8) | | (5) Average (6) | | (6) Poor (4) | | (7) Very poor (2) | | (8) | (9) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Subfactor | Subfactor weight | EP | EV | EP | EV | EP | EV | EP | EV | EP | EV | Total EV | Subfactor evaluation |
| Product superiority | 1.0 | 0.1 | 1.0 | 0.2 | 1.6 | 0.5 | 3.0 | 0.2 | 0.8 | – | – | 6.4 | 6.4 |

| | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Unique features for users | 1.0 | 0.1 | 1.0 | 0.2 | 1.6 | 0.4 | 2.4 | 0.2 | 0.8 | 0.1 | 0.2 | 6.0 | 6.0 |
| Reduces customers' costs | 3.0 | 0.3 | 3.0 | 0.4 | 3.2 | 0.2 | 1.2 | 0.1 | 0.4 | – | – | 7.8 | 23.4 |
| Higher quality than competitors | 1.0 | 0.1 | 1.0 | 0.2 | 1.6 | 0.5 | 3.0 | 0.2 | 0.8 | – | – | 6.4 | 6.4 |
| Does unique task for user | 2.0 | 0.5 | 5.0 | 0.4 | 3.2 | 0.1 | 0.6 | – | – | – | – | 8.8 | 17.6 |
| Priced lower than competing products | 2.0 | – | – | 0.2 | 1.6 | 0.5 | 3.0 | 0.3 | 1.2 | – | – | 5.8 | 11.6 |
| | 10.0 | | | | | | | | | | | Total value of factor: | 71.4 |

*Note*: EP = estimated probability as judged by management. EV = expected value, computed by multiplying the rating's numerical value by the estimated probability.

*Source*: Robert G. Cooper, 'Selecting Winning New Product Projects: Using the NewProd System', *Journal of Product Innovation*, March 1985, p. 39. Copyright © 1985 by Elsevier Science Publishing Co., Inc. Reprinted by permission of the publisher.

#### 11.3.4.5 Gate 3: Decisions on the Business Case

If an idea successfully passes the tests at Gate 2, a more detailed investigation, the subject of Stage 2, is made into the market potential for the proposed product. Such an investigation includes a comprehensive customer, market, and competitive analysis using the tools and analytical frameworks provided in Modules 3–6. Primary research is customarily done at this stage. Thus, some resources are now invested in research, and development of product prototypes is sometimes done to support these research efforts. For many technology-based products, development before this point has likely been limited to basic research, and actual development of a truly functional product has awaited confirmation of the business case. Decisions at Gate 3, while based on similar criteria as those at Gate 2, are based on greater depth of information and are the last chance to stop before proceeding with full-scale development of the product and of the marketing plan for introducing it.

#### 11.3.4.6 Gate 4: Post-development Review Decisions

During Stage 3, the technological development of the actual product design proceeds, and a marketing plan, including a total product/service offering (as we noted earlier in this module) is developed. A critical decision here is to settle on the product's design and its particular features.

A classic analysis of more than 200 new products revealed that product design was the most important single factor in their success for a number of reasons.[24] First, it can influence costs by its choice of materials and shapes, which strongly influence the manufacturing processes. Second, it can call favourable attention to the product in a crowded marketplace, as was the case with Swatch, which used a number of unusual forms to call attention to its line of watches. Third, it creates impressions concerning other product attributes. For example, the first Apple iPhone had a simple compact form designed to emphasise that it was user friendly. And fourth, product design enhances our lives by the satisfaction we derive from seeing and using beautiful artistic products.

In addition to product design and specific product features, pricing and channels are determined at this stage, along with brand name, packaging, and a planned marketing communications programme. Additional marketing research may be needed to complete this process. These technological and marketing activities proceed in tandem, with considerable communication along the way, so that the 'over the wall' problem is avoided. There are two possible causes why a product would fail to pass Gate 4, as many do. The first is that stumbling blocks are encountered with the technology or product design or with the projected costs of the final version of the product, thereby calling into question whether the product will actually work as planned or whether it will provide target customers with good value for the money. The second is the discovery, during marketing planning, that market or competitive conditions that now prevail raise questions about the marketability of the product. The entry of an unforeseen competitor, for example, is often the cause for abandoning or delaying a previously attractive product idea at Gate 4.

Thus, gatekeepers at Gate 4 must take a careful look at whether the product is likely to perform, whether the marketing plan is likely to lead to market acceptance for the product, and whether the degree of acceptance is sufficient to merit further development. Making a 'no-go' decision at this point is often difficult, however, given the considerable momentum the product already enjoys within the company. Failing to do so, however, in the face of cautionary market or product evidence, is one reason that many new products fail.

#### 11.3.4.7 Gate 5: Precommercialisation Business Analysis Decisions

Gate 5 is the last hurdle before the product is rolled out. To clear Gate 5, the product typically must pass muster in a **test market**, in companies with budgets large enough to afford this step. Two major kinds of test markets are commonly used by large consumer products firms to prepare for Gate 5: field and laboratory test markets. Smaller firms, whose budgets may not allow for formal market tests, may simply begin marketing the product, assessing early results as they go. With the advent of the Internet, some firms now turn the stage-gate process upside down and simply begin selling on the Internet or in limited channels as a form of market learning quite different from traditional marketing research. One such effort that led to a successful introduction of an upscale scooter to 'hip' urban markets is described in Exhibit 11.14.

In a **field test market**, the marketing plan for the product is typically implemented in a small geographical area to ensure that it will deliver the expected results. This test seeks to obtain an estimate of the sales that will be achieved once the product is rolled out into the broader market, given the planned marketing strategy and marketing budget.

In the past, the big food-, household-, and personal care-products companies typically used a sample composed of a few small cities as the test market – and did so for between 12 and 18 months. The cost of such research was often several million dollars. Increasingly such companies want faster and less-expensive ways of testing their products, and not only for cost reasons. More importantly, long test markets give competitors the opportunity to evaluate the results, even to the point of introducing their own new product. For example, General Mills was sufficiently impressed by a Procter & Gamble test market to quickly introduce its own version of the test product under the Betty Crocker brand name, which quickly became the best seller.[25] These concerns have led to increasing use of **laboratory test markets**.

**Exhibit 11.14 Real-time market and product development turns the stage-gate process upside down**

Sometimes it's not clear who the real target market is for an innovative new product. Such was the case for Nova Cruz Products (www.xootr.com), whose lightweight Xooter scooter had flopped in a market test on a college campus. Puzzled about who might constitute the best target market and what product attributes might be most important, Nova Cruz management decided to launch the product in a couple of channels – in a few independent retail stores and on the Internet – and iteratively refine the product concept, design, features, and options as well as its positioning, segmentation, pricing, and channels based on user feedback and early results. The idea was to try some things and 'do what works,' using one-on-one emails and face-to-face conversations with early users. As Karl Ulrich of Nova Cruz points out, 'For some products, it's better just to try selling than to conduct expensive research.' What worked turned out to be targeting 'urban hipsters,' as well as importers in gadget-happy Japan!

When might such an approach be called for? Ulrich, also a marketing professor at a leading business school, says there are four conditions under which real-time product and market development makes sense: when the product category is new, so that obvious users and competitors can't be identified; when market timing is not likely to be critical; when there's little risk to the brand itself (Coca-Cola probably would not want to try this for a new beverage); and when tooling and development costs are low (e.g., not for a new automobile). Benefits include the ability to tinker with pricing and product features (no fancy brochures to produce, nor substantial commitments to important channel partners); the ability to reach global markets (Japanese importers found the Xooter on the Internet, providing early cash flow); and early and close interaction with users, aided by friendly emails to build customer relationships.

*Source*: Karl Ulrich, Nova Cruz Products, 'Pre-Market Research *vs.* Real-Time Market Research,' a presentation to a conference of the Marketing Science Institute, Denver, CO, June 1, 2000.

In laboratory test markets, which are used most commonly for packaged consumer products, the procedure measures the process by which a consumer adopts a new product, consisting of three major steps: **awareness**, **trial** and **repeat buying**.

In the lab procedure, respondents representative of the target audience see commercials about the new product imbedded in a TV programme. Then they are given the option of buying such a product in a simulated store also stocked with competing brands. If they choose the test product, then researchers make follow-up interviews to determine the extent of satisfaction (including preference over their regular brand) and repurchase intentions. These tests have the advantage of relatively low costs ($60 000–$80 000) *and* confidentiality. Their biggest disadvantage is the small range of products that can be accommodated and that they provide little or no information about the difficulty of obtaining and maintaining distribution.

Marketing managers working toward Gate 5, or in entrepreneurial companies such as Nova Cruz Products (*see* Exhibit 11.14) much earlier in the process, are faced with decisions about whether and how to use scarce resources for market testing, in order to reduce the risk of a possibly unsuccessful market launch. Decisions about whether to conduct a market test, and whether to do so in the field or in a laboratory, must consider the likelihood of competitive interference with a field test, competitors' ability to benefit themselves from such a test, and the company's willingness and ability to spend money on test marketing.

### 11.3.4.8 Stage 5: Commercialisation Decisions

At this point, the horse is 'out of the stable,' but key strategic decisions remain about how to roll out the product in hopes of winning competitive advantage. **Commercialisation** requires considerable coordination between the various functional areas. Large sums are required even if the new product is a brand extension. Because marketing is responsible for making the new product available, developing awareness of its unique properties, inducing trial, and fostering repeat purchases, its role is critical.

There are a number of different commercialisation strategies. One is to forgo market testing and move directly to a rollout region by region or nationally or internationally from the outset. Such a strategy is used when there is little risk, as is usually the case with brand extensions and when copying a competitor's product that has experienced successful test marketing. For industrial products, the use of the Internet and email to contact large accounts facilitates and accelerates the introduction.

Some companies use a rollout test versus a more elaborate market test, provided the results from the market simulation studies are strongly positive. Thus, they launch their product in a limited geographical area and rely on fast sales results data (by scanners when possible) to check how well the product is doing. As global consumer goods markets become more similar, more companies are testing in a few countries, then following with a global rollout. For example, after Colgate successfully launched a new shampoo in the Philippines, Australia, Mexico, and Hong Kong, it was rolled out in Europe, Asia, Latin America, and Africa.[26]

Choices among the above strategies are based on the trade-offs between risk, the need to cash-flow the introduction, and the speed with which competitors are likely to react, among other factors. We'll examine alternative marketing strategies for the commercialisation of new products, and the market conditions where each makes most sense, in greater detail in Module 15.

Stage-gate thinking is useful in companies of all ages and sizes. Even in new start-ups or in small or young companies whose resources – both human and financial – are limited, the simultaneous creativity and discipline entailed in stage-gate thinking can serve as a foundation for entrepreneurial initiative while balancing these factors with some measure of discipline. Such balance can help mitigate the risk of costly new product failures that could lead a precarious young company to bankruptcy.

On the other hand, critics of the overly restrictive role of planning – in both large and nascent companies alike – argue that most of the time, the best-laid plans do not predict how success is won. More often, what eventually works is a product different than that which was initially proposed, sold to different consumers than originally intended, and used for something that its inventor had not even imagined. Who could possibly have imagined all the different ways in which personal computers, mobile phones, the Internet and other technological innovations have changed people's behaviour, even their lives?

Thus in their best-selling book on business model innovation, *Getting to Plan B*, Mullins and Komisar argue that a more experimental, open-minded approach to innovation – one fundamentally different from the more linear, traditional approaches like the stage-gate process – is needed to maximise innovators' chances of success.[27]

## Learning Summary

- Decisions about product design – including product features, brand names, related services, and warranties, for both goods and services – are among the most critical in differentiating one's product from others to achieve competitive advantage. Factors to consider in making product decisions are provided in this module.
- While speed to market is important in today's fast-paced business climate, bringing the *right* products to market and keeping them current are far more important than seeking first-mover advantage for a product that customers don't want.
- Decisions about the depth and breadth of product lines must be carefully considered in market segmentation terms. Product lines that are too long or too short can place the company at a competitive disadvantage.
- *How* the new product development process is managed, from a process perspective, is as important as *what* product decisions are made. The stage-gate system helps companies strike a balance between entrepreneurial creativity and business discipline in their new product efforts.
- Though new products constitute the lifeblood of long-term success for most firms, most new products fail! Thus, product decisions, in both content and process terms, are critical to the successful implementation of business strategies.

# Review Questions

## Content Questions

11.1 What is a product? Describe its various components.

11.2 Describe the four subgroups of consumer goods.

11.3 What are the eight dimensions of quality? How do these affect a firm's quality strategy?

11.4 How does branding benefit consumers? Sellers?

11.5 Discuss briefly the various branding-strategy options.

11.6 Define each of the following:

A. Line filling.
B. Line stretching.
C. Line extensions.

11.7 Discuss briefly the five criteria consumers use to evaluate service quality.

11.8 How can the variation in new-product failure-rate estimates be explained?

11.9 Why are more and more firms using teams to introduce new products?

11.10 What are the major steps of the new-product development process?

11.11 What are the more important sources of new product ideas?

11.12 What are the various ways new product ideas can be tested?

11.13 Describe a laboratory test market and how it operates.

11.14 What factors might influence a firm's decision about whether to conduct a field test market?

11.15 Describe briefly the various commercialisation strategies.

## Multiple Choice Questions

11.16 A product is defined in the text as:

A. a good involved in exchange for buyer use, consumption or acquisition.
B. any tangible object that satisfies a want or a need.
C. any object or collection of objects that satisfies a human want or need.

D. any tangible object or collection of objects that satisfies a human want or need and which is offered within an exchange relationship.
E. anything that satisfies a want or a need in terms of use, consumption or acquisition.

11.17 Tangible or intangible attributes given to the product by its designers is a:
A. benefit.
B. feature.
C. distinction.
D. quality dimension.
E. product characteristic.

11.18 Dishwashers and refrigerators are most likely examples of:
A. convenience goods.
B. shopping goods.
C. unsought goods.
D. speciality goods.
E. staple goods.

11.19 The type of consumer product subgroup most likely to be associated with limited distribution is:
A. speciality goods.
B. shopping goods.
C. convenience goods.
D. staple goods.
E. unsought goods.

11.20 The qualitative product design and marketing research technique, where customers are observed in their own environment, is called:
A. home interviews.
B. mall intercept studies.
C. empathic design.
D. hidden camera studies.
E. all of the above.

11.21 Coca-Cola, who also owns Minute Maid and Powerade, uses what type of branding strategy for these products?
A. Family branding.
B. Multiple branding.
C. No-name branding.
D. Individual branding.
E. Cobranding.

11.22 The more service-sensitive the market:
A. the greater the amount of customer complaints a company will receive.
B. the lesser the opportunity for profits.
C. the greater the chance for losing customers.

D. the greater the need to charge more for a product.
E. the greater the opportunity for profits.

11.23 The benefit of expanding a product line is:

A. to satisfy demand.
B. to control shelf space.
C. to avoid cannibalisation.
D. all of the above.
E. only A and B above.

11.24 _____ constitute the lifeblood of long-term firm success.

A. Cash cows
B. Product-line extensions
C. New products
D. Product systems
E. Continuous product improvement

11.25 More _____ structures are called for when a highly innovative product is involved and more _____ structures may be better when less-innovative products are involved.

A. participative; bureaucratic.
B. bureaucratic; participative.
C. regimented; simple.
D. vertical; horizontal.
E. multi-layered; simple.

11.26 The stage-gate system is designed to:

A. 'kill' ideas that lack market potential.
B. get new products to market quickly.
C. increase market success by making sure products have the 'right' attributes.
D. all of the above.
E. only A and C.

11.27 At a minimum, what area of expertise should staff the stage-gate system?

A. Marketing.
B. R&D.
C. Production.
D. Someone with the clout to commit resources.
E. All of the above.

11.28 The multidimensional nature of product quality and the nature of the competitive market imply that firms should seek:

A. high performance on a limited number of quality dimensions.
B. to spread or average performance among all dimensions of quality.
C. high performance on all dimensions of product quality.
D. to obtain high performance on at least one dimension of quality significant in common among all market segments.
E. to obtain high performance on at least one dimension of quality significant to each segment of the market.

11.29 Branding:

A. is the part of a firm's recognised and registered symbol that can be vocalised.
B. is the part of a firm's recognised and registered symbol that cannot be vocalised.
C. is an unregistered symbol representing a product class.
D. is an unregistered symbol representing a product type.
E. identifies and differentiates products of one seller from another.

11.30 McDonald's 'golden arches' in the front of the restaurant building are an example of:
- A. a brand name.
- B. a brand mark.
- C. a private label brand.
- D. store branding.
- E. individual branding.

11.31 A brand name that legally belongs exclusively to a given company is known as:
- A. brand name.
- B. a brand mark.
- C. a trade mark.
- D. a family brand.
- E. an individual brand.

11.32 A component of brand equity is:
- A. brand name awareness.
- B. brand loyalty.
- C. perceived quality.
- D. both A and B above.
- E. A, B and C above.

11.33 A brand may not be necessary when:
- A. quality is hard to measure.
- B. the market is very large.
- C. the brand engenders a favourable stereotype.
- D. the product possesses a significant 'point of difference.'
- E. the product is to be sold at below market prices.

11.34 Manufacturer brands are also known as _____, while distributor brands are known as _____.
- A. national brands; private labels.
- B. individual brands; family brands.
- C. multiple brands; private brands.
- D. private labels; national brands.
- E. primary brands; intermediary brands.

11.35 Companies or individuals that develop innovations that are ahead of market trends and have needs that go beyond those of the typical user are:
- A. lead users.
- B. top developers.
- C. trend setters.
- D. innovative developers.
- E. forward thinkers.

11.36 In the stage-gate system, at which gate is an idea screened?

A. Gate 1.
B. Gate 2.
C. Gate 3.
D. All of the above.
E. Only A and B above.

11.37 If any of five products under consideration varies widely in quality, the least effective branding strategy is likely to be:

A. cobranding.
B. national branding.
C. private labelling.
D. no-name branding.
E. family branding.

11.38 The production by Whirlpool of appliances for Sears under the Kenmore name is an example of:

A. manufacturer branding.
B. national branding.
C. individual branding.
D. sale of OEM components to competitors.
E. private labelling.

11.39 Packaging serves which of the following functions?

A. Facilitating and protecting.
B. Product usage and promotion.
C. Retail impact and safety.
D. All of the above.
E. Only A and B above.

11.40 The Ford Explorer Eddie Bauer edition illustrates which branding strategy?

A. Cobranding.
B. Global branding.
C. Individual branding.
D. Family branding.
E. Multiple brands.

11.41 Toyota's introduction of the Lexus at the top end of the car market is an example of:

A. line filling.
B. line extension.
C. brand extensions.
D. product systems.
E. none of the above.

11.42 Which best illustrates a product system strategy?
A. Burger King's Whopper.
B. Toyota's Lexus and Toyota car lines.
C. British Airways vacation packages.
D. Cost Cutter's hair salons.
E. Microsoft's Windows.

11.43 In a field test market, where is the marketing plan for the product implemented?
A. A random sample of the target market.
B. Focus group.
C. Small geographical area.
D. Laboratory.
E. Across the country.

11.44 Adding tangibility to service channels is best illustrated by:
A. Dodge's ram logo for its line of pickup trucks.
B. American Express' doubling of manufacturers' warranties.
C. Sprint's use of Candice Bergen as their spokesperson.
D. BurgerKing's consistent branch design and decor.
E. McDonald's golden arches logo.

11.45 What does a laboratory test market measure?
A. Awareness of the product.
B. Likelihood of product trial.
C. Chance for repeat buying.
D. All of the above.
E. Only A and B above.

## Application Questions and Cases

11.46 What are the major want–satisfying benefits that customers are likely to receive from the following products?
a. Cars.
b. Motor cycles.
c. Raincoats.
d. Contribution to a local charity.
e. Reading a book about the life of Gandhi.

11.47 Some men consider a business suit a shopping good, while others view such a product as a speciality good. How are the shopping and purchasing behaviours of the two groups likely to differ? Why?

11.48 A large over-the-counter drug company developed a new mint-flavoured toothpaste that would retard the development of plaque. The firm's marketing department was uncertain of how to best position the new product – as a convenience or a speciality item. If they decided to market it as a convenience good, what are the product-line, price-distribution and promotion implications as against marketing it as a speciality good?

11.49 Suppose you are the marketing manager for Ralph Lauren's line of designer women's fashions. You believe that your products are speciality goods in the eyes of most potential customers. What does this fact imply for each of the following areas of your strategic marketing programme?

a. Price policy.
b. Distribution.
c. Promotion.

11.50 The Pontiac division of General Motors has adopted a market targeting strategy aimed at the segment of the car market consisting of younger consumers who are interested in sporty and expressive cars. How has this strategy affected the division's decisions concerning the breadth of its product line and the design and features of individual products in its line?

11.51 Large discount organisations in the United States such as Walmart are increasing their emphasis on store brands. What is meant by a store brand, sometimes referred to as a private label? Why are such companies making this decision? How should the manufacturers of national brands respond?

11.52 Should Walmart adopt a family branding strategy as it expands the number and type of its private labels? What would it possibly gain in so doing? What are the dangers in adopting such a strategy?

11.53 When Honda introduced a line of luxury cars to the US market, it decided to use a new brand name, Acura, along with a new and independent dealer network and marketing programme, rather than treating the new cars as part of the Honda line. What were the advantages and disadvantages of this branding strategy?

11.54 Even though the firm decided not to use the Honda brand when it introduced the new models described in Question 11.53, the introduction can still be seen as an attempt to stretch the company's product line. What do you think motivated this strategic move? What risks were involved?

11.55 Doctors, lawyers, and other professionals have become increasingly active in recent years in marketing their services. Which unique characteristics or concerns make such professional services different from tangible products? What are the implications of those differences for the design of effective marketing programmes for professional services?

11.56 The World Wide Web can offer considerable opportunities for manufacturers of farm equipment such as tractors, combines, and harvesters to better serve their customers. Discuss the various ways in which the WWW can help such manufacturers better meet customer needs.

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# Module 12

# Pricing Decisions

## Contents



## Ryanair: Low Prices, High Profits – But Increasing Costs[1]

When the Ryan family launched Ryanair as Europe's first low-fare, no-frills airline in 1985, travellers wondered how the firm would ever make money offering €99 fares from Dublin to London when the cheapest flights available on British Airways or Aer Lingus cost more than twice as much. But the Irish company has not only made money, it has grown into one of Europe's largest and most profitable airlines, hauling nearly 51 million passengers in the fiscal year ending in March 2008 and earning €481 million net profit on revenues of €2.7 billion.

From the beginning, the firm's executives have pursued a very straightforward corporate strategy. It focused exclusively on providing low-cost air transportation for consumers within the European Union, and it sought a competitive advantage by offering the lowest fares of any airline operating in Europe.

Of course, a low-price competitive strategy can only be profitable when the firm's costs are also low. Therefore, all of Ryanair's functional activities and operating policies are designed with efficiency in mind. For instance, the firm owns rather than leases its airplanes, and most of those planes are older Boeing 737–200s, thereby reducing depreciation charges and allowing some standardisation of maintenance activities and parts inventories. Ryanair also concentrates nearly all its flights to and from underutilised regional airports, such as Stansted outside of London and Charleroi south of Brussels. Such airports offer the company more favourable terms with respect to taxes, facilities fees, and ground handling charges than more popular and congested airports closer to major cities. The lack of congestion also helps reduce turn-around times and thereby lowers costs by increasing utilisation rates for planes and flight crews. It also helps Ryanair achieve the best on-time record of any European airline, 89 per cent.

The firm's operating efficiencies have helped it successfully implement its low-price competitive strategy and hold its average fare below €35; substantially lower than even easyJet's, its strongest low-price competitor. Unfortunately, many of Ryanair's cost savings come at the expense of customer comfort and convenience. Not only do passengers have to find their way to and from small airports far from the big cities, they have to carry and stow their own bags and do without meals, drinks, and other in-flight services. And there is not much room for them to stretch out and relax during their flight since Ryanair carries 15 per cent more seats per aircraft than traditional airlines. It is even harder for customers to buy their tickets because Ryanair pays no fees to computer reservation systems and no commissions to travel agents.

Advertising and promotion, however, are among the few areas where Ryanair has not tried to cut costs below its competitors. With the exception of the sales commissions mentioned above, the company's marketing costs are about the same per passenger-kilometre as those of more traditional airlines. Even the most frugal flyers will not seek out Ryanair's cheap fares without being aware – and being frequently reminded – that they exist. And the firm must also maintain an extensive website and call centre to facilitate the direct sale of tickets.

While Ryanair's low-cost/low-price strategy has been very successful so far, there may be some turbulence on the company's horizon. The European Commission has ruled that the €15 million incentive that the airline received from the Charleroi airport in Belgium was excessive and anticompetitive, and it ordered the firm to pay back €4 million. Consequently, the company may have to renegotiate its agreements with other airports and thus face higher operating costs, costs which have already escalated in recent years because of soaring fuel prices.

Some analysts also question whether Ryanair's corporate development strategy and growth objectives might be overly optimistic. The firm's growth objective was to double in size to over 84 million passengers by 2012. But some experts doubt that the segment of travellers willing to sacrifice comfort and convenience for low fares is sufficiently large to make such aggressive development plans obtainable. While Ryanair's cost structure should enable the firm to make money at lower fares than the major airlines can match, some customers may see those low fares as a poor value since they have to schlep their own bags and do without frequent flier miles.

On the other hand, while the double whammy of soaring fuel prices and low economic growth in Europe are likely to squeeze Ryanair's profitability, it is generating major losses for the full-service carriers like British Airways. In order to survive, those carriers are cutting flights to smaller cities, charging extra for baggage and snacks, and reducing the seats available for frequent flyers. With competition like that, maybe Ryanair's low-cost, no-frills flights aren't such a lousy value after all.

## Learning Objectives

The critical question addressed in this module is, How can a marketer determine a price that captures a fair share of the value customers receive from a product or service without violating the constraints imposed by its strategic objectives, cost structure, and competitive environment? To answer that question, the first part of this module describes a price-setting process that begins by considering of a variety of strategic, market demand, cost, and competitive factors. It then discusses methods that different firms use to set a price level, with emphasis on methods geared to reflecting the product's value as perceived by customers in the target market.

Determining an appropriate price level for a product or service is complicated, and most firms do not charge the same list price to every customer all the time. Instead, they develop a **price structure** that establishes guidelines for adapting the price to variations in costs and demand across different markets. Consequently, the last half of this module examines some price adjustments marketers often make to accommodate differences across (1) geographic territories, (2) national boundaries, (3) levels of the distribution channel, (4) types of distribution channels, especially the Internet, (5) items within the product line, and (6) customer segments.

# 12.1 A Process for Making Pricing Decisions

A manager's freedom to select a price for a given good or service is constrained by several factors. First, the firm's costs determine the floor of the range of feasible prices – at least longer term. At the other extreme, the price sensitivity of demand for the product determines the ceiling of the range of acceptable prices. Beyond some price level, most potential customers seek less costly substitutes, such as private labels, or do without the good or service.

Where should managers set a product's price within the range of feasible prices? There are a number of ways to calculate a price,[2] but whichever one is used should consider situational factors. Such factors include (1) the business strategy and the other components of the marketing mix with which it must be compatible, (2) the extent to which the product is perceived to differ from competitive offerings in quality or level of customer service, (3) competitors' costs and prices, and (4) the availability and prices of possible substitutes.

Given the variety of factors to consider when setting a price, the following paragraphs describe, and Exhibit 12.1 diagrams, a step-by-step procedure for managers to follow. This process is particularly appropriate for first-time pricing decisions, as when a firm introduces a new product or enters a bid for nonroutine contract work. It includes several steps involving detailed analyses of demand, costs, and the competition. First, however, managers must establish a pricing objective consistent with the firm's business and marketing strategies.

## 12.1.1 Strategic Pricing Objectives

The strategic pricing objective should reflect what the firm hopes to accomplish with the product in its target market. When the business strategy, the target market, and the positioning strategy for the product are all clearly defined, then formulating objectives and policies for the marketing programme elements, including price, can be relatively simple. For instance, Ryanair's business strategy of being the lowest-cost competitor in Europe makes the most appropriate pricing objectives and policies rather obvious.

We examine marketing objectives for different market and competitive situations, and their implications for the marketing mix components, in more detail in Module 15, Module 16 and Module 17. But to clarify the role of price in different marketing programmes, we discuss some strategic pricing objectives next and summarise them in Exhibit 12.2. The exhibit also suggests the conditions under which each objective is appropriate and the implications for choosing a price level within the range of feasible prices.

**Exhibit 12.1 The price-setting decision process**

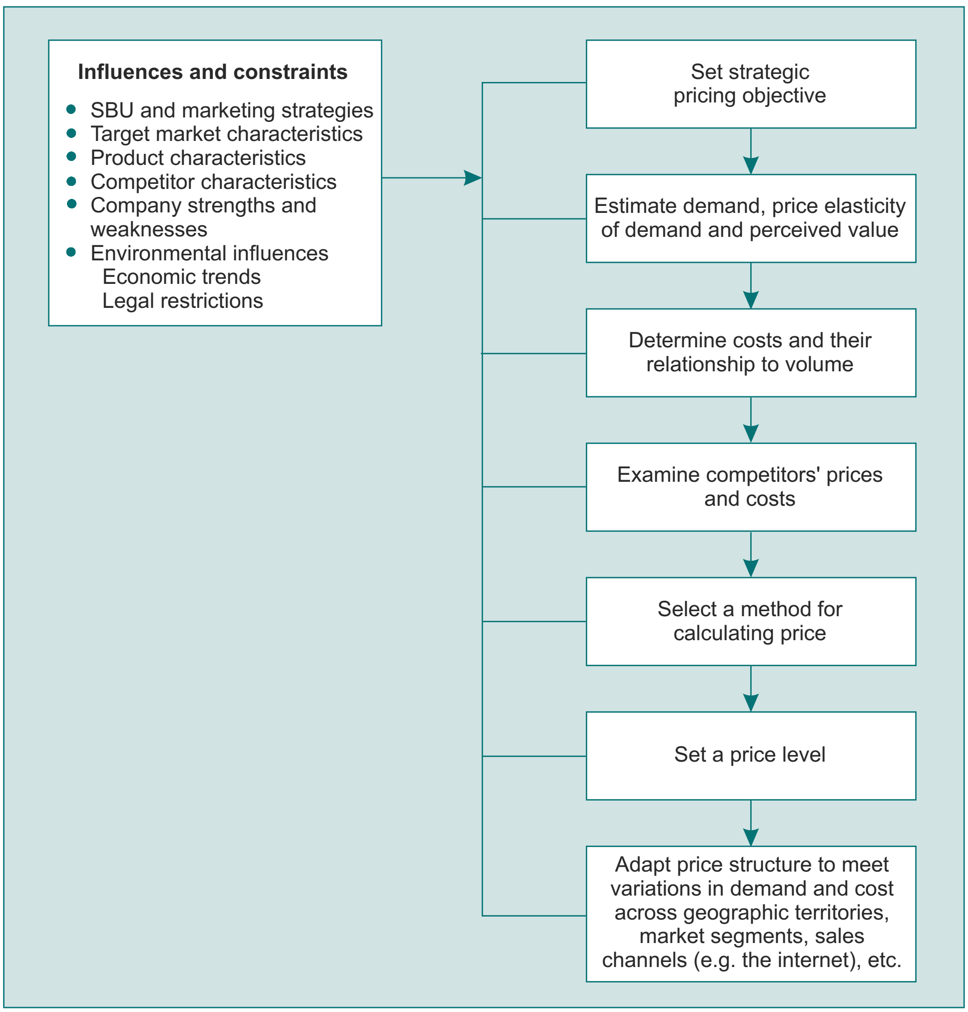


**Exhibit 12.2 Strategic pricing objectives**

| Objective | Conditions where most appropriate | Implications for relative price level |
|---|---|---|
| Maximise sales growth and penetration | Product-market is in introductory or growth stage of life cycle; firm is early entrant; target customers are sensitive to price; firm has low-cost position and is pursuing a low-cost business strategy; firm can gain experience-curve effects with increasing volume; low price may pre-empt potential competitors. | Set relatively low price – slightly above costs; penetration pricing policy aimed at winning new customers, expanding realised demand and capturing as large a market share as possible. |
| Maintain quality or service differentiation | Product-market is in growth or maturity stage of life cycle; firm's offering is perceived to have a quality or service advantage over competitive offerings; firm does extensive advertising to maintain the product's quality image; firm has high costs; firm is pursuing differentiated defender strategy; target customers are relatively insensitive to price. | Set price high relative to competitors to cover high production, distribution and advertising costs; price high to reinforce prestige image. |
| Maximise current profit | | |
| • Skimming | Product-market is in introductory or early growth stage of life cycle; firm is the first entrant; firm is pursuing a prospector strategy; firm has limited capacity; advanced technology or other barriers prevent immediate entry by competitors. | Set price very high to appeal to only the most price-insensitive customer segment; as market matures and competitors enter, firm can: (a) reduce price to attract new segments; or (b) withdraw from the product-market. |
| • Harvesting | Product-market is in late maturity or decline stage of life cycle; firm is pursuing differentiated defender strategy; there is no basis (e.g. product improvements, increased promotion) to sustain product demand or competitive position into the future; product is cash cow funding growth in other product-markets. | Set price to maintain margins and maximise profit or return on investment even though some customers may switch to competitive brands or substitutes. |
| Survival | Firm's product has a weak competitive position, but major shortcomings are correctable; firm needs to buy time and maintain cash flow to make necessary adjustments; product-market is still in growth or maturity stage of life cycle. | Reduce price, perhaps even below total cost, as long as price covers variable costs and makes a contribution to overhead. |
| Social objectives | Firm is a not-for-profit organisation; costs are subsidised in part by tax revenues or contributions; one or more segments need the product or service but are unwilling or unable to pay full costs. | Set low price, perhaps below total cost for some segments, to stimulate or subsidise demand. |

### 12.1.1.1 Maximise Sales Growth

When a firm is an early entrant into a new product-market with the potential for substantial growth, its objective may be to maximise its product's rate of sales growth (in units). This suggests it should set a relatively low price to attract as many new customers as quickly as possible and to capture a large share of the total market before it becomes crowded with competitors. This low-priced strategy is called **penetration pricing**. It is appropriate when, in addition to a large market,

1. Target customers are relatively sensitive to price.
2. The firm's costs are low compared to competitors' and the SBU is pursuing a low-cost strategy.
3. Production and distribution costs per unit are likely to fall substantially with increasing volume.
4. Low prices may discourage potential competitors from entering the market.

However, there is major risk in using low prices to achieve maximum sales growth in the short term as a base for future profits. If market, competitive, or technological conditions change, those future profits may never be realised.

### 12.1.1.2 Maintain Quality or Service Differentiation

When a firm has a strong competitive position based on superior product quality or customer service, its primary pricing objective is to generate sufficient revenue to maintain that advantage. Such a firm usually asks a premium price for its product for two reasons: First, it needs additional revenue to cover the R&D, production, distribution, and advertising costs it takes to maintain both the reality and the perception of superior quality or service. Second, customers are usually willing to pay more for a superior offering; high quality decreases the elasticity of demand.[3]

A premium price policy is most appropriate for businesses pursuing differentiated defender strategies, as is the case with Europe's traditional, full-service airlines like British Airways and Air France. However, there are limits to the price premium customers are willing to pay for superior quality and performance. Those limits may change with shifting economic and competitive conditions. Thus, a premium price strategy is most appropriate when target customers attach relatively greater importance to quality or service attributes than to price, such as business travellers who are willing to pay more for flights convenient to major cities.

### 12.1.1.3 Maximise Current Profit

#### Skimming

When firms pioneer the development of a new product-market, sometimes their pricing objective is to maximise short-run profits. They adopt a **skimming price policy**, setting the price very high and appealing to only the least price-sensitive segment of potential customers. This can also be accomplished over time, as in 'periodic discounting,' when the seller prices high at the beginning of each period and low at the end. Examples include off-season travel fares, peak-load pricing by utilities, and markdowns of fashion goods.[4] Skimming is particularly appropriate for businesses pursuing prospector strategies involving investments in the development and commercialisation of a stream of new products. Such businesses may not have the production capacity to fill a large initial demand for any one new product. They must try to recoup their development costs quickly so they can fund the next generation of new product ideas. Skimming works best when the new product involves proprietary technology, when the higher price reinforces the image of a superior product, or when other barriers discourage competitors from quickly entering the market and undercutting the pioneer's price. Skimming is most relevant to a small market because a large market is more apt to attract competitors.

#### Harvesting

At the other end of the life cycle, some product-markets decline rapidly as customer preferences change or new technologies and substitute products are introduced. Often it is too late to divest the product and earn a reasonable return, so firms facing this situation adopt a **harvesting** strategy to maximise short-term profits before demand for the product disappears. This typically involves cutting marketing, production, and operating costs of the product, while setting a relatively high price to maintain margins and maximise profits.[5] The opportunity to accomplish this ideal state depends largely upon exit barriers. If large barriers are present, then competitors will exert a downward pressure on prices. If few barriers are present, marginal competitors will exit and falling supplies may drive prices up.

The risk of maximising short-run profits for a declining product is that demand can decline even faster as price-sensitive customers switch to competing brands or substitute products. Therefore, this is an appropriate strategy only where there is no way – such as by making product improvements or increasing promotion – to sustain market demand or the item's competitive position very far into the future.

### 12.1.1.4 Survival

Sometimes businesses with an established product in a market expected to grow or experience stable demand well into the future run into trouble because of strategic mistakes, such as failing to adapt to customers' changing desires or to competitive threats, or building excess capacity. If such mistakes are correctable, the firm may adopt a pricing objective of simply keeping the product alive while strategic adjustments are made. Because short-term profits are less important than survival for such products, this situation usually demands a low price to attract enough demand to keep the plant operating and maintain cash flow. So long as the price covers variable costs and at least contributes to fixed costs, the firm may be able to buy time to correct its competitive weaknesses.

### 12.1.1.5 Social Objectives

Some organisations may forgo possible profits – at least among some price-sensitive customer segments – by offering a low price to those customers to achieve some broader social purpose. This is most common among not-for-profit organisations such as performing arts organisations and public hospitals, especially if subsidised by government agencies, foundations, or private contributions and not relying on sales as their sole source of revenue. In reality, they are simply shifting the price 'reduction' burden to organisations or individual contributors who are willing to subsidise one or more price-sensitive segments to achieve some social purpose. For example, performing arts organisations often offer substantial discounts to students. This is not just a strategy for building loyal future audiences. It also provides intellectual benefits to a customer group that would otherwise be unable to afford them.

## 12.1.2 Estimating Demand and Perceived Value

Demand sets the ceiling on the range of feasible prices for a product. Even before that ceiling is reached, however, the total number of customers willing to buy during a given period varies according to the price charged. The familiar **demand curve** depicts this variation in the quantity demanded at different prices.

In most cases there is an inverse relation between a product's price and the quantity demanded: the higher the price, the less people want to buy. Thus, the typical demand curve has a negative, or downward, slope. However, prestigious products (such as expensive wines and spirits) and those whose quality is difficult to objectively judge sometimes have positively sloping demand curves. Some customers use price as an indicator of the prestige or quality of such products, and they are induced to buy more as the price increases.[6]

### 12.1.2.1 Factors Affecting Customers' Price Sensitivity

The demand curve sums the reactions of many potential buyers to the alternative prices that might be charged for a product. The curve's degree of slope reflects the fact that different buyers have different sensitivities to the product's price.

Thomas Nagle identified specific factors influencing variations in sensitivity to price across customers and products. Exhibit 12.3 summarises these factors. Each factor reflects three basic phenomena that determine customers' willingness and ability to pay for a good or service. First, buyers' willingness to pay a given price for a product is influenced by their perceptions and preferences: their needs, desires, awareness of, and attitude toward, the item in question.

Second, the price, availability, and attractiveness of alternative brands and substitute products affect buyers' willingness to buy the product. So do the prices of complementary items that customers must buy to gain full value from the product. For example, the rising price of gasoline has dampened consumer demand for large, fuel-inefficient sport utility vehicles.

Finally, the size of their incomes relative to the price influences customers' ability to pay for a product or service. Taken together, these factors determine the **perceived value** a potential customer will associate with a given product-market entry, and thus the price he or she is willing to pay. Later in this module, we discuss how perceived value might be estimated for a given customer segment and used as a basis for setting a price level.

**Exhibit 12.3 Factors affecting customers' sensitivity to price**

| | |
|---|---|
| **Buyer's perceptions and preferences** | |
| Unique-value effect | Customers are less price sensitive when they perceive the product or service provides unique benefits; there are no acceptable substitutes. |
| Price-quality effect | Customers are less price sensitive when they perceive the product or service offers high quality, prestige or exclusiveness. |
| **Buyer's awareness of and attitude towards alternatives** | |
| Substitute-awareness effect | Customers are less price sensitive when they are relatively unaware of competing brands or substitute products or services. |
| Difficult-comparison effect | Customers are less price sensitive when it is difficult to compare objectively the quality or performance of alternative brands or substitutes. |
| Sunk-investment effect | Customers are less price sensitive when the purchase is necessary to gain full benefit from assets previously bought. |
| **Buyer's ability to pay** | |
| Total-expenditure effect | Customers are less price sensitive when their expenditure for the product or service is a relatively low proportion of their total income. |
| End-benefit effect | Customers – particularly industrial buyers purchasing raw materials or component parts – are less price sensitive when the expenditure is a relatively small proportion of the total cost of the end product. |
| Shared-cost effect | Customers are less price sensitive when part of the cost of the product or service is borne by another party (e.g. when part of the cost of medical services is covered by health insurance, or when a salesperson's travel costs are covered by an expense account). |
| Inventory effect | Customers are less price sensitive in the short run when they cannot store large quantities of the product as a hedge against future price increases. |

*Source*: Adapted from Thomas T. Nagel, *The Strategy and Tactics of Pricing* (Englewood Cliffs, NJ: Prentice Hall, 1987), pp. 73–76. Copyright © 1987 by Prentice Hall, Inc. Used with permission.

### 12.1.2.2 Price Elasticity of Demand

The larger the proportion of price-sensitive customers in a product's market, the more sensitive overall demand is to a change in the product's price. This degree of responsiveness of demand to a price change is referred to as the **price elasticity of demand**. The following formula calculates the price elasticity of demand for a product or service:

$$\text{Price elasticity of demand (E)} = \frac{\text{Per cent change in quantity demanded}}{\text{Per cent change in price}}$$

If, for instance, a seller raised the price of a product by 2 per cent and demand subsequently fell by 6 per cent, the price elasticity of demand for that product would be −3 (with the minus sign reflecting the inverse relationship between price and demand), indicating substantial **elasticity**. Conversely, if a 2 per cent increase produced only a 1 per cent decline in the quantity demanded, then price elasticity is −½ indicating that demand is **inelastic**. If a 2 per cent price increase leads to a 2 per cent decline in quantity, price elasticity is **unitary**. In such a case the seller's total revenue stays the same because the smaller quantity sold is offset by the higher price.

There are major problems in using price elasticity – as discussed above – to help set price in any precise way. These difficulties include the failure to consider the response of competitors to the company's change in price; that demand may be inelastic for a given price change, but elastic for a larger amount; that elasticity is measured in terms of sales revenues not profit margins (one reason being it doesn't take into account scale effects); that a lowering of price may affect the sales of other items in the company's product line (for example, cannibalisation); and that it ignores any societal benefits accorded the company for benefiting low-income segments via a price reduction.

#### 12.1.2.3 Methods for Estimating Demand

Many firms, particularly larger ones, attempt to estimate the demand curves for their products through marketing research. This is easier said than done, though, for two reasons: First, laboratory or test-market experiments can provide insights into the price–demand relationship for a product, but do not reflect the likely reactions of competitors to different prices or changes in price over time. Underestimating the aggressiveness and impact of such reactions can lead to debilitating price wars, particularly in mature industries suffering from excess production capacity.[7] A second problem researchers encounter when trying to empirically estimate demand curves is that *effects of nonprice factors*, such as changes in economic conditions or in other components of the marketing mix, must be controlled or measured. Thus, if a firm conducted a test market in which it increased advertising expenditures at the same time it lowered prices, researchers could not tell how much increased volume was a result of the sensitivity of demand to price and how much was a result of the heavier advertising.

Keeping these two problems in mind, there are a number of ways for marketers to estimate a product's demand curve. One approach is to survey a sample of consumers, or bring them into a laboratory setting, and ask them how much of the product they would buy at different possible prices. The artificiality of this approach, however, and the fact that respondents are not required to 'put their money where their mouth is' leads to questions about the validity of the findings. More realistic approaches include estimating the price–quantity relationship via the regression analysis of historical sales using consumer panel data, in-store experiments where a product's price is systematically varied, or multiple test markets. The expense of the latter limits their use.

Recently, software providers like SAP and Profit Logic Inc. have developed programmes that sift through massive databases available on a corporate intranet with information about past orders, promotions, product revenues, inventory levels in warehouses and stores, and the like. Historically, this wealth of information was usually divided among different departments, but the new programmes are bringing it all together via the Internet. The programmes' sophisticated algorithms then crunch historical sales, pricing, and inventory data to estimate the response of different customer segments to different price levels or price promotions. While such programmes are expensive and can be difficult to implement initially, many analysts expect them to greatly improve the future accuracy of firms' demand estimates and pricing decisions.[8]

### 12.1.3 Estimating Costs

Demand and perceived value set the ceiling on the range of feasible prices a firm might charge for a product, but costs determine the floor. A firm's costs take two forms: fixed and variable. **Fixed costs** (or **overhead**) are constant in the short term, regardless of production volume or sales revenue. They include rent, interest, heat, executive salaries, and functional departments – such as purchasing and R&D – needed to support the products made by the firm. Because total fixed costs remain constant in the short term regardless of volume, the **fixed cost per unit** of a product declines as a firm produces and sells more of the product in a given period.

**Variable costs** vary in magnitude directly with the level of production, but they remain constant *per unit* regardless of how many units are produced. They involve such things as the costs of materials, packaging, and labour needed to produce each unit of the product.

**Total costs** equal the sum of fixed and variable costs for a given level of production. The product's price must cover this total cost figure – divided by the number of units produced – if it is to be economically viable in the long run.

**Marketing mix** costs, which may include both fixed and variable costs as well as other costs such as retailers' or distributors' markups that don't even appear on the company's books, must also be considered in determining the level at which a product's price will be set. For example, it is common for a greater portion of the consumer's dollar to be spent on **distribution channel markups** than for a product's actual manufacturing cost. Similarly, in some product categories – diet aids and colognes, among others – the cost to promote the product, establish its brand name, and acquire customers can be higher – sometimes far higher – than manufacturing costs. For new products in categories such as these, marketers are faced with a clear choice between setting a high price together with a substantial promotional budget to communicate the product's benefits and attract customers or a low penetration price along with little promotional support. Either strategy can be viable, depending on market and competitive conditions. Setting a high price with too little promotional support, however, is likely to lead to sales problems. Similarly, setting a low price alongside an aggressive promotional programme can lead to profit and cash flow problems, as many dot-com retailers have learned the hard way. Thus, price setting for a product cannot occur in isolation. It requires considering the costs of the planned overall marketing mix for the product, including product, promotion, and distribution decisions.

### 12.1.3.1 Measuring Costs

The firm's cost accounting system provides managers with information about the fixed and variable costs associated with each of the company's products. Even though it is a relatively simple matter to measure each product's variable costs, fixed costs present a problem. The analyst has the option of using full costing (which involves allocating indirect costs) or direct costing (often referred to as the contribution margin approach because it takes into account only variable costs). These topics are covered in depth in Module 19 and will not be discussed here.

Examining the impact on a product's contribution is a useful way to evaluate the economic viability of marketing programme components directly linked to a specific product. However, it does not provide enough detailed information for a manager to judge whether a given price is adequate to cover the total costs incurred by that product. Consequently, many firms are beginning to revise their cost accounting systems to provide more accurate product-cost information to managers. They often develop multiple systems for financial reporting, cost control, and product-cost measurement purposes. **Activity-based costing systems** – which allocate costs across individual products by directly observing the level of various functional activities such as shipping, receiving, supervising, and selling that are devoted to each item in the line – often generate very different estimates of the total costs associated with a given product than does the firm's standard cost control system. But such activity-based cost estimates are often more useful for making strategic marketing decisions, such as setting prices, because they reduce some of the distortions inherent in the allocation of indirect costs within standard cost accounting systems while avoiding the imprecision of the contribution margin approach.[9]

### 12.1.3.2 Cost and Volume Relationships

A product's average cost per unit – and the price necessary to cover that cost – varies with the quantity produced. Managers should take two different volume–cost relationships into account when making pricing decisions. The first relationship involves **economies of scale**. In the short run, scale economies result from more complete use of available capacity. In the long run, companies can gain further economies by constructing larger and more efficient facilities. The average cost per unit is high if few units are produced, but it falls as production approaches the plant's capacity because fixed costs are spread over more units. This is why excess capacity is anathema to the profitability and competitive cost position of a product, particularly in mature, commodity-like product categories where margins tend to be low. If, however, a company tries to produce more than capacity, average costs per unit would rise. The overworked machinery would break down more often, workers would get in each other's way, and other inefficiencies would occur.

The second volume–cost relationship involves the **experience curve** – the fall in production and marketing costs per unit as a firm gains accumulated experience. Regardless of a firm's plant size, its average costs per unit decline as it gains experience. Its production workers discover efficient shortcuts, procurement costs fall, and the accumulated impact of past advertising and marketing efforts may enable the firm to succeed with smaller per-unit marketing expenditures.

### 12.1.4 Analysing Competitors' Costs and Prices

To achieve a desired strategic competitive position for a product or service in its target market, the manager must take competitors' costs and prices into account. To successfully implement a low-cost strategy, for instance, the manager must be sure that the product's costs are truly lower than any competitor's and that those lower costs are reflected in the product's relative price. Thus, the manager needs to learn and track the price, cost, and relative quality of each competitor's offer. For example, the continued success of Ryanair's low-price strategy obviously depends on the firm's ability to hold its total costs and prices well below those of other airlines – especially other no-frills carriers like easyJet – while offering a reasonably comparable choice of destinations, flight times, and customer services.

Competitors' costs are harder to measure than their prices. Reverse engineering can be used to take apart competing products and estimate the cost of their components, packing, and production processes. Because the costs associated with services are often largely fixed, such as the costs of labour, physical facilities, and the like, a manager can estimate competitors' relative cost positions in a service industry by comparing their numbers of employees or the number and size of outlets and then looking at efficiency ratios like sales per employee or sales per square foot. And there is usually a relationship between costs and market share – the higher the relative share, the lower the relative cost is likely to be based on scale and learning effects.

## 12.2 Methods Managers Use to Determine an Appropriate Price Level

Given the complexity of the concerns involved in setting a price – and the frequent incompleteness of information about demand and costs – managers often rely on rules of thumb to set list prices. Although these practical pricing methods are unlikely to produce an optimal – or profit-maximising – price, they are all based on a set of relevant considerations. These various pricing methods fall into three categories: cost-oriented pricing, competition-oriented pricing, and demand or customer-oriented pricing.

### 12.2.1 Cost-Oriented Methods

Perhaps the simplest and most commonly used pricing method is to add a standard markup to the cost of the product. This kind of **cost-plus** or **markup pricing** does not explicitly consider the price sensitivity of demand or the pricing practices of competitors. But it is convenient and easy to apply – important considerations when a firm faces hundreds or thousands of pricing decisions each year, as in the case of retail stores and wholesaling institutions. It is also widely used among firms that must submit competitive bids for a variety of projects, as is the case with construction firms.

The typical procedure for determining price under the markup approach is to first calculate the cost per unit by adding variable cost to fixed costs divided by an expected level of unit sales:

$$\text{Unit cost} = \text{Variable cost} + \frac{\text{Fixed cost}}{\text{Expected unit sales}}$$

To find the price, add a desired markup on retail to the unit cost (or divide unit cost by 1 minus the desired per cent markup):

$$\text{Markup price} = \frac{\text{Unit cost}}{(1-\text{Desired per cent markup on retail})}$$

Suppose, for instance, that a small-appliance manufacturer produces a line of electric coffeemakers and expects to sell 50 000 in the coming period. Fixed costs of \$500 000 are associated with producing the coffeemakers, and variable costs are \$10 per unit. The unit cost for each coffeemaker would be

$$\text{Unit cost} = \$10 + \frac{\$500000}{50000} = \$10 + \$10 = \$20$$

Suppose further that the manufacturer wants to earn a markup (or margin on selling price) of 30 per cent. The markup price would be

$$\text{Markup price} = \frac{\$20}{(1-0.30)} = \frac{\$20}{0.70} = \$28.57$$

This approach largely ignores the price sensitivity of demand. It assumes a level of sales *before* the price is set. Furthermore, if the manager's assumption about likely sales volume is wrong, the desired markup is not achieved. A shortfall in units sold would mean that fixed costs would be spread over fewer units and the realised markup would be smaller than desired.

In the distributive trades, retailers and wholesalers often add standard markups to what they paid for the item to attain a margin sufficient to cover overhead and provide a profit. These standard markups do not explicitly consider variations in demand. However, they have evolved in a way that reflects general variations in price sensitivity across products. In supermarkets, for instance, markups on selling price range from as low as 10 per cent on baby foods to more than 50 per cent on some toiletries and greeting cards.[10] The products with the lowest markups tend to be frequently purchased, commodity-like items for which many consumers make price comparisons.

**Rate-of-return** or **target return pricing** is similar in principle to, but somewhat more sophisticated in practice than, markup pricing. This cost-oriented approach brings one more cost element into the pricing decision – the cost of capital tied up in producing and distributing the product. The objective is to set a price yielding a target rate of return on investment. This pricing approach is common at General Motors and other automobile companies that price their cars to achieve a target of 15 to 20 per cent return on investment.

Operationally, this pricing approach demands that managers (1) estimate the unit sales volume of the product, (2) figure unit costs (variable costs plus overhead attributable to the product), (3) estimate the amount of capital involved in producing and selling the product, and (4) select a target rate of return on investment. They can then determine the price as follows:

$$\text{Target return price} = \text{Unit cost} + \frac{\text{Desired \% return} \times \text{Capital invested}}{\text{Unit sales}}$$

For example, suppose our small-appliance manufacturer has invested \$1 million in facilities and equipment to produce and distribute its coffeemakers and wants to make a 20 per cent return on that investment. The target return price for each coffeemaker would be

$$\text{Target return price} = \$20 + \frac{0.20 \times \$1000000}{50000\ \text{units}} = \$20 + \frac{\$200000}{50000} = \$24$$

When managers make these estimates accurately, the target return method results in a more rational pricing decision than the simpler markup method. As typically practised, however, this method does not explicitly consider the interaction between alternative prices and demand.

What happens if the price is set on the basis of an overly optimistic sales estimate? As with markup pricing, the realised return falls below the target level because fixed costs have to be covered by a smaller unit volume. The impact of such variations in volume can be examined by preparing a **break-even analysis**. Suppose our appliance manufacturer decided to price its coffeemakers at $26. With variable costs of $10 per unit and fixed costs of $500 000, the break-even chart in Exhibit 12.4 indicates that the product's **break-even volume** is 31 250 units – the volume necessary to just cover total costs. To calculate this result, use the following formula:

$$\text{Break-even volume} = \frac{\text{Fixed cost}}{\text{Price} - \text{Variable cost}} = \frac{\$500000}{\$26 - \$10} = 31\,250\ \text{units}$$

If we also consider the $1 million of capital invested in the product and the manufacturer's target return of 20 per cent (or $200 000), the chart shows that the firm must sell 43 750 to achieve the desired return. Break-even analysis can also calculate break-even and target return volumes at different price levels. Exhibit 12.5 indicates how these volumes vary for our product example over a range of prices. Break-even analysis, however, suffers from the same limitations as other cost-oriented pricing methods. It does not explicitly consider the price sensitivity of demand or the likely reactions of competitors. Therefore, managers must rely on their own judgement to decide how likely it is that the product's actual volume will reach or exceed the break-even level associated with each alternative price.

**Exhibit 12.4 Break-even chart showing break-even and target return volume**

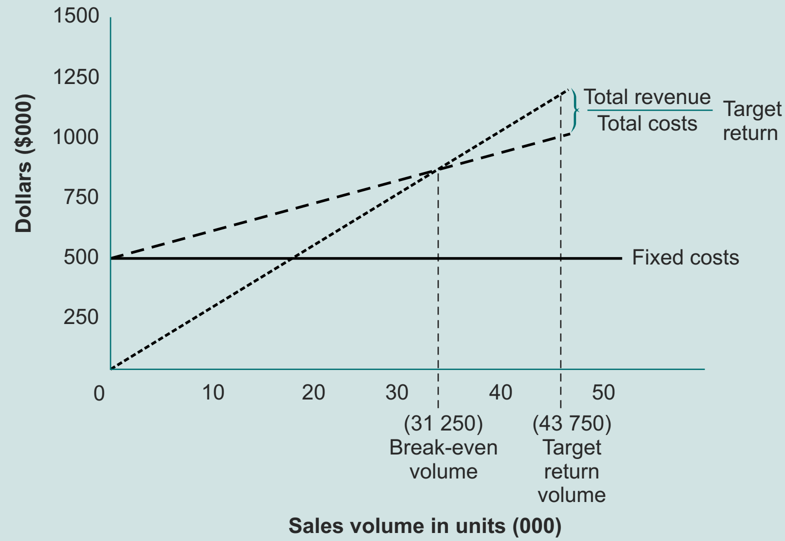



**Exhibit 12.5 Break-even and target return volumes for alternative selling prices**

| Selling price ($) | Fixed costs ($000) | Per-unit average variable cost | Target return ($000) | Break-even volume (units) | Target return volume (units) |
|---|---|---|---|---|---|
| 18 | 500 | 10 | 200 | 62 500 | 87 500 |
| 20 | 500 | 10 | 200 | 50 000 | 70 000 |
| 24 | 500 | 10 | 200 | 35 714 | 50 000 |
| 26 | 500 | 10 | 200 | 31 250 | 43 750 |
| 28 | 500 | 10 | 200 | 27 778 | 38 889 |
| 30 | 500 | 10 | 200 | 25 000 | 35 000 |

## 12.2.2 Competition-Oriented Methods

Some companies key their pricing decisions to what competitors are charging for similar offerings and pay relatively less attention to their own costs or demand schedules. This is not to say that their prices and competitors' prices are always the same; some firms may add a premium or discount their price below the industry average. Such competition-oriented pricing is also found in mature industries where little product differentiation and a few strong competitors make it difficult for one firm to change its price without precipitating a competitive reaction. Under such circumstances, a common industry price structure reflects the collective wisdom about finding the price that will yield a fair return and minimise the chances that a price war will jeopardise the profits of all industry firms.

Firms that pursue competition-oriented pricing approaches do not ignore cost or return-on-investment considerations. Instead, they try to control costs to make adequate returns at prices consistent with those of competitors. But if this cannot be done (for instance, because the firm is less efficient), the target rate of return may be the factor that is changed.

In some cases, firms adopt a **going-rate** or **competitive parity** pricing approach, where they try to maintain prices equal to those of one or more major competitors. This has been common in oligopolistic industries with little product differentiation and a few large competitors, as in steel, paper, and fertiliser. Price virtually ceases to be a controllable element of the marketing mix under such circumstances. No firm can increase its price without some assurance that others will follow, because most customers would switch to lower-priced competitors. Similarly, a firm would be reluctant to price below the competition lest other companies also cut their prices and reduce profits for all concerned. Consequently, prices are usually quite stable in such industries until a **price leader** decides an increase in industry prices is necessary to meet increased costs and maintain returns.

The ability of a firm to be a price leader whose pricing decisions are emulated by other companies is not determined solely by its size or market share. The leader also tends to be one of the most efficient firms in the industry; that is, it is one of the last to feel the need for a price increase. Often leaders are also perceived to have good marketing expertise and have had past success in making price increases stick. Even so, there is no guarantee that a given price leader can maintain its position. 'Follower' firms are particularly likely to cut prices below the leader during periods of overcapacity and to increase prices faster than the leader during periods of high inflation.

In industries where product quality, service, or availability vary across brands, a firm may still base its pricing on what its competitors are charging, but try to hold its prices either below or above the competition. Such **discount** or **premium price policies** usually reflect differences in positioning strategies. Ryanair's low-price strategy is a good example of a discount price policy. Once again, however, such a policy is only sustainable if the firm can maintain a total cost advantage over its competitors.

**Sealed bidding** is common in many businesses, especially in dealing with the government. In such situations buyers request a formal bid with no later opportunity for change. In public procurement the bids are opened publicly, enabling bidders to learn what competitors bid. Such is not typically the case with private bidding.

One approach used to set a bid price is an **expected value** model based on the following formula:

$$E(X) = P(X)Z(X)$$

where $X$ = bid price, $Z(X)$ = the profit at the bid price, $P(X)$ = the probability of an award at the bid price and $E(X)$ = the expected profit of a bid. The price the company bids is the one yielding the highest expected profit. But such models suffer because of the subjectivity of the probability estimates and objectives other than profit to take into account, such as the possibility of follow-on work, capacity availability, and need to keep the workforce intact.[11]

#### 12.2.2.1 Internet Auction Sites Make Accurate Cost Estimates More Critical

The Internet might make old-fashioned sealed bidding procedures obsolete. Instead of asking for a single submission of sealed bids from alternative suppliers, government agencies are likely to turn to Internet auctions where suppliers can adjust their bids in response to those of competitors.

Recall that in Module 7 we discussed the rapid growth of auction websites, particularly in business-to-business markets.[12] Some business-to-business sites focus on **seller's auctions**. These sites are usually specialised by industry and facilitate global spot markets for relatively standardised materials, component parts, used equipment, and the like. On www.MetalSite.com, for example, a steelmaker such as LTV can offer a block of sheet or rolled steel whenever its plants have excess capacity and inventories grow too large. Potential buyers then enter bids for the steel over two or three days, and the highest bid wins.

More recently, **buyer's auction** sites have emerged in a number of industries where qualified suppliers are invited to compete for a contract where the buyer has specified all the technical requirements and purchase criteria in detail, except the price. Because the buyer must be able to specify all its requirements before suppliers can submit firm bids, such auctions are likely to work best for purchases where the buyer has past experience to draw on and where those requirements are unlikely to change rapidly, as, for example, when Ford buys seats or bumpers for one of its current car models.

Most analysts believe that, in markets where they are appropriate, both kinds of Internet auctions will work to increase price competition. Whether that turns out to be the case or not, one thing is clear: To be profitable selling goods or services at auction a firm must work to hold its costs down relative to its competitors, and it must have an accurate understanding of what those costs are.

When selling excess inventory on a seller's auction site, for instance, the firm may be willing to accept a bid that is below its full cost as long as that bid covers variable costs and makes a contribution to fixed costs. This is particularly true if the product or service would otherwise go unsold and contribute nothing to cover fixed costs, as is the case with empty seats on an airline flight or empty hotel rooms on weekends. Nevertheless, the selling firm must know what its fixed and variable costs are with some certainty before it can decide whether a given bid will provide enough revenue to cover variable cost and therefore be worth accepting.

The critical question facing managers bidding for contracts on a buyer's auction site is, How low should we go? Winning too many contracts by bidding prices that are too low to cover costs and provide a reasonable return on invested capital is a good recipe for failure in the long run.

### 12.2.3 Customer-Oriented Methods

#### 12.2.3.1 Pricing to Capture the Value Perceived by the Customer

Perhaps the key concept in setting a price is the notion of *perceived value*. Whether the product offering is an industrial product or service that delivers primarily economic and functional benefits or a consumer item whose benefits are more psychological, potential customers usually have some idea of what constitutes a good or bad price. They develop such perceptions by comparing the prices being charged by a firm and its competitors to the benefits or value they think they can derive from purchasing the product or service. The essential purpose of the price level set by the marketing manager, then, should be to enable the firm to capture the value of the product as perceived in the mind of the customer.

While a firm's costs establish a minimum floor for long-term profitability, customers generally do not care what those costs are. The only thing important to them is the value they are likely to receive for the price they pay. Thus, one danger of cost-oriented (or even competition-oriented) pricing methods is that they can produce prices that are lower than perceived value, causing the firm to 'leave money on the table.' Such approaches might also result in prices that exceed many customers' perceptions of value, resulting in lost sales and competitive vulnerability.[13]

Of course, the perceived value of a given product offering can vary from customer to customer. When setting a price level within a strategic marketing programme, however, the manager should try to determine an 'average' perceived value for the customers in a particular target market segment. Such a determination typically requires research. Exhibit 12.6 summarises a variety of methods for calculating customer value, ranging from reverse-engineering methods aimed at estimating the economic benefits generated by the product's performance to more common survey research approaches for measuring customers' perceptions.

**Exhibit 12.6 Methods for estimating perceived customer value**

1. **Industrial engineering methods:**
   - Internal engineering assessment: Physical laboratory tests within the firm.
   - Field value-in-use assessments: Customer interviews determining economic benefits to using the product.
   - Indirect survey questions: Customer estimates of the effects of product changes on firm's operations used to infer the value of product attributes.
2. **Overall estimates of customer value:**
   - Focus group value assessment: Willingness-to-pay questions in a small group setting.
   - Direct survey questions: Willingness-to-pay questions in a survey format.
3. **Decomposition approaches:**
   - Conjoint analysis: A method for estimating customer trade-offs of product attributes.
   - Benchmarks: Customer indication of willingness to pay for incremental (or fewer) attributes that can be compared to an example from the product category.
4. **Compositional approach:** Direct customer questions about the value of product attributes.
5. **Importance ratings:** Customer rank ordering or rating of the importance of product attributes as well as comparisons between competitors.

*Source*: James C. Anderson, Dipak C. Jain and Pradeep K. Chintagunta, 'Customer Value Assessment in Business Markets: A State-of-Practice Study', *Journal of Business-to-Business Marketing*, 1 (1993), pp. 3–29.

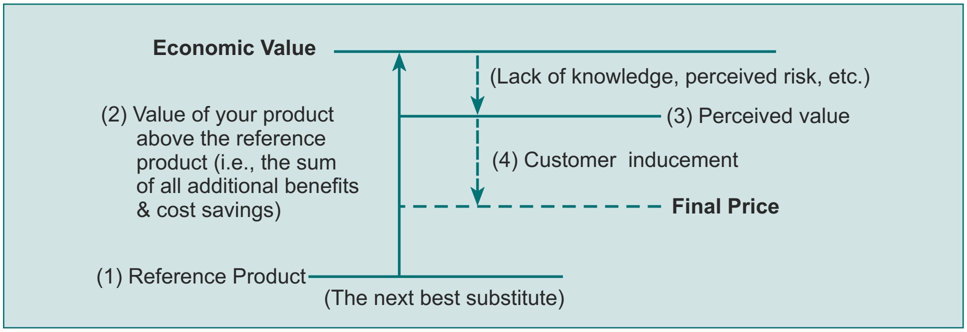
### 12.2.3.2 Estimating Customer Value by Assessing Value-in-Use

One of the most useful ways to estimate customer value, particularly for industrial products and consumer durables, is by assessing the product's **value-in-use**. The value-in-use assessment process begins with the selection of a reference product, usually the product the customer is currently using or a major competitor's product. The manager then calculates the incremental benefits to the customer – in monetary terms – of using his or her product instead of the reference product. These benefits may be the result of improved performance and additional features, or improved efficiency and reduced costs over the life cycle of product. In either case, the additional monetary value of the manager's product added to the price of the reference product [(1) + (2) in Exhibit 12.7] equals the **economic value** of the manager's product to the customer: the maximum amount the customer should be willing to pay, assuming that she is fully informed about the product and the offerings of competitors.

For example, suppose New Holland introduces a new farm tractor to compete with a particular John Deere model. The John Deere is priced at $25 000. However, field use trials indicate that the New Holland tractor will use on average $2000 less fuel over its 15-year productive life, and it has a more user-friendly hitch system that will save 100 hours of the farmer's time, worth (if we assume the farmer's time is valued at $20 an hour) another $2000. Finally, the New Holland comes with a superior air-conditioned cab and a Bose stereo system, which a survey of farmers suggests is worth another $1000 to potential buyers. Thus, if we add the additional cost savings and benefits provided by the New Holland model to the price of the reference product, we get $25 000 + $2000 + $2000 + $1000 = $30 000. This is the total economic value-in-use to the average farmer of the New Holland tractor.

Therefore, $30 000 is the maximum amount a farmer should be willing to pay for the new tractor, *assuming* that he or she has all the relevant information. But while providing such 'complete' information should obviously be the goal of New Holland's salesforce and promotional materials, it is unlikely such as state of complete information will usually exist. Therefore, the manager must anticipate some discounting on the customer's part due to lack of knowledge about the product's benefits, competitive offerings, the perceived risk of buying something new, and so on. Therefore, as indicated in Exhibit 12.7, the customer's actual *perceived* value of the New Holland tractor (3) is likely to be somewhat less than the tractor's actual economic value-in-use.

**Exhibit 12.7 The 'value-in-use' approach to determining a customer's perception of value**




The difference between the value perceived by the customer and the manufacturer's marginal cost defines the range of possible prices. Suppose, for instance, that a farmer perceives the New Holland tractor to be worth \$3000 more than the John Deere, or \$28 000, and that New Holland's marginal cost producing another tractor (including the dealer's margin, etc.) is \$20 000. New Holland's managers could set the price anywhere between those two figures.

From New Holland's perspective, it might seem desirable to set the price as close to the customer's perceived value as possible. The customer should be willing to pay such a price since the farmer would receive benefits equal to the cost. By capturing all of the incremental value the company has created, New Holland would fatten its profit margin and return on investment. However, there are sound strategic reasons for setting a price that shares at least some of the economic value with the customer [as indicated by (4) in Exhibit 12.7]. If New Holland's price is exactly equal to the perceived incremental value of the tractor in the customer's mind, then he or she will be indifferent between the two tractors; either tractor will leave the farmer equally well off after he pays for it. Therefore, passing some of the incremental value along to the customer in the form of a lower price provides an inducement to purchase the New Holland instead of the competing brand. Such inducements give the salesforce a strong argument to persuade potential purchasers. They also can be particularly important in achieving some strategic pricing objectives, such as when the firm is pursuing a penetration strategy to maximise sales growth.

### 12.2.3.3 Other Perceptual Pricing Issues

Often, a number of psychological factors can influence customers' perceptions of the relationship between a product's price and its value. Thus, many firms use such practices as customary pricing, price lining, psychological pricing, and promotional pricing. All of these are particularly popular in consumer nondurable product categories.[13]

In some product categories consumers expect a single **customary price** for the product. Candy bars, for example, sold for many years at a customary price of 10 cents. When increasing costs put pressure on manufacturers' margins, they elected to reduce the size of the bar rather than upset customers' expectations by raising the price.

**Price lining** is another common customer-oriented pricing practice, especially among retailers. It involves selling all products in a category at one of several predetermined 'price points' or levels. Each price line represents a different level of quality. For example, different brands of men's shirts in the same store might be priced at $29.95, $34.95, and $39.95. This practice helps customers make quality comparisons, assuming the price differences can be easily associated with differences in quality, including the number and type of features offered. It also simplifies pricing decisions for the retailer and guides the retail buyer in deciding which brands to stock.

In **psychological pricing** the firm takes advantage of the fact that many consumers use price as an indication of quality. For example, Heublein successfully repositioned its Popov brand of vodka by substantially raising its price. The 8 per cent price increase reduced the brand's market share by 1 per cent but produced a 30 per cent increase in profit.[14] Some perfumes are priced high to elevate their status as a gift.

Another common psychological pricing practice is called *odd pricing*. For instance, a product or service might be priced at $29.95 instead of $30.00, 19 cents instead of 20 cents, or $39 950 instead of $40 000. Odd prices convey the psychological impression of a lower price.[15] A final demand-oriented pricing practice is the use of **promotional pricing** to transmit a message about the product in conjunction with, or sometimes in lieu of, advertising or other forms of promotional activity. The most common form of promotional pricing is the familiar sale: the offer of a reduced price on the product for a limited time to encourage trial or increased purchasing.

## 12.3 Deciding on a Price Structure: Adapting Prices to Market Variations

Even though determining a product's price level is a complicated process, most firms do not stop with the selection of a single list price. Instead, the final step in the pricing process is usually to develop a **price structure** that adapts the price to variations in cost and demand across geographic territories, national boundaries, types of customers, and items within the product line.

### 12.3.1 Geographic Adjustments

Within a domestic market, firms with only one or a few plants must adjust prices for the variations in transportation costs of selling to customers in different parts of the country. One approach is called **FOB origin pricing**: The manufacturer places the goods 'free on board' a transportation carrier. At this point the title and responsibility passes to the customer, who pays the freight from the factory to the destination. Advocates argue that this is the fairest way to allocate freight charges: Each customer picks up its own costs. The disadvantage, though, is that the manufacturer may be at a cost disadvantage when trying to sell to customers in distant markets.

The opposite alternative is **freight absorption pricing**. Here the seller picks up all or part of the freight charges. New competitors trying to penetrate new markets and smaller competitors in maturing industries trying to increase their share sometimes use this approach. Their rationale is that if they can obtain more business, their average unit costs will fall enough to compensate for the high freight costs.

Most firms use a compromise approach to deal with variations in transportation costs. One method is **uniform delivered pricing**, where a standard freight charge – equal to the average freight cost across all customers – is assessed every customer, regardless of location. This lowers the overall cost to distant customers, but raises costs for customers near the company's plant. Nevertheless, the approach is popular because it is easy to administer and enables the firm to maintain a single nationally advertised price. **Zone pricing** is another compromise approach that falls between FOB and uniform delivered pricing. Here the company divides the country into two or more pricing zones. It charges all customers within the same zone the same delivered price, but a higher price is set for distant zones than for those closer to the plant.

### 12.3.2 Global Adjustments

Geographic adjustments become even more complicated when the geographic areas involve different countries. In addition to reflecting transportation costs, prices in different countries may also have to be adjusted for different exchange rates, variations in competition, market demand, or strategic objectives (volume growth versus profit generation), and different governmental tax policies or legal regulations.

In some cases, firms attempt to minimise such adjustments by adopting a highly standardised global pricing policy similar to an FOB origin policy in the domestic market. They charge the same price around the world and require each customer to absorb all freight and import duties. Such a policy has the obvious virtue of simplicity, but it fails to respond to variations in local demand or competitive conditions.

Other firms charge a transfer price to their various national branches or subsidiaries but then give local managers in each country wide latitude to charge their customers whatever price they think most appropriate. Although sensitive to variations in local conditions, such a policy may lead to arbitrage involving the transshipment of goods across countries when price differences exceed the freight-and-duty costs separating the markets. There is also the question of control and whether the strategic objectives of local managers are always consistent with the higher business and corporate objectives.

For all the above reasons, most firms follow an intermediate approach to global pricing.[16] Corporate management establishes an acceptable range of prices. Local country managers are then given the flexibility to select the price within that range that is best suited to local demand and competitive conditions, though their decisions are often subject to strategic review and approval by top management. Thus, a firm might allow local managers to set a high price in countries where the product has a strong competitive position and high perceived value, but demand lower penetration pricing in less-established markets.

#### 12.3.2.1 Countertrade

An additional pricing problem often arises when selling to customers in developing economies, which may lack sufficient hard currency to pay for their purchases. Such customers may offer items other than money as payment. While many companies dislike such deals, it is often in their best economic interest to facilitate them via a set of activities known as *countertrade*. For example, given the sharp devaluation of the Argentine peso and the resulting decline in new auto sales a few years ago, Toyota began bartering pickup trucks in Argentina for a trade-in and 44 tons of soybeans.[17] Countertrade can take a variety of forms, several of which are discussed in Exhibit 12.8.

**Exhibit 12.8 Global countertrade**

Countertrade, which occurs in international transactions where the potential customer lacks sufficient hard currency to pay for a purchase, can take a variety of forms. These include:

- **Barter.** Barter involves the direct exchange of goods with no money and no third party involved. For instance, a German firm might agree to build a steel plant in Mexico in exchange for a given amount of Mexican oil.
- **Compensation deals.** Here the seller agrees to take some percentage of the payment in cash and the rest in goods, as when Boeing sells aircraft to Brazil for 70 per cent cash and an agreed-upon number of tons of coffee.
- **Buyback arrangements.** Under such arrangements a seller offers a plant, equipment or technical expertise to a customer and agrees to accept as partial payment products manufactured with the equipment or training supplied. For example, a US chemical company built a plant for an Indian company in return for some cash and a volume of chemicals to be made in the plant.
- **Offsets.** The seller is compensated in cash but agrees to spend a substantial amount of that cash with the customer or its government over a stated time period. For instance, Pepsi sells its cola syrup to Russia for roubles and agrees to buy Russian vodka at a given rate for sale in the United States.

*Source*: Adapted from Stephen S. Cohen and John Zysman, 'Countertrade, Offsets, Barter and Buybacks', *California Management Review*, Winter 1986, pp. 41–56.

### 12.3.3 Discounts and Allowances

Firms relying on independent wholesalers and retailers to distribute their products must adjust their list prices to motivate and reward these firms to perform needed marketing activities.[18] We discuss programmes for gaining reseller support in more detail in the next module, but briefly describe price discounts and allowances – basic tools used in creating such programmes – in the next sections.

#### 12.3.3.1 Trade Discounts

To induce wholesalers and/or retailers to carry a product and perform their usual marketing activities in its support, manufacturers offer **trade** (or **functional**) **discounts** from the suggested retail list price. Such discounts vary, depending on the intermediary's wholesale or retail level in the channel and the specific activities they are expected to perform. A manufacturer who distributes stereo speakers through a channel of independent wholesale distributors and retailers, for instance, might have a suggested retail price of $100 for each speaker and a trade discount schedule of 50/15. The 50 represents the per cent discount from list price offered to retailers who carry the product. The 15 is the discount offered to the wholesaler. Thus, a retailer would pay $50 for each speaker ($100 - [.5 × $100]). The wholesaler would pay the manufacturer $42.50 ($50 - [.15 × $50]).

#### 12.3.3.2 Quantity Discounts

To encourage channel members, or even ultimate customers, to purchase more of the product, a manufacturer might offer a price reduction for ordering in large quantities. The **quantity discount** often increases as order size increases. For example, a firm might offer no additional discount on orders of 50 units or less, a 2 per cent discount off list on orders of 51 to 100 units, 4 per cent off on orders of 101 to 500 units, and 5 per cent off on orders of more than 500 units. To avoid charges of illegal price discrimination against smaller purchasers, the size of such discounts should be justified by the cost savings that manufacturers gain by filling larger orders. These savings include reductions in per-unit selling, order processing, transportation, and inventory carrying costs. In addition to cost savings, quantity discounts help move more inventory closer to the ultimate customer, thereby encouraging more impulse purchases and reducing the probability of stockouts occurring among wholesalers or retailers in the distribution system.

#### 12.3.3.3 Cash Discounts

A **cash discount** is a price reduction to encourage customers to pay their bills promptly. A common example of such a discount is ‘2/10, net 30.’ This means that payment in full is due within 30 days, but the buyer can deduct 2 per cent from the price if payment is made within 10 days. Such discounts help reduce the capital the seller has tied up in accounts receivable and lower collection costs and bad debts.

#### 12.3.3.4 Allowances

Allowances are similar to discounts in that they are inducements to encourage channel members or final customers to engage in specific behaviours in support of the product. One common example in consumer durable goods categories – particularly automobiles – is the **trade-in allowance**. This is essentially a price reduction granted to customers for turning in an old item when buying a new one. Such allowances help customers recoup the value from their used products and thereby encourage more frequent replacement purchases. **Promotional allowances** such as cooperative advertising programmes reward distributors or retailers for advertising the product at the local level. Other promotional allowances may induce retailers to devote more shelf space to the product or to encourage middlemen’s salespeople to provide more aggressive selling support.

#### 12.3.3.5 Price-Off Promotions

This is one of the simplest kinds of sales promotion since all that’s involved is a temporary reduction in the product’s price. A similar popular promotion increases the amount of product provided while holding the price constant – like Pepsi’s offer of 15 cans of soda for the normal price of a 12-pack. Price-off promotions may be the most effective way to boost sales temporarily; however, they suffer from several disadvantages. Often they only transfer future sales to the present as loyal customers stock up. Another problem is that competitors can easily copy them. Also, they may lead consumers to the notion that the product should be bought *only* below the suggested retail price when a promotional deal is offered.

#### 12.3.3.6 Coupons, Rebates and Refunds

The proportion of consumer promotion dollars devoted to **cents-off coupons** declined somewhat during the 1990s. As redemption rates fell to about 2 per cent and processing costs increased, many consumer goods manufacturers attempted to cut their couponing budgets and emphasise 'value pricing' or 'everyday low price' policies instead. Such actions were also motivated by other drawbacks of heavy reliance on coupons, including the potential for fraud – ranging from counterfeiting to misredemption by retailers – and the fact that it is difficult to gain a competitive advantage using such a ubiquitous tactic.

Nevertheless, couponing remains the dominant form of price-oriented promotion in the United States. Approximately 300 billion coupons are distributed each year, and a recent survey found that 100 per cent of manufacturers who sell consumer goods through supermarkets still devote at least some of their promotion dollars to coupons.[19]

What accounts for the continuing popularity of coupons? Coupons can be an effective way to target discounts to specific customer segments, particularly as information technology makes it possible for firms to collect more detailed information about customers. For instance, by combining a computer database of purchase histories with a direct mail programme, a marketer can direct coupons to the most price-sensitive households while maintaining higher regular prices for less price-oriented buyers.[20] Coupons are also useful for accomplishing specific strategic marketing objectives, such as motivating first-time buyers to try a product or encouraging the purchase of larger package sizes.

**Rebates** reduce the price of the product through a money refund offer. Such offers typically require the consumer to mail some proof of purchase to the manufacturer to receive the refund. In recent years rebates have been used extensively by producers of durable goods, including automobiles, major appliances, and cameras because they can move excess inventories quickly.

**Premiums** are attempts to attract buyers by offering a product or service free or at a substantially reduced price to encourage the purchase of another product. Premiums can be included in a package, sent by mail, or via another product (a free soft drink with the purchase of a pizza). Premiums can even be to some extent self-liquidating – as when the consumer sends in a package and 50 cents for a premium.

### 12.3.4 Differential Pricing

**Differential pricing** (also known as discriminatory pricing) occurs when a firm sells a product or service at two or more prices not determined by proportional differences in cost. This is usually done to adjust to differences in the price sensitivities or preferences of various customer segments. Prices may even vary on a customer-to-customer basis in organisational markets or consumer durable categories where the final price is determined through negotiation. For example, automobile retailers are noted for such pricing practices, although some manufacturers, such as Saturn, have moved toward a common list price with no bargaining.

Some common differential pricing adjustments targeted at particular customer segments include:

- *Time pricing*. Prices might be adjusted seasonally, across days of the week, or across hours of the day to capitalise on predictable fluctuations in demand over time. Movie theatres, for instance, often charge higher prices for evening shows than for early matinees, and hotels charge less for weekend occupancy.
- *Location pricing*. The same product or service might be priced differently at various retail locations to capitalise on local demand or the intensity of competition. Even within a single theatre, seats in some locations are typically more expensive because many theatre-goers are willing to pay more to sit near the stage.
- *Customer segment pricing*. Perhaps the most common differential pricing practice is to charge different prices to customer segments that vary in their willingness or ability to buy. Many arts organisations, for example, offer lower prices to senior citizens whose fixed incomes might otherwise prohibit their attendance.

#### 12.3.4.1 Conditions Allowing Differential Pricing

It is not always possible or wise to set different prices for essentially the same product. For such a differential pricing policy to work, first there must be identifiable customer segments with different price sensitivities. Second, the customer segments must either be physically separated from one another or the firm must institute control procedures to ensure that the segment paying the lower price cannot resell the product to customers paying the higher price. Obviously, too, the cost to the manufacturer of segmenting and monitoring the market should not exceed the extra revenue generated by the discriminatory pricing. And the firm should be confident that resentment among customers asked to pay the higher price, or competitive conditions in the market, will not leave it vulnerable to competitive attacks in the high-price segments. Consumer resentment is particularly likely if they are aware that different people pay different prices for what they perceive to be essentially the same product or service. Thus, the perceived unfairness of differential pricing can be offset by customising the product or service, differentiating the offerings sold for different processes, or communicating a social or economic rationale to justify the price differences (e.g., elderly customers get a lower price because they have limited incomes).[21]

#### 12.3.4.2 The Internet Facilitates Differential Pricing

As we have mentioned before, many analysts argue that the Internet will make product categories more price competitive. It is also making it easier to identify – and charge different prices to – customer segments with different price sensitivities. For instance, there are software programmes that let a Web-based seller examine the click-streams of visitors to its site. If the individual examines a number of alternatives without making a purchase, he or she might be identified as a high-involvement, price-sensitive shopper and therefore be offered lower prices.[22]

The Internet also enables firms, especially service firms, to do more differential pricing by allowing them to change prices quickly at different times of the day or week (i.e., time pricing) or in response to unused capacity, as when airlines make last-minute special fares available on their websites.

#### 12.3.4.3 Legal Considerations[23]

Price discrimination is not the legal issue in the US today that it was in the past. It is important to note, however, that the Robinson-Patman Act outlaws price discrimination among buyers of goods of 'like grade and quality' where the effect may be to 'injure, destroy, or prevent competition.' Because individual consumers buy goods and services for their own use and are not competing with one another, the law usually does not prevent discriminatory pricing of consumer goods at the retail level because there is no injury to competition. To legally offer different prices for the same product to retailers, distributors, or industrial buyers, the manufacturer must be sure that the buyers involved are not in direct competition, or that the difference in prices offered is justified by differences in the cost of doing business with the different buyers. This cost defence, for example, is the rationale for offering the quantity discounts mentioned in the preceding section. Because transportation and order processing costs are usually lower for large orders, firms can legally pass those cost savings on to the buyer as a discount or lower price.

In addition to price discrimination, the Sherman Act prohibits both horizontal and vertical price fixing. In the case of the former, competitors agree to maintain a given price. The latter involves an agreement between manufacturers and retailers to sell products at a certain price. The Miller Tyding Act (1937) was passed to permit such vertical price fixing, but in 1976, Congress passed the Consumer Goods Pricing Act, which made such pricing once more illegal. Predatory pricing is also illegal under the Sherman Act because it involves selling below cost to drive one or more competitors out of the market.

In addition to legal concerns, differential price adjustments can raise some ethical issues as well. One such issue concerns the inherent 'fairness' of charging higher prices to some customers simply because they are not very price sensitive.

### 12.3.5 Product-Line Pricing Adjustments

Pricing decisions become even more complicated when a firm produces a line of several models or styles that potential customers perceive as bearing some relationship to one another. In such cases, firms need to adjust the prices of various models to reflect customers' perceptions of their relative value. In theory, producers should determine the prices for all the products in the line simultaneously, taking into account not only the price elasticity of demand for each model, but also the cross-elasticities among them. A **cross-elasticity** is the percentage change in sales of one product induced by a 1 per cent change in the price of another product that is assumed to be a close substitute.

Because of the difficulties in estimating such cross-elasticities, however, firms seldom use this approach. About the best that managers can do is to price each item separately and then adjust those prices to reflect the likelihood that customers will trade up or down and will perceive the prices of the related items to be fair and reasonable. Since some products require the use of other products (razors and razor blades or printers and ink cartridges), the seller may price one product lower to stimulate the sale of the other.

Many companies offer optional features with their basic product. Automobile companies offer such extras as bigger engines, special tyres, sun roofs, higher-quality sound systems, and leather interiors – all for an extra cost. Luxury cars include most such features as standard equipment and many retailers use them as a way of bargaining with consumers. Such practices make it difficult to price these options in any realistic way. A somewhat similar situation exists when firms sell a basic service for a fixed amount and then charge an additional amount based on the extent of usage (telephone companies and their long-distance charges).

Sellers often **bundle** the various items in their product line and sell the bundle at a price less than the total of the items if priced separately (McDonald's meals for children, season subscriptions to concerts, option packages offered by car companies). Since some customers may not want the bundle, provision must be made to allow purchase of individual items.

## Learning Summary

- Pricing decisions involve an inherent conflict between (1) the need to win customers by allowing them to retain a portion of the value inherent in a product or service and (2) the need to maintain profit margins sufficient to compensate employees, fund growth, and satisfy the firm's various stakeholders.
- The price of a good or service must be high enough to cover per unit costs – at least in the long term – but cannot exceed its value as perceived by the customer. Therefore, the region between unit cost and perceived value represents the range of feasible prices.
- The decision about what price to select from within the range of feasible prices should be based on a careful analysis of competitors' costs and prices, the product's strategic objectives, and consistency with other components of the marketing plan.
- Perhaps the key concept in setting a price is the notion of perceived value. An essential purpose of the price set by a marketing manager should be to enable the firm to capture a fair share of the value of the product as perceived in the mind of the customer.
- The final step in deciding what price to charge for a product or service involves the development of a price structure that adapts the price to variations in cost

and demand across geographic territories, national boundaries, customer segments, and items within the product line.

# Review Questions

## Content Questions

12.1 Why has price become a more important part of a firm's marketing strategy in recent years?

12.2 Why is price an area in which managers feel the most pressure to perform yet the least certain they are doing a good job?

12.3 What are the steps in the price-setting decision process?

12.4 Under what conditions is penetration pricing appropriate?

12.5 Describe a skimming price policy.

12.6 Describe a harvesting price strategy.

12.7 What are the major factors affecting a customer's sensitivity to price?

12.8 Define the term 'elasticity of demand'.

12.9 What is the formula for calculating the price elasticity of demand for a product or service?

12.10 What are the major problems in using this formula?

12.11 What are the more common ways of estimating a product's demand curve?

12.12 How can competitors' costs and prices be estimated?

12.13 Describe (using an example) cost-plus or markup pricing, rate-of-return or target return pricing and break-even pricing.

12.14 Describe the various competition-oriented pricing methods.

12.15 Describe the various customer-oriented pricing methods.

12.16 Define the following terms:

a. FOB origin pricing.
b. freight absorption pricing.
c. zone pricing.

12.17 Describe the various forms countertrade can take.

12.18 Define trade or functional discounts, quantity discounts, cooperative advertising, allowances and rebates.

12.19 What conditions allow for differential pricing?

## Multiple Choice Questions

12.20 A firm's price floor is most directly affected by:

A. price sensitivity of demand.
B. competitors' prices and costs.
C. product costs.
D. prices of substitute products.
E. business and marketing strategy.

12.21 A survival pricing strategy would probably be used when the firm is:

A. pursuing a differentiated defender strategy.
B. in a weak competitive position relative to other competitors.
C. seeking to reach several segments that need the product but are unable to pay full costs.
D. an early entrant to the market.
E. pursuing a prospector strategy.

12.22 A firm following a harvesting strategy would set a price that is:

A. relatively low, only slightly above costs.
B. high relative to that of its competitors.
C. very high, to appeal to only the most price-insensitive customers.
D. relatively high, to maintain margins and maximise profits.
E. lower, to maintain a presence in the market.

12.23 A premium price policy is especially appropriate when the firm is following a _____ strategy.

A. prospector.
B. low-cost analyser.
C. differentiated defender.
D. low-cost defender.
E. differentiated analyser.

12.24 The demand curve depicts the relationship between:

A. profitability and sales.
B. product costs and price.
C. long-term pricing objectives and short-term price fluctuations.
D. price and profitability.
E. price and sales.

12.25 When museums offer lower prices to disadvantaged youth this illustrates which pricing objective?

A. Maintain quality or service differentiation.
B. Prestige.
C. Social.
D. Harvesting.
E. Survival.

12.26 When the St Louis Symphony, a nonprofit organisation, gives a lower price to college students it may be pursuing a ____, the cost of which is borne by ____.

A. social pricing policy; other contributors.
B. survival pricing policy; the local government.
C. survival pricing policy; individual patrons.
D. prestige pricing policy; the local government.
E. prestige pricing policy; other contributors.

12.27 Buyers of BMW cars perceive such cars as higher in quality and more prestigious than other cars and are willing to pay more for these cars. This is an example of the ____ effect.

A. unique-value.
B. price-quality.
C. substitute-awareness.
D. difficult-comparison.
E. end-benefit.

12.28 Which of the factors that affect customers' sensitivity to price is a restaurant in a Hawaiian hotel using when it charges its hotel guests premium prices for food because it assumes that they are unaware of lower-priced restaurants in the area?

A. Shared-cost effect.
B. Sunk-investment effect.
C. Substitute-awareness effect.
D. Unique-value effect.
E. End-benefit effect.

12.29 Which of the factors which affect customers' sensitivity to price is a car dealer using when it charges a premium price for a car stereo which is installed in a luxury sedan?

A. Shared-cost effect.
B. Substitute-awareness effect.
C. Inventory effect.
D. End-benefit effect.
E. Unique-value effect.

12.30 According to the price elasticity of demand, the _____ the proportion of price-sensitive customers in a product's market, the _____ sensitive overall demand is to a change in the price of the product.

A. larger; more.
B. larger; less.
C. smaller; more.
D. smaller; less.
E. None of the above.

12.31 If a company institutes a 3 per cent price decrease and the result is a 6 per cent increase in the quantity demanded, what is the price elasticity of demand for the product?

A. − 2.
B. + 2.
C. − 0.5.
D. + 0.5.
E. + 0.75.

12.32 One way that firms can estimate the demand curve for their offerings is by asking potential customers to _____.

A. take a sum of money provided by the researcher and monitoring their purchases.
B. tell the researchers how many units they would buy at different prices.
C. provide price elasticity information.
D. describe the effect that price has on their purchases of similar items.
E. meet with groups of their friends and discuss their sensitivities to prices.

12.33 When production workers identify better, more efficient ways of producing the product, the firm is taking advantage of:

A. economies of scale in the short term.
B. the experience curve.
C. economies of scale in the long term.
D. the efficiency curve.
E. the production curve.

12.34 If unit production costs vary with the quantity produced, _____ reflect(s) savings from higher levels of asset utilisation while _____ reflect(s) savings from other factors at a given level of asset utilisation.

A. economies of scale; economies of scope.
B. economies of scale; experience curves.
C. economies of scope; economies of scale.
D. experience curves; economies of scale.
E. experience curves; economies of scope.

12.35 If General Motors Corporation prices its new cars so that it plans to achieve a 15 per cent return on its investment in these cars at that price, which type of pricing policy is it using?

A. Odd pricing.
B. Price lining.
C. Functional pricing.
D. Prestige pricing.
E. Target return pricing.

12.36 Target return pricing adds one critical element to the pricing equation over markup pricing. What is this additional cost element?

A. The price sensitivity of demand.
B. An evaluation of competitors' prices.
C. The cost of all marketing functions.
D. The markup of other channel members.
E. The capital invested.

12.37 What is the break-even volume (in units) if the fixed costs of the product are $1 million, the price of the product is $50 and variable costs are $25 per unit?

A. 70 000.
B. 60 000.
C. 50 000.
D. 40 000.
E. None of the above.

12.38 Target return pricing is similar to _____, except that it takes into account the firm's _____.

A. break-even analysis; cost of capital.
B. cost-plus pricing; cost of capital.
C. markup pricing; fixed costs.
D. markup pricing; expected sales volume.
E. break-even analysis; expected sales volume.

12.39 In an industry where competitive parity is the prevailing pricing approach, a product's price _____ unless a price leader _____ it.

A. is usually stable; lowers.
B. usually tends to go down; raises.
C. usually tends to go up; lowers.
D. is usually stable; raises.
E. is usually stable; changes.

12.40 If Sears prices its small home appliances so that models are offered at four different price points, what type of pricing policy is it using?

A. Price lining.
B. Prestige pricing.
C. Odd pricing.
D. Standard pricing.
E. Competitive parity pricing.

12.41 In FOB origin pricing:

A. the company pays all freight charges.
B. a standard freight charge equal to the average freight cost to all customers is made to each customer.
C. a series of zones is identified across the country, and each customer in a particular zone is charged the same price.
D. the company and the customer split the freight charges equally.
E. the customer pays all freight charges.

12.42 Trade discounts are _____ to channel members designed to compensate them for _____.

A. inducements; buying.
B. inducements; selling.
C. inducements; performing their usual marketing activities.
D. allowances; paying their bill on time.
E. allowance; unusable products.

12.43 If PepsiCo sells its cola syrup to Russia for roubles and agrees to buy Russian vodka at a given rate for resale in the USA, what type of countertrade agreement does this represent?

A. Barter.
B. Buyback arrangement.
C. Offset agreement.
D. Compensation deal.
E. Currency exchange rate.

12.44 Suppose that a manufacturer who distributes a product through independent wholesalers and retailers has a suggested retail selling price of $50 for his product and a trade discount schedule of 40/10. What is the selling price of this manufacturer to the wholesalers?

A. $23.
B. $27.
C. $31.
D. $35.
E. None of the above.

12.45 _____ gives cents off on products, _____ reduces the product price through a money refund offer, and _____ offers a product for free or for a substantially reduced price.

A. Rebates; coupons; premiums.
B. Rebates; premiums; coupons.
C. Coupons; rebates; premiums.
D. Coupons; premiums; rebates.
E. Premiums; coupons; rebates.

12.46 Differential pricing involves a firm selling the same product at _____ to take advantage of different market segment's _____.

A. multiple prices; price sensitivities.
B. a higher than normal price; naiveté.
C. a higher than normal price; price elasticity's.
D. multiple prices; price expectancies.
E. a lower than normal price; price insensitivities.

12.47 What type of pricing method is McDonald's practising when it sells Happy Meals at a price less than the total of the items if priced separately?

A. Differential pricing.
B. Quantity pricing.
C. Price lining.
D. Bundling.
E. Promotional pricing.

## Application Questions and Cases

12.48 How does value pricing differ from traditional pricing? If a firm wanted to adopt a value pricing strategy for its line of packaged consumer household products, how should it proceed to do so? In your answer, be sure to consider the reactions of retailers.

12.49 Under which market and competitive conditions are each of the following *pricing objectives* most appropriate for a business to consider?

a. Maximise sales growth through penetration pricing.
b. Maximise current profit through skimming pricing.
c. Maximise current profit through harvesting.

12.50 Firms sometimes set a low price in a new product-market (penetration pricing) to discourage potential competitors from entering the market. Can you think of any circumstances where a company might deliberately want to attract competitors to a new market and set a high price to help accomplish such an objective?

12.51 What is *price elasticity*? Distinguish between price-elastic demand and price-inelastic demand. What are the pricing implications of each type of elasticity?

12.52 The demand curve sums the reactions of many potential buyers to the alternative prices that might be charged for a product. What are the more important factors affecting a customer's price sensitivity? How can a firm go about estimating the demand curve for each of their major products?

12.53 Suppose executives estimate that the unit variable cost for their firm's videocassette recorder (VCR) is $100, the fixed cost related to the product is $5 million annually and the company's estimated sales volume for next year is 100 000 VCRs. The firm has a target rate of return of 20 per cent and it has made capital investments totalling $4 million to produce and distribute its VCRs. What price will the firm have to obtain for each VCR to achieve its target rate of return?

12.54 The manufacturer of VCRs described in Question 12.53 sells its VCRs through electronics wholesalers, who in turn sell to retail stores. The manufacturer's *trade discount* policy is 40/20. What should the suggested retail price for the firm's VCRs be? How much should the retailer have to pay for each VCR?

12.55 Tennant Company manufactures cleaning equipment for commercial applications. Its walk-behind electric floor waxer/buffer is priced at $350. The product's unit variable cost is $200 and total fixed costs associated with the product are $3 million. How many units must Tennant sell to reach *break even*? How would the break-even volume change if the firm reduced the price of the product by $50?

12.56 A uniform manufacturer in North Carolina operates at a freight-cost disadvantage relative to competitors in the western United States. Which methods of quoting prices could the firm adopt to make it more competitive in the western states? What are the possible disadvantages of each method?

12.57 Manufacturer A has experienced cost increases for its product in recent months. It would like to initiate a price increase, but only if its major competitors are likely to follow A's lead with price increases of their own. Which characteristics of Manufacturer A and which market and competitive conditions, are most likely to encourage A's competitors to follow its lead in increasing prices?

12.58 Ford Motor Company offers a number of car models in different price ranges. In addition to the usual cost and demand considerations, what other factors should the company consider when determining the relative prices for various products in its line?

12.59 Some companies are using the Internet to sell their products – both new and old. How could the Internet be used to develop a demand curve for a new product? An established product?

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# Module 13

# Distribution Channel Decisions

## Contents



## Changing Global Retail Trends Send a 'Get Well' Greeting to Hallmark[1]

Hallmark Cards, the privately held greeting card company in Kansas City, Missouri, enjoyed steadily increasing revenues and profits from its founding in the early 1900s through the mid-1990s. But then things started going wrong. By 1995 the firm's revenues had sagged by nearly half a billion dollars from their previous peak, and its share of the domestic US greeting card market slipped below 50 per cent for the first time in decades.

Part of the problem was that Hallmark's cards and other merchandise began to look somewhat staid and dated next to hipper upstarts, such as Recycled Paper Greetings and Blue Mountain Arts (www.bluemountain.com). The firm was also slow to pursue expansion into other countries in Europe, Asia, and South America. But Hallmark's biggest challenge came from a change in customer buying patterns that favoured mass merchandisers – and eventually the Internet – over the 9000 speciality card stores the firm historically relied on to sell its products. While speciality shops once accounted for more than 65 per cent of Hallmark's sales, their share had slipped below 30 per cent by the mid-1990s, reflecting a trend occurring throughout the card industry.

The firm responded to its falling revenues and market share by first attempting to jazz up its product offerings. It formed cross-functional product teams and gave them greater creative control over the more than 20000 card designs in 30 languages the company produces every year. It also created new product lines targeted at different ethnic and religious subcultures, such as cards for Hispanics, African-Americans, and Jewish religious holidays.

Hallmark also increased its presence in global markets, largely through the acquisition of domestic greeting card companies and by allocating substantial resources to product development, advertising, and promotion campaigns tailored to different countries. For instance, Hallmark launched a £3 million campaign in 2002 aimed at raising its profile and establishing it as the leading greeting card brand in the UK.

The firm's most vexing issue, however, was what to do with the thousands of independently owned Hallmark card shops now that discounters, supermarkets, and drugstores dominate the card market. Historically, those speciality shops agreed to carry mostly Hallmark merchandise in exchange for use of the Hallmark name, merchandising support, and designation as the primary outlet for the firm's products. The company's close relationship with those shops helped protect its brand's top-quality image.

Nevertheless, in recent years the firm has signed agreements with a number of large drugstore, supermarket, and discount chains – such as Target and Tesco – to carry the Hallmark line. As a result, there are now more than 22 000 mass-merchandise retail outlets selling Hallmark cards in the US, and many more in Europe and elsewhere. The company also began marketing a specialised line of cards directly to businesses and organisations through its Business Expressions unit. It opened a website (www.hallmark.com) where customers can purchase cards, gifts, flowers, and related merchandise or select and send e-cards over the Internet. And more recently the firm has been collaborating with Sony Ericsson to develop content that takes advantage of new mobile phone technologies such as MMS. Branded as Hallmark Hiya, the new content includes iMode greetings and screensavers in Japan, Germany and the Netherlands, and picture messages and logos in the UK and Southeast Asia.

All these actions went against decades of Hallmark culture and initially elicited howls of protest from the company's speciality retailers. In an attempt to resolve this conflict and retain the active support of its traditional retailers, Hallmark created a second brand, Expressions from Hallmark, that was offered exclusively through discount stores, while reserving its top-of-the-line products primarily for speciality shops. It also launched a $175 million advertising campaign promoting its Gold Crown retail affiliates, began a customer loyalty programme through which customers earn discounts and awards for purchases made in Gold Crown stores, and included a store locator on the company website.

Finally, Hallmark spent $30 million to develop a wholesale marketplace – www.ebizmix.com – where its retailers can purchase 70 000 different items ranging from candy to stuffed animals to stock their shelves. In addition to giving retailers quick access to a variety of suppliers who have agreed to offer discounts of up to 10 per cent to members, the site also provides industry news and merchandising tips. 'We figure we can immediately improve a retailer's bottom line by 10 to 15 per cent,' says Mark Ciaramitaro, sales and marketing chief for MIX, Inc., which handles the day-to-day operation of ebizmix.com on Hallmark's behalf. That fact has made the firm's longtime retailers much happier with its decision to distribute its cards in many new and different ways.

## Learning Objectives

This module examines both the channel design and channel management decisions a marketer faces.[2] The module begins by discussing the economic rationale for having multiple institutions involved in distributing a given product or service. Why are channels involving networks of many independent firms often more efficient and effective than distributing things directly from the producer to the consumer?

Next, the module discusses the various marketing objectives a distribution channel might be designed to accomplish. Also examined are some alternative channel designs for both consumer and organisational goods and services, including the various types of institutions and the numbers of those institutions that might be included in a distribution channel given different objectives and strategic circumstances.

Finally, the module examines the major issues involved in managing an existing channel, starting with various legal mechanisms, such as vertical integration and franchising, that some firms employ to control channel activities. However, because most channel systems consist of networks of legally independent firms, most attention is given to examining the incentives that can be used to motivate those firms to act in concert with the manufacturer's marketing programme. The module concludes with a discussion of channel conflicts and the strategies firms employ to resolve them.

# 13.1 Why Do Multi-firm Marketing Channels Exist?

As noted earlier, someone must perform a number of marketing functions or activities before a producer and a customer can exchange goods or services – transportation and storage; communication of information via advertising, personal selling, and sales promotion; feedback (marketing research); financing; and such services as installation and repair. Sometimes the customer performs most of the marketing activities in an exchange, as when a family takes a drive through the country to buy vegetables at a farmer's roadside stand. In other cases, a producer may distribute goods or services directly to end users, for example, through mail-order catalogues or the Internet. Most goods are, however, distributed through systems consisting of a variety of middlemen such as retailers, wholesalers, and agents. Thus, a **marketing channel** is

> the set of interdependent organisations involved in the process of making product or service available for consumption or use by consumers or industrial users.[3]

Many services are distributed through marketing channels, too. Due to their intangible nature, services often do not require the physical distribution activities, such as transportation and storage, that are necessary for goods. Nevertheless, many marketing activities are still necessary to facilitate exchanges with service customers, such as communicating information, customising the service to a particular customer's needs, personal selling, and financing. Many of these activities are performed by independent middlemen; sometimes by franchised retailers such as McDonald's fast-food outlets and in other cases by agent middlemen like insurance agents, travel agents, or stockbrokers.

The rationale for marketing channels lies in the trade-off between costs and benefits. Performing the marketing activities costs money, which is reflected in the final selling price of the product or service. Such costs vary widely across products and customers, but are often substantial – on average about 50 per cent of the retail price of most consumer package goods with about half that being the retailer's margin. The rest consists of the marketing expenses of the manufacturer and wholesale middlemen. Although the marketing costs for many industrial goods such as sheet steel or basic chemicals tend to be considerably lower since they are sold in large quantities to a smaller number of regular customers, they still account for 10 to 15 per cent of the final selling price.

**Exhibit 13.1 Ways by which using middlemen improves market efficiency**

- **Functional efficiency**: Middlemen can often perform one or more marketing activities more efficiently than manufacturers or their customers because of their specialisation and greater economies of scale. For example, they can spread costs across different manufacturers and thus perform the selling function at a lower cost.
- **Scale efficiency**: By purchasing goods in large quantities, storing them and then breaking them down into the smaller quantities their customers prefer, middlemen enable manufacturers and their customers to operate more efficiently. Rather than having to make small production runs to fill the orders of individual customers, manufacturers can achieve the economies of large-scale production. And their customers can buy smaller quantities without having their capital tied up in large inventories.
- **Transactional efficiency**: Through their various activities, wholesalers and retailers make it possible for customers to acquire wide assortments of products from a single source with one transaction. This reduces the time and effort that businesses and consumers expend in finding and purchasing the goods they need.

Would consumers be better off buying directly from the manufacturer and bypassing channel intermediaries? Usually not. It's a classic marketing truth that although middlemen can be eliminated, someone must still perform the marketing functions. Middlemen often perform the needed functions at a lower cost than either the customer or the manufacturer could by themselves. This is particularly true when a product must be distributed to large numbers of geographically dispersed customers. *See* Exhibit 13.1 for a discussion of the various ways marketing efficiency can be improved using middlemen.

However, not all middlemen perform a full range of marketing functions, nor are they equally efficient or effective. Therefore, the first step in designing a distribution channel for a given product is to determine what objectives the channel must accomplish and their relative importance.

## 13.2 Designing Distribution Channels: What Are the Objectives to Be Accomplished?

Managers can design distribution channels to accomplish one or more of the following objectives: (1) increase the availability of the good or service to potential customers, (2) satisfy customer requirements by providing high levels of service, (3) ensure promotional effort, (4) obtain timely and detailed market information, (5) increase cost-effectiveness, and (6) maintain flexibility. As summarised in Exhibit 13.2, the achievement of each of these objectives can be measured and thus can be used to evaluate the performance of a particular channel. However, there are trade-offs among these various objectives, and they are not all equally relevant for all types of products or market circumstances. Consequently, we briefly discuss in the following sections each of these objectives and the conditions where each might be given greater emphasis.

**Exhibit 13.2 Distribution channel objectives and measurement criteria**

| Performance objective | Possible measures | Applicable products and channel level |
|---|---|---|
| *Product availability:* | | |
| • Coverage of relevant retailers | • Percentage of all commodity volume (ACV) | • Consumer products (particularly convenience goods) at retail level |
| • In-store positioning | • Percentage of shelf facings or display space gained by product, weighted by importance of store | • Consumer products at retail level |
| • Coverage of geographic markets | • Frequency of sales calls by customer type; average delivery time | • Industrial products; consumer goods at wholesale level |
| *Meeting customer service requirements:* | | |
| • Installation, training, repair, reliability, order cycle time, etc. | • Number of service technicians receiving technical training; monitoring of customer complaints; customer satisfaction level. | • Industrial products, particularly those involving high technology; consumer durables at retail level; consumer and commercial services |
| *Promotional effort:* | | |
| • Effective point-of-purchase (P-O-P) promotion | • Percentage of stores using special displays and P-O-P materials, weighted by importance of store | • Consumer products at retail level |
| • Effective personal selling support | • Percentage of salespeople's time devoted to product; number of salespeople receiving training on product's characteristics and applications | • Industrial products: consumer durables at all channel levels: consumer convenience goods at wholesale level |

| Performance objective | Possible measures | Applicable products and channel level |
|---|---|---|
| *Market information:* | | |
| • Monitoring sales trends, inventory levels, competitors' actions | • Quality and timeliness of information obtained | • All levels of distribution |
| *Cost effectiveness:* | | |
| • Cost of channel functions relative to sales volume | • Middlemen margins and marketing costs as percentage of sales | • All levels of distribution |
| *Flexibility:* | | |
| • Ability to switch to new channels or types of middlemen as conditions change | • Amount of specialised assets or dedicated investments devoted to current channel | • All levels of distribution; product or service categories experiencing rapid market development or technological change |
| | • Number of long-term legal commitments to current channel members | |

## 13.2.1 Product Availability

The most important objective for any distribution channel is to make the product conveniently available for customers who want to buy it. For consumer goods, two aspects of availability must be considered. The first is to attain the desired level of coverage in terms of appropriate retail outlets. Because retailers differ in their sales volume, manufacturers need to weight the relative importance of each retailer on the basis of its per cent of sales within the product category in question. The resulting figure is referred to as the per cent of **all commodity volume (ACV)**. For example, a packaged food item may be carried by only 40 per cent of an area's food stores. But it may have 70 per cent ACV because it is handled primarily by supermarkets accounting for a large proportion of the total sales of such products. The second important aspect of availability for consumer products is the item's positioning within the store. One way to measure performance here is the percentage of available shelf or display space devoted to the brand, weighted by the importance of the store.

For industrial products – and for assessing channel performance at the wholesale level for consumer products – the relevant issue of availability is whether the industrial customer or retailer has the opportunity to place an order and obtain the product when it is needed. This is a question of the adequacy of market coverage. Firms can assess coverage by measuring how often customers in a territory are called on by company or distributor salespeople *and* by the time required to fill and deliver an order (i.e., order cycle time). Cycle time measures are particularly relevant when dealers are able to purchase their requirements directly from a firm's website, or when they are linked to a manufacturer via an electronic reorder system.

Product availability is an important objective for all distribution channels. The appropriate *degree* of availability varies with the characteristics of the product and the target customers, particularly the product's importance to those customers and the amount of time and effort they will expend to obtain it. For example, consumer convenience goods, such as packaged foods and health products, demand immediate availability since most customers are unwilling to devote much effort to obtaining a particular brand. At the other extreme, immediate availability is less critical for unique and important products such as consumer speciality goods or major industrial equipment and installations.

Market and competitive factors also influence a firm's *ability* to achieve a desired level of availability for its product. When demand is limited or when the brand holds a small relative share of the total market, wholesalers or retailers willing to carry it may be difficult to find. The firm may have to offer extra incentives and inducements to achieve an adequate level of product availability. Also, as we'll discuss in more detail later, firms can enhance at least some aspects of availability through effective use of the Internet.

### 13.2.2 Meeting Customers' Service Requirements

A second channel objective, which is closely related to availability but broader in scope, is to achieve and maintain some target level of satisfaction in meeting the service requirements of target customers. This tends to be a particularly crucial objective for analyser and defender businesses attempting to differentiate themselves from competitors on one or more service dimensions. Some service requirements that might be targeted for consumers, industrial end users, or other members of the distribution channel (e.g., the firm's 'intermediate customers' such as distributors or retailers) include:

1. **Order cycle time**, which refers to how long it takes the manufacturer to receive, process, and deliver an order.
2. **Dependability**, which relates to the consistency/reliability of delivery. This is probably the most important element of distribution service, especially for those using just-in-time delivery systems.
3. **Communication** between buyer and seller, which enables both parties to resolve problems at an early stage.
4. **Convenience**, meaning that the system is sufficiently flexible to accommodate the special needs of different customers.
5. **Postsale services**, which help the customer attain full benefits over the life of the product. Such service might include installation, user training, help lines to resolve technical glitches, repair, and spare parts availability. Such services can be particularly important in the distribution of consumer durable goods and technically complex industrial products, like computer systems, major software applications, manufacturing machinery, and the like.

Monitoring customer complaints, and the ongoing measurement of customer (or channel member) satisfaction, retention, and loyalty levels are all appropriate measures of whether the firm is meeting its customer service targets. Monitoring customer complaints can also provide useful guidance for improving a firm's product and service quality levels in the future. For example, Dell Computer monitors blogs criticising the firm's products or service and attempts to correct the problems discussed. The company also started Idea-Storm where customers offered more than 8500 suggestions for improvement in the first year, voted on those suggestions 600 000 times, and left 64 000 comments. More than a dozen of those ideas have been implemented so far.[4]

## 13.2.3 Promotional Effort

Another common channel objective is to obtain strong promotional support from channel members for the firm's product, including the use of local media, in-store displays, and cooperation in special promotion events. Gaining broad retailer support for in-store promotions is particularly important for low-involvement, convenience goods.[5] Both the amount and quality of personal selling effort that channel members devote to particular products can be critical. Strong selling support is particularly important when (1) firms are marketing technically complex and expensive consumer durables or industrial goods, (2) the market is highly competitive, or (3) a differentiated defender is trying to sustain a competitive advantage based on superior product quality or customer service.

## 13.2.4 Market Information

Because of their proximity to the marketplace, middlemen are often relied on for fast and accurate feedback of information about such things as sales trends, inventory levels, and competitors' actions. A high level of channel feedback is particularly important for firms in highly competitive industries characterised by rapid changes in product technology or customer preferences, such as the computer and fashion industries. Feedback is crucial for firms pursuing prospector business strategies since they depend on the early identification of new product and market development opportunities for their success.

## 13.2.5 Cost-Effectiveness

Channels must be designed to minimise the costs necessary to attain the firm's channel objectives. The cost-effectiveness of the distribution channel is of particular concern to businesses pursuing low-cost analyser or defender strategies. However, there is often a trade-off between channel costs, particularly those associated with physical distribution activities such as transportation and inventory storage, and achieving high levels of performance on many of the other objectives we have examined, such as product availability and meeting customer service requirements. We will examine these trade-offs in more detail when we examine the pros and cons of alternative channel designs.

## 13.2.6 Flexibility

As Hallmark discovered, well-entrenched channels where the members have long-standing commitments or substantial mutual investments can be hard to change in response to shifting market or competitive conditions. Consequently, some firms, particularly those pursuing prospector strategies in new or rapidly growing or technically turbulent product categories, consider channel flexibility an important goal. A flexible channel is one where it is relatively easy to switch channel structures or add new types of middlemen (discount retailers and a direct-sales website in

Hallmark's case) without generating costly economic or legal conflicts with existing channel members.

## 13.3 Designing Distribution Channels: What Kinds of Institutions Might Be Included?

There are four broad categories of institutions that a manager might decide to include in the distribution channel: merchant wholesalers, agent middlemen, retailers, and facilitating agencies. Each of these categories is defined in Exhibit 13.3 and discussed below.

### 13.3.1 Merchant Wholesalers

Some types of merchant wholesalers engage in a full range of wholesaling functions while others specialise in only limited services. But both buy goods from various suppliers (that is, they take title) and then resell those goods to their commercial customers, either industrial buyers or other resellers such as a retailer. They are compensated by the margin between the price they pay and the price they receive for the goods they carry. Approximately 400 000 merchant wholesalers are operating in the United States, including sales branches maintained by manufacturing firms.[6]

### 13.3.2 Agent Middlemen

The primary role of agent middlemen is to represent other organisations in the sale or purchase of goods or services. Agents do not take title to, or physical possession of, the goods they deal in. Instead, they specialise in either the buying or selling function. There are about 45 000 agent middlemen in the United States, of which manufacturer's agents and sales agents are the two major types used by producers.[7]

**Exhibit 13.3 Institutions found in marketing channels**

| Institution | Definition |
|---|---|
| Merchant wholesalers | Take title to the goods they handle; sell primarily to other resellers (e.g. retailers), industrial and commercial customers rather than to individual customers. |
| Agent middlemen | Include manufacturer's representatives and brokers. Also sell to other resellers and industrial or commercial customers, but do not take title to the goods. Usually specialise in the selling function and represent client manufacturers on a commission basis. |
| Retailers | Sell goods and services directly to ultimate consumers for their personal, nonbusiness use. Usually take title to goods they handle; are compensated by the margin between the price they pay for those goods and the price they receive from their customers. |

| Institution | Definition |
|---|---|
| Facilitating agencies | Include advertising agencies, marketing research firms, collection agencies, trucking firms and railways; specialise in one or more marketing functions; work on a fee-for-service basis to help clients perform those functions more effectively and efficiently. |

*Note*: Terms such as *distributor* and *jobber* refer to wholesalers – especially those handling industrial goods. The term *dealer* may refer to either a wholesaler or a retailer.

*Source*: Adapted from Louis W. Stern and Adel I. El-Ansary, *Marketing Channels* (Englewood Cliffs, NJ: Prentice Hall, 1992), p. 11.

#### 13.3.2.1 Manufacturer's Agents or Manufacturer's Reps

These usually work for several manufacturers, carry noncompetitive, complementary merchandise in an exclusive territory, and concentrate only on the selling function. They are important where a manufacturer's sales are not sufficient to support a company salesperson in a particular territory. Manufacturer's reps are common in the industrial equipment, automotive supply, footwear, and toy industries.

#### 13.3.2.2 Sales Agents

In contrast, **sales agents** usually represent only one manufacturer and are responsible for the full range of marketing activities needed by that producer. Because they have a wider range of responsibilities, their commissions are much larger than those of manufacturer's reps. Sales agents are used primarily by small firms or start-ups that have limited marketing capabilities. They are particularly common in the electronics, apparel, and home furnishing industries.

#### 13.3.2.3 Brokers

These are independent firms whose purpose is to bring buyers and sellers together for an exchange. Unlike agents, brokers usually have no continuing relationship with a particular buyer or seller. The producers of seasonal products such as fruits and vegetables and the real estate industry use brokers extensively.

#### 13.3.2.4 E-Hubs[8]

These emerging forms of business-to-business Internet sites serve the same major function as brokers; they help bring potential buyers and sellers together for an exchange. Also like a broker, the e-hub is usually compensated by commissions from one or both parties.

Some hubs focus on broad product categories of frequently purchased goods and services that are not industry specific, such as office supplies, airline tickets, or janitorial supplies, and add value by giving buyers in a range of industries access to a 'virtual catalogue' of offerings from an array of suppliers. While the hub is not directly responsible for performing any of the physical distribution functions, such as transportation or storage, it may maintain relationships with third-party facilitating agencies such as UPS to help ensure that buyers get what they pay for in a timely manner. Examples of this kind of hub include W.W. Grainger and www.BizBuyer.com.

Other hubs are more industry-specific, bringing buyers and sellers together within a single product category. They create value by enabling one-stop shopping by purchasers. For example, www.PlasticsNet.com allows plastics processors to issue a single purchase order for hundreds of plastics products sourced from a diverse set of suppliers. Because the products they offer tend to be specialised, industry-specific hubs often work with established merchant wholesalers (distributors) in their industry to ensure product availability and reliable delivery. Other examples include SciQuest in the life sciences industry and Chemdex in speciality chemicals.

### 13.3.3 Retailers

Retailers sell goods and services directly to final consumers for their personal, nonbusiness use. Because retailers usually take title to the goods they carry, their compensation is the margin between what they pay for the merchandise and the prices they charge their customers. Retailing is a major industry in the United States, with over 1.6 million retail establishments.

Retail stores can be categorised in many different ways, such as by the type of merchandise carried (supermarkets, drugstores), breadth of product assortments (speciality or department stores), pricing policies (discount or speciality stores), or nature of the business's premises (e-tailers, mail-order retailers, vending-machine operators, traditional stores). One useful classification scheme groups stores according to their method of operation – low margin/high turnover versus high margin/low turnover.

The former compete primarily on a price basis. To keep volume high while minimising inventory investments, **low-margin/high-turnover** stores usually concentrate on fast-moving items – such as food, health and beauty aids, basic clothing items, and housewares – and carry a relatively limited selection in each product category. Examples of such retailers include mass-merchandise discounters, wholesale clubs, most supermarket and drug chains, and some speciality chains in such areas as women's clothing, shoes, hardware, office supplies, and building supplies.

To profit, low-margin/high-turnover retailers must minimise their costs. Their focus on standardised, prepackaged merchandise helps lower personnel costs by reducing or eliminating in-store sales assistance. It also enables them to centralise many purchasing and store operating decisions, thus reducing the number of administrative personnel needed. Many such operations – particularly the mass merchandisers – also minimise their capital investment by operating out of free-standing, no-frills facilities near major traffic arteries, locations where land costs, rents, and taxes are low. Many speciality store chains, however, operate out of sizable malls.

At the other extreme, **high-margin/low-turnover** retailers differentiate themselves with unique assortments, quality merchandise, good customer service, and a prestigious store image. They focus on shopping or speciality goods, usually carrying a narrow range of product categories but offering deep assortments of styles and sizes within each category. They also emphasise prestigious national brands or exclusive goods unavailable elsewhere. Tiffany's, for example, carries many one-of-a-kind crystal and jewellery items. This category includes most department stores and upscale speciality stores.

### 13.3.4 Nonstore Retailing

These institutions fit the definition of a retailer, but we discuss them separately because they don't have a fixed brick-and-mortar physical location and most do not enable customers to personally inspect the merchandise or take immediate possession. This category includes direct selling (as in the case of door-to-door sales and telemarketing), mail-order catalogues, TV shopping, vending machines, and websites.

There are several varieties of retail websites, including start-ups (Amazon.com, CDNow) that exist solely on the Web and do not have any physical stores, websites developed by large catalogue retailers (Lands' End, L.L. Bean) to leverage their direct-delivery operations, and websites developed by established bricks-and-mortar retailers (like Target and Tesco) to leverage their brand names and customer service skills.

Historically an established brand name and customer base typically enabled the catalogue and bricks-and-mortar retailers to attract customers to their websites at lower cost than the Web start-ups. However, survey results suggest that retail websites in general have not done a great job of satisfying customers, particularly on basic customer service dimensions. The bricks-and-mortar sites appear to have been more successful at keeping those buyers coming back for repeat purchases.[9]

Many of the start-ups began life as 'virtual' businesses that outsourced many of the physical distribution functions such as inventory storage and delivery. But because of the critical importance of good customer service for developing a satisfied and loyal customer base, some of those start-ups have begun developing their own physical distribution and fulfilment competencies to gain tighter control over those activities. For instance, Amazon.com has invested hundreds of millions of dollars in warehouses and inventory to help ensure fast, reliable delivery. As a result, repeat customers now account for more than three quarters of Amazon.com's orders.[10]

Similarly, bricks-and-mortar stores have sought more creative uses for their websites and other communication channels as their customers have changed the way they shop. A summary of survey results detailing some of these changes in shopping behaviour is presented in Exhibit 13.4. The bottom line is that many customers who make their purchases within a store rely on the retailer's website – as well as those of manufacturers and competing retailers and bloggers – to compare features, brands, and prices before they make a purchase.

To help in-store salespeople remain relevant as their customers use the Internet to become increasingly savvy, some retailers have revamped their job descriptions, training programmes, and incentives. At Best Buy, for instance, 30 per cent of store staff have been redeployed from specific departments to roam the entire store. Their job is to understand all the electronic gadgets in the store, how they work together, and how a customer can get the best performance from a product when she or he gets it home. To get those salespeople up to speed, the company has them meet with manufacturers' reps, attend frequent training programmes, and – when customers are scarce – play with the products.[11]

#### 13.3.4.1 Auction Sites Facilitate Retail Start-ups

Auction sites like eBay and China's TaoBao not only provide a convenient way for consumers to sell possessions they want to get rid of, they also enable entrepreneurs to start new retail businesses with minimal capital and red tape. In the United States, nearly 500 000 people now make 25 per cent or more of their annual incomes as retailers on eBay. But eBay-based start-ups are becoming even more popular in Europe where government regulations and scarce venture capital have historically posed problems for small retailers. Starting an eBay business is relatively easy for anyone with broadband and inventory and shipping software, which is readily available for a few thousand dollars. And European logistics companies such as Deutsche Post offer services tailored to small e-commerce operations. Consequently, more than 60 000 entrepreneurs in both Germany and Britain, 15 000 in France, and nearly 10 000 in Italy earn at least 25 per cent of their income as eBay merchants. As a result, the diversity of products available to consumers and their price competitiveness are increasing rapidly.[12]

## 13.4 Channel Design Alternatives

Deciding which channel members to include when designing a distribution system depends in part on whether the good or service is to be sold to individual consumers or organisational customers. Therefore, we begin our examination of alternative channel designs by enumerating the options available for distributing consumer versus industrial goods. But the choice also depends, as we'll see in subsequent sections, on the firm's competitive strategy and resources and therefore on the relative importance of the various channel objectives we discussed earlier.

**Exhibit 13.4 How in-store purchasers use the Internet**

| Percentage of in-store shoppers . . . who: | |
|---|---|
| 69% | Research products online before going to a store to make a purchase. |
| 62% | Have looked at least once at an online peer review before making a purchase. |
| 61% | Want to be able to scan bar codes and access information on other stores' prices. |
| 39% | Compared a product's features and price across retail outlets before buying. |
| 9% | Used a cell phone to text-message a friend or relation about a product |

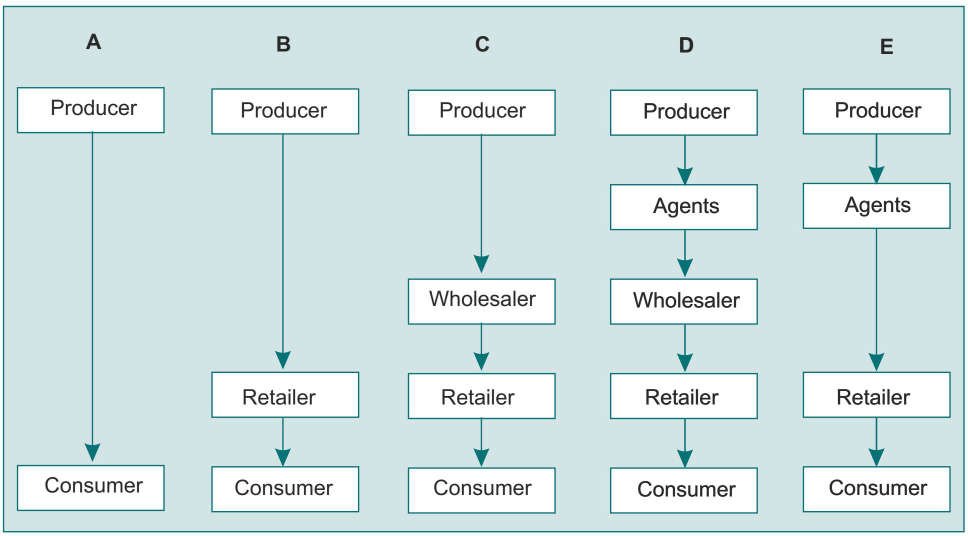
while shopping.

*Source:* Data reported in Nanette Byrnes, 'More Clicks at the Bricks,' *BusinessWeek* December 17, 2007, p. 51.

## 13.4.1 Alternative Consumer Goods Channels

Five channel designs are commonly used to distribute consumer goods and services, as shown in Exhibit 13.5. Channel A involves direct distribution from the producer to the consumer. This is becoming a more popular channel, particularly for products targeted at two-wage-earner households where time is of the essence. As noted earlier, a number of technologies can be employed to achieve direct distribution, including direct mail catalogues, telephone or door-to-door selling, interactive cable TV, and manufacturers' websites.

**Exhibit 13.5 Marketing channels for consumer goods and services**



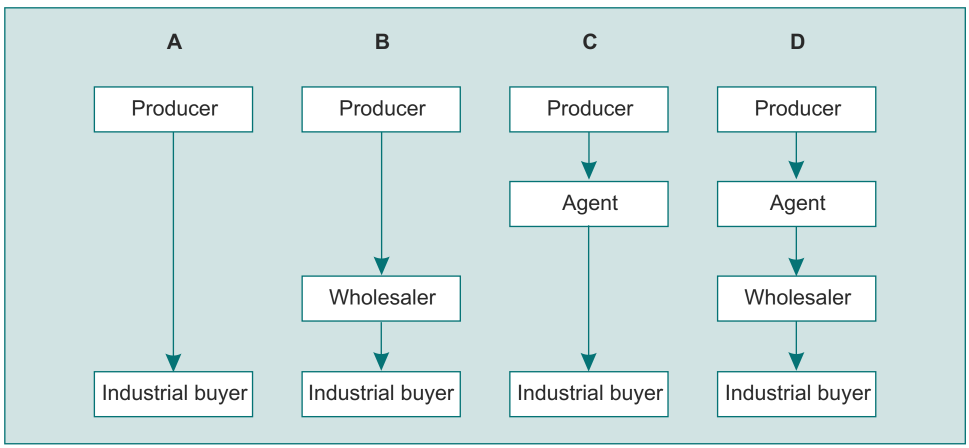

Channel B in Exhibit 13.5 involves producers that sell directly to retailers, who in turn sell to consumers. Such channels are typically used when the retailers are large enough to perform their own wholesaling functions or to form efficient logistical alliances with the manufacturer, as is the case for chains like Walmart, Sears and Marks & Spencer. This kind of channel is also appropriate for distributing speciality goods such as designer fashions, expensive watches, or even greeting cards through selected retail outlets like Saks or Hallmark Card shops. Of course, the retailers involved in such channels may be traditional bricks-and-mortar operations, Internet start-ups, or some combination of the two.

Channel C uses both a wholesaler and a retailer and is most common for low-cost, frequently purchased items extensively distributed through a large number of retailers. Because many of the retailers in such channels are small, the manufacturer's cost of dealing with them directly would be prohibitive. This channel system is common for such products as packaged food items, alcohol, and health and beauty aids. Channel D, where an agent sells to wholesalers who in turn sell to retailer, is used when the manufacturer is too small, or its product line too narrow, to justify a company salesforce. In some cases, particularly where a small producer sells to retail chains that are large enough to take care of their own wholesaling functions, an agent may be employed to sell directly to the retailers', as shown in channel E.

## 13.4.2 Alternative Industrial Goods Channels

Exhibit 13.6 illustrates four alternative channel designs for distributing industrial goods. Direct distribution (channel A) is much more common for industrial goods and services than it is in the consumer sphere. It is particularly popular when buyers are large and well-known, the product or service is technically complex and of high unit value, and the selling function requires technical expertise or extended negotiation. For example, large computer systems, commercial aircraft, and consulting services are sold through direct distribution.

**Exhibit 13.6 Marketing channels for industrial goods and services**




Many industrial goods manufacturers distribute through wholesalers (industrial distributors), as in channel B. While a manufacturer loses some control over such activities as the negotiation of sales contracts, installation, and maintenance by using distributors, wholesalers can improve distribution efficiency by lowering costs for such functions as selling, storage, and transportation. This is particularly likely when the product is standardised, there are many potential buyers with similar requirements, the average order value is relatively small, and the item is easy to handle and store.

The two other industrial goods channels involve the use of agents or brokers, either to sell directly to customers, as in channel C, or to wholesalers, as in channel D. Manufacturers too small to support a company salesforce most frequently use agents. For example, Stake Fastener Company, a small producer of industrial fasteners, uses agents to call on its customers rather than employing a company salesforce. Larger firms also employ agents, particularly to call on smaller customers or to cover low-potential geographic areas.

## 13.5 Which Alternative Is Best? It Depends on the Firm's Objectives and Resources

As we pointed out earlier, there are trade-offs among the various objectives a company might try to accomplish with its distribution channel; it's generally impossible to design a channel that performs well on all of them. In addition, each of the alternative designs outlined above are better suited for attaining some objectives than others. Therefore, the decision about which alternative to adopt depends on which distribution objectives are considered most important, which is influenced by the business's competitive strategy and the other components of the marketing programme, including characteristics of the product itself.

The following sections briefly examine the alternative channel designs most appropriate for the various objectives outlined earlier. For any given objective, channel design decisions may be further influenced by the availability of human and financial resources within the firm and by factors in the environment, such as technological developments.

### 13.5.1 Availability and the Satisfaction of Customer Service Requirements

#### 13.5.1.1 Consumer Goods and Services

**Exhibit 13.7** **Comparison of intensive, exclusive and selective retail coverage strategies**

| | Retail coverage | Major strength | Major weakness | Products most appropriate for |
|---|---|---|---|---|
| **Intensive** | Maximum | Maximises product availability | Lack of retailer support | Low-involvement consumer convenience goods |
| **Exclusive** | Single | Matches retailer clientele with target market; facilitates close cooperation with retailer | Risk of relying on single retailer | High-involvement speciality or shopping goods |
| **Selective** | Limited | Provides adequate coverage but not at expense of manufacturer–retailer cooperation | Difficult to implement given interstore competition, especially where discounts may occur | Infrequently purchased shopping goods |

For consumer goods and services, achieving a desired level of product availability is largely a matter of gaining the cooperation of appropriate numbers and types of retail outlets. A manufacturer can pursue three basic **strategies of retail coverage** – intensive, exclusive, or selective distribution (*see* Exhibit 13.7). The best strategy for a given product depends on the nature of the product, the target market pursued, and the competitive situation.

### Intensive Distribution

Such a strategy uses the maximum possible number of retailers and is most appropriate for low-involvement, frequently purchased convenience goods such as candy, soft drinks, deodorants, and razor blades. This strategy maximises product availability, which generates greater product recognition and more impulse buying. However, firms that adopt intensive distribution often experience implementation and cost problems. Individual retailers may be more reluctant to carry the product or to cooperate fully with the manufacturer's marketing programme than if they were given an exclusive right to carry the product in their territory. This was the problem Hallmark ran into with its traditional speciality retailers when the firm attempted to increase the intensiveness of its distribution by adding discounters and a website. Also, gaining cooperation from a large proportion of available retailers is a problem when total demand for the product is relatively small or when the brand is not the share leader in its product category.

### Exclusive Distribution

This strategy relies on only one retailer or dealer in a given geographic territory. It is most appropriate when the product is a high-involvement speciality or shopping good. Exclusive distribution is also useful when a firm wants to differentiate its product on the basis of high quality, prestige, or excellent customer service. The main advantages of exclusive distribution are that the manufacturer can choose retailers whose clientele match its target market, and that there will be close cooperation in implementing the producer's merchandising and customer service programmes. Examples of products that are exclusively distributed include Ethan Allen furniture, and Rolls-Royce automobiles. The major disadvantage of exclusive distribution is the risk involved in relying on a single retailer in a given territory.

### Selective Distribution

This is a compromise between the other two extremes since it uses more than one but fewer than all available retailers in a geographic area. It is an appropriate strategy for shopping goods. Most brands of automobiles are distributed this way.

## 13.5.1.2 Implications for Channel Design

In general terms, the greater the strategic importance of availability and the more intensive the desired level of retail coverage, the more likely wholesalers and/or agents are to be used. Intensive distribution requires large numbers of retail outlets, many of which are small, independently owned operations. The personal selling, order processing, inventory storage, and delivery costs involved in servicing such a large network of retailers would be prohibitive for most manufacturers. Therefore, channel designs such as B and C in Exhibit 13.5 are most common for large, deeppocketed firms seeking intensive distribution, while channel designs D and E are used by smaller firms needing intensive distribution. Firms with exclusive or selective distribution goals are likely to employ channel design B in order to interface directly with their retailers.

### 13.5.1.3 Industrial Goods and Services

In organisational markets, availability and customer service objectives tend to go together because it is order cycle time (the time it takes for customers to place orders and have the goods delivered to their plants or offices) and delivery dependability that tend to be most important for keeping customers satisfied. Historically, firms that wanted to provide fast and reliable delivery had to design channels with a relatively large number of 'distribution points' – either wholesale distributors or company-owned warehouses and sales branches. Many distribution points were necessary to ensure adequate inventories would be available to avoid out-of-stock conditions and that those inventories would be close enough to the customer to allow quick delivery. Consequently, firms that tried to differentiate themselves on the basis of excellent customer service tended to rely on channels with substantial numbers of wholesale distributors, such as channel B in Exhibit 13.6 (for companies that could afford a field salesforce) or channel D (for those that could not). The reason, once again, had to do with the trade-offs between good customer service and physical distribution costs. Unless the producer was pursuing only a few very large customers or had sufficient sales volume and resources to make substantial investments in warehouses and field salespeople, the selling, storage, and transportation functions necessary to provide quick and reliable service could usually be performed more efficiently by independent distributors. As we'll see later, however, this historical trade-off between customer service levels and physical distribution costs is changing as the result of improved communication technologies and the logistical alliances they have made possible.

### 13.5.1.4 The Impact of the Internet on Availability and Customer Service

Some analysts argue that the Internet will lead to the 'death of distance'; the geographic locations of sellers and their customers will no longer be relevant when they engage in transactions in cyberspace.[13] Consequently, they argue that the Internet will facilitate the availability of all sorts of goods and services – both consumer and industrial. Keep in mind, though, that there are two aspects of availability from the customer's point of view. The first has to do with product **search**: identifying available alternatives, collecting information about them, and placing an order. The second concerns product **acquisition** or order cycle time: how long it takes to gain physical possession of the product at the location where it is to be used or consumed.

Websites, whether sponsored by the manufacturer (as is the case with Hallmark's site) or by wholesalers, retailers, or e-tailers who are members of the distribution channel, have clearly enhanced the search aspect of availability. Potential customers can learn about available brands, compare features and prices, and make purchases any time of the day or week without ever getting up from their computer. And in many product categories, 'aggregator' sites, or e-hubs, bring together many buyers and sellers under one virtual roof, enabling potential customers to compare alternatives and decide on a final purchase all at one site.

On the other hand, the Internet is not much help with the acquisition or physical distribution aspects of availability, at least not in most product categories. While it can help coordinate inventories and delivery schedules among channel members, it can't help move the physical product from the producer to the customer's home or plant, unless the product, like music or books, can be delivered in digital form. In fact, many e-tailers outsource inventory storage and delivery activities to an established wholesaler or order fulfilment specialists. Therefore, channels incorporating traditional bricks-and-mortar wholesalers and retailers with the ability to provide quick delivery likely have a competitive advantage on the acquisition/order cycle time dimension;[14] particularly for consumer convenience and impulse items, fashion goods and big-ticket durables that need to be tried out or tried on before purchase, and industrial components where quick and reliable delivery are critical.

### 13.5.2 Promotional Effort, Market Information, and Postsale Service Objectives

One of the most vexing questions facing a manager who must rely on independent agents, wholesalers, and/or retailers is how to get them to do what he or she thinks is best for the product. This is particularly important when it comes to achieving high levels of promotional effort within the channel, collecting timely market information, and servicing customers after the sale. Achieving these objectives requires substantial effort and expense on the part of the middleman, but many of the benefits accrue to the manufacturer or service producer.

As we'll see, firms can attempt to control the activities related to these objectives by writing detailed legal contracts, such as franchise agreements, or to motivate voluntary effort from their channel members by providing appropriate incentives, such as cooperative advertising allowances or liberal service cost reimbursements. In many cases, though, firms can gain better control of such activities by using more direct, vertically integrated distribution channels, such as channel A in Exhibit 13.5 and Exhibit 13.6. It's easier to control a company salesforce and company-owned warehouses, retail outlets, or websites than it is to monitor the behaviours of many independent middlemen[15] and find acceptable replacements for those who perform poorly.[16]

The replacement problem is particularly difficult when an intermediary must invest in specialised (or **transaction-specific**) assets, such as extensive product training or specialised capital equipment, in order to sell the manufacturer's good or service effectively. It's more difficult to find – or to develop – replacement channel members when such specialised assets are required. Thus, the theory of **transaction cost analysis** (TCA) argues that when substantial transaction-specific assets are involved, the costs of using and administering independent channel members are likely to be higher than the costs of managing a company salesforce and/or distribution centres. This is because TCA assumes independent channel members will pursue their own self-interest – even at the expense of the manufacturer they represent – when they think they can get away with it. For instance, they might provide only cursory postsale service or expend too little effort calling on smaller accounts because they are unlikely to earn big commissions from such activities. Because independent intermediaries are more likely to get away with such behaviour when it is difficult for the manufacturer to monitor or replace them, the transaction cost of using independent agents or wholesalers under such circumstances is likely to be high.[17]

Recently, though, both managers and researchers have questioned TCA's assumption that independent intermediaries will always put their own short-term interests ahead of those of the manufacturer when they can avoid getting caught and replaced. Many argue that when both manufacturer and intermediary believe their relationship can be mutually beneficial for years into the future, norms of trust and cooperation can develop.[18] Such beliefs and norms are essential for the development of effective long-term relationships and alliances among channel partners.

## 13.5.3 Cost-Effectiveness

As pointed out earlier, firms often face a trade-off between high product availability and short order cycle times on one hand and higher distribution costs on the other. To service the large number of retailers necessary to provide intensive distribution of consumer products typically requires many salespeople, widely dispersed warehouses, and large inventories. Similarly, guaranteeing fast and reliable delivery to organisational customers, especially smaller ones, demands a relatively large number of wholesale distribution points. Therefore, the manager's task is to design a marketing channel that minimises physical distribution costs subject to the constraint of achieving some target level of product availability and customer service.

### 13.5.3.1 Make-or-Buy Decisions

One issue that has a bearing on distribution costs is the choice among different types of institutions at each channel level. Would the firm be better off financially performing the functions necessary to achieve the desired level of customer service itself in a vertically integrated system or could independent intermediaries perform them more efficiently? In other words, for a given service level, are more direct, vertically integrated channel designs – such as channels A and B in Exhibit 13.5 or channel A in Exhibit 13.6 – more cost-effective than channels incorporating independent, wholesalers and/or agent middlemen?

To answer this question, the manager needs to compare the relative costs of performing the necessary selling, storage, order processing, and transportation functions across the various alternative institutions for different levels of sales volume. For instance, at each sales level the margins that would have to be paid to wholesale distributors could be compared to the costs the firm would incur if it took over the sales and distributive functions necessary to support that level of volume. Similarly, the costs of maintaining a company salesforce can be compared to the commissions earned at various volume levels by external agents, such as manufacturer's reps.

The results of this analysis typically vary by the amount of sales projected. For physical distribution activities to be handled efficiently in-house, the firm's products must generate sufficient sales volume to achieve economies of scale. At lower volume levels, independent wholesale distributors are usually less costly because they can spread their fixed costs across the many different suppliers they represent, and the aggregated sales of all those suppliers' products enable greater scale economies.

Similarly, the fixed costs of using external agents are lower than those of using a company salesforce because there is usually less administrative overhead and agents do not receive a salary or reimbursement for selling expenses. But costs of using agents tend to rise faster as sales volume increases because agents usually receive larger commissions than company salespeople. Thus, agents are typically more cost efficient at lower levels of sales but less so as volumes increase. This helps explain why agents tend to be used by smaller firms or by larger firms in their smaller territories where sales are too low to justify a company salesforce.

#### 13.5.3.2 Supply Chain Management – The Impact of New Technologies and Alliances

Recent developments may be changing the historical trade-offs between distribution costs and customer service levels. New data collection, communication, materials handling, and transportation technologies are enabling firms to reengineer their distribution processes in ways that increase customer service levels while *simultaneously* reducing costs. These new processes are commonly referred to as **supply chain management** (although some consumer package goods firms that distribute through supermarkets have labeled them **efficient consumer response [ECR]** programmes).

Much of the resulting improvement in customer service on dimensions such as order cycle time and dependability has been due to the electronic interchange of sales and inventory data – and the development of computerised ordering systems – between manufacturers and their channel partners. As we saw in Module 7, sales information from a retailer's checkout scanners can be sent directly to either a wholesaler's or a manufacturer's computer, which figures out when to replenish each product and schedules deliveries to appropriate warehouses or stores. And, as we saw in the relationship between DHL Exel and Océ in Module 7, logistics service firms or transportation agencies such as trucking or airfreight companies may also be included in these supply chain alliances to facilitate timely order processing and delivery.

Logistical alliances based on electronic data interchange are often able to reduce the total amount of inventory needed via improved coordination of the stocks kept at various levels in the distribution channel, quicker order processing, and speedier delivery. Thus, the number of wholesale distribution points required to provide a given level of customer service is often reduced. These reductions cut inventory carrying costs (the costs of capital tied up in inventory), storage costs, and damage to the stock. In most cases such reductions in inventory costs are more than sufficient to offset the costs of the computers and telecommunications equipment and the more costly modes of fast transportation usually involved in logistical alliances. For example, one study suggests that widespread adoption of such systems could reduce the average length of time it takes dry grocery products, such as cake mixes, soups, and pasta sauces, to reach the ultimate consumer from more than 100 days down to only 60 days. It is estimated that this would save consumers about 11 per cent of their current grocery bills.[19]

Another potential benefit of improved logistical cooperation in the food industry is the reduction of 'shrink' – the amount of perishable food that is thrown away because of spoilage. It is estimated that about $20 billion worth of food is dumped by retailers each year in the United States alone. By improving the speed of order delivery, the monitoring and forecasting of consumer demand, and thereby reducing inventories and the size of in-store displays, Stop & Shop – a grocery chain owned by Holland's Ahold – was able to cut shrink by a third recently, saving over $50 million, eliminating 36 000 tons of rotten food, and improving customer satisfaction with the freshness and quality of the chain's produce.[20]

### 13.5.4 Flexibility

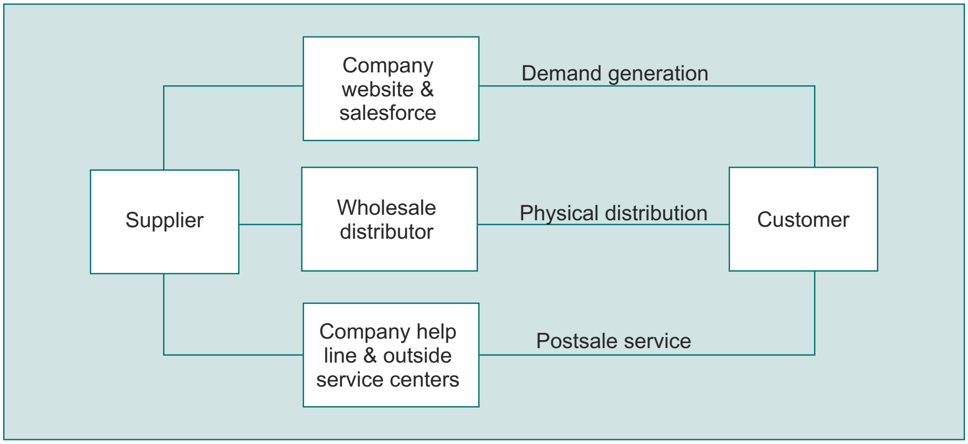
Different channel designs involve different levels of commitment and loss of flexibility by manufacturers. Generally, vertically integrated systems are difficult to alter quickly, particularly when a firm has made substantial investments in physical (buildings) and human resources (salespersons). Channels involving independent middlemen are often more flexible, especially if the firm does not have to sign long-term contracts to gain their support. Manufacturers facing uncertain and rapidly changing market or competitive environments often rely on independent reps or wholesalers to preserve the adaptability of their distribution channels. Conversely, firms operating in relatively mature and stable markets, and defenders whose efficiency or good service is more critical than flexibility, might attach greater importance to the increased control inherent in vertical integration.[21] However, making major changes in channel design can lead to substantial conflict and resistance even when that channel is made up of independent middlemen, especially if channel members have had a long and profitable relationship with the supplier. Note, for instance, the reaction of Hallmark's traditional speciality retailers to the firm's addition of mass merchandisers, drugstores, and a company website to its channel.

### 13.5.5 Multichannel Distribution

Companies are increasingly using multiple channels. Some use **dual (two-channel) distribution** systems – as, for example, when a manufacturer of industrial goods uses wholesalers to sell small accounts and its own salesforce to handle large accounts. An increase in the number of target segments typically forces many companies to use more than two channels. For example, a manufacturer of brake fluid distributes its product (a) directly to Toyota, Ford, and BMW for use in new cars; (b) through major oil companies that wholesale the fluid to their retail stations for use in servicing cars; and (c) through auto parts wholesalers to retail auto parts stores to reach do-it-yourself customers.

Multichannel systems can create conflict and control problems. Conflicts can arise if different channel members try to pursue the same customer segment, and multiple channels are harder for the manufacturer to coordinate and control than a simpler system. Nevertheless, such systems often provide more complete market coverage with greater efficiency, which can provide a competitive advantage.

**Exhibit 13.8 Example of a hybrid marketing channel**




A variation of multichannel systems is the **hybrid system**.[22] While multichannel systems employ separate channels to reach different target segments (e.g., service stations versus do-it-yourselfers), the members of a hybrid system perform complementary functions for the same customer segment. As Exhibit 13.9 indicates, for example, a supplier might rely on its own website and salespeople to contact customers and generate sales, employ an independent wholesaler or fulfilment organisation to deliver the goods, and then use a company help line and independent service centres to provide service after the sale. Some analysts expect such hybrid systems to become the most common channel design in the future, largely because the Internet is making it easier to effectively coordinate a large number of functional specialists. Also, by outsourcing or offshoring some of those specialised functions, firms can often provide a given level of customer service more efficiently.[23]

## 13.6 Channel Design for Global Markets

When designing marketing channels to reach customers in more than one country, the manager faces a couple of additional issues. First, when entering a new national market for the first time, he or she must decide on an entry strategy. Subsequently, a decision must be made whether to rely on middlemen in the firm's home country that specialise in selling to foreign markets or to deal directly with foreign middlemen who operate in those markets.

### 13.6.1 Market Entry Strategies

There are three major ways of entering a foreign country – via export; by transferring technology and the skills needed to produce and market the goods to an organisation in a foreign country through a contractual agreement; and through direct investment.

**Exporting** is the simplest way to enter a foreign market because it involves the least commitment and risk. It can be direct or indirect. The latter relies on the expertise of domestic international middlemen: **export merchants**, who buy the product and sell it overseas for their own account; **export agents**, who sell on a commission basis; and **cooperative organisations**, which export for several producers, especially those selling farm products. Direct exporting uses foreign-based distributors/agents or operating units (branches or subsidiaries) set up in the foreign country.

**Contractual entry modes** are nonequity arrangements that involve the transfer of technology and/or skills to an entity in a foreign country. In **licensing**, a firm offers the right to use its intangible assets (technology, know-how, patents, company name, trademarks) in exchange for royalties or some other form of payment. Licensing is less flexible and provides less control than exporting. Further, if the contract is terminated, the licensor may have developed a competitor. It is appropriate, however, when the market is unstable or difficult to penetrate.

**Franchising** grants the right to use the company's name, trademarks, and technology. Also, the franchisee typically receives help in setting up the franchise. It is an especially attractive way for service firms to penetrate foreign markets at low cost and to couple their skills with local knowledge and entrepreneurial spirit. Host countries are reasonably receptive to this type of exporting since it involves local ownership. American companies have largely pioneered franchising, especially such fast-food companies as McDonald's, Pizza Hut, Burger King, and Kentucky Fried Chicken. In recent years foreign franchisers have entered the United States – largely from Canada, the UK, and Japan – in a variety of fields, including food, shoe repair, leather furniture, and home furnishings.

Other contractual entry modes include **contract manufacturing**, which involves sourcing a product from a manufacturer located in a foreign country for sale there or elsewhere (auto parts, clothes, and furniture). Contract manufacturing is most attractive when the local market is too small to warrant making an investment, export entry is blocked, and a quality licensee is not available. A **turnkey construction contract** requires the contractor to have the project up and operating before releasing it to the owner. **Coproduction** involves a company's providing technical know-how and components in return for a share of the output, which it must sell. **Countertrade** transactions (as discussed in Module 12) include barter (direct exchange of goods – hams for aircraft), compensation packages (cash and local goods), counterpurchase (delayed sale of bartered goods to enable the local buyer to sell the goods), and a **buyback arrangement** in which the products being sold are used to produce other goods.

**Overseas direct investment** can be implemented in two ways – through joint ventures or sole ownership. **Joint ventures** involve a joint ownership arrangement (such as between a UK firm and one in the host country) to produce and/or market goods in a foreign country. Today, joint ventures are common because they avoid quotas and import taxes and satisfy government demands to produce locally. They also have the advantage of sharing investment costs and gaining local marketing expertise.

For example, Sir Richard Branson's Virgin Books Ltd partnered with a group of Indian entrepreneurs, who were running a comics distribution business, to form a new venture called Virgin Comics LLC. The joint venture plans to build India into a multi-billion-dollar comic-book market be combining Virgin's capital and production expertise with the Indians' distribution system to appeal to the country's 500 million teenagers with mythic tales and possibly animated movies and TV shows. There may also be substantial opportunities to export some of the firm's offerings to the West via Virgin's established retail channels.[24]

A **sole ownership** investment entry strategy involves setting up a production facility in a foreign country. Direct investment usually allows the parent organisation to retain total control of the overseas operation and avoids the problems of shared management and loss of flexibility. This strategy is particularly appropriate when the politics of the situation require a dedicated local facility.

High risks are associated with direct investment. Nevertheless, direct investments everywhere are accelerating because companies have concluded that capturing and retaining customers demands constant innovation and a rapid, flexible response to the dynamics of the environment.

## 13.6.2 Channel Alternatives

Two major types of international channel alternatives are available to a domestic producer.[25] The first involves the use of domestic middlemen who provide marketing services from a domestic base and the second is the use of foreign middlemen. These alternatives are discussed below.

### 13.6.2.1 Domestic Middlemen

While convenient to use, these may suffer from a lack of knowledge about a foreign market and their inability to provide the kind of local representation offered by foreign-based middlemen. The more common **merchant middlemen** (those taking title) include the **export merchant**, who takes physical possession of the goods (mostly manufactured), has a broad line, and sells in his own right; the **export jobber**, who handles mostly bulky and raw materials (but does not take physical control of them); and **trading companies**, which sell manufactured goods to developing countries and buy back raw materials and unprocessed goods.

**Agent middlemen** include **brokers**; **buying offices** (primarily concerned with searching for and purchasing merchandise upon request); **selling groups** (an arrangement by which various producers cooperate to sell their goods overseas); the **export management company**, which operates in the name of its principal; and the **manufacturer's export agent** (**MEA**), which specialises in only a few countries and has a short-term relationship with its clients.

#### 13.6.2.2 Foreign Middlemen

In contrast to dealing with domestic middlemen, a manufacturer may decide to deal directly with **foreign middlemen**. This shortens the channel, thereby bringing the manufacturer closer to the market. A major problem is that foreign middlemen are some distance away, and therefore more difficult to control than domestic ones. Since many foreign middlemen, especially merchant middlemen, are prone to act independently of their suppliers, it is difficult to use them when market cultivation is needed.

Wholesalers around the world, while performing similar functions, vary tremendously in size, margins, and service quality. A broad generalisation is that the less developed a country, the smaller the wholesaler and the more fragmented the wholesale channels. In recent years, however, the emergence of wholesaler-sponsored voluntary chains has tended to consolidate distribution power in the hands of a smaller number of wholesalers. Also, there is a worldwide trend of vertical integration from the wholesale or retail level to the manufacturer. And the growth of national wholesalers in many countries has made it easier for manufacturers to distribute their product(s) nationwide.

#### 13.6.2.3 Retail Structures in Foreign Countries

These vary tremendously across countries because of differences in the cultural, economic, and political environments; for example, a generalisation is that the size of retail stores increases as gross national product per capita increases. Both European and Japanese retailing are following a path similar to that pioneered by the United States with respect to store size, self-service, discounting, automation (use of electronic checkout counters), expansion of national chains, and direct marketing. And in some cases the effectiveness and efficiency of retailers in developing nations are being improved with the help of training programmes, promotional materials, and inventory planning advice from large multinational manufacturers. A good example of this sort of proactive approach to improving the retail distribution of a firm's products in emerging markets is discussed in Exhibit 13.9.

It is also becoming increasingly possible to promote and sell goods and services directly over the Internet almost anywhere. The online population was estimated to be 1.46 billion in the year 2008, with 248 million in North America, 384 million in Europe, 520 million in the Asia-Pacific region, 39 million in South America, 51 million in Africa, and 42 million in the Middle East.[26]

As we have seen, however, while the Internet enables firms to contact customers and generate orders, they must still rely on foreign middlemen to carry out the necessary physical distribution functions.

**Exhibit 13.9 Procter & Gamble and the Chinese government work to improve rural retailers**

Since Procter & Gamble, the consumer package goods giant, first introduced Head & Shoulders, Pampers, and many other brands to mainland China in 1988, it has enjoyed steady growth. The firm racked up $2.5 billion in revenues in fiscal 2006, and its wholly owned China business unit employs 6300 people, many of whom work in the firm's extensive sales and wholesale distribution network.

While much of P&G's past growth came from large retailers in China's biggest cities, company managers expect that future growth will come from the rural countryside where there are more than 700 million potential first-time buyers for many of P&G's products. Since family incomes in the countryside average less than one-third of those in the cities, however, P&G has been developing new brand extensions and packaging to lower costs and prices, and to appeal to rural cultural preferences.

Since retail stores in rural China tend to be small, numerous, and unsophisticated, the firm has also had to expand its distribution network to reach them. The firm relies on a group of wholesale subdistributors and their vans to deliver a variety of P&G products as well as sales aids like posters, display racks, and the like to hundreds of small shops. And the firm signed an agreement with China's Commerce Ministry in 2007 whereby P&G promises to help renovate existing retail outlets, design and build new ones, and train local shopkeepers in some 10 000 small villages in the art of retailing. The government supports the programme as a means of reducing the flow of counterfeit goods and spurring economic development in the countryside, while P&G hopes that improving the effectiveness and efficiency of China's rural retailers will lower its distribution costs and gain increased local promotion of its many brands.

*Source:* Dexter Roberts, 'Scrambling to Bring Crest to the Masses,' *BusinessWeek,* June 25, 2007, pp. 72–73.

## 13.7 Channel Design for Services

Producers of services also face the problem of making their outputs available to targeted customer segments. In some cases, this results in forward vertical integration involving decisions about branch outlets – as in bank services that are accessible through branch banks (some of which may be located in supermarkets) and automatic tellers. Another example is a hospital that establishes outpatient clinics to serve the specific health needs of various community segments, such as high-stress or drug- or alcohol-dependent groups.

Ordinarily, the marketing of services does not require the same kind of distribution networks as does the marketing of tangible goods. Marketing channels for services tend to be short – direct from the creator or performer of the service to the end user – hence the emphasis on franchising (discussed later).

Some services require the use of longer channels, however. Health care services use a variety of channel systems other than the traditional fee system employed by many doctors and hospitals in selling directly to the consumer. Health maintenance organisations (HMOs) sometimes use a vertically integrated system, where consumers pay a monthly charge to an organisation (such as Baptist Medical Systems-HMO, Inc.) that coordinates the services of all the health care needs of its constituents. Hotels rely increasingly on indirect channels for their bookings. Intermediaries include travel agents who may deal directly with a hotel or contact another intermediary holding blocks of rooms, sales representatives who represent a number of noncompeting hotels or resorts, airlines that provide tour packages that include hotels, and automated reservation services that maintain a computerised inventory of available rooms travel agents can tap into for a fee, e-hubs that enable business buyers to reserve rooms online, and 'name-your-own-price' sites such as www.priceline.com where hotels can dispose of excess capacity if potential buyers offer an acceptable price.[27]

## 13.8 Channel Management Decisions

Designing the perfect channel to accomplish the firm's objectives is one thing; getting the middlemen to carry the product and perform the desired functions is another. In recent years manufacturers – and in some cases large wholesalers and retailers – have developed **vertical marketing systems** (VMSs) to improve coordination among channel members, thereby improving their performance. Greater coordination and cooperation in VMSs have led to greater marketing effectiveness and distribution economies by virtue of their size, bargaining power, and the elimination of duplicated functions. As a result, VMSs have become the dominant form of channel arrangement, particularly in the distribution of consumer goods and services.

This section discusses the various types of VMSs and how firms can develop and maintain such systems. Next, we examine the sources of power and the inducements and incentives that channel members use to gain the support of other system members. Finally, we identify possible sources of conflict in VMSs and some resolution mechanisms that firms use to preserve cooperation within their channels.

### 13.8.1 Vertical Marketing Systems

Firms attempt to develop and manage integrated distribution systems in one of four ways: (1) a corporate VMS, which involves a vertically integrated system, (2) a contractual VMS, which formulates agreements spelling out a coordinated set of rights and obligations for members of the system, (3) an administered VMS, in which one firm uses its economic position or expertise to provide inducements for cooperation from other members, or (4) a relational VMS, where cooperation between two or more channel partners is based on norms of mutual trust and the expectation that cooperation will increase the total system's success and thereby make all members better off in the long term. Each of these four types is shown in Exhibit 13.10 and discussed in the following sections.

#### 13.8.1.1 Corporate VMSs

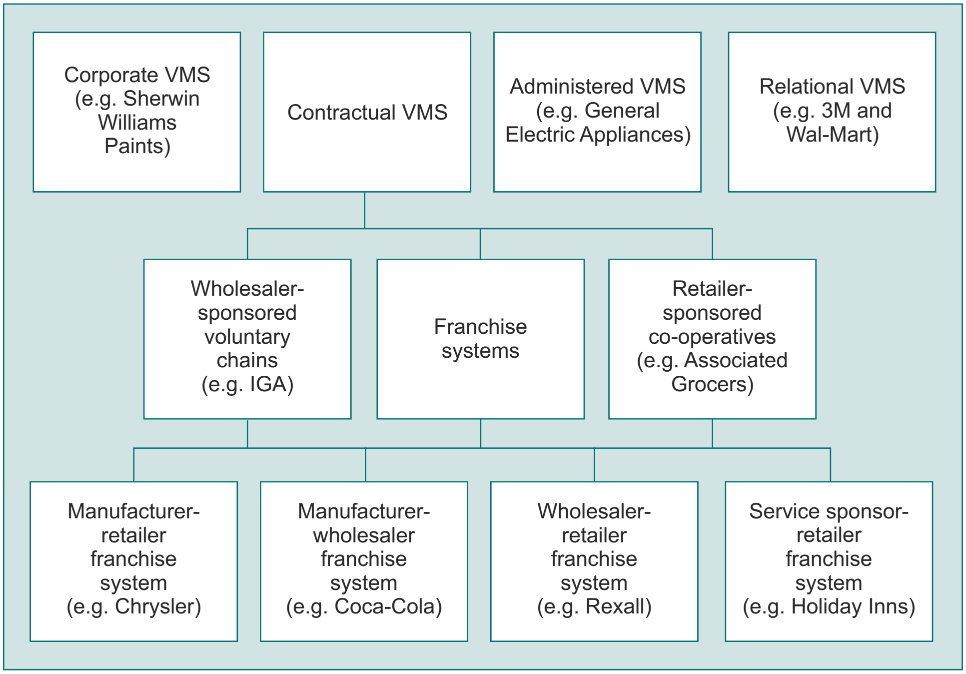
In these systems firms achieve coordination and control through corporate ownership. In most cases, this is the result of forward integration by a manufacturer of the functions at the wholesale – and perhaps even the retail – levels. For example, many industrial firms have their own salesforces, warehouses, or branch sales offices. **Backward integration** occurs when a retailer or wholesaler assumes ownership of institutions that normally precede them in their distribution channels. Such integration is common among large supermarket chains.

The primary advantage of these systems is the tight control they provide over personal selling, promotion, distribution, and customer service activities. Such control is particularly important when the product is technically complex; when specialised knowledge or facilities are needed to sell, distribute, and/or service the product; and when few capable independent middlemen are available. Corporate VMSs are not without their disadvantages, which include the large capital investment required and less flexibility than conventional systems.

### 13.8.1.2 Contractual VMSs

In such systems independent firms at different levels of production and distribution coordinate their programmes through contracts that spell out the rights and duties of each party. The intent is to obtain greater economies and market impact than they could achieve alone. Contractual VMSs have had the greatest growth of any channel system in recent years. There are many kinds of contractual systems, but the three basic types are **wholesaler-sponsored voluntary chains**, **retailer cooperatives**, and **franchise systems**.

**Exhibit 13.10 Vertical marketing systems**



*Wholesaler-sponsored voluntary chains* are formed by getting independent retailers to sign contracts in which they agree to standardise their selling practices and to purchase a certain portion of their inventories from the wholesaler. The Independent Grocers Alliance (IGA), Western Auto, and Ben Franklin are among the best-known wholesaler-sponsored voluntaries.

*Retailer cooperatives* are groups of independent retailers who form their own cooperative chain organisations. Typically, they agree to concentrate their purchases by forming their own wholesale operations. In many cases they also engage in joint advertising, promotion, and merchandising programmes. Profits are passed back to the member retailers in proportion to their purchases. Such cooperatives are particularly common in the grocery field, where Associated Grocers and Certified Grocers are examples.

In *franchise systems*:[28] a channel member can coordinate two successive stages in the distribution channel by offering franchise contracts that give others the right to participate in the business provided they accept the agreement terms and pay a fee. Such contracts usually specify a variety of operational details – including which members of the system will perform specific functions and how – as well as mechanisms to evaluate members' performance and to terminate members who fail to perform adequately.

Franchising has great versatility. Such systems operate in almost every business area and cover a wide variety of goods and services. There are four major types of franchise systems.

1. **Manufacturer–retailer franchise systems** account for the largest number of franchisees and the largest volume of sales and are common in the automotive (DaimlerChrysler, Toyota, and Ford) and petroleum industries (Exxon, Shell, and BP).
2. **Manufacturer–wholesaler franchise systems** are exemplified by the soft-drink industry; Coca-Cola and Pepsi sell syrup concentrate to franchised wholesale bottlers who then carbonate, bottle, sell, and distribute soft drinks to retailers in their territories. In recent years, however, Coca-Cola has acquired several of its larger and previously independent bottlers to gain control over its distribution channel.
3. **Wholesaler–retailer franchise systems** are similar to wholesaler-sponsored voluntary chains, but the retail franchisees agree to conduct and coordinate their operations according to detailed standards specified by the franchise agreement. Examples include Rexall drugstores and SuperValu supermarkets.
4. **Service sponsor–retailer franchise systems** are the most familiar to consumers. Examples include McDonald's, Burger King, and Kentucky Fried Chicken in fast foods; Holiday Inn in lodging; Hertz and Avis in car rentals; Midas and Precision Tune in auto repair; and Manpower in employment services.

The popularity of franchise systems from a customer's point of view derives from their ability to deliver consistent quality at a convenient location and a reasonable price. From the franchiser's perspective, such systems provide a legal basis for exercising some control over franchisees without the large capital investments required by a vertically integrated system. On the other side, franchisees can gain access to the franchiser's operational expertise, brand recognition, and loyal customers in exchange for providing local capital and management oversight.

#### 13.8.1.3 Administered VMSs

Firms using this system coordinate the necessary activities at successive stages of distribution through the informal guidance and influence of one of the parties (rather than through ownership or contractual agreements). The administrator is typically the manufacturer, but in some cases the role is performed by a large retailer or wholesaler (Walmart). Usually, the administration of such systems develops a detailed merchandising programme in which the manufacturer spells out shelf-space arrangements, a promotional calendar, pricing policies, and guidelines for other activities to be followed by its wholesalers and retailers.

To encourage the other members of the distribution channel to go along with its merchandising programme, the channel administrator typically relies on its superior economic or expert power to provide incentives for cooperation. Therefore, administered VMSs are typically designed and managed by the most powerful member. As a result, however, the performance outcomes that are rewarded may be more reflective of the powerful member's objectives than of the interests of the system as a whole. And there is often a tendency for the administrator to use its power to 'share the pain' when economic conditions are tough or to 'hog the gain' during the good times.

#### 13.8.1.4 Relational VMSs

Relational VMSs also rely on economic rewards – and often contractual agreements, as well – to specify what is expected of each channel member and to provide incentives for cooperation. However, in relational systems what is expected of each partner may change by mutual agreement as market or competitive conditions change, and the economic incentives depend more on the long-term market success of the entire system than on the power and largess of the strongest member.

As we have seen, such relational systems or alliances are often more effective and efficient than more traditional systems. This is largely because of the extensive and rapid sharing of information, cost savings resulting from better coordination of activities and less duplication of efforts, and the cooperative search for innovative ways for the system to gain a competitive advantage over other systems.

However, the open sharing of internal operating data and innovative ideas for improving efficiency and sales performance requires substantial mutual trust and long-term commitments from each partner. As we discussed in Module 7, trust tends to build slowly. Thus, the partners in a relational system must typically have some history of satisfying experiences with one another to provide a foundation for trust and a history of mutually rewarding performance outcomes to motivate continued commitment for the long haul.[29]

### 13.8.2 Sources of Channel Power

As mentioned, the channel leader in an administered VMS typically coordinates the actions of other members by exercising power over them. Channel member A has power over channel member B to the extent that A can get B to do something that B would not do if left alone.

The power of any firm within a distribution channel is inversely proportional to how dependent the other channel members are on that firm. Thus, the extent of Firm A's power over Firm B is determined by A's ability to deliver rewards desired by B, and by B's ability to attain those rewards outside of a relationship with A (that is, by the alternatives open to B). Thus, sources (or bases) of power within channel relationships include the following:

- **Economic power** exists when channel members perceive that a firm can mediate economic rewards for them if they follow its directives.
- **Coercive power** is based on a perception that one channel member will punish another for failure to cooperate. It is the inverse of economic power, since such punishments usually take the form of a reduction in or withholding of economic rewards. For example, a manufacturer might threaten to withdraw a retailer's exclusive territorial rights if the retailer's performance does not meet expectations.
- **Expert power** stems from a perception that one channel member has special knowledge or expertise that can benefit other members of the system. Because of the reputations of firms like Unilever and Procter & Gamble as savvy marketers, middlemen are often willing to abide by their merchandising suggestions.
- **Referent power** is based on the belief that the benefits generated are likely to continue. A channel member that has earned substantial profits from a manufacturer over the years may be willing to accede to its suggestions or requests, without demanding any additional rewards.
- **Legitimate power** flows from the belief that one channel member has the right to make certain decisions or demands and to expect compliance from other members. Legitimate power is usually the result of ownership or contractual agreements, but in some instances it is based on moral authority or common beliefs about what is right and proper. For example, most middlemen would agree that a food manufacturer has the right to print expiration dates on its packages and to expect middlemen to remove outdated packages from the shelves as a means of protecting the product's quality and the consumer's health.

Of course, economic rewards and expertise are exchanged among partners in relational VMSs as well, but such exchanges tend to be relatively symmetrical – both parties benefit – rather than being dominated by one powerful member. Therefore, when one party in a relational VMS accedes to the requests or suggestions of a partner, that response often reflects the partner's referent power, a belief that the relationship will continue to be mutually beneficial in the future.[30]

### 13.8.3 Channel Control Strategies

Two strategies used by manufacturers to improve their perceived economic power and to gain better cooperation from channel members are a pull and a push strategy.

#### 13.8.3.1 Pull Strategy

When pursuing this strategy, a manufacturer focuses primarily on building selective demand and brand loyalty among potential customers through media advertising, consumer promotions, extended warranties and customer service, product improvements, line extensions, and other actions aimed at winning customer preference. Thus, by building strong consumer demand, the manufacturer increases its ability to promote economic rewards in the form of large sales volumes to its channel members in return for their cooperation. A share leader or most prestigious brand in its category has substantial power to influence other channel members, particularly if the product is in the growth stage of its life cycle.

But what if the manufacturer is introducing a new product with no past sales history? In such situations, the manufacturer must convince prospective channel members that its marketing programme can quickly build strong customer demand and loyalty for the new brand. Such efforts at persuasion are most likely to be successful when the manufacturer has substantial resources to devote to the new product's marketing programme, is perceived to have a great deal of marketing expertise, and has an extensive track record of past new product successes. Thus, pull strategies are commonly employed by large consumer goods marketers such as Procter & Gamble, Gillette, Frito-Lay, and Diageo PLC. Such companies have the deep pockets necessary to implement pull strategies, and their products typically have sufficiently broad appeal to make an aggressive consumer promotion and advertising programme worthwhile.

#### 13.8.3.2 Push Strategy

Smaller firms with limited resources, those without established reputations as savvy marketers, and those attempting to gain better channel support for existing products with relatively small shares and volumes often have difficulty achieving cooperation solely on the promise of future sales and profits. In such situations firms usually adopt a **push strategy** in which much of the product's marketing budget is devoted to direct inducements to gain the cooperation of wholesalers and/or retailers. Typically, a manufacturer offers channel members a number of rewards, each aimed at motivating them to perform a specific function or activity on the product's behalf. The rationale is that by motivating more wholesalers or retailers to carry and aggressively sell the product, more customers are exposed and persuaded to buy it.

Most small and medium-sized marketers of consumer goods employ push strategies because they lack the necessary resources for, or sell products whose relatively narrow appeal cannot justify, the expense involved in a pull strategy. The growing number of energy bars – Clif bars, Luna bars, Balance bars, and others – are examples of products marketed largely through push strategies, even though some limited consumer promotion does appear for these products.

### 13.8.4 Trade Promotions – Incentives for Motivating Channel Members

Manufacturers typically use a combination of incentives to gain reseller support and push their products through the channel. Most of these incentives constitute **sales promotion** activities. As we shall see in the next module, sales promotions are incentives designed to stimulate the purchase or sale of a product in the short term.

There are two categories of sales promotion activities: (1) **consumer promotions**, such as coupons, rebates, and contests, aimed at stimulating consumer purchases, and (2) **trade promotions**, which encourage resellers to engage in activities that will support and increase local sales of the product. In the next module we will discuss how both types of sales promotion can be combined with other communications tools such as advertising, personal selling, and publicity to create integrated marketing communications programmes. In this section, we focus on the variety of trade promotion incentives and their role in motivating reseller support.

Different trade promotion incentives motivate resellers to engage in different functions or activities on the manufacturer's behalf. By combining various rewards, manufacturers can tailor trade incentives to the specific marketing and distribution needs of a product and its target customers. Exhibit 13.11 lists a variety of reseller incentives along with the functional activities that each is appropriate for motivating.

**Exhibit 13.11 Incentives for motivating channel member performance**

| Functional performance dimensions | Examples of channel incentives |
|---|---|
| Increased purchases/carry larger inventories | Larger margins, exclusive territories, buy-in promotions, quantity discounts, seasonal discounts, buy-back allowances, free goods, shelf-stocking programmes, slotting allowances. |
| Increased personal selling effort | Sales training programmes, instructional materials, incentive programmes for channel members' salespeople. |
| Increased local promotional effort | |
| • Local advertising | Cooperative advertising; advertising allowances; print, radio or spot television advertisements for use by local retailers. |
| • Increased display space | Promotion allowances tied to shelf space. |
| • In-store promotions | Display racks and signs, in-store demonstrations, in-store sampling. |
| • Price promotions | Off-invoice allowances. |
| Improved customer service | Service training programmes, instructional materials, high margins on replacement parts, liberal labour cost allowances for warranty service. |

### 13.8.4.1 Incentives to Increase Reseller Purchases and Inventories

For new products, the most critical objective is simply to get wholesalers or retailers to stock the new item. Manufacturers unable to build much pull for their products by stimulating selective demand often have to offer more direct inducements to build distribution. They can offer higher margins than are typical for the category, introductory discounts for a limited time, or even agree to give selected resellers exclusive rights to the product in their local territory (although exclusive territories are not appropriate for convenience goods requiring extensive distribution). In many cases, the manufacturer must also pay a onetime fee called a **slotting allowance** to induce retailers to stock the product on their shelves.

Once a product has achieved adequate distribution, the manufacturer's purpose changes to one of maintaining adequate inventories of the product as close to the end customer as possible to minimise out-of-stock conditions. This usually involves offering some form of **quantity discount** tied to the volume of a reseller's purchases. Similar incentives include **buy-back allowances**, where the producer offers a discount on a future second order based on the size of the initial order, and **free goods**, where the manufacturer rewards volume purchases with additional merchandise at no cost. Of course, the manufacturer may also try to form logistical alliances or relationships involving electronic data interchange and computerised reordering with their larger resellers. As we have seen, such alliances help ensure that adequate stocks are available while reducing the volume of inventory (and the associated costs) that resellers must carry.

#### 13.8.4.2 Incentives to Increase Personal Selling Effort

To motivate and assist resellers in upgrading the knowledge and professionalism of their salespeople, manufacturers can provide instruction manuals, training seminars, or detailed training programmes held at the manufacturer's headquarters. Some firms also attempt to increase the amount of effort their resellers' salespeople devote to their products by offering incentives directly to those sales personnel. Such programmes usually take the form of sales contests. The rewards may be monetary – sometimes called **push money** or **spiffs** – or in the form of merchandise or travel. However, manufacturers should obtain approval from each reseller before initiating such programmes.

#### 13.8.4.3 Incentives to Increase Local Promotional Effort

Middlemen can play an important role in advertising and promoting a manufacturer's product in their local areas, particularly for consumer goods. Thus, to stimulate more local advertising, many manufacturers offer **cooperative advertising programmes** that pay a percentage of a reseller's expenses for local advertising up to some limit based on that reseller's sales of the product. Firms may also offer retailers **promotional allowances** tied to the amount of shelf or display space they devote to a product. To further encourage in-store promotions, many manufacturers offer free racks, signs, and other materials for use in point-of-purchase (P-O-P) displays.

Producers may also encourage periodic or seasonal price promotions featuring their product by providing **off-invoice discounts** for limited periods. The intention of such discounts is to encourage the reseller to pass along the savings to customers in the form of a special promotional price or sale event. One problem with such discounts, though, is that resellers may simply pocket the money as a means of increasing their own margins.

#### 13.8.4.4 Incentives to Improve Customer Service

For consumer durables and industrial products, manufacturers often rely on distributors or retailers to provide product-related services, such as installation and repair, to the final customer. One way for firms to strengthen the quality of such service is to provide detailed instructional materials or company-sponsored training programmes for their dealers' service technicians. Some firms, such as Caterpillar, are now making detailed repair guidelines and technical assistance available to dealers over the Internet.[31] Manufacturers also offer high margins on replacement parts or liberal labour cost reimbursements to reward resellers for performing warranty service.

#### 13.8.4.5 The Changing Role of Incentives in Relational Distribution Systems

In channel systems where the manufacturer has forged successful long-term relationships with major resellers, the primary incentive for continued cooperation among the parties is focused on the improved sales volumes and reduced operating costs such cooperation can generate. Consequently, some of the specific trade promotion incentives discussed above are less important and less frequently used in such systems. As mentioned, for instance, logistical alliances and computerised reordering systems can reduce the amount of inventory that resellers must carry to avoid out-of-stock problems (though many manufacturers continue to offer quantity discounts to resellers based on their total sales volume during the year to encourage aggressive sales effort on behalf of their products). Similarly, some firms have reduced or eliminated off-invoice price promotions in favour of 'everyday low prices' aimed at improving resellers' average margins. The purpose is to smooth out manufacturing schedules and inventories by discouraging resellers from stocking up during promotion periods. Some manufacturers continue to offer periodic price promotions, but they pay discounts to their resellers only on goods that were actually sold to consumers at a promotional price.[32]

### 13.8.5 Channel Conflicts and Resolution Strategies

Regardless of how well a manufacturer administers its channel system, some amount of **channel conflict** is inevitable. Some conflict is essential if members are to adapt to change. Conflict should result in more effective and efficient channel performance, *provided* it does not become destructive. Disagreements among channel members can occur for several reasons, including incompatible goals, unclear rights and responsibilities, and misperceptions and poor communication.

Because channel conflict is inevitable, the challenge is not to eliminate it but to manage it better. Firms can pursue several approaches aimed at recognising and resolving potential conflicts early before they cause a breakdown of cooperation in the system. These include involving channel members in policy decisions (use of dealer advisory boards), increasing interaction among personnel at all levels (a manufacturer's salespersons making sales calls with each of its distributors), focusing on common goals, and the use of mediation and arbitration.

A manufacturer might also proactively adjust policy to defuse the source of conflict or increase the incentives and rewards available to channel members to lessen the economic consequences of contentious issues. For example, Hallmark created a separate line of greetings cards for sales through mass merchandisers to reduce the amount of direct competition with its traditional retailers, and it created a website that helped those retailers attain discounts from other, noncompeting suppliers and thereby improve their profits.

There are legal constraints on how much and what kinds of power can be used to resolve conflicts or control channel members' actions. This is most apt to be the case when the firm uses an exclusive or selective distribution strategy and/or attempts to dictate how the channel intermediary will perform in marketing the product. In recent years, the US courts have begun to use more of a rule-of-reason approach to potential offenses rather than finding specific practices inherently illegal. Even so, vertical relationships are covered by the major US antitrust acts – Sherman, Clayton, and FTC. See Exhibit 13.12 for a brief discussion of the major nonprice legal constraints imposed by the federal government.

**Exhibit 13.12 Summary of nonprice legal constraints in the United States**

1. **Exclusive dealing.** The requirement that a channel member sells or leases only the seller's products is illegal if the requirement substantially lessens competition.
2. **Tying contracts.** This requires a buyer to take products other than the one wanted and, with some exceptions, is illegal per se. *Reciprocity*, wherein a buyer refuses to do business with a supplier unless that firm buys its products, is similar to tying contracts and is illegal when coercion is involved and substantial commerce is affected.
3. **Territorial restrictions.** This involves the granting of a geographical monopoly to a buyer for a given product. The decision here rests on the effect of intrabrand restrictions in interbrand competition. *Resale restrictions* on the type of customer the buyer can sell to are handled on much the same basis.
4. **Refusal to deal.** The right of a seller to select its customers – or to stop selling to one – is legal as long as it does not substantially lessen competition or foster a restraint of trade.
5. **Promotional allowances and services.** These must be offered to all resellers on proportionally equal terms and must be used for the purposes intended (e.g. advertising allowances must be used to pay for advertising).
6. **Incentives for resellers' employees.** Such incentives (e.g. push money) are generally acceptable, provided they do not injure competition substantially.

## Learning Summary

- The importance of good distribution decisions in designing a marketing plan is simple: Customers won't buy your good or service unless it is conveniently available when and where they want to buy it.
- Distribution channel decisions have a major economic impact because distribution costs, many or which do not even appear in the firm's income statement, often exceed the costs of producing a good or service.

- Channel design involves decisions about the appropriate types and numbers of middlemen to include in the distribution channel in order to link the marketing strategy for the good or service to the needs of the target customers.
- Distribution channels can be designed to accomplish a number of objectives, including maximising the product's availability, satisfying customer service requirements, encouraging promotional effort, obtaining timely market information, minimising distribution costs, and maintaining flexibility. However, each design alternative is better for achieving some objectives than others, and there are trade-offs across objectives; increasing availability and customer service, for example, tends to increase distribution costs. Therefore, good channel design decisions require compromise and careful judgement.
- A manufacturer or service provider can attempt to gain the support and direct the efforts of its channel partners through vertical integration, by legal contracts (e.g., franchise agreements), by providing economic incentives, and/or by developing mutually beneficial relationships based on trust and the expectation of future benefits. Given the large investments required for vertical integration and the difficulty of writing enforceable contracts when market conditions are changing rapidly, the development of effective incentives and long-term relationships with channel members is increasingly vital to the market success of most firms.

# Review Questions

## Content Questions

13.1 Define a marketing channel.

13.2 Define each of the institutions found in marketing channels.

13.3 Define the following:
  a. Manufacturer's agent.
  b. Broker.

13.4 What are the major types of retailer?

13.5 What are the major types of nonstore retailing?

13.6 Describe each of the five alternative consumer goods channels.

13.7 Describe each of the four alternative industrial goods channels.

13.8 Firms design channels to accomplish one or more objectives? What are they?

13.9 Describe the three basic strategies of retail coverage.

13.10 Describe the various types of vertical marketing system.

13.11 What are the major sources of channel power?

13.12 Under what conditions should a manufacturer use a pull strategy? A push strategy?

13.13 Discuss briefly the various purposes channel incentives are used for.

13.14 Discuss the three major ways of entering a foreign country.

## Multiple Choice Questions

13.15 The set of interdependent organisations involved in the process of making a product or service available for consumption or use by consumers or industrial users is known as a(n):

A. retail market.
B. wholesale channel.
C. marketing channel.
D. intermediary stream.
E. distribution function.

13.16 What percentage of the marketing costs associated with consumer goods can be attributed to the manufacturer and wholesale middlemen?

A. 20 per cent.
B. 33 per cent.
C. 40 per cent.
D. 50 per cent.
E. 66 per cent.

13.17 The marketing expenses for industrial goods such as sheet steel account for about what percentage of the final selling price for this type of product?

A. 3 to 5 per cent.
B. 6 to 10 per cent.
C. 10 to 15 per cent.
D. 20 to 25 per cent.
E. 30 to 35 per cent.

13.18 The idea that wholesalers can spread their costs across different manufacturers and, therefore, perform the selling function at a lower cost than can these manufacturers is known as:

A. scale efficiency.
B. functional efficiency.
C. transactional efficiency.
D. service efficiency.
E. agent efficiency.

13.19 The idea that retailers such as department stores make it possible for customers to purchase a wide variety of goods at a single source is known as:

A. service efficiency.
B. agent efficiency.
C. scale efficiency.
D. transactional efficiency.
E. functional efficiency.

13.20 _____ specialise in the selling function and represent client manufacturers on a commission basis.

A. Merchant wholesalers
B. Agent middlemen
C. Retailers
D. Jobbers
E. Facilitating agencies

13.21 The most common type of middleman found in an industry like OEM automotive parts, where manufacturers typically do not produce broad enough product lines to support a company salesperson in a particular territory, would be a:

A. broker.
B. sales agent.
C. full-service wholesaler.
D. limited-service wholesaler.
E. manufacturer's agent.

13.22 In the oil industry, the function of _____ is to bring buyers and sellers of oil together so that an exchange can take place.

A. sales agents.
B. manufacturers' agents.
C. brokers.
D. jobbers.
E. intermediaries.

13.23 Middlemen who sell goods directly to final consumers for their or their family's personal use are known as:

A. wholesalers.
B. agent middlemen.
C. sales agents.
D. retailers.
E. full-service merchandisers.

13.24 IBM would be most likely to use a _____ channel to distribute its mainframe computers.

A. producer → wholesaler → industrial buyer.
B. producer → agent → industrial buyer.
C. producer → wholesaler → wholesaler → industrial buyer.
D. producer → industrial buyer.
E. producer → agent → wholesaler → industrial buyer.

13.25 Which of the following is NOT an objective of a distribution channel?

A. Obtaining market information.
B. Ensuring promotional effort.
C. Specifying who the end user is.
D. Maintaining flexibility.
E. Increasing cost effectiveness.

13.26 The most important objective of any distribution channel is to:

A. ensure that promotional effort is devoted to the product.
B. provide a high level of customer service.
C. make the product available.
D. attain feedback on market information.
E. provide cost effectiveness.

13.27 The primary advantage of an intensive distribution strategy is that:

A. shipping and handling costs are lower than with other strategies.
B. there is better retailer support because more retailers are involved in the channel.
C. the company does not rely on a single channel member for success.
D. product availability is maximised.
E. promotional effort is reduced because more retailers carry the cost of promotion.

13.28 An appropriate strategy for shopping goods that customers buy infrequently and compare for differences in price and product features, such as television sets, is _____ distribution.

A. intensive.
B. exclusive.
C. preferred.
D. effective.
E. selective.

13.29 Selective distribution would probably be used to distribute:

A. Bold detergent.
B. Rolls-Royce cars.
C. Timex watches.
D. Polo sportswear.
E. Crest toothpaste.

13.30 For industrial goods and services what objective is most important for keeping customers satisfied?

A. Delivery dependability.
B. Order cycle time.
C. Product availability.
D. All of the above.
E. Only A and B above.

13.31 The theory of transaction cost analysis (TCA) argues that when substantial transaction specific assets are involved:

A. the cost of using independent channel members is lower than the cost of managing a company salesforce.
B. the cost of using independent channel members is higher than the cost of managing a company salesforce.
C. the cost of using independent channel members is about the same as the cost of managing a company salesforce.
D. cost is not a consideration.
E. cost should be evaluated for each individual transaction.

13.32 Which of the following functions would a manager need to evaluate in order to determine a channel design?

A. Selling.
B. Storage.
C. Order processing.
D. Transportation.
E. All of the above.

13.33 Channel power is best defined as:

A. A's ability to get B to do what A wants.
B. A's ability to deliver what B wants relative to B's alternative sources of fulfilment.
C. A's ability to reward B so B will do what A wants.
D. A's ability to find what it wants independent of B's ability to deliver it.
E. A's ability to use C and bypass B.

13.34 When a supermarket charges a manufacturer $20 000 to 'rent' shelf space for its new product in that supermarket, this is known as:

A. push money.
B. pull money.
C. a slotting allowance.
D. price lining.
E. odd pricing.

13.35 One incentive used to increase personal selling effort in the channel is to:

A. increase promotional allowances.
B. provide display racks and signs.
C. ensure exclusive territories.
D. institute push money.
E. provide more instructional materials.

13.36 When a manufacturer requires that an independent retailer sell only the manufacturer's products it is called:

A. refusal to deal.
B. a tying contract.
C. exclusive dealing.
D. offering incentives to the retailer's employees.
E. a promotional allowance.

13.37 One example of direct overseas investment is:

A. joint venture.
B. countertrade.
C. franchising.
D. cooperative exporting.
E. coproduction.

13.38 What are firms referring to when they reengineer their distribution processes in ways that increase customer service levels while simultaneously reducing costs?

A. Supply chain management.
B. Efficient consumer response.
C. Distribution management.
D. All of the above.
E. Only A and B above.

## Application Questions and Cases

13.39 The Hallmark example illustrates the problems facing a manufacturer when a new and potentially dominating channel emerges, thereby setting up a conflict with the company's traditional channel. What could Hallmark have done to help its Hallmark card shops cope with this problem, given that the company had to sell its cards to the large drug, supermarket and general merchandise discount chains? Part of Hallmark's problem may have been of its own making because of its failure to recognise the growing importance of mass merchandisers in selling its cards. What kind of a monitoring system would have alerted the company to the emerging problem? How could Hallmark have taken advantage of the early warning?

13.40 The president of a carpet manufacturer has asked you to look into the possibility of bypassing the firm's wholesalers (who sell to carpet, furniture and department stores) and using company salespeople to sell directly to these stores. What caution would you voice on this matter and what information would you gather before making a recommendation?

13.41 Under what conditions is a manufacturer most likely to consider the use of *multiple distribution channels* for marketing a product? Describe an example of multiple channels involving a consumer good or service.

13.42 A Swedish manufacturer of home entertainment equipment such as stereos and VCRs is interested in entering the US market. What kinds of institutions should it consider including in its distribution channel in the United States? Why?

13.43 Calvin Klein jeans are *selectively distributed* through a limited number of fashionable department and speciality stores. Is this an appropriate channel design for such a product? Why or why not?

13.44 One of a number of trends affecting wholesalers in the United States, Europe and Japan is *just-in-time*. Describe what this term means and explain what forces are making it a more and more important business practice. For a wholesaler to adopt this practice, what must it be able to do?

13.45 A few years ago, large manufacturers with well-known brands – General Foods and Procter & Gamble – held substantial power over even the largest retailers in their distribution channels. Today, large retailers such as Tesco have the power to demand more rewards and support from major manufacturers. What has caused this change in the balance of power? What are the bases (or sources) of retailers' power over their suppliers?

13.46 Why would an independent hardware store owner agree to become a member of a *cooperative chain*? What benefits would the store owner receive? How would the development and growth of the cooperative chain affect the balance of power in hardware distribution channels?

13.47 A small and relatively unknown manufacturer of valves and fittings wants to induce large plumbing wholesalers to carry and promote its products. Which strategy should it pursue? Which specific incentives might it offer to wholesalers to gain their support?

13.48 A cereal manufacturer is considering using a pull strategy to gain extensive retail coverage for a new cereal brand targeted at health-conscious adults. Which characteristics and capabilities of the manufacturer can help determine its ability to successfully implement such a strategy?

13.49 There is often conflict between manufacturers and the retailers who distribute their products. What are some major causes of such conflicts? What can a manufacturer do to minimise or resolve these conflicts?

13.50 In establishing and maintaining a channel system in the developing countries in Africa, what problems might the manufacturer of small electrical appliances expect to encounter? For each such problem, what can be done to solve it?

13.51 As a consultant to a small chain of supermarkets, you have been asked by the president to list, in outline form, what ethical subject areas the company should discuss internally before writing an ethical manifesto, which would be distributed to suppliers, staff and stockholders.

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# Module 14

# Integrated Promotion Decisions

## Contents



## Integrated Marketing Communication Takes on Some New Twists

Marketers have long known that marketing communications of various kinds should be integrated, so that each communications effort builds on the others. Advertising campaigns, publicity, sales pitches delivered by the salesforce, even sales promotions – all should sing from the same hymnal. The advent of new digital media – from the Internet to email to text messaging via mobile telephones – has opened a vast array of new opportunities to take integrated marketing communication – IMC for short – to a whole new level.

With today's technology, marketers can encourage radio listeners to email the show. They can run a television campaign that drives audiences to a website. They can put radio or TV content on the web to make it available any time, anywhere.

### *Larazade*

Take, for example, the UK's garishly orange energy drink from GlaxoSmithKline (GSK), Lucozade. To coincide with the UK launch of the film 'Tomb Raider' in 2001, GSK temporarily rebranded the drink as Larazade, using broadcast and new digital media to support the effort. In one television commercial, 'Lara Croft, adventurer and archaeologist, flees through an underground cavern from a pack of pursuing dogs, only to find her way blocked by a chasm. Cornered, she reaches over her shoulder into her back-pack, retrieves an orange bottle, and drinks its contents. Revitalised, she gives the dogs the slip and sprints to safety.'[1] The television ads not only delivered Larazade messages directly; they also directed viewers to a website that reflected the film's theme.

Visitors to the Larazade website were encouraged to leave their mobile phone numbers and email addresses to receive a message from Lara, the film's heroine. Drawing on the story line in the film and in the video games of the same name, email and text messages were then sent to drive Tomb Raider fans to a second and secret Larazade website. This multichannel approach targeted the hard to reach 18–24 market segment that GSK sought to address. A stunning 83 per cent of those who received the text message from Lara went to her secret website.

### *Big Brother*

In another example, the Big Brother TV programme in the UK (like the somewhat similar programme Survivor in the US) used a voting engine that allowed viewers on Sky Digital to vote, using their remote control. The voters decided which contestants should stay and which should go, thereby pruning the cast over time until a final winner was picked. The voting element converted typically passive television viewers into active participants, which was a plus for advertisers. In 2001, more than 5 million votes were cast using the voting engine to evict contestants from Big Brother 2. But instead of limiting itself to simply being a TV show, Big Brother broadcast the activities of its contestants in their own homes 24 hours each day, live on the web, thereby offering the show's advertisers yet another way to deliver messages to their audience.

### *What's Next?*

What will integrated marketing communication planners think of next? Observers think that text, web, radio, and television will become more and more integrated so viewers can go from, say, a TV programme to a website or use text messages or email to connect with the broadcaster. All these elements provide promotional opportunities that today's marketers are just beginning to learn to use. A critical link in making all this happen is implementing digital networks, which will make improved targeting and localised content possible. 'It means that local radio can get even closer to its audience by being able to deliver services in a more localised way, as well as improving reliability and enhancing production values,' says Sandy Milne, a digital products manager for the BBC.[2]

Thus, creating truly integrated marketing communication is not about simply linking advertising messages with the packaging and the sales pitch of the salesforce, as was often the case a decade or two ago. It's a digital game today, one best played by effectively combining – as did Larazade – traditional media like TV with what today's and tomorrow's new digital technologies offer.

## Learning Objectives

Module 14 addresses the considerable challenges entailed in the last of the four Ps – **promotion** – and provides tools and analytical frameworks for addressing several age-old marketing questions. To whom should marketing messages be directed, inside the company and outside, to consumers and other stakeholders? How can the marketing manager most effectively and efficiently inform the target market about the product? How can the manager persuade them to try or buy? What message should be delivered? How much should the firm spend to deliver it? In what media, or with what promotional tools? Finally, how might the manager assess whether the promotional strategy has been both effective and efficient? These are not easy questions to answer.

The module begins by introducing the promotion mix, the collection of promotional elements from which marketers can choose. It then explore the communication process and the barriers that make it difficult to get promotional messages across to their intended audiences. Finally, the module provides tools for marketing managers or entrepreneurs to use in answering the questions just raised, in order to prepare evidence-based marketing plans that stand a good chance of meeting their marketing objectives.

## 14.1 The Promotion Mix: A Communication Toolkit

In deciding how to best promote their products, whether good or services, marketing managers must decide which promotional tools to use and with whom they wish to communicate. These decisions, as we shall see, must consider the objectives the marketer has in mind, as well as the merits of and costs entailed in using different tools in the **promotion mix**. In making these decisions, the marketer is developing a promotional or an **integrated marketing communication (IMC) plan**. Arens defines the IMC planning process as one of 'building and reinforcing mutually profitable relationships with employees, customers, other stakeholders, and the general public by developing and coordinating a strategic communications programme that enables them to make constructive contact with the company brand through a variety of media.'[3]

The process by which the IMC plan is developed follows essentially the steps in the marketing management process that have served as the basis for the structure of this book. Of particular importance are the steps involving segmentation, targeting, and positioning, which ideally would provide information on the choice criteria of the target audience. Setting marketing objectives and strategy for a product-market is also critical since it sets the stage for the development of the strategic marketing programme, which establishes the role of the various elements in the marketing mix.

Successful execution of these steps and those concerned with the development of the promotion mix (as discussed in this module) should produce an effective IMC plan. Also important is the development of message consistency over time, regardless of the form the message takes and the media vehicles used.

The principal tools from which a marketer can choose in developing an IMC plan, comprising the **promotion mix**, are **advertising**, **personal selling**, **sales promotion**, and **public relations**, though there are other promotional tools, such as sponsorships and staged events, that do not fall neatly into any of these categories. Definitions of these tools or promotional elements follow, and are elaborated in Exhibit 14.1.

- **Advertising** – Any paid form of *nonpersonal* (i.e. through some medium, such as radio, print, direct mail, or email) presentation and promotion of ideas, goods, or services by an identified sponsor.

- **Personal selling** – A process of helping and persuading one or more prospects to purchase a good or service or to act on any idea through the use of an *oral* presentation (person-to-person communication).
- **Sales promotion** – Incentives designed to stimulate the purchase or sale of a product, usually in the short term.
- **Public relations** – Nonpaid, nonpersonal stimulation of demand for a product, service, or business unit by planting significant news about it or a favourable presentation of it in the media.

**Exhibit 14.1 Examples of promotional activities**

| | |
|---|---|
| • **Advertising** | Print advertisements (newspaper and magazine), radio, television, billboard, direct mail, brochures and catalogues, signs, in-store displays, posters, motion pictures, web pages, banner ads and emails. |
| • **Personal selling** | Sales presentations, sales meetings, sales training and incentive programmes for intermediary salespeople, samples and telemarketing (either inbound or outbound). |
| • **Sales promotion** | Coupons, sweepstakes, contests, product samples, rebates, tie-ins, self-liquidating premiums, trade shows, trade-ins and exhibitions. |
| • **Public relations** | Newspaper and magazine articles/reports, television and radio presentations, charitable contributions, speeches, issue advertising and seminars. |

Firms spend substantial sums on their advertising and sales promotion activities. Advertising expenditures in all media, including the Internet, were estimated to be $600 billion in the US alone in 2007. Spending levels in Europe were not far behind. Collectively this amounted to a per-capita expenditure of nearly $1000 per year[4] – and the above totals do not include personal selling and public relations on which many billions more are spent.

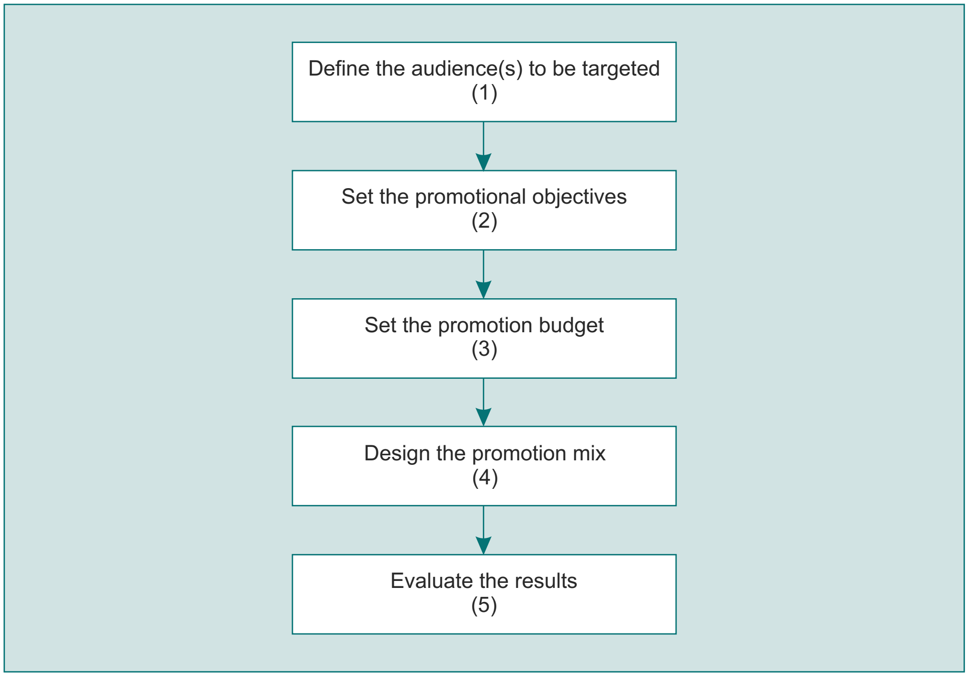
## 14.2 Developing an Integrated Marketing Communications Plan

There are many factors to consider in developing an effective promotion, or marketing communications, programme, whether for goods or services. These include the objectives the marketer has in mind, the characteristics and decision processes of the target market(s) the communication is intended to reach, and the available budget. In addition, the product's positioning, its competitors' promotional strategies, the distribution channels through which it will be sold, the product's stage in the product life cycle, and the merits of the various elements of the promotion mix must be considered. Thus, promotional decision making is no simple task! Simply having a creative idea for an advertising campaign is not sufficient.

Each of the four elements of the promotion mix – advertising, personal selling, sales promotion, and public relations – has its own unique strengths and weaknesses, though these vary for specific tools and media within each of the four elements.

The marketer's challenge is to develop a budget that will accomplish the promotional objectives and distribute that budget across the elements of the promotion mix in the most effective and efficient manner. To do so, skilled marketers follow a five-step process like that outlined in Exhibit 14.2.

**Exhibit 14.2 Decision sequence for developing the promotion mix**




## 14.2.1 Step 1: Define the Audience(s) to Be Targeted

In the market segmentation module, we identified three broad ways to segment both consumer and organisational markets: on the basis of demographic variables, geographic criteria, or behavioural descriptors of various kinds. Segmentation decisions are especially important to the marketing communications effort because they identify who the target market is, so those planning the communications effort can identify the best ways to reach the target customers. Making promotional decisions without a clear idea as to who the target market is can often lead to misdirection or waste of scarce marketing funds. Sometimes promotional messages in an integrated marketing communications programme must target multiple audiences, such as for medical products. For example, Rogaine, the drug for male pattern baldness, was promoted to doctors, to encourage them to prescribe it, as well as to consumers, to encourage them to ask their doctors about the product.

Consider the Super Bowl, an annual American football game that has long been the most watched sporting event in the United States and the top TV advertising opportunity in the country. Two dot-com high fliers, Monster.com and HotJobs.com advertised on the Super Bowl telecast in 1999 with considerable success. Their target markets were those who were looking for new jobs anywhere in the United States, a behavioural segment that crosses virtually all adult demographic and geographic groups. The Super Bowl, with its broad viewing audience, was a good way to reach this large target and get some press attention as well.

Now consider OurBeginning.com, a marketer of wedding invitations that advertised on the Super Bowl in 2000.[5] Women ages 18 to 30 comprise the most attractive target market for wedding invitations, since women's families plan most weddings and most weddings are still among couples in these age brackets. Was the Super Bowl an effective and efficient way to reach this target market? It may have been seen as effective, since many young women do watch the Super Bowl, though they may be less glued to the screen at a Super Bowl party than are their male counterparts. But it was not efficient. Only a small portion of the total Super Bowl viewing audience fell into OurBeginning.com's target market, but OurBeginnings had to pay Super Bowl prices for the entire viewing audience. Thus, OurBeginning.com's cost to reach its target customers was very high. Note that Ourbeginning.com no longer exists.

### 14.2.2 Step 2: Set the Promotional Objectives

Having clearly identified the target audience for the marketing communication being planned, the marketer's next job is to decide exactly what the communication is supposed to accomplish, in measurable terms. Growth in sales and market share are often used as promotional objectives, but marketers should note that sales increases are a function of the entire marketing programme, not just the promotion mix. Advertising a poorly designed or overpriced product or one that has little distribution is not likely to be successful. Appropriate promotional objectives, like other business objectives, should follow the SMART acronym: **s**pecific, **m**easurable, **a**ttainable, **r**elevant (to the firms' mission and overall market and competitive context), and **t**ime-bound. Thus, good promotional objectives should include four key elements:

- a statement defining the target audience;
- a statement of how some specific aspect(s) of the audience's perceptions, attitudes, or behaviour should change;
- a statement of how quickly such a change is expected to occur; and
- a statement of the degree of change required.

### 14.2.3 Step 3: Set the Promotion Budget

There are a number of ways to prepare the promotion budget, most of which work from the top down (managers first determine the total amount to be budgeted and then allocate various amounts to the different mix components). The major budget-setting methods used are discussed briefly below.

The **percentage of sales** method is the most common. The procedure consists of setting this year's budget as a percentage of this year's anticipated sales. Under this approach, sales determine the promotional activity versus planning to achieve some desired sales objective. Even though illogical, this method has some advantages. It is simple to calculate and is risk-averse because spending is linked to sales.

The **competitive parity** method sets the relative level of promotional spending equal to the firm's market share or larger if an attempt is being made to increase share. Thus, if the firm's market share is 20 per cent, then its budget would be its 20 per cent of the total amount spent by the industry on promoting a given product category. This method of budgeting tends to create stability in market shares among competitors and has the advantage of considering competition. Share of market budgeting is often used in connection with new products where one rule of thumb is to spend one and a half times the share objective at the end of the first or second year.

Because the **objective-and-task** method avoids most of the flaws inherent in the top-down budgeting approaches, it is the best one – though the most difficult – to use. It essentially involves three steps – first, define promotional objectives as specifically as possible; second, determine the strategies and specific tasks necessary to meet those objectives; and third, estimate the costs of performing those tasks and budget accordingly.

The objective-and-task method has the advantage of forcing firms to set specific promotional objectives through careful analysis of the specific situation. It is most effective when the results obtained from a particular promotion activity can be measured (for instance, the awareness generated among members of the target audience or the number of persons who would be exposed to the product via sampling).

### 14.2.4 Step 4: Design the Promotion Mix

Designing the promotion mix is itself a three-step process.

- First, marketers decide which promotion components to use: advertising, personal selling, sales promotion, and/or public relations.
- Second, they choose the specific activities within each component. In advertising, this involves considering such media as TV, radio, newspapers, magazines, the Internet, or billboards. A consumer sales promotion could consist of coupons, free samples, or premiums.
- Third, within each activity they must decide which specific vehicle to employ; for example, in advertising, this might require selecting a TV or radio programme, while in sales promotion they must decide about the coupon specifics – its value, size and colour, message format, and how it will be delivered.

### Exhibit 14.3 Strategic circumstances and the relative importance of personal selling as a promotional tool

| Advertising relatively important | | Personal Selling |
|---|---|---|
| Large | Number of customers | Small |
| Low | Buyers – information needs | High |
| Small | Size and importance of purchase | Large |
| Little | Postpurchase service required | Much |
| Low | Product complexity | High |
| Pull | Distribution strategy | Push |
| Preset | Pricing policy | Negotiated |
| Many | Resources available for promotion | Few |

*Source*: Adapted from David W. Cravens, *Strategic Marketing* (Burr Ridge, IL: Richard D. Irwin, 1987), p. 508.

These decisions are complex because the elements of the promotion mix are not independent; for example, a consumer sales promotion (perhaps a coupon or sweepstakes) often requires advertising to inform the target audience about the promotion. Making specific decisions about promotion mix elements requires examining the target audience, objectives, and budget, already established in Steps 1 through 3 (*see* Exhibit 14.2), as well as the company's overall strategic objectives and resources, the product's stage in the product life cycle, and various market characteristics and the other elements – the kind of product being promoted; its price and distribution – in the marketing mix. It also usually involves making a choice between advertising and personal selling as the principal driver of the promotion strategy (*see* Exhibit 14.3).

In practice, either advertising or personal selling generally plays a dominant role in the promotion mix, with sales promotion and/or publicity playing supporting roles. In marketing goods, especially consumer goods, when advertising dominates, the idea is to communicate with the consumer and encourage him or her to pull the product through the distribution channel, by demanding that the channel stock the product. As we saw in the previous module, this strategy is called a **pull strategy**. Major consumer goods marketers typically use pull strategies. For consumer goods when personal selling dominates, the marketer attempts to convince channel members to stock the product, so consumers will find it at their local store – a **push strategy**. Smaller consumer goods marketers who lack the budgets to pursue pull strategies typically use push strategies. Many little-advertised products found in supermarkets and mass merchants found their way to the shelf through effective push strategies.

Different elements in the promotion mix may be called on to meet different objectives. For example, advertising may be asked to develop awareness and brand recognition; the Internet may be used to build a contact list; personal selling may be used to complete the sale. Even when the strategic conditions and communications tasks faced by a firm favour the allocation of substantial promotional resources to the salesforce, the specific marketing objectives that salespeople are asked to pursue vary widely across firms facing different market and competitive situations. A company's sales personnel might be asked to focus on one or more of the following objectives:

- winning acceptance of new products by existing customers;
- developing new customers for existing products;
- maintaining the loyalty of current customers by providing good service;
- facilitating future sales by providing technical services to potential customers;
- facilitating future sales by communicating product information to potential customers or influencers; and
- gathering market information.

An important part of designing the promotion mix is creating the messages to be communicated to the target audience(s). Preparing a successful message is difficult, if only because of the countless ways in which it can be constructed. Yet the payoffs from good messages are substantial. For example, simple changes in the wording of a print ad have been known to generate a substantial increase in sales for retail stores, mail-order houses, and direct mail sellers. In concept, then, our discussion of this step highlights the remaining issues the marketer must consider in preparing a promotional plan. At the risk of being overly general, Exhibit 14.4 provides guidance in assessing some relative merits of the various elements of the promotion mix. But we have not yet provided enough specifics that the marketer charged with preparing a marketing or integrated marketing communications plan for a new or existing product can determine the specific budgets and activities necessary to meet a sales forecast. We address these important details in the balance of this module. First, however, comes Step 5, which assesses the results of the promotion plan, once it has been implemented.

### 14.2.5 Step 5: Evaluate the Results

This step involves finding out whether the objectives of the promotional activity have been met – usually via marketing research. For example, in advertising a new consumer product, the company could conduct a telephone survey after the promotional campaign had run for a designated period to determine whether the objective of generating a certain level of awareness among members of the target audience had been achieved. Further, the survey could determine what per cent had tried the brand and of these how many had bought it two or more times. In this way management could obtain information about the relationship of trial to awareness. For example, assume a trial/awareness ratio of 25 per cent and an awareness level of 50 per cent among members of the target audience group. Under such conditions, management should seriously consider spending additional funds to increase awareness. Research can also provide important insights into whether the firm attained its distribution objectives.

**Exhibit 14.4 Comparing the merits of the promotion mix elements**

| Promotion mix element | Amount of information communicated | Credibility | Control over the message | Cost to reach one customer | Strategic suitability |
|---|---|---|---|---|---|
| **Advertising** | Varies: little information in a radio or TV ad, to lots on a website | Low | Good | Low | Well-suited to a **pull strategy**. |
| **Personal Selling** | Lots of information | Depends on the credibility of the company and the personality and sales skills of the salesperson | Poor, but training helps | Very high in developed countries, can be low elsewhere | Well-suited to a **push strategy.** |
| **Sales Promotion** | Virtually no information | Not applicable | Good | Low and self-liquidating: generally pays for itself as the product is purchased | Consumer promotion supports a **pull strategy**. Trade promotion supports a **push strategy.** |
| **Public Relations** | Lots of information | High | Poor | Very low or nil | Supports both **pull** and **push** strategies. |

## 14.3 The Nitty-Gritty of Promotional Decision Making

Faced with meeting a sales forecast, how should a marketer determine the specifics of his or her promotional programme? How big an ad budget is needed? In which media should it be spent? What role should personal selling play? How might the Internet be used to best advantage? Are coupons or trade promotions called for? What about samples to encourage trial? Should we seek publicity through a public relations effort? We address these practical questions in this portion of the module.

### 14.3.1 Making Advertising Decisions

Advertising is a complex decision area and the changing macroenvironment has made it even more so. Major social and economic changes include a redefined family unit (fewer members, more single parents and two wage earners), which leads to less pressure to conform to traditional family values, more lifestyle options, and an increase in basic household needs; higher education levels leading to a demand for more meaningful information about products; an older population with the greatest wealth of any population segment; and an exploding media scene including a dramatic increase in the number of media options, not the least of which is the Internet and the emergence of the World Wide Web, where companies can advertise, provide demonstrations, answer questions, and even sell their products.

Advertising decision making is concerned with setting objectives and budgets, choosing which media types and vehicles to use with what frequency, deciding what the message should be and how to present it, and analysing the effectiveness of the advertising programme. We address these issues next.

### 14.3.1.1 Setting Advertising Objectives

Promotional objectives are important in developing an integrated promotion plan. They derive from the firm's marketing objectives and strategy and are concerned with communicating certain information about the company and its product(s) to target audiences. They help in the development of a promotion plan, which, in turn, facilitates decision making by a large number of diverse individuals both inside and outside the company. Promotional objectives serve as the basis for evaluating the advertising programme once it is completed.

Advertising objectives must somehow relate to attitudes and behaviour. Results can sometimes best be assessed by measuring the *process* by which the desired objectives are met. Hence the use of hierarchy-of-effect models that move prospective buyers through a series of steps – awareness, comprehension, conviction, action – to the ultimate goal of purchasing the product. Knowing the various steps in such models helps the marketer better set its advertising objectives. Thus, if most prospects are aware of the product *and* its advantages but not convinced of its uniqueness, the advertising objective would be to create conviction by demonstrating product superiority.

Another advantage of using the communication hierarchy as the basis for setting advertising objectives is that it is possible to measure the proportion of potential customers who are at each stage in the hierarchy. This means that advertising objectives can be set forth in numerical terms for a stated time period and pertaining to a defined audience group.

Thus, in setting advertising objectives, a clear understanding of precisely what the advertising is expected to accomplish, often measured in terms of attitude change, provides an ad agency or others who make the media choices and develop the ads with the direction they need to do their jobs. In large company settings, where advertising enjoys multimillion-dollar budgets, marketing research is used to assess whether the advertising is doing its intended job as we discuss later in this section. Setting SMART advertising objectives makes such an assessment possible.

### 14.3.1.2 Setting Advertising Budgets and Making Media Choices

Whether an advertising programme consists of radio or television ads, banner ads on the Internet, print ads in magazines or newspapers, direct mail, or other media choices, setting budgets and choosing media comes down to making decisions about the extent to which a message is delivered to its target audience, or **reach** and the **frequency** with which it does so. Thus, advertisers must choose some combination of *reach* and *frequency* to attain their advertising objectives. Reach is defined as the total number of individuals or households exposed to at least one ad during a given period – typically four weeks. The term can be used in connection with a single media vehicle (a specific TV show) or a media schedule comprising a number of different vehicles. Reach is typically expressed as a per cent of the target audience; for example, if the target audience was 100 000 persons and the media schedule reached 70 000, then the reach would be 70 per cent. Ordinarily, costs rise at an increasing rate as higher levels of reach are sought.

There are several problems in using these measures. The first is defining the target audience and correlating it with the audiences reached by the various media vehicles. We discuss these problems later in this section. A second problem is defining exposure – is it an opportunity to be exposed to a given message or is it an actual reading of a print ad, actual watching of a TV commercial, or actual listening to an ad on radio? It is difficult to measure exposure no matter how it is defined. Third, not all who are exposed are of equal value to the advertiser, some may not even be prospects. Fourth, how should successive exposures be weighted? Is a second exposure worth more than a third? How much? And how much time should elapse between exposures?

**Exhibit 14.5 Setting an advertising budget for a new wine cooler brand – a hypothetical example**

1 Establish a market-share goal. By the end of the first year, achieve a 15 per cent share of the estimated 40 million case wine cooler market, which is expected to grow by ten million cases per year for the next few years. This target of six million cases is to be obtained by attracting first-time wine cooler buyers and getting users to switch to the new brand. Assume some ten million wine cooler drinkers and the net addition of 2.5 million new drinkers each year. The number of individual consumers needed to attain a 15 per cent share is estimated to be two million.

2 a) Determine the percentage of the target audience that needs to be made aware of the new brand in order to induce a trial and repeat usage rate (three or more bottles) that will attract two million consumers. The agency estimates that 40 per cent of those who try a bottle of the new brand will become long-term users. This means five million persons must try the product. The agency further assumes that 75 per cent of those who become aware of the product will try it. This translates into a need to make 6.67 million – or some 53 per cent of the 12.5 million total present and prospective buyers – aware of the brand.

b) Determine the number of impressions needed to obtain an awareness level of 53 per cent followed by trial and repeat buying. The agency estimates that 35 impressions on average will be needed for each of 12.5 million individuals in the target audience to bring this about (less than one per week). Thus, the total number of impressions needed is 35 × 12.5 million = 437.5 million.

c) Determine the number of gross ratings points (GRPs) needed.* Based on needed reach and repetition (35), assume 3500 GRPs are needed.

3 Determine the cost of the needed 3500 GRPs. The agency estimates an average cost per GRP of $4000 – hence, the advertising media budget would be $14 million. To this amount, the costs of advertisement production and marketing research have to be added.

* GRPs are computed by multiplying the *reach* by the average *frequency*. *Reach* means the different individuals (or households) exposed to an advertising schedule per time period. Reach measures the unduplicated audience exposed to a media schedule and is typically expressed as a percentage of the target audience. *Frequency* is a measure of the number of times on average a person or household receives an advertising measure. Thus, it is a measure of repetition.

Reach and frequency measures are used to prepare the advertising schedule, which, in turn, determines total advertising expenditures. In estimating the cost of a given schedule, media planners simplify their task by using gross rating points (GRPs), which are calculated by multiplying reach by average frequency. Assuming a desired reach of 70 per cent and a desired average frequency of four, the number of planned GRPs would then be 280. By multiplying this by an estimated cost per GRP, the cost for a proposed media schedule can be estimated. A step-by-step procedure for setting an advertising budget for a new wine cooler brand is shown in Exhibit 14.5. This example also illustrates the use of the objective and task method to set an advertising budget.

Exhibit 14.5 shows that various assumptions must be made about desired levels of reach and frequency in order to prepare a media budget. On what are these assumptions based? In practice, marketers rely on their prior experience to determine how much reach and frequency is necessary to deliver a certain level of results. Thus, in preparing promotional plans, marketers must draw on either their own experience, that of others within their company, or that of experts, such as ad agency personnel, to determine how large a budget, or media buy, is necessary to meet a particular objective.

The costs of advertising in various media may be found from a variety of sources. Typically, an advertising medium provides to prospective advertisers upon request a **rate card**, which specifies the nature and size of the audience it reaches and the costs of advertising in that medium. Costs are expressed in **cost per thousand** impressions (an impression is one person being exposed to the ad one time), or **CPM**, making comparisons across different kinds of media possible. Various industry sources compile such information and make it available to prospective advertisers for their use in planning promotional programmes. Exhibit 14.6 provides several such sources and their Internet addresses. Most business libraries have copies of these or similar publications.

**Exhibit 14.6 Comprehensive sources of media audience and rate information**

| Source | Website address | Description |
|---|---|---|
| Standard Rate and Data Service (SRDS) | www.srds.com | Provides rates and audience information for US television, radio, newspaper, magazine (both consumer and business) and direct mail media |
| BPA Worldwide | www.bpaww.com | Provides circulation and traffic information for newspaper, magazine (both consumer and business), trade show, website, industry database and wireless communication media in 25 countries |

| | | |
|---|---|---|
| A.C. Nielsen | www.nielsen.com | Provides, on a fee basis, North American ratings and traffic data for television, cable television and websites based on proprietary samples who report their viewing and Web traffic behaviour |

## Traditional Media Types

Of the four major types of mass media, network and cable TV traditionally has the largest share in the US at 32 per cent, followed by newspaper advertising at 27 per cent in 2001. Direct marketing is on the rise globally, for example, the direct marketing industry in the UK grew by 10 per cent in 2001,[6] despite the slowdown in ad spending in other media.[7] Various Internet and email media are taking market share, however, from these traditional media. Each media type offers unique advantages to the advertiser, but each also has limitations.

**Television** is best at communicating images and symbols because it can demonstrate product usage and consumer reactions. It is a particularly good medium to help sell a mass-market product. It has enormous reach – for example, in the US, almost all households have a TV set (98 per cent have one set and nearly two-thirds have two or more). Cable TV has experienced such substantial growth in the US that it covers more than two-thirds of all households. While cable TV penetration is not as high in most countries in Europe, satellite television is increasing in popularity and advertising on the free-to-air channels reaches all of the television households.

A lively debate has been under way about the extent to which television is likely to give way to the Internet and other new media, as consumers spend more and more time online and less and less time in front of the TV. As executive VP Jim Helberg of media buying firm PHD notes, the sizes of audiences and the demand for TV ads simply 'don't connect anymore.' Helberg predicted a dramatic shift of ad spending away from TV by 2011.

Other observers disagree. In spite of the apparently inexorable decline in TV viewing, media analyst Jon Fine writes, 'Waiting for ad dollars to shift decisively away from TV is like being a weatherman during a 30-year drought. You know the heavy rains have to come down at some point. It's just taking awfully long for those showers to arrive.'[8] Adman and Saatchi & Saatchi CEO Kevin Roberts puts it more forcefully: 'TV will be the absolute dominant screen in the world. Just look at China, look at Russia, look at India, look at Brazil, look at Indonesia and look at the way TVs are absolutely going crazy. Even in the US, people still spend two and a half hours a day in front of a television screen.'[9] The debate about the future of TV advertising as we know it has ad agencies, marketers of all kinds, and numerous observers on the edge of their couches. It's an important question about which only time will give us an answer.

**Radio** is less involving than television, but offers economy and the opportunity to target specific audiences – particular ethnicities, teenagers, senior citizens. Radio advertising – while inexpensive compared with TV and newspapers – suffers in that it reaches people mostly when they are doing something else – working, driving, or walking. It is often used to reinforce TV advertising.

**Print media** are more involving than broadcast media. Readers select what advertising they want to read and take as much time as they wish to read it. Thus, print is effective in communicating detailed information about a product. This can be particularly important for many industrial products and high-involvement consumer goods.

There are many types of magazines based on the nature of their content and the scope of their geographical coverage – regional, national and international. And they can be categorised on the nature of their audience ranging from general or mass appeal (*The Economist*, *Newsweek*), to highly specific such as those dedicated to sports (football, golf, tennis), hobbies (gardening, stamp collecting, antiques), ethnic groups (Hispanic), age groups (teens, seniors), gender (working women), and financial (investment opportunities). In recent years more focused magazines in terms of market segments have gained circulation versus the larger more generalised ones.

Newspaper advertising, on the other hand, has trended inexorably down, with newspapers shutting down in many places. The shift of most classified and much employment advertising to online sources has played a key role in driving this decline. Will newspapers survive in their traditional print formats? At this point, nobody knows.

**Out-of-home, exhibition, and supplementary media** cover a wide variety of media types.[10] These three categories are discussed briefly below.

- **Out-of-home.** Billboards are the most prominent media and come in a variety of shapes and sizes as well as location opportunities. These include spectacular electronic signs that feature moving messages and colour graphics. Other outdoor media include transit shelters, terminals, and airports; transit vehicles – both inside and out – such as taxis, buses, and streetcars; sports stadiums (many carry the name and logo of a prominent advertiser); parking meters, public phones, and shopping malls.
- **Exhibition.** This category is dominated by in-store display materials, which include signs, banners, video displays on shopping carts, and electronic ads on in-store screens. Trade shows and exhibits are a favourite with many business goods companies.
- **Supplementary.** Directories and yellow pages (both print and online) are the major media in this category.

**Direct marketing** using advertising media has been covered in part in Module 13 (distribution decisions). For consumer products, this approach typically involves direct mail (including catalogues and Internet marketing), TV, radio, and print ads with a toll-free phone number. Despite its high cost (per exposure) and despite typical response rates in the 1–2 per cent range, direct mail's selectivity has enabled some companies to reap substantial profits.

## New Media

Among the greatest challenges facing advertisers today is how to take best advantage of the opportunities presented by the new media made possible by advances in computing and communications technology. In late 1998 – eons ago in Internet time – J. William Gurley, a venture capitalist and columnist writing in *Fortune* magazine, predicted that Internet technologies would revolutionise advertising, largely because the performance of Internet ads is measurable. 'On the Internet an advertiser can not only measure the number of people who see his ad but can also track the number of people who "click through" an ad to get more information from the advertiser's own Web page. Armed with such data, an advertiser doesn't have to settle for spots that don't deliver customers. Unlike a print or television ad buyer – and like a direct marketer – he can pay only for messages that reach the most receptive audience.'[11]

Gurley's prediction has begun to play out, as Internet shopping and advertising take off. Aided by recent software innovations, advertisers can now measure not only how many customers 'click through' a banner ad, but they can also determine which customers bought online, how much they bought, and what the margins were on each sale. More traditionally, advertisers can also use the Internet for image-oriented brand building for both Web-based and traditional businesses (*see* Exhibit 14.7).

**Exhibit 14.7 Unilever's Axe switches from TV to the Internet**

As consumers spend more and more time on the Internet, advertisers are following suit. 'Ultimately it comes down to where the customer is,' says Kevin George, Unilever's general manager for deodorants. Axe, Unilever's growing line of personal care products for young men, has moved the majority of its ad budget to the Internet, a switch from 2002 when it launched the brand with a television-based campaign. Axe spends its online budget where young men are found, on sites such as Heavy.com and MySpace.com. One of its efforts featured an online game that was centred on techniques for picking up women, a theme that would have been difficult to deliver in traditional 30-second TV spots. 'We all recognise our consumers are online and we all continue to share the sense that the effectiveness of a traditional 30-second television ad is continuing to erode,' says Noreen Simmons, who directs Unilever's US strategic media planning. Unilever's US online spending quadrupled from 1 per cent to 4 per cent of its ad budget from 2001 to 2004 and has grown further since then. Simmons expects Unilever's online spending will continue to grow.

Source: Kevin J. Delaney, 'Once-Wary Industry Giants Embrace Internet Advertising,' *The Wall Street Journal*, April 17, 2006, p. 1.

Company websites, nearly as *de rigueur* for today's companies as having email and business cards, provide a cost-effective way to provide detailed product information about one's entire product line, as well as information of interest to investors and, unfortunately, to competitors. Websites are also good ways to build one-on-one relationships with customers, by giving them an easy place to go for information, day or night, and by offering opportunities to receive email messages that might be of interest.

**Exhibit 14.8 Is the party over for Internet advertising?**

On November 6, 2007, Google's share price hit a record high of $742. Just five months later, Google had fallen by nearly 40 per cent. ComScore, a research firm, reported that Google's 'paid clicks' in January 2008 had fallen by 7 per cent and were flat against the prior January. February was no better. The question was why. Were surfers doing fewer Web searches? Was a softening economy the culprit? Or were ads getting better, resulting in fewer clicks to take surfers to satisfactory destinations?

The ComScore data threw a scare into the still-rosy projections that abound about the future of Web-based advertising. Globally, online ad spending was expected to top $40 billion by 2011. Forrester predicted that spending on Internet advertising in Europe alone would more than double to €16 billion by 2012, reaching 18 per cent of overall media budgets.

Are the rosy forecasts accurate? Has Internet advertising lost its lustre? Has Google? Despite paltry click-through rates of just 0.2 per cent for online ads in general, Google's search ads still deliver over 5 per cent, according to Nielsen Online, so search ads seem a solid segment of this still-nascent market. In the rough-and-tumble Internet world, however, where the only constant is change, even high-flying Google may not be immune to challenges from Facebook and the rest of the social networking phenomenon.

Sources: 'What Does it Mean When People Click on Google' *The Economist,* April 5, 2008, p. 77; Josh Quittner and Jessi Hempel, 'The Battle for Your Social Circle,' *Fortune* European edition, November 26, 2007, pp. 11; Jessi Hempel, 'The Battle for Your Social Circle,' *Fortune* European Edition, November 12, 2007, p. 38; and Katie Allen, 'Spending on Internet Advertising "to Double",' *The Guardian,* July 13, 2007.

**Banner ads** and other forms of Internet ads, including buttons, text links, pop-up windows, and other new versions that are invented regularly, can be placed on Web portals or other websites. Ads can consist of text, graphics, audio, or video, and some are even interactive. In many cases, advertisers can choose how they wish to pay for such ads. They can pay for placements for a certain time period, like a billboard on a highway. They can pay on a cost per thousand impressions (CPM) basis, as they do for traditional print and broadcast media. They can pay for 'click-throughs' or pay a fee only when the customer buys, thus bearing out Gurley's 1998 prediction.

Unfortunately for Internet sites that rely on advertising-driven business models, click-through rates for many kinds of Internet advertising, especially those that are not very well targeted, have plummeted as their novelty has worn off. (For more on trends in Internet advertising, see Exhibit 14.8.)

**Search keywords** have become a proverbial pot of gold for Google, and now account for some 40 per cent of online advertising.[12] Type 'Tuscany vacation' into Google and along with Google's free listings on the left side of the Google page come paid ads on the right side of the page for cheap flights to Italy, villa rentals, even cooking schools. Such ads are the holy grail of Internet advertising, and the main reason for Google's lofty market capitalisation. Because they are highly targeted – you would be unlikely to type 'Tuscany vacation' unless you were actually considering such a trip – they're worth much more to the advertiser than most other kinds of Internet ads, and are priced accordingly.

**Portal deals**, whereby marketers pay Web portals for prime or exclusive positions on the portals' websites, can establish competitive advantage for marketers by enhancing the likelihood that theirs will be the site in their product category or industry that customers find first on the Web. These deals are particularly popular with Web-based marketers, including travel, auction, and other services. A quick visit to the America Online home page (aol.com) makes clear who has paid AOL for prime space on its busy site.

Email is also a rapidly growing new advertising medium, one particularly well suited to building one-on-one relationships with customers. The best thing about email as a medium, from an advertiser's view, is that it is virtually cost-free. Many airlines now send weekly email updates on bargain weekend airfares to consumers who sign up for such services. On Tuesday or Wednesday, consumers are offered low-priced deals on flights the airlines need to fill. Those in a position to take short, spur-of-the-moment vacations appreciate the opportunities such services provide, and the airlines like having a way to fill seats, which would otherwise fly empty, without having to discount their fares to the general public. As Seth Godin in his book *Permission Marketing* points out, however, the considerable benefits attainable through email marketing come only when the customer gives his or her permission to be sent marketing messages. Were this not the case, the system would be inundated with unwanted messages to the point that it would come to a screeching halt![13] The growth of unwelcome emails, or spam, is a customer problem that software makers are working hard to address.

**Blogging** is another fast-growing Internet application. Given the ease with which anyone can now post material on the Web, companies large and small are developing blogs with which they can, sometimes anonymously, promote their products or ideas or even disparage competition. There are even sites (for example, www.betterbusinessblogging.com) to help businesses develop their blogs!

**Podcasting**, a technology that provides a way for consumers to receive audio via the Internet, is another growing Web-based application. Advertisers and other providers such as CNN, the Cable News Network, provide short audio feeds that can be downloaded and listened to on a PC or on a portable MP3 player.

While the new media seem, on the surface, to be radically different from their more traditional counterparts – radio, television, and print – the logic entailed in planning their roles in promotional programmes is no different than for other media. Considerations of reach, frequency, and cost – measured in cost per thousand impressions (or 'hits' or 'click-throughs' on the Web) – provide a means of comparing their value to one another and to traditional media. **Cost per acquisition**, another measure, is useful for Web advertising that results directly in actual customer purchases, a model familiar in the direct marketing industry. To the extent that new media performance can be measured (How many extra customers does a restaurant get for weekday lunches as a result of its SMS ad, and at what cost per customer?), marketers will be encouraged to use them to their full economic potential.

The rapid growth of these and other new media has led to a variety of ethical issues marketers must address, including the security of Web transactions, privacy, and the sending of unwanted electronic messages, or SPAM, to unwilling customers. Some of these ethical issues are discussed in Ethical Perspective 14.1.

### International Media

Global advertising has been aided by the rise of globally oriented television media like CNN, MTV and ESPN, all of which originate primarily in the United States, and a variety of other media like STAR-TV and Al Jazeera, which originate in Asia and the Middle East, respectively. The ability of media like these to deliver to advertisers an international audience that spans national boundaries offers new possibilities to advertisers seeking to reach global audiences.

### Ethical Perspective 14.1

**Ethical Issues in New Media Marketing**

In the early days of the Web, a principal consumer concern was whether it was safe to transmit one's credit card number to buy something from a Web-based merchant. Such concerns have largely gone by the wayside, as electronic shopping has proven no more risky than the bricks-and-mortar variety. Bigger concerns today have to do with privacy and unauthorised use of customer information, as played out in unwanted emails or unwanted monitoring of Web shopping behaviour. Many websites, including those of Internet retailers such as Amazon.com, place so-called 'cookies' on their customers' computers, to track their shopping preferences and enable enhanced customer services, like Amazon.com's One-Click ordering. When a repeat customer logs on to Amazon.com, the site knows who she is, offers recommendations of books she may like, and permits her to purchase books with a single click. These consumer benefits, however, come at the cost of Amazon's being able to track her behaviour and learn things about her that she may not wish to have the company know. If Amazon sells this information to others, such concerns are heightened. Further, Amazon is able to send her emails announcing promotions, such as when it adds new merchandise categories to its offering.

While consumers typically have the ability to opt in or out of such email lists, knowing how to do so is not always obvious or easy. Similar concerns will arise as the use of mobile telephones for advertising grows. How many of us will want to receive unsolicited messages about bargain lunches on our cell phones? Ultimately, legislation is likely to govern how consumer information may be gathered and used by Web-based and other new media marketers, though different countries are likely to pass different laws. Given the global reach of the Web, does this mean that Web-based marketers will have to comply with whomever passes the most restrictive laws? These and other ethical issues are far from resolved, and new technological developments will likely raise issues not contemplated today.

### 14.3.1.3 Developing the Creative Strategy

Creative strategy derives from the product's targeting and positioning decisions coupled with what the advertising must accomplish. From this information the major selling idea for communicating the key benefits must be developed. This, in turn, generates a strategy statement – often referred to as a copy platform (*see* Exhibit 14.9 for the contents of such a document). Deciding on the major selling idea or theme is the essence of the creative strategy process since it dictates the nature and scope of the various messages that collectively make up an advertising campaign and it delivers on the positioning decisions already made as we saw in Module 10.

**Exhibit 14.9 Copy platform contents**

- Basic issue or problem advertising must address.
- Advertising objective.
- Target audience.
- Major selling idea – or key benefits.
- Creative strategy statement (campaign theme, appeal and execution technique).
- Supportive information.

*Source*: George E. Belch and Michael A. Belch, *Introduction to Advertising and Promotion* (Burr Ridge, IL: Richard D. Irwin, 1996), p. 278.

Designing creative and effective marketing communications – regardless of media, whether traditional or new – is a task that requires creativity and special expertise. Copywriters, art directors, and others who ply this trade effectively are worth their weight in gold, for there are many ineffective ads in every medium. It is far beyond the scope of this book to explore how such messages are best created. The issues involved in managing the creative effort, however, include decisions about the **unique selling proposition** to be delivered (based on the desired positioning of the product), the **source** of the message (Should a company spokesperson or a celebrity be used?), the nature of the **appeal** embodied in the message (Should it be primarily rational, emotional, or both? Should it compare one's own product with those of competitors? Should it use fear, humour, or music?). Effective creative strategies almost always contain at least some **emotional appeal**, and not only deliver the desired message, but also manage to attract the **attention** and **interest** of the target audience despite an extremely cluttered advertising environment. Some ads even include a **call to action**, in which the customer is asked to do something (like call a toll-free telephone number, clip a coupon, or click through to a website).

In today's highly competitive markets where many competing products are at parity, and in our increasingly cluttered advertising environment, Saatchi & Saatchi's Kevin Roberts argues that making an emotional connection with consumers is what effective advertising must accomplish. 'It took (Michael) Jordan to move Nike from being irreplaceable to becoming irresistible,' he says. 'This is because Jordan gave it aspiration, he gave it emotional connectivity. If you wear Nikes you can be like Mike.'[14]

Several ethical issues are involved in developing advertising messages, including issues of morals, good taste, community values, and truth (or deception) in advertising. These issues are discussed in Ethical Perspective 14.2.

## Ethical Perspective 14.2

### Issues in Advertising

To many, the ethical question is more than whether advertising is deceptive. Rather, the moral issue is seen as whether advertisers have the right to encourage the purchase of a product that might be harmful to certain individuals – for instance, the sale of tobacco and alcohol products in general and, especially, to young people and certain minority groups. Seagram's decided to end the liquor industry's long practice of not doing television advertising. While all three major networks continue to refuse drinks ads, some of their affiliates will probably accept.

One of the most controversial areas is advertising to children, especially on TV, which is watched by children 2 to 11 years old an average of 26 hours a week. Critics argue that the advertising of toys creates unreasonable expectations, that children are encouraged to eat harmful foods (sugared cereals), and that the long-term effects of TV may negatively affect children's values, beliefs, and behaviour (especially with respect to violence). Sweden and Canada prohibit any advertising aimed at children; France and Japan limit the use of cartoon characters in advertising to children; and the major networks have strict guidelines for children's ads. In the United States the Federal Trade Commission has taken a much less aggressive stance on this subject.

In the United States, both the federal government and a variety of industry groups have tried to regulate and control deception in advertising. For a given ad to be ruled illegal, it must have the potential to deceive a significant number of consumers as to the facts relating to a purchasing decision. However, deception is difficult to detect in many cases because of the subtle ways in which it can work. Enforcement is hindered by the fact that advertisers can legally employ *puffery*, which uses subjective claims (the 'best' or 'greatest') to promote the product. Many believe that since the role of advertising is to provide information relevant to the purchasing decision, puffery should be prohibited.

Deception can also occur via the use of mock-ups, which involve the alteration of a product or situation to get a realistic photograph of it (using mashed potatoes to represent ice cream, which melts under the photographer's lights). While the FTC has ruled that mock-ups are legal as long as they do not misrepresent the product's characteristics, some critics of advertising argue that many are misleading.

Endorsements and testimonials for products and services have increased in recent years. But do the individuals involved *really* use the products, or are they 'hired guns'? Even though the FTC has rules governing their use, many such ads have the potential to
deceive.

Partial disclosure concerning a product's attributes is yet another way consumers can be misled. An example is when an ad talks about a low cholesterol count but fails to mention the amount of fat the product contains.

### 14.3.1.4 Measuring Advertising Results

Management must know to what extent the message was received, understood, and believed by the target audience, as well as what effect it had on the behaviour of the receiver (trial, repeat buying). Message (copy) testing typically is concerned with alternative ways to present a message to the target audience. The discussion here is divided into two parts – tests made *before* the message is released on a full-run basis and tests done *after* the copy is run in the prescribed media.

#### Before Tests

No copy pre-test can simulate exactly the conditions of exposure and the long-run effects of repetition on a particular audience group. There are, however, a number of ways to pre-test message effectiveness, including the following:

- **Recall tests** of proposed print ads are inserted into a simulated magazine and respondents are told to read whatever interests them. After doing so, they are asked to 'play back' ads they remember. They are also asked questions about ad credibility and product usage. Using the results, researchers can determine the extent to which the message got through and to what extent it achieved the communicator's objective(s). Unfortunately, recall scores too often reflect a brand's popularity rather than message content.
- **Sales tests** as administered by commercial research firms such as BehaviorScan measure the effects of TV commercials through the use of consumer panels located in a number of small cities. Purchases are recorded electronically by scanners at supermarket checkout counters by panel members using special ID cards. BehaviorScan can insert test TV commercials into TV programmes at the individual panel household level. They select household samples on the basis of their purchase behaviour history. Thus, the consumer panel becomes a single source of both purchase and viewing behaviour, thereby enhancing its value. Because alternative ad treatments can be shown to different balanced samples at the same time, it is possible to measure the sales effect of one copy treatment against another based on actual purchase data.

#### After Tests

Measuring the effects of an advertising message after it has run is difficult because the results are confounded by the effects of the media used and the frequency with which the audience received the message. *After* tests tend to measure the effectiveness of the total advertising effort. Here we look at only those *after* tests used primarily to measure message effects. Thus, for example, BMW's advertising agency reported that consumer research showed that consumers were getting the right message – namely, that a BMW is not only dynamic, but comfortable and affordable as well.

Advertisers design *after* tests in a number of ways, and they all rely on the respondent's memory, which raises the problem of how soon after running the ad the measurement should be taken. Also, testing that relies on a single measure in time does not reflect the learning that occurs with repeated exposure.

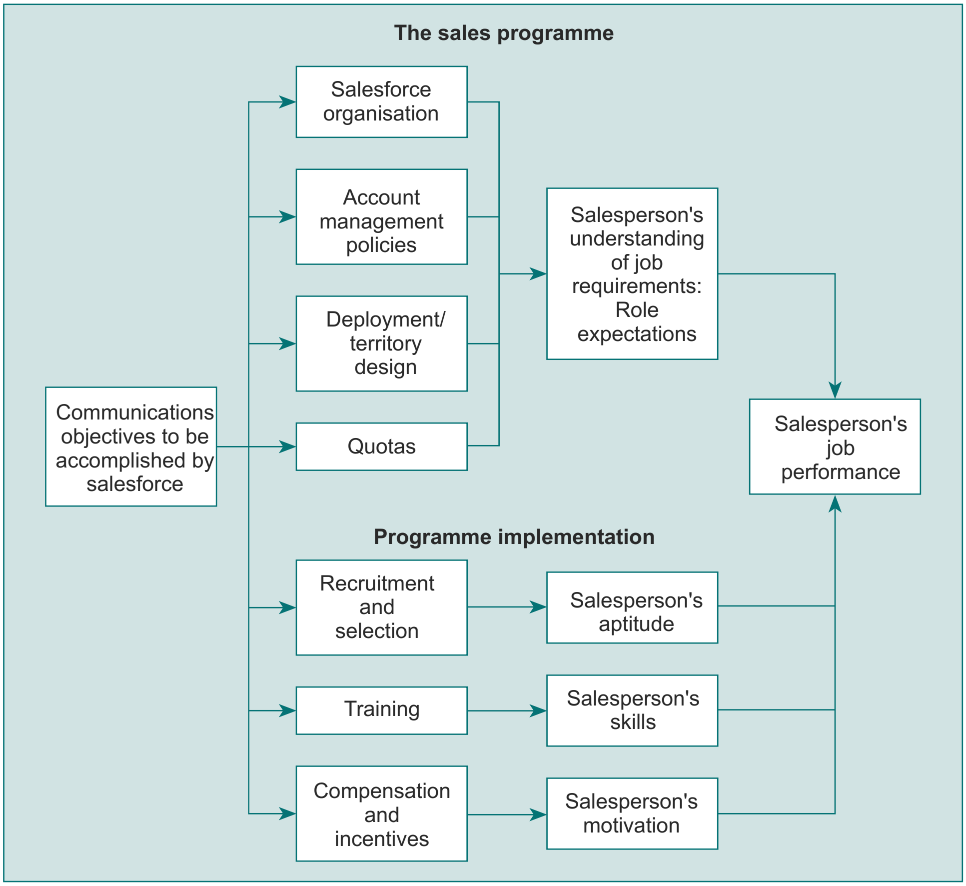
- **Recognition tests** are the most popular postexposure testing method for print media. Advertisers design these tests to measure the extent to which advertising copy is noted and read. Field workers interview people who say they have read a given issue of a magazine. Each respondent goes through the issue pointing out what was seen and read. When the respondent reports seeing an ad, the interviewer asks which parts were read. The interviewer starts each interview at a random point within the issue, so that the ratings are not affected by respondent fatigue.
- **Recall tests** are another common way to measure the effectiveness of an advertising message, especially a TV commercial, after it has been run. Respondents are typically aided in their recall. Interviewers show them a list of the advertisers and brands presented and ask which ones they have seen recently. Interviewers proceed to obtain playbacks of these ads from the respondents.

The industry has long raised questions of whether recall and recognition tests provide adequate measures of memory. Other postexposure ways of measuring the effectiveness of the message include sales tests similar to those used to test new products, inquiries (possible when coupons are used or a toll-free telephone number is made available for placing orders), and measurements of attitudinal change. The latter typically involve *before–after* measurements of the degree to which a given brand possesses certain salient features.

Where the objectives of an advertising effort involve increases in customer traffic, sales, market share, or other tangibly measurable outcomes, such measures should be taken to assess advertising effectiveness. Such measures – including cost per acquisition (to win a new customer) and cost per order (in absolute or per cent of sales terms) – are commonly used in direct marketing and in many emerging Internet marketing contexts. Caution should be exercised, however, as other market and competitive factors – the product itself, its pricing or distribution, the weather, or competitive activities – may also have influenced the outcomes being measured. Blaming the advertising for unacceptable sales performance that really results from other causes is not uncommon!

## 14.3.2 Making Personal Selling Decisions

**Exhibit 14.10 Implementing the strategic sales programme**




Advertising is one of the two principal elements in the promotion mix, as we saw in Exhibit 14.3. We now turn to the second key element, personal selling. As the top half of Exhibit 14.10 indicates, planning a sales programme involves four sets of decisions. First, the salesforce must be organised to facilitate the most efficient allocation of effort. Second, **account management policies** should be developed as guidelines for the way different types of customers are approached, persuaded, and serviced. Third, **deployment** decisions must be made to define territories and assign salespeople to those territories. Fourth, performance expectations – **quotas** – should be developed for each sales rep based on forecasted demand in that territory. When these four aspects of a sales programme are well planned and clearly communicated, they help the sales staff understand the job requirements and the role they are expected to play in implementing the firm's strategy. That improved understanding, in turn, should help the sales staff achieve desired levels of performance.

Space does not permit us to deal in any depth in this book with these four sets of decisions. For readers interested in additional detail, there are numerous books on salesforce management that treat these topics extensively.[15] But we do want to address several key strategic issues that marketing managers must consider in planning a marketing programme or preparing a marketing plan: the sales cycle, organising the sales effort in global markets, and managing customer service, an activity that new technology has the potential to influence dramatically, for better or worse.

#### 14.3.2.1 The Sales Cycle

The sales cycle refers to the duration – expressed either in calendar time or number of sales visits – that it will take to meet with the various decision makers and convince them to try the product, perhaps on a limited basis at first, and then to adopt it more fully. As we saw in Module 7, in many business-to-business selling situations, numerous individuals in a typical client organisation have influence over the purchase decision. Each of them will need to be contacted, often more than once. In some companies, annual budgeting cycles mean the purchasing window is open only at certain times of the year. Planning the sales programme and determining how many – and what kind of – salespeople it will take to get the job done require a clear understanding of the length of the sales cycle, the number of sales calls it is likely to take to complete a sale, and the nature of the sales task at hand.

#### 14.3.2.2 Organising the Sales Effort in Global Markets

As firms expand their marketing and sales efforts into other countries, they face a critical decision concerning how to organise their selling efforts across national boundaries. While globalisation obviously adds complexity to a firm's organisational design, the basic questions to be answered are the same as those faced in domestic markets. First, should the firm rely on independent agents to represent its interests in a foreign market or hire its own company salespeople? If the firm decides to establish its own subsidiary or sales office with a dedicated company salesforce in a foreign country, a second question arises concerning the appropriate horizontal structure for that salesforce. Should it be organised geographically, by product line, by type of customer, or some other way? It is beyond the scope of this course to address these questions.

Industry factors are also related to the use of agents versus company salespeople. Firms selling complex, high-tech products such as computers and pharmaceuticals are significantly more likely to rely solely on their own salespeople than firms in other industrial or consumer goods industries. The higher levels of product knowledge and postsale service required to sell such high-tech products make it relatively more desirable for firms to employ their own salespeople. By doing so, they can maintain better control over the marketing and sales efforts devoted to their products and reduce their transaction costs.

While globalisation makes the organisation of the salesforce more complicated, firms tend to resolve organisational issues in international markets in largely the same way as they do in their native countries. The situational and strategic factors that influence firms' organisational decisions appear to be similar in both types of markets, and those factors seem to affect organisational choices in similar ways both at home and abroad.

#### 14.3.2.3 Customer Service: An Increasingly Important Personal Selling Function

As the economies in developed countries have become more dominated by services businesses, the importance of customer service has grown. Even in today's manufacturing businesses, intense competition, sometimes from lower-cost providers, has made competent and responsive customer service a point of differentiation for companies seeking to provide complete customer solutions. Thus, just as marketing managers must make decisions about how to best manage their salesforce, they also must decide how best to provide the service that customers demand. How many times have you called a cable television provider, your bank, – or even the telephone company itself! – only to have to wade through seemingly endless levels of voicemail prompts. Finally, you're placed on 'hold' at the end of the process! Is this any way to win loyal long-term customers? There must be a better way (*see* Exhibit 14.11).

**Exhibit 14.11 Is the best service no service at all?**

Amid all the hand-wringing about how to improve customer service in companies where customer service is a long-forgotten phrase, a recent book by Bill Price and David Jaffe argues that the best service, in fact, is no service at all! How can this be? People usually seek 'service,' they argue, when something has gone wrong. Getting things right in the first place is the real solution, for customers won't then need any 'customer service.' An example makes the point. By obsessing over a metric it calls contacts per order (CPO) and by working out exactly why customers contact Amazon and eliminating the need for this to happen, Amazon.com has reduced its CPO by 90 per cent over the last five years.

There are four broad causes that drive customer service requests, the authors argue in their book, *The Best Service Is No Service:* quality issues ('It doesn't work,' about 15 per cent of customer service requests), poor processes or customer communication ('How do I . . . ?' about 25 per cent), basic information requests ('Where can I get . . . ?' about 40 per cent), and customers wanting to buy (20 per cent). If the 80 per cent of queries that comprise the first three categories can be reduced – through better quality, better processes, and better communication – then more attention can be paid to the last category, where additional revenue is to be found.

Among the authors' recommendations is this one: to charge those responsible for generating customer service requests, even outside suppliers, for the full cost of the customer contacts they cause. 'This final step brings most of the dividends – when owners get hit in the pocket, they may pay more attention to customer service issues.'

It sounds easy, doesn't it? Fix the quality, fix the processes, fix the communication, all from the customer's perspective, of course. But it's all really hard to do, which is probably why so many companies still have such dreadful customer service.

*Source:* Bill Price and David Jaffe, *The Best Service Is No Service,* (San Francisco: Jossey Bass, 2008).

Managing the customer service process is an important part of managing the personal selling function. Increasingly, responsibility for customer service and 'outside' sales is being brought together on company organisation charts, so the two functions can work together seamlessly to serve customers effectively and efficiently, before and after the sale. Managing customer service involves thinking carefully about the firm's objectives for serving customers before the sale and adding additional objectives for after-sale service, along with people and strategies for meeting these objectives. It is no longer sufficient to simply put some people at telephones and ask them to try to help the customers as best they can. Sophisticated systems now make it possible to identify customers as they call, so customer service representatives have their account information at their fingertips, and provide detailed product knowledge to answer the customers' questions, all electronically.

In the next section, we discuss how modern technology is changing the way the customer service game is played. Modern technology allows companies to place call centres in different time zones, following the sun. Calls to a single number are automatically routed to the active call centre. Technology also allows call centres to be located in countries like India, which offer a lower cost basis and access to a large pool of highly skilled workers.[16] Where local knowledge is part of what customers see as good service, however, far-away call centres can be more a problem than a solution.

### 14.3.2.4 Using Technology to Enhance Sales and Customer Service Performance[17]

Companies concerned about improving their personal selling, sales management, and customer service can turn to the latest computer technologies for help. Salesforce automation, contact management software, call centre software, and other decision support tools are identified below and in Exhibit 14.12.

**Exhibit 14.12 Decision support software for personal selling and salesforce management**

| Tool | Software package | Functions |
|---|---|---|
| Contact Management Software | ACT, from Interact Commerce Corporation, at www.act.com | Keeps track of client lists – including addresses, phone numbers, and other |
| | Goldmine, available (along with other sales management software) from www.sales-tools.com | Tracks idiosyncratic client information, such as birthdays – and organises records of prior client contact and other customer-relevant information. |
| Sales Compensation Design Software | $alescom, from www.salesforcecompensation.com | Helps design base salary and/or incentive plans for any incentive-eligible position. |
| Customer Relationship Management Software marketing applications | Entice!, from www.multiactive.com | Integrates sales, marketing, and customer service, with e-commerce and wireless telephony, for online and offline. |

An early player in this domain was Siebel Systems, Inc.[18] Siebel and others provide software for managing field sales, telesales and call centres, and related marketing functions in large companies. Such software enables field sales reps to track accounts, prospects, and inventories, either from the office PC or from a laptop on the road. The latest call centre software enables customer service representatives to see customer account histories while talking with them and provides scripts to help solve common customer problems.

Other companies, like Kana Communications, Inc.,[19] offer software to manage email-based customer service operations. Kana's customers include eBay and Lycos and other large Web-based consumer-to-consumer and business-to-consumer businesses. Use of such software is already paying some companies huge dividends. Companies as diverse as Nieman Marcus and Hewlett-Packard are also using other software tools like Chat to help customers who are looking for help with their online shopping.

All these innovations have likely just scratched the surface in making inside and outside sales and customer service people more efficient and effective. If one is not careful, however, some of these tools can enhance efficiency at the expense of effectiveness. Horror stories about endless waits for customer service reps in call centres or punching layer upon layer of keys to obtain the desired automated information illustrate some of the less welcome paths to customer satisfaction! Astute marketing managers carefully assess such trade-offs. As these technologies develop, one thing is certain. Regardless of the size of one's company, selling with just a telephone, a company car, a frequent flyer card, and a pair of well-worn shoes is a thing of the past.

#### 14.3.2.5 Recruiting, Training, and Compensating Salespeople: The Keys to Salesforce Performance

There is no guarantee that even a very well designed and clearly communicated sales plan can be carried out effectively. Good implementation requires that the members of the salesforce have both the ability and the desire to meet management's expectations. Thus, as Exhibit 14.10 indicates, implementing the sales programme requires three more sets of management actions: First, management must **recruit** and **select** appropriate kinds of salespeople with the aptitude for effectively carrying out the activities involved in the job. Second, management must provide appropriate kinds and amounts of training to ensure that the salespeople have the knowledge and skills needed to do their jobs. Finally, management must design an attractive package of compensation and other incentive rewards to motivate the salesforce to expend the effort necessary to achieve good performance. For a more detailed discussion of these key elements in sales programme implementation see a text on salesforce management.[20]

#### 14.3.2.6 Evaluating and Controlling Salesforce Performance to Ensure Delivery of Budgeted Results

Managers collect and evaluate information about their salespeople's performance and compare these data to the IMC plan's objectives and forecasts to determine how well the salesforce is doing. The purpose is much like that of navigating a ship at sea. By determining where the ship is relative to its destination, the captain can see how well the ship is doing and make necessary corrections when it is off course.

Companies use three main approaches in monitoring the salesforce to evaluate and control sales performance.

1. **Sales analysis.** Managers monitor sales volume for each salesperson. In addition, they break down sales figures by geographic territory, by each product in the line, and by different types of customers. They compare results to the forecasts and quotas in the firm's sales plan to determine which salespeople are doing well and where adjustments may be needed.
2. **Cost analysis.** They can also monitor the costs of various selling activities such as travel and entertainment expenses. Managers often examine these costs across individual salespeople, districts, customers, and product types. However, doing so presents some difficult technical challenges about how certain costs, such as administrative costs and overhead, should be allocated. When put together with the results of a sales analysis, this procedure allows managers to evaluate the profitability of different territories, products, and customer types.
3. **Behavioural analysis.** When sales volume or profitability in a territory falls below expectations, managers may be uncertain as to the cause. Perhaps the salesperson in that territory is not working hard enough or is allocating effort to the wrong activities. Or the disappointing results could be due to factors beyond the salesperson's control, such as poor economic conditions or heavy competition in the territory. To gain a better understanding of the cause – and provide a better basis for taking corrective action – many managers believe it is necessary to monitor and evaluate the actual behaviour of the salesperson as well as the outcomes of that behaviour. They obtain much information for this kind of behavioural analysis from activity reports and call reports submitted by the salespeople. In addition, some firms use self-rating scales, field observations, and supervisor ratings to compile the needed information.

Many of these methods apply equally well to the evaluation and control of entire marketing programmes, not just the salesforce, a topic we examine in more detail in Module 17.

At this point, we've discussed the two principal elements in the promotion mix, advertising and personal selling. The two remaining elements, sales promotion and public relations, often play a secondary or supporting role to one or both of the first two elements. In some cases, however, especially in early stage companies with limited marketing budgets, their roles can be more substantial.

### 14.3.3 Making Sales Promotion Decisions

The American Marketing Association defines **sales promotion** as 'those marketing activities, other than personal selling, advertising, and publicity, that stimulate consumer purchasing and dealer effectiveness.' Sales promotions typically offer an incentive to consumers and resellers to stimulate short-term demand for a product. As we saw in Module 12, sales promotion can be of two kinds: consumer promotion (targeted at consumers, often as part of a pull strategy) and trade promotion (targeted at channel members, often as part of a push strategy). More money is spent on sales promotion than on advertising in the US and Europe. For example, Reebok launched a pan-European promotion for its new A6 shoe, using SMS, supported by advertising on websites like mp3.com and Yahoo, running hip-hop and dance music ads.[21] More generally, expenditures for consumer promotions have lagged (especially for coupons) in recent years and are smaller than trade promotions.

Marketers use a variety of sales promotion techniques, the primary ones being price-off promotions, premiums, sampling, rebates, contests and sweepstakes, and trade promotions. The first four of these were discussed earlier in Module 12 on pricing. The non-price-related promotion techniques are described below. As might be expected, trade allowances made to retailers by manufacturers dominate their promotional expenditures. More than half of all items sold by supermarkets are discounted.

- **Sampling** has become increasingly important because marketers have found more efficient ways to get samples to their target markets. Today's sampling promotions are cleverly designed so that shoppers who receive the samples use them right away. For example, Unilever handed out its personal hygiene products to students at the end of a sweaty fitness class, and Starbucks gave away free samples of its iced-coffee drink, Frappuccino, to commuters in Manhattan during a sweltering afternoon.[22]
- **Contests and sweepstakes** add interest to the sale of ordinary products. In a consumer contest, buyers compete for prizes on the basis of skill. Contests typically require proof of purchase to enter or the use of an entry form available only from a dealer. Popular formats for contests include naming new products or finding new uses for existing products as in the famous Pillsbury Bake-off in the US. Sweepstakes, on the other hand, distribute prizes on the basis of chance and, in many countries, cannot require proof of purchase as a condition of entry. They are more popular than contests since no judges are required. But they do little to enhance the brand's image and often overshadow the product involved. Recently, several companies launched contests via text messages, where users send a text message with a code printed on products to enter, for example McDonalds in the UK to coincide with the launch of the Disney movie Monsters Inc.[23]
- **Trade promotions** are used by manufacturers to stimulate resellers to improve their performance in a variety of ways, including contests and incentives for sales personnel, training a distributor's salesforce, and cooperative advertising and promotional allowances including in-store promotions. The latter is the most important. We discussed the role of trade promotions as incentives for distribution members in Module 13.

As is the case for advertising, designing a sales promotion programme and budget involves choosing particular types of sales promotion and using experience to predict what the response rates are likely to be. Unlike advertising, for which considerable monies can be spent with little assurance that significant revenues will follow, many kinds of sales promotion require the customer to buy as the incentive is redeemed. This self-liquidating feature is true for coupons and rebates, for example, and for trade discounts to retailers who stock or display a new product. In this sense, sales promotion is less risky than advertising. Marketers also like it because its performance is usually easily measurable. As a result, and due also to scarce resources in small companies and to pressures on management in large public companies to deliver consistent short-term earnings, sales promotion is garnering an increasing share of many firms' total promotional budgets.

There's a downside to sales promotion, however. Empirical evidence in the automotive industry suggests that while sales promotions may increase demand in the short term, they can diminish financial performance and shareholder value over the long term. This may be due to habit formation, whereby customers learn to wait for the next promotion, rather than buying at full price. From a managerial perspective, reliance on sales promotions to meet sales targets is somewhat akin to drug addiction: once started, it's difficult to stop the promoting for fear of a top-line sales slump.

### 14.3.4 Making Public Relations Decisions

Public relations has many uses. One that is sometimes overlooked is its potential for marketing new products, whether goods or services. During the 1996 Christmas season in the US, a publicist at Tyco Toys sent a Tickle-Me-Elmo (a Sesame Street character stuffed toy) to the son of a popular TV talk-show host, and several more to the producers of the show. The toy became an instant hit and the hottest toy of the season, and several stores across the country sold their entire stock within minutes. Tyco expected to originally sell 400 000 toys, but instead wiped out its inventory of a million, and projected it could have sold 2 million.[24] Many of today's most creative entrepreneurs use PR in a similar fashion. When it catches the media's fancy, it can make a new company or a new brand (*see* Exhibit 14.13).

**Exhibit 14.13 Jones Soda's icky flavours create buzz**

Brussels Sprout soda? Broccoli Casserole soda? Turkey and Gravy soda? 'Repulsive. Awful. Tastes like gasoline,' said the taste testers at Inc. magazine. But to Peter Van Stolk, Jones Soda's founder, cringeing writers and gagging television commentators were music to his ears. Van Stolk's company caters to hip urban youth in their teens and twenties. He figured his customers – not to mention the media – would notice the wacky flavours and therefore notice his brand, for which public relations was the only affordable promotion strategy in the hotly competitive soft drink industry. His instincts were right. Thanks in part to a wacky press release and his icky flavours' appearances on the likes of Good Morning America and the Jay Leno Show, his company's sales jumped 18 per cent in the first nine months of 2005 over the prior year. 'People went crazy for it,' said Van Stolk. One customer even made money on it, selling a bottle of Turkey and Gravy soda on eBay for $100! Halloween flavours like Candy Corn and Caramel Apple followed, and Love Potion No. 6 made its debut for Valentine's Day in February 2006. While most of his revenue still comes from normal flavours like root beer and cream soda, the media attention garnered by the icky stuff surely helps them sell!

Source: Ellen Neuborne, 'Gag Marketing,' Inc. February 2006, p. 35. For more on offbeat promotional strategies, see Christopher Locke, *Gonzo Marketing: Winning through Worst Practices* (Cambridge, MA: Perseus Publishing, 2001).

Public relations has several unique advantages (*see* Exhibit 14.4). It is credible; most people feel that the mass media have no reason to carry favourable information about a product unless it is true. Thus, public relations reinforces the firm's advertising campaign by increasing awareness and the believability of product claims. Publicity also makes it easier for the salesforce to present a case for the product. Also, it is low cost, in that there are few media costs. The major disadvantage is that publicity is beyond the company's control, not only as to whether the release will be run, but also what is finally said about the company and/or the brand.

Of course, the media are not in business to provide free publicity to marketers. They only do so when they believe something is newsworthy because it is new, different, or tells an interesting story about a local person or organisation. Because there is no cost entailed in having publicity picked up by the media, budgeting for public relations is easy – simply staff time to manage the effort – although many firms choose to use specialised public relations agencies to handle the media contacts. Fees for such activities, once negotiated, are easily budgeted, but whether a given public relations effort will actually attain the desired results is another story. Unfortunately, most public relations firms are unwilling to accept assignments in which they are paid based on performance.

Through public relations, firms communicate with a variety of publics, including the consumer (information about new products), the financial community and stockholders (improvement in the company's profitability), the community (the firm's being a good citizen), prospective employees (a good place to work), current employees (developing pride in the company), and suppliers (a good company with which to build an enduring relationship). This listing of audiences suggests that publicity can be used to accomplish different objectives among different groups. Such objectives range from simply increasing awareness of a company or its products to stimulating an actual response, such as sending for a free bulletin. Thus, public relations can play an important role in the development of an integrated marketing communication programme.

Firms also use public relations to cope with an unexpected shock. This was the case with the public relations campaign Johnson & Johnson (J&J) mounted in the US when seven people died from poisoned Tylenol capsules. In part because of its responsible and well-orchestrated public relations response, J&J was able to restore confidence in the company and its Tylenol brand.

## Learning Summary

- Marketing managers in most companies face fundamental strategic decisions about whether to emphasise advertising or personal selling in their promotion mix. Identifying the strategic circumstances (*see* Exhibit 14.3 in Section 14.2.4) provides direction for these decisions.

- Getting marketing communications messages – of any kind, in any medium – noticed and understood is no easy task. Many ads and other communication attempts simply don't meet their objectives. Following the guidelines in this module will mitigate this risk.
- A clear understanding of one's target market is essential for planning and implementing an effective promotional programme. Without such an understanding, money is likely to be wasted.
- Many marketing communications efforts are not easy to evaluate. Setting clear and measurable objectives up front facilitates doing so.
- New media, including the Internet, email, and mobile telephones, are revolutionising ad spending, because their results – like those for direct marketing programmes – can often be directly measured.
- In companies of all sizes, technology will play an increasingly meaningful role in managing sales and customer service efficiency and effectiveness. Caution must be exercised, however, to avoid sacrificing effectiveness for efficiency.

## Review Questions

### Content Questions

14.1 Define each of the promotion mix components.

14.2 What are the steps needed to develop a promotion programme?

14.3 What subjects is advertising decision making concerned with?

14.4 What are the contents of a copy platform?

14.5 Describe the various ways to pre-test message effectiveness.

14.6 Describe the various ways to measure the effects of an advertising message after it has run.

14.7 Define the term 'sales promotion'.

14.8 What are the most commonly used sales promotion techniques?

14.9 Define the term 'integrated marketing communications plan'.

## Multiple Choice Questions

14.10 All of the following are examples of promotion mix components EXCEPT:

A. advertising.
B. personal selling.
C. sales promotion.
D. public relations.
E. price.

14.11 The vice president for marketing at a consumer goods company picks up *Wall Street Journal* (WSJ) and notices a front-page article which announces the introduction of the firm's highly innovative new product. This article is an example of which element of the promotion mix?

A. A sales promotion.
B. A press release.
C. Public relations.
D. An exclusive interview.
E. A barter arrangement with the WSJ.

14.12 Two friends are having lunch and one tells the other about a great new movie that she and her husband saw, the text would classify this exchange as:

A. publicity.
B. advertising.
C. a consumer sales promotion.
D. personal selling.
E. none of the above.

14.13 Any paid form of nonpersonal presentation and promotion of ideas, goods or services by an identified sponsor is called:

A. public relations.
B. sales promotion.
C. personal selling.
D. packaging.
E. advertising.

14.14 All of the following are examples of sales promotion activities EXCEPT:

A. coupons.
B. contests.
C. free samples of the product.
D. rebates.
E. new product press release.

14.15 The first step in developing a promotion mix is:
A. design the promotion mix.
B. set the promotional objectives.
C. define the audience to be targeted.
D. set the promotion budget.
E. evaluate the results.

14.16 Which of the following is the best method for setting promotional budgets, by using careful analysis of the specific situation?
A. Affordable method.
B. Percentage of sales method.
C. Competitive parity method.
D. Objective-and-task method.
E. Return on sales method.

14.17 Which of the following is the most commonly used top-down method of setting the promotion budget?
A. Affordable method.
B. Percentage of sales method.
C. Competitive parity method.
D. Objective-and-task method.
E. Return on sales method.

14.18 Which of the following is an example of a decision to be made in designing the promotion mix?
A. Determining the target market.
B. Selecting actors for a television commercial.
C. Determining the cost of advertising in different magazines.
D. Deciding the value and message of a coupon.
E. Evaluating effectiveness of past advertising results.

14.19 What promotional strategy is best for consumer goods, when advertising is the dominant element in the promotional mix?
A. Objective-and-task.
B. Creative strategy.
C. Push strategy.
D. Pull strategy.
E. Unique selling proposition.

14.20 When a product is complex and expensive and distribution is likely to be difficult, what element in the promotion mix is best utilised?
A. Advertising.
B. Personal selling.
C. Sales promotion.
D. Public relations.
E. None of the above.

14.21 Of the following elements in the promotional mix, which would a company have the most control over the message?

A. Advertising.
B. Sales promotion.
C. Personal selling.
D. All of the above.
E. Only A and B above.

14.22 Of the following elements in the promotional mix, which is best suited for the push strategy?

A. Public relations.
B. Personal selling.
C. Sales promotion.
D. All of the above.
E. Only B and C above.

14.23 Of the following elements in the promotional mix, which gives virtually no information about the product?

A. Advertising.
B. Personal selling.
C. Sales promotion.
D. Public relations.
E. None of the above.

14.24 A rate card specifies:

A. the nature of the audience a particular advertising medium reaches.
B. the size of the audience a particular advertising medium reaches.
C. the cost of advertising in a particular advertising medium.
D. all of the above.
E. only A and B above.

14.25 Of the four major types of mass media what is their order in terms of use in the US, from largest to smallest?

A. Network and cable TV, newspaper advertising, direct mail, radio.
B. Newspaper advertising, network and cable TV, direct mail, radio.
C. Newspaper advertising, direct mail, radio, network and cable TV.
D. Network and cable TV, radio, newspaper advertising, direct mail.
E. Direct mail, network and cable TV, newspaper advertising, radio.

14.26 Of the following categories, where do billboards fall?

A. Out-of-home.
B. Exhibition.
C. Supplementary.
D. Print media.
E. Direct marketing.

14.27 Of the following, which is best medium for enhancing the likelihood that a company website will be the first that customers find on the Web?

A. Email.
B. Banner ads.
C. Portal deals.
D. Websites.
E. Text links.

14.28 The major reason advertisers repeat the same message over and over is that repetition:

A. is more cost effective.
B. increases audience retention of the message.
C. focuses on a key message and does not confuse the consumer.
D. is more efficient, since it takes a great deal of time and manpower to develop an effective message.
E. enables the advertiser to be more efficient in presenting the message in multiple media outlets.

14.29 'Reach' can be defined as:

A. the number (or per cent) of the target audience exposed to a given media mix during a given time period.
B. how many times the target audience is exposed to a message within a given time period.
C. how often the target audience is expected to receive the message in a given time period.
D. the rate of retention in the average consumer after exposure to the message.
E. a ranking of media based on which media will provide the greatest exposure to the
target audience.

14.30 The number of times an individual in a given target market could see an ad is a definition of:

A. subscribe rate.
B. frequency.
C. duplication.
D. repetition.
E. the recognition period (usually 3 months).

14.31 If the target audience is 80 000 households and the media schedule reached 50 000 of these households, the reach of this ad was:

A. 50 per cent.
B. 57.2 per cent.
C. 62.5 per cent.
D. 160 per cent.
E. None of the above.

14.32 How many gross rating points (GRPs) would be needed in a media schedule if an advertisement had a reach of 60 per cent and a need for an average frequency of 15?

A. 600.
B. 1500.
C. 900.
D. 300.
E. 1200.

14.33 An advertising manager for a company marketing a product with broad mass-market appeal wants to select a media type that will allow the product to be displayed and shown in use. Which media type would probably be the most appropriate?

A. Radio.
B. Local newspapers.
C. National network television.
D. Direct mail.
E. National news magazines.

14.34 While _____ media offer greater reach to particular audiences, _____ media offer greater reach to heterogeneous audiences. And _____ media are more involving.

A. print; broadcast; outdoor.
B. print; broadcast; print.
C. broadcast; print; broadcast.
D. print; outdoor; broadcast.
E. broadcast; outdoor; print.

14.35 Which is the largest interactive medium in the world?

A. Newspapers.
B. Television.
C. Direct mail.
D. The Internet.
E. Magazines and other related publications.

14.36 Measuring reach and frequency for ads on websites is:

A. very difficult because once at the website, we do not know where the user goes.
B. difficult unless the website registers its visitors.
C. no different than for any other media.
D. easy if we use roster recall tests.
E. very easy given the electronic ‘trail’ users leave behind.

14.37 Which types of tests measure the effects of TV commercials by using consumer panel data from families which are located in several cities?

A. Sales tests.
B. Recognition tests.
C. Double-blind tests.
D. Repetition tests.
E. Image tests.

14.38 A primary advantage of new technology like BehaviorScan is that:

A. it is extremely cost effective relative to other tests.
B. it enables the researcher to test physiological as well as attitudinal responses to ads.
C. it is capable of multiple message designs at the same time.
D. both purchase and viewing behaviour data are collected at the same time.
E. it has less sampling error than other message tests.

14.39 If a planned advertisement is inserted into a recent issue of Time magazine and a respondent is told to read whatever interests her in this magazine and is then asked to 'play back' the ads which she remembers, what type of testing procedure does this represent?

A. Repetition test.
B. Recall test.
C. Double-blind test.
D. Roster recall test.
E. Image test.

14.40 Probably the single most important disadvantage of public relations over other elements of the promotional mix is the:

A. lack of coordination with other promotional elements.
B. inability to create awareness about products.
C. high cost of developing and maintaining a PR department.
D. lack of credibility associated with publicity.
E. lack of company control over publicity.

## Application Questions and Cases

14.41 IBM does a substantial amount of television advertising for its various computer products. On the other hand, Cray Research – the most successful builder of the supercomputers used by government agencies, the US Weather Service and large scientific research organisations – does no television advertising. In fact, Cray does very little advertising of any kind. Instead, the firm relies on the efforts of a small salesforce. Why do the two firms pursue such different *promotion strategies*?

14.42 You are the marketing manager for a major airline. How would you vary the emphasis among the *tools in your promotion mix* when designing promotional strategies for (a) individual consumers who travel for pleasure and (b) corporate travel departments that select the airlines to be used by company employees?

14.43 Suppose you are the advertising manager of a large insurance company that has just developed a new policy designed to protect against hurricane losses. You ask your agency to help develop a copy platform for this new policy. What should be included and from what source will the required information come?

14.44 What medium would you recommend using as your primary buy for each of the following situations?

a. A small ice cream retail chain selling premium products.
b. A consumer electronics firm selling sophisticated and relatively expensive equipment.
c. A large home-appliance company selling such major units as refrigerators, stoves, washing machines and dryers.
d. A laundry detergent firm selling several brands of such a product.

14.45 The advertising manager for a large firm asked you – the marketing vice president – to approve a $500 000 *increase in the advertising budget* for one of the company's products. She predicts that the additional advertising will produce a $2 million increase in the product's sales. What additional information would you ask for before making a decision?

14.46 A car company sets the advertising and promotion budget for one of its car lines by allocating a fixed number of dollars for each car it forecasts will be sold in the company year. What are the advantages and limitations of this approach to determining a promotional budget?

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## PART 4

# Strategic Marketing Programmes for Selected Situations

# Module 15

# Marketing Strategies for New Market Entries

## Contents



## Canon, Inc. – Success That Is Hard To Copy[1]

While Japan's economy has returned to robust health, it had suffered through four recessions during the 1990s and the early years of this century. Consequently, many Japanese manufacturers – even some of the largest global competitors – have struggled to remain profitable and survive. However, a few firms have not only survived but grown and prospered in spite of the difficult domestic market environment. Canon, Inc. is one of those stellar performers. The company earned about $6.6 billion on consolidated net sales of approximately $39 billion in 2007, which gave it a third straight year of record profits and a nearly 12 per cent return on equity.

How has Canon managed to wring so much money out of its copiers, printers, and cameras when other Japanese electronics firms have floundered? For one thing, Fujio Mitarai, the firm's CEO, has been willing to adopt some Western cost-cutting practices he learned during the 23 years he worked for Canon in America. First, he narrowed the company's strategic scope by concentrating on a few product-markets where the firm had an established market presence and superior technological capabilities, while abandoning other businesses where it had a weaker competitive position, such as personal computers and liquid-crystal displays. Mr Mitarai also scrapped the assembly lines in all of Canon's Japanese plants, replacing them with small work teams – or 'cells' – of about six employees who do the work of about 30 workers under the old system. These self-managed cells have not only reduced Canon's labour costs, but have enabled the firm to cut its inventory of component parts by 30 per cent and to close 20 of its 34 warehouses.

But a sharper market focus and increased manufacturing efficiency are not sufficient to explain the firm's strong performance. Other Japanese electronics firms have copied such cost-cutting actions without duplicating Canon's results.

A second important strategic thrust underlying Canon's success is a heavy emphasis on developing and marketing a stream of new products, product improvements, and line extensions in order to sustain a leading share position in its core businesses.

As a first step toward implementing this product development strategy the company ploughs nearly 8 per cent of its total revenues back into product R&D. Some of that investment is targeted at continued improvement of Canon's offerings in businesses where it already holds a dominant market share. For instance, Canon's technical leadership has enabled it to maintain a 60 per cent share of the global market for the core engines used to power laser printers, including printers developed through an alliance with Hewlett-Packard. In other cases, Canon's development efforts focus on innovative new-to-the-world products, like the development of a digital radiography system or an advanced diagmatic imaging technology, which the firm hopes will enable detection of metabolic changes in patients and thus facilitate early diagnosis of disease. And sometimes the firm simply modifies existing products or technologies to better serve new application segments, such as developing a wide-format bubble-jet printer for use in the commercial printing industry.

Of course, it is one thing to develop a bunch of new products on the cutting-edge of technology, but making potential customers aware of those new products and their benefits – and actually generating sales revenues – requires effective and well-funded marketing and sales efforts as well. Consequently, Canon has restructured its global sales and marketing organisation in recent years to decentralise decision making and make its marketing plans better adapted to local market conditions. This is particularly critical because the firm earns more than 70 per cent of its sales revenues in markets outside of Japan. For example, the company established Canon Europe Ltd in the UK to help coordinate regional marketing efforts and strengthen its sales network in the European Union, which is now the company's largest market in terms of revenue.

## Learning Objectives

In Module 11 focuses on the problems and processes involved in developing and evaluating product offerings that are *new to the company*. The first part of this module examines marketing strategies and programmes appropriate for offerings that are *new to the target customers*. The primary focus is on programmes used by the pioneer firm – or first entrant – into a particular product-market. Being the pioneer gains a firm a number of potential competitive advantages, but it also involves some major risks. Some pioneers capitalise on their early advantage and maintain a leading market share of the product category, earning substantial revenues and profits, well into the later stages of the product's life cycle.

Other pioneers are less successful. In some cases this is a consequence of not sustaining superior technical expertise. But in other cases, followers have overtaken the pioneer by offering better products, superior customer service, or lower prices.

This leads to an interesting strategic question: Is it usually better for a firm to bear the high costs and risks of being the pioneer in hopes of maintaining a profitable position as the market grows or to be a follower that watches for possible design or marketing mistakes by the pioneer before joining the fray with its own entry?

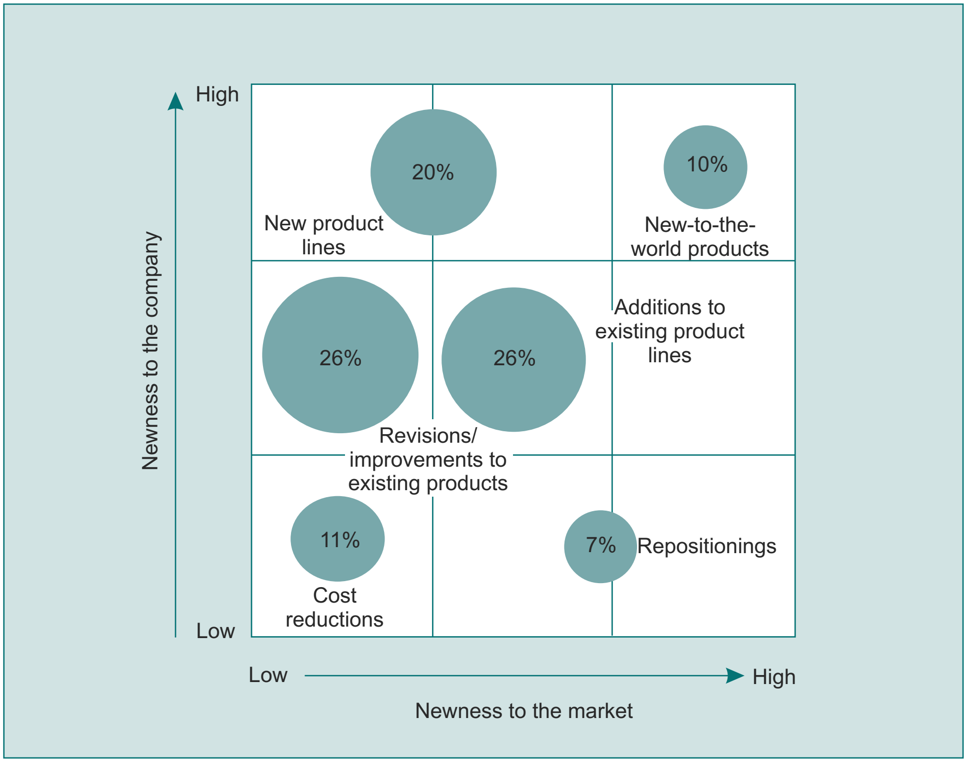
Not all pioneers are intent on remaining the overall share leader as the market grows. Some adopt a niche market strategy geared to making substantial profits from specialised market segments where they will face fewer large competitors. Which strategy is best? It depends on the firm's resources and competencies, the strength of likely future competitors, and characteristics of the product and its target market. This module examines some alternative strategies that might be adopted by a pioneer and the situations where each makes most sense.

## 15.1 How New Is New?

A survey of the new product development practices of 700 US corporations conducted by the consulting firm of Booz, Allen & Hamilton found that the products introduced by those firms over a five-year period were not all equally 'new.' The study identified six categories of new products based on their degree of newness as perceived by both the company and the target customers. These categories are discussed below and diagrammed in Exhibit 15.1, which also indicates the percentage of new entries falling in each category during the five-year study period. Notice that only 10 per cent of all new product introductions fell into the new-to-the-world category.[2]

- *New-to-the-world products* – True innovations that are new to the firm and create an entirely new market (10 per cent).
- *New product lines* – A product category that is new for the company introducing it, but not new to customers in the target market because of the existence of one or more competitive brands (20 per cent).
- *Additions to existing product lines* – New items that supplement a firm's established product line. These items may be moderately new to both the firm and the customers in its established product-markets. They also may serve to expand the market segments appealed to by the line (26 per cent).
- *Improvements in or revisions of existing products* – Items providing improved performance or greater perceived value brought out to replace existing products. These items may present moderately new marketing and production challenges to the firm, but unless they represent a technologically new generation of products, customers are likely to perceive them as similar to the products they replace (26 per cent).
- *Repositionings* – Existing products that are targeted at new applications and new market segments (7 per cent).
- *Cost reductions* – Product modifications providing similar performance at lower cost (11 per cent).

**Exhibit 15.1** **Categories of new products defined according to their degree of newness to the company and customers in the target market**




*Source*: *New Products Management for the 1980s* (New York: Booz, Allen & Hamilton, 1982).

A product's degree of newness – to the company, its target customers, or both – helps determine the amount of complexity and uncertainty involved in the engineering, operations, and marketing tasks necessary to make it a successful new entry. It also contributes to the amount of risk inherent in those tasks.

Introducing a product that is new to both the firm and target customers requires the greatest expenditure of effort and resources. It also involves the greatest amount of uncertainty and risk of failure because of the lack of information and experience with the technology and the target customers.

Products new to target customers but not new to the firm (such as line extensions or modifications aimed at new customer segments or repositionings of existing products) are often not very innovative in design or operations, but they may present a great deal of marketing uncertainty. The marketing challenge here – as with new-to-the-world products – is to build **primary demand**, making target customers aware of the product and convincing them to adopt it. We investigate this marketing problem in this module.[3]

Finally, products new to the company but not to the market (such as new product lines, line extensions, product modifications, and cost reductions) often present fewer challenges for R&D and product engineering. The company can study and learn from earlier designs or competitors' products. However, these products can present major challenges for process engineering, production scheduling, quality control, and inventory management. Once the company introduces such a product into the market, its primary marketing objective is to build **selective demand** and capture market share, convincing customers the new offering is better than existing competitive products. We discuss marketing programmes a firm might use to accomplish these objectives later in Module 16.

## 15.2 Market Entry Strategies: Is It Better to Be a Pioneer or a Follower?

With products such as Word, Excel, and PowerPoint, Microsoft holds a leading share of most office application software categories. But in most of those categories, the firm was not the pioneer. Lotus 1-2-3 was the leading spreadsheet for many years, and WordPerfect and other programmes led the word processing category. But as a follower, Microsoft developed improved product designs offering better performance, and it had superior financial resources to aggressively promote its products. Microsoft's Windows also held a commanding share of the operating systems market, a position the firm could leverage to convince personal computer manufacturers to bundle its applications software with their machines.

On the other hand, some of the software industry's pioneers have not fared so well in the marketplace. Lotus, for example, experienced financial difficulties and was ultimately acquired by IBM. While we have stressed the competitive importance of growth via the introduction of new products, the important strategic question is whether it always makes sense to go first. Or do both pioneer and follower market entry strategies have some particular advantages under different conditions?

### 15.2.1 Pioneer Strategy

Conventional wisdom holds that although they take the greatest risks and probably experience more failures than their more conservative competitors, successful pioneers are handsomely rewarded. It is assumed competitive advantages inherent in being the first to enter a new product-market can be sustained through the growth stage and into the maturity stage of the product life cycle, resulting in a strong share position and substantial returns.

Some of the potential sources of competitive advantage available to pioneers are briefly summarised in Exhibit 15.2 and discussed below.[4]

**Exhibit 15.2 Potential advantages of pioneer and follower strategies**

| Pioneer | Follower |
|---|---|
| • Economies of scales and experience. | • Ability to take advantage of pioneer's positioning mistakes. |
| • High switching costs for early adopters. | • Ability to take advantage of pioneer's product mistakes. |
| • Pioneer defines the rules of the game. | • Ability to take advantage of pioneer's marketing mistakes. |

| Pioneer | Follower |
|---|---|
| • Distribution advantage. | • Ability to take advantage of the latest technology. |
| • Influence on consumer choice criteria and attitudes. | • Ability to take advantage of pioneer's limited resources. |
| • Possibility of pre-empting scarce resources. | |

1. *First choice of market segments and positions.* The pioneer has the opportunity to develop a product offering with attributes most important to the largest segment of customers or to promote the importance of attributes that favour its brand. Thus, the pioneer's brand can become the standard of reference customers use to evaluate other brands. This can make it more difficult for followers with me-too products to convince existing customers that their new brands are superior to the older and more familiar pioneer. If the pioneer has successfully tied its offering to the choice criteria of the largest group of customers, it also becomes more difficult for followers to differentiate their offerings in ways that are attractive to the mass-market segment. They may have to target a smaller peripheral segment or niche instead.
2. *The pioneer defines the rules of the game.* The pioneer's actions on such variables as product quality, price, distribution, warranties, postsale service, and promotional appeals and budgets set standards that subsequent competitors must meet or beat. If the pioneer sets those standards high enough, it can raise the costs of entry and perhaps pre-empt some potential competitors.[5]
3. *Distribution advantages.* The pioneer has the most options in designing a distribution channel to bring the new product to market. This is particularly important for industrial goods where, if the pioneer exercises its options well and with dispatch, it should end up with a network of the best distributors. This can exclude later entrants from some markets. Distributors are often reluctant to take on second or third brands. This is especially true when the product is technically complex and the distributor must carry large inventories of the product and spare parts and invest in specialised training and service.

   For consumer package goods, it is more difficult to slow the entry of later competitors by pre-empting distribution alternatives. Nevertheless, the pioneer still has the advantage of attaining more shelf-facings at the outset of the growth stage. By quickly expanding its product line following an initial success, the pioneer can appropriate still more shelf space, thereby making the challenge faced by followers even more difficult. And as many retailers are reducing the number of brands they carry in a given product category to speed inventory turnover and reduce costs, it is becoming more difficult for followers with unfamiliar brands and small market shares to gain extensive distribution.[6]
4. *Economies of scale and experience.* Being first means the pioneer can gain accumulated volume and experience and thereby lower per unit costs at a faster rate than followers. This advantage is particularly pronounced when the product is technically sophisticated and involves high development costs or when its life cycle is likely to be short with sales increasing rapidly during the introduction and early growth stages.

As we shall see later, the pioneer can deploy these cost advantages in a number of ways to protect its early lead against followers. One strategy is to lower price, which can discourage followers from entering the market because it raises the volume necessary for them to break even. Or the pioneer might invest its savings in additional marketing efforts to expand its penetration of the market, such as heavier advertising, a larger salesforce, or continuing product improvements or line extensions.

5. *High switching costs for early adopters.* Customers who are early to adopt a pioneer's new product may be reluctant to change suppliers when competitive products appear. This is particularly true for industrial goods where the costs of switching suppliers can be high. Compatible equipment and spare parts, investments in employee training, and the risks of lower product quality or customer service make it easier for the pioneer to retain its early customers over time.

   In some cases, however, switching costs can work against the pioneer and in favour of followers. A pioneer may have trouble converting customers to a new technology if they must bear high switching costs to abandon their old way of doing things. Pioneers in the development of music CDs, for instance, faced the formidable task of convincing potential buyers to abandon their substantial investments in turntables and LP record libraries and to start all over again with the new technology. Once the pioneers had begun to convince consumers that the superior convenience, sound quality, and durability of CDs justified those high switching costs, however, demand for CDs and CD players began to grow rapidly and it was easier for followers to attract customers.

6. *Possibility of positive network effects.* The value of some kinds of goods and services to an individual customer increases as greater numbers of other people adopt the product and the network of users grows larger. Economists say that such products exhibit **network externalities** or **positive network effects**. Information and communications technologies, such as wireless phones, fax machines, computer software, email, and many Internet sites, are particularly likely to benefit from network effects.[7] For instance, the value of eBay as an auction site increases as the number of potential buyers and sellers who visit and trade on the site increase. If the pioneer in such a product or service category can gain and maintain a substantial customer base before competing technologies or providers appear on the market, the positive network effects generated by that customer base will enhance the benefits of the pioneer's offering and make it more difficult for followers to match its perceived value. And recent research suggests that the positive impacts of such network effects on pioneer survival and economic success are enhanced when the new products involved are relatively radical and technologically advanced.[8]

   On the other hand, for the digital new products and services most likely to benefit from positive network effects, some of the other potential first-mover advantages may not be as relevant. For instance, because of the relatively modest fixed costs and low marginal costs of producing digitised information products like software and music, pioneers are unlikely to benefit from substantial economies of scale.[9]

7. *Possibility of pre-empting scarce resources and suppliers.* The pioneer may be able to negotiate favourable deals with suppliers who are eager for new business or who do not appreciate the size of the opportunity for their raw materials or component parts. If later entrants subsequently find those materials and components in short supply, they may be constrained from expanding as fast as they might like or be forced to pay premium prices. For example, Apple computer was able to absorb more than half the entire production of Toshiba's innovative 1.8-inch hard disk; a crucial component of its iPod digital music player. As a result, competitors had difficulty matching the small size and simplicity of Apple's product for several years until Toshiba was able to expand production capacity and other producers – like Hitachi – developed similar hard drives.[10]

## 15.2.2 Not All Pioneers Capitalise on Their Potential Advantages

There is some evidence to suggest that the above advantages can help pioneers gain and maintain a competitive edge in new markets. For instance, some research has found that surviving pioneers hold a significantly larger average market share when their industries reach maturity than firms that were either fast followers or late entrants in the product category.[11]

On the other hand, some pioneers fail. They either abandon the product category, go out of business, or get acquired before their industry matures. One study, which took these failed pioneers into account and averaged their performance together with that of the more successful survivors, found that pioneers overall did not perform as well over the long haul as followers.[12]

Of course, volume and market share are not the only dimensions on which success can be measured. Unfortunately, there is little evidence concerning the effect of the timing of a firm's entry into a new market on its ultimate profitability in that market or the value generated for shareholders.[13]

In view of the mixed research evidence, then, it seems reasonable to conclude that while a pioneer may have some potential competitive advantages, not all pioneers are successful at capitalising on them. Some fail during the introductory or shakeout stages of their industries' life cycles. And those that survive may lack the resources to keep up with rapid growth or the competencies needed to maintain their early lead in the face of onslaughts by strong followers.[14]

## 15.2.3 Follower Strategy

In many cases a firm becomes a follower by default. It is simply beaten to a new product-market by a quicker competitor. But even when a company has the capability of being the first mover, the above observations suggest there may be some advantages to letting other firms go first into a product-market.[14] Let the pioneer shoulder the initial risks while the followers observe their shortcomings and mistakes. Possible advantages of such a follower strategy are briefly summarised in Exhibit 15.2 and discussed below.

1. *Ability to take advantage of the pioneer's positioning mistakes.* If the pioneer misjudges the preferences and purchase criteria of the mass-market segment or attempts

to satisfy two or more segments at once, it is vulnerable to the introduction of more precisely positioned products by a follower. By tailoring its offerings to each distinct segment, the follower(s) can successfully encircle the pioneer.

2. *Ability to take advantage of the pioneer's product mistakes.* If the pioneer's initial product has technical limitations or design flaws, the follower can benefit by overcoming these weaknesses. Even when the pioneering product is technically satisfactory, a follower may gain an advantage through product enhancements. For example, the iPhone's sleek design, innovative software, and functionality enabled Apple to capture a substantial share of the global mobile phone market from well-established competitors like Nokia and Motorola.
3. *Ability to take advantage of the pioneer's marketing mistakes.* If the pioneer makes any marketing mistakes in introducing a new entry, it opens opportunities for later entrants. This observation is closely related to the first two points, yet goes beyond product positioning and design to the actual execution of the pioneer's marketing programme. For example, the pioneer may fail to attain adequate distribution, spend too little on introductory advertising, or use ineffective promotional appeals to communicate the product's benefits. A follower can observe these mistakes, design a marketing programme to overcome them, and successfully compete head-to-head with the pioneer.

   Marketing mistakes can leave a pioneer vulnerable to challenges from later entrants even in product categories with substantial positive network effects. For example, Microsoft's Windows operating system was not the first user-friendly system on the market. However, Microsoft promoted and priced Windows very aggressively, it formed alliances with original equipment manufacturers (OEMs) in the personal computer industry to encourage them to install Windows on their machines, and it engaged in extensive licensing and cooperative agreements with other software developers. All these actions helped Windows capture a commanding share of the operating systems market, which in turn generated tremendous positive network effects for Windows and made it difficult for alternative systems to compete (perhaps too difficult, from the US Justice Department's and European Union antitrust officials' perspectives).
4. *Ability to take advantage of the latest technology.* In industries characterised by rapid technological advances, followers can possibly introduce products based on a superior, second-generation technology and thereby gain an advantage over the pioneer. And the pioneer may have difficulty reacting quickly to such advances if it is heavily committed to an earlier technology. Thus, Canon expects its new diagmatic imaging technology to give it an advantage in the medical imaging market that major competitors like General Electric will have trouble matching.
5. *Ability to take advantage of pioneer's limited resources.* If the pioneer has limited resources for production facilities or marketing programmes, or fails to commit sufficient resources to its new entry, followers willing and able to outspend the pioneer experience few enduring constraints.

## 15.2.4 Determinants of Success for Pioneers and Followers

Our discussion suggests that a pioneering firm stands the best chance for long-term success in market-share leadership and profitability when (1) the new product-market is insulated from the entry of competitors, at least for a while, by strong patent protection, proprietary technology (such as a unique production process), substantial investment requirements, or positive network effects, or (2) the firm has sufficient size, resources, and competencies to take full advantage of its pioneering position and preserve it in the face of later competitive entries. Evidence suggests that organisational competencies, such as R&D and marketing skills, not only affect a firm's success as a pioneer, but also may influence the company's decision about whether or not to be a pioneer in the first place. Firms that perceive they lack the competencies necessary to sustain a first-mover advantage may be more likely to wait for another company to take the lead and to enter the market later.[15]

McDonald's is an example of a pioneer that has succeeded by aggressively building on the foundations of its early advantage. Although the firm started small as a single hamburger restaurant, it used the franchise system of distribution to rapidly expand the number of McDonald's outlets with a minimum cash investment. That expansion plus stringent quality and cost controls, relatively low prices made possible by experience-curve effects, heavy advertising expenditures, and product-line expansion aimed at specific market segments (such as Egg McMuffin for the breakfast crowd) have all enabled the firm to maintain a leading share of the fast-food hamburger industry.

On the other hand, a follower will most likely succeed when there are few legal, technological, or financial barriers to inhibit entry and when it has sufficient resources or competencies to overwhelm the pioneer's early advantage. For example, given Procter & Gamble's well-established brand name and superior advertising and promotional resources, the company was able to quickly take the market share lead away from pioneer Minnetonka, Inc., in the plaque-fighting toothpaste market with a reformulated version of Crest.

A study conducted across a broad range of industries in the PIMS database supports these observations.[16] The author's findings are briefly summarised in Exhibit 15.3 and discussed below. The author found that, regardless of the industry involved, pioneers able to maintain their preeminent position well into the market's growth stage had supported their early entry with the following marketing strategy elements:

- *Large entry scale* – Successful pioneers had sufficient capacity, or could expand quickly enough, to pursue a mass-market targeting strategy, usually on a national rather than a local or regional basis. Thus, they could expand their volume quickly and achieve the benefits of experience-curve effects before major competitors could confront them.
- *Broad product line* – Successful pioneers also quickly add line extensions or modifications to their initial product to tailor their offerings to specific market segments. This helps reduce their vulnerability to later entrants who might differentiate themselves by targeting one or more peripheral markets. As we have seen, this has been one of the keys to Canon's success.
- *High product quality* – Successful pioneers also offer a high-quality, well-designed product from the beginning, thus removing one potential differential advantage for later followers. Competent engineering, thorough product and market test-

ing before commercialisation, and good quality control during the production process are all important to the continued success of pioneers.

- *Heavy promotional expenditures* – Successful pioneers had marketing programmes characterised by relatively high advertising and promotional expenditures as a percentage of sales. Initially the promotion helps to stimulate awareness and primary demand for the new product category, build volume, and reduce unit costs. Later, this promotion focuses on building selective demand for the pioneer's brand and reinforcing loyalty as new competitors enter.

**Exhibit 15.3 Marketing strategy elements pursued by successful pioneers, fast followers and late entrants**

| These marketers … | are characterised by one or more of these strategy elements: |
|---|---|
| Successful pioneers | • Large entry scale.<br>• Broad product line.<br>• High product quality.<br>• Heavy promotional expenditures. |
| Successful fast followers | • Larger entry scale than the pioneer.<br>• Leapfrogging the pioneer with superior:<br>– product technology.<br>– product quality.<br>– customer service. |
| Successful late entrants | • Focus on peripheral target markets or niches. |

The same study found that the most successful fast followers had the resources to enter the new market on a larger scale than the pioneer. Consequently, they could quickly reduce their unit costs, offer lower prices than incumbent competitors, and enjoy any positive network effects. Some fast followers achieved success, however, by leapfrogging earlier entrants. These followers won customers away from the pioneer by offering a product with more sophisticated technology, better quality, or superior service.

Finally, the author found that some late entrants also achieved substantial profits by avoiding direct confrontations with more established competitors and by pursuing peripheral target markets. They often offer tailor-made products to smaller market niches and support them with high levels of service.[17]

Followers typically enter a market after it is in the growth phase of its life cycle, and they start with low market shares relative to the established pioneer. Consequently, our discussion in the next module of marketing strategies for low-share competitors in growth markets is germane to both fast followers and later entrants. Before focusing on strategies for followers, however, we should first examine strategies that might be successfully employed by the first entrant in a new product-market.

## 15.3 Strategic Marketing Programmes for Pioneers

The preceding discussion suggests that the ultimate success of a pioneering strategy depends on the nature of the demand and competitive situation the pioneer encounters in the market and on the pioneer's ability to design and support an effective marketing programme. It also depends on how the pioneer defines success – in other words, the objectives it seeks to achieve. Thus, a pioneer might choose from one of three different types of marketing strategies: mass-market penetration, niche penetration, or skimming and early withdrawal. Exhibit 15.4 summarises the primary objectives of each strategy and the circumstances favouring their use. But while specific conditions may favour a given strategy, they do not guarantee its success. Much still depends on how effectively a firm implements the strategy. Also, it is highly unlikely that all the listed conditions will exist simultaneously in any single product-market.

**Exhibit 15.4 Marketing objectives and strategies for new product pioneers**

| | **Alternative marketing strategies** | | |
|---|---|---|---|
| **Situational variables** | **Mass-market penetration** | **Niche penetration** | **Skimming; early withdrawal** |
| Primary objective | • Maximise number of triers and adopters in *total market*.<br>• Maintain leading share position in *total market*. | • Maximise number of triers and adopters in *target segment*.<br>• Maintain leading share position in *target segment*. | • Recoup development and commercialisation costs as soon as possible.<br>• Withdraw from market when increasing competition puts pressure on margins. |
| Market characteristics | • Large potential demand.<br>• Relatively homogeneous customer needs.<br>• Customers likely to adopt product relatively quickly; short diffusion process. | • Large potential demand.<br>• Fragmented market; many different applications and benefit segments.<br>• Customers likely to adopt product relatively quickly; short adoption process. | • Limited potential demand.<br>• Customers likely to adopt product relatively quickly; short adoption process.<br>• Early adopters willing to pay high price; demand is price inelastic. |
| Product characteristics | • Product technology patentable or difficult to copy.<br>• Components or materials difficult to obtain; limited sources of supply.<br>• Complex production process; substantial development and/or investment required.<br>• Substantial network effects; value increases with growth in installed customer base. | • Product technology offers little patent protection; easily copied or adapted.<br>• Components or materials easy to obtain; many sources of supply.<br>• Relatively simple production process; little development or additional investment required.<br>• Limited or no network effects. | • Product technology offers little patent protection; easily copied or adapted.<br>• Components or materials easy to obtain; many sources of supply.<br>• Relatively simple production process; little development or additional investment required.<br>• Limited or no network effects. |

| Situational variables | Alternative marketing strategies: Mass-market penetration | Niche penetration | Skimming; early withdrawal |
|---|---|---|---|
| Competitor characteristics | • Few potential competitors.<br>• Most potential competitors have limited resources and competencies; few sources of differential advantage. | • Many potential competitors.<br>• Some potential competitors have substantial resources and competencies; possible sources of differential advantage. | • Many potential competitors.<br>• Some potential competitors have substantial resources and competencies; possible sources of differential advantage. |
| Firm characteristics | • Strong product-engineering skills; able to quickly develop product modifications and line extensions for multiple market segments.<br>• Strong marketing skills and resources; ability to identify and develop marketing programmes for multiple segments; ability to shift from stimulation of primary demand to stimulation of selective demand as competitors enter.<br>• Sufficient financial and organisational resources to build capacity in advance of growth in demand. | • Limited product-engineering skills and resources.<br>• Limited marketing skills and resources.<br>• Insufficient financial or organisational resources to build capacity in advance of growing demand. | • Strong basic R&D and new-product development skills; a prospector with good capability for continued new product innovation.<br>• Good sales and promotional skills; able to quickly build primary demand in target market; perhaps has limited marketing resources for long-term market maintenance.<br>• Limited financial or organisational resources to commit to building capacity in advance of growth in demand. |

## 15.3.1 Mass-Market Penetration

The ultimate objective of a mass-market penetration strategy is to capture and maintain a commanding share of the total market for the new product. Thus, the critical marketing task is to convince as many potential customers as possible to adopt the pioneer's product quickly to drive down unit costs and build a large contingent of loyal customers before competitors enter the market.

Mass-market penetration tends to be most successful when entry barriers inhibit or delay the appearance of competitors, thus allowing the pioneer more time to build volume, lower costs, and create loyal customers, or when the pioneer has competencies or resources that most potential competitors cannot match, as in the case of Canon's technical and R&D expertise in the copier industry. Other relevant competencies include product engineering, promotional and channel management skills, and the financial and organisational resources necessary to expand capacity in advance of demand. In some cases, though, a smaller firm with limited resources can successfully employ a mass-market penetration strategy if the market has a protracted adoption process and slow initial growth. Slow growth can delay competitive entry because fewer competitors are attracted to a market with questionable future growth. This allows the pioneer more time to expand capacity.

Mass-market penetration is also an appropriate strategy when the product category is likely to experience positive network effects. Since the value of such products increases as the number of users grows, it makes sense for the pioneer to quickly capture and maintain as large a customer base as possible.

### 15.3.2 Niche Penetration

Even when a new product-market expands quickly, however, it still may be possible for a small firm with limited resources to be a successful pioneer. In such cases, though, the firm must define success in a more limited way. Instead of pursuing the objective of capturing and sustaining a leading share of the entire market, it may make more sense for such firms to focus their efforts on a single market segment. This kind of **niche penetration** strategy can help the smaller pioneer gain the biggest bang for its limited bucks and avoid direct confrontations with bigger competitors.

A niche penetration strategy is most appropriate when the new market is expected to grow quickly and there are a number of different benefit or applications segments to appeal to. It is particularly attractive when there are few barriers to the entry of major competitors and when the pioneer has only limited resources and competencies to defend any advantage it gains through early entry.

Some pioneers may intend to pursue a mass-market penetration strategy when introducing a new product or service, but they end up implementing a niche penetration strategy instead. This is particularly likely when the new market grows faster or is more fragmented than the pioneer expects. Facing such a situation, a pioneer with limited resources may decide to concentrate on holding its leading position in one or a few segments, rather than spreading itself too thin developing unique line extensions and marketing programmes for many different markets or going deep into debt to finance rapid expansion.

### 15.3.3 Skimming and Early Withdrawal

Even when a firm has the resources to sustain a leading position in a new product-market, it may choose not to. Competition is usually inevitable, and prices and margins tend to drop dramatically after followers enter the market. Therefore, some pioneers opt to pursue a **skimming** strategy while planning an early withdrawal from the market. This involves setting a high price and engaging in only limited advertising and promotion to maximise per-unit profits and recover the product's development costs as quickly as possible. At the same time, the firm may work to develop new applications for its technology or the next generation of more advanced technology. Then when competitors enter the market and margins fall, the firm is ready to cannibalise its own product with one based on new technology or to move into new segments of the market.

The 3M Company is a master of the skimming strategy. According to one 3M manager, 'We hit fast, price high (full economic value of the product to the user), and get the heck out when the me-too products pour in.' The new markets pioneered by the company are often smaller ones of $50 million to $100 million, and the firm may dominate them for only about five years or so. By then, it is ready to launch the next generation of new technology or to move the old technology into new applications. For instance, within two years of 3M's introduction of the first water-activated casting tape for setting broken bones, eight other firms had introduced similar products. But since the company's R&D people had been working on a replacement version all along, it was able to drop the old product and introduce a technically superior tape that was stronger, easier to use, and commanded a premium price.[18]

As Exhibit 15.4 indicates, either small or large firms can use strategies of skimming and early withdrawal. But it is critical that the company have good R&D and product development skills so it can produce a constant stream of new products or new applications to replace older ones as they attract heavy competition. Also, since a firm pursuing this kind of strategy plans to remain in a market only short term, it is most appropriate when there are few barriers to entry, the product is expected to diffuse rapidly, and the pioneer lacks the capacity or other resources necessary to defend a leading share position over the long haul.

### 15.3.4 Marketing Programme Components for a Mass-Market Penetration Strategy

As mentioned, the crucial marketing task in a mass-market penetration strategy is to maximise the number of customers adopting the firm's new product as quickly as possible. This requires a marketing programme focused on (1) aggressively building product awareness and motivation to buy among a broad cross-section of potential customers and (2) making it as easy as possible for those customers to try the new product, on the assumption that they will try it, like it, develop loyalty, and make repeat purchases.

Exhibit 15.5 outlines a number of marketing activities that might help increase customers' awareness and willingness to buy or improve their ability to try the product. This is by no means an exhaustive list; nor do we mean to imply that a successful pioneer must necessarily engage in all of the listed activities. Marketing managers must develop programmes combining activities that fit both the objectives of a mass-market penetration strategy and the specific market and potential competitive conditions the new product faces.

**Exhibit 15.5 Components of strategic marketing programmes for pioneers**

| Strategic objectives and tasks | Alternative strategic marketing programmes: Mass-market penetration | Niche penetration | Skimming; early withdrawal |
|---|---|---|---|
| Increase customers' awareness and willingness to buy | • Heavy advertising to generate awareness among customers in mass market; broad use of mass media. | • Heavy advertising directed at target segment to generate awareness; use selective media relevant to target. | • Limited advertising to generate awareness, particularly among least price sensitive early adopters. |
| | • Extensive salesforce efforts to win new adopters; possible use of incentives, to encourage new product sales. | • Extensive salesforce efforts focused on potential customers in target segment; possible use of incentives to encourage new product sales to target accounts. | • Extensive salesforce efforts particularly focused on largest potential adopters; possible use of volume-based incentives to encourage new product sales. |
| | • Advertising and sales appeals stress generic benefits of new product types. | • Advertising and sales appeals stress generic benefits of new product type. | • Advertising and sales appeals stress generic benefits of new product type. |
| | • Extensive introductory sales promotions to induce trial (sampling, couponing, quantity discounts). | • Extensive introductory sales promotions to induce trial, but focused on target segment. | • Limited use, if any, of introductory sales promotions; if used, they should be volume-based quantity discounts. |
| | • Move relatively quickly to expand offerings (line extensions, multiple package sizes) to appeal to multiple segments. | • Additional product development limited to improvements or modifications to increase appeal to target segment. | • Little, if any, additional development within the product category. |
| | • Offer free trial, liberal return or extended warranty policies to reduce customers' perceived risk of adopting the new product. | • Offer free trial, liberal return or extended warranty policies to reduce target customers' perceived risk of adopting the new product. | • Offer free trial, liberal return or extended warranty policies to reduce target customers' perceived risk of adopting the new product. |
| Increase customers' ability to buy | • Penetration pricing; or start with high price but bring out lower-priced versions in anticipation of competitive entries. | • Penetration pricing; or start with high price but bring out lower-priced versions in anticipation of competitive entries. | • Skimming pricing; attempt to maintain margins at level consistent with value of product to early adopters. |
| | • Extended credit terms to encourage initial purchases. | • Extended credit terms to encourage initial purchases. | • Extended credit terms to encourage initial purchases. |

| Strategic objectives and tasks | Alternative strategic marketing programmes: Mass-market penetration | Niche penetration | Skimming; early withdrawal |
|---|---|---|---|
| Increase customers' awareness and willingness to buy | • Heavy advertising to generate awareness among customers in mass market; broad use of mass media. | • Heavy advertising directed at target segment to generate awareness; use selective media relevant to target. | • Limited advertising to generate awareness, particularly among least price sensitive early adopters. |
| | • Heavy use of trade promotions aimed at gaining extensive distribution. | • Trade promotions aimed at gaining solid distribution along retailers or distributors pertinent for reaching target segment. | • Limited use of trade promotions; only as necessary to gain adequate distribution. |
| | • Offer engineering, installation and training services to increase new product's compatibility with customers' current operations to reduce switching costs. | • Offer engineering, installation and training services to increase new product's compatibility with customers' current operations to reduce switching costs. | • Offer limited engineering, installation and services as necessary to overcome customers' objections. |

### 15.3.4.1 Increasing Customers' Awareness and Willingness to Buy

Obviously, heavy expenditures on advertising, introductory promotions such as sampling and couponing, and personal selling efforts all can increase awareness of a new product or service among potential customers. This is the critical first step in the adoption process for a new entry. The relative importance of these promotional tools varies, however, depending on the nature of the product and the number of potential customers. For instance, personal selling efforts are often the most critical component of the promotional mix for highly technical industrial products with a limited potential customer base, such as Canon's new wide-format bubble-jet printer. Media advertising and sales promotion are usually more useful for building awareness and primary demand for a new consumer good among customers in the mass market. In either case, when designing a mass-market penetration marketing programme, firms should broadly focus promotional efforts to expose and attract as many potential customers as possible before competitors show up.

Firms might also attempt to increase customers' willingness to buy their products by reducing the risk associated with buying something new. This can be done by letting customers try the product without obligation, as when car dealers allow potential customers to test-drive a new model, or when software developers allow customers to download a trial version and use it free for 30 days. Liberal return policies and extended warranties can serve the same purpose.

Finally, a firm committed to mass-market penetration might also broaden its product offerings to increase its appeal to as many market segments as possible. This helps reduce its vulnerability to later entrants who could focus on specific market niches. Firms can accomplish such market expansion through the rapid introduction of line extensions, additional package sizes, or product modifications targeted at new applications and market segments.

#### 15.3.4.2 Increasing Customers' Ability to Buy

For customers to adopt a new product and develop loyalty toward it, they must be aware of the item and be motivated to buy. But they also must have the wherewithal to purchase it. Thus, to capture as many customers in as short a time as possible, it usually makes sense for a firm pursuing mass-market penetration to keep prices low (penetration pricing) and perhaps offer liberal financing arrangements or easy credit terms during the introductory period.

Pioneers introducing new information or communications technologies tend to be particularly aggressive in pricing their offerings for two reasons. First, as we have seen, such products often can benefit from positive network effects if enough customers can be induced to adopt them quickly. Second, the variable costs of producing and distributing additional units of such products are usually very low, perhaps even approaching zero. For instance, the costs of developing a new software product are high, but once it is developed, copies can be made and distributed over the Internet for next to nothing. These two factors mean that it often makes sense for pioneers in such product categories to set their price very low to initial customers – perhaps even to give away trial copies – in hopes of quickly building a large installed base, capturing more value from later customers with higher prices, and maximising the lifetime value of their customers by selling them upgrades and enhanced versions of the product in the future.[19]

Another factor that can inhibit customers' ability to buy is a lack of product availability. Thus, extensive personal selling and trade promotions aimed at gaining adequate distribution are usually a critical part of a mass-market penetration marketing programme. Such efforts should take place before the start of promotional campaigns to ensure that the product is available as soon as customers are motivated to buy it.

A highly technical new product's incompatibility with other related products or systems currently used also can inhibit customers' purchases. It can result in high switching costs for a potential adopter. The pioneer might reduce those costs by designing the product to be as compatible as possible with related equipment. It also might offer engineering services to help make the new product more compatible with existing operations, provide free installation assistance, and conduct training programmes for the customer's employees.

The above actions are suited not just to the marketing of products; most are essential elements of mass-market penetration strategies for new service, retail, and even e-commerce websites as well. The marketing actions of an e-retailer such as Amazon.com, discussed in Exhibit 15.6, provide a textbook example of the elements of, as well as some of the risks inherent in, a mass-market penetration strategy.

**Exhibit 15.6 Amazon's mass-market penetration strategy**

Founded in 1994 by Jeff Bezos as the first online bookstore, Amazon.com (www.amazon.com) has employed many of the marketing tactics we have listed as possible components of a mass-market penetration strategy. In the early days, the firm spent heavily on various promotional tools to attract buyers and build a base of loyal customers. In the late 1990s, the firm was spending an average of more than $50 for each new customer it attracted. The money was spent on banner advertising and alliances with other sites and Web portals, traditional media advertising, special consumer promotions, and an 'associates' programme through which sites that offer a link to Amazon get a cut of any sales they referred. As Amazon has built its customer base and increased public awareness, its acquisition costs per customer have declined substantially.

In the early years, many of Amazon's inventory storage and order fulfilment functions were outsourced, its fixed costs were low, and it had huge amounts of capital to play with. Consequently, it was able to attract customers from bricks-and-mortar bookstores by offering very low prices and a wide selection of titles.

To gain the loyalty of new customers it attracted, Amazon worked hard to constantly improve its customer service. It collected information from customers concerning their preferences, desires, and complaints, then launched a series of customer service innovations, such as one-click ordering and a popular best-seller list ranking sales on the site. More recently, it has invested hundreds of millions of dollars to build a network of six automated distribution centres around the US to better control order fulfilment, ensure quick and reliable delivery, and lower fulfilment costs. Indeed, those fulfilment costs were down to 10.6 per cent of sales in 2002, compared to 12.8 per cent the year before.

Finally, Amazon has greatly expanded its product lines over the years to include CDs, toys, electronics, tools, and a variety of other things. This move was motivated by the company's desire to become a one-stop shopping venue, and to increase the average annual revenues per customer. Amazon's mass-market strategy has been very successful so far. The firm made $476 million in net income on nearly $14.8 billion of global sales in 2007. However, the future remains somewhat unsettled due to ongoing changes in the firm's competitive and technical environments. New challengers in Internet retailing include both established bricks-and-mortar firms, like Walmart and Tesco, and other Web portals, like Germany's Otto. To stay one step ahead of such rivals, Amazon has been investing heavily in new technology – particularly software development – to further personalise its website and improve the customer's shopping experience.

The company is also pursuing a new strategy aimed at leveraging those investments in technical infrastructure by selling Internet services to other firms who want a sophisticated Internet presence but don't have the resources to develop it in-house.

Some analysts and investors were concerned that Amazon might never be able to recoup the heavy investments inherent in its pursuit of the mass market. Consequently, between 2004 and 2006, when many Web companies were coming back to life after the dot-com crash of 2002, Amazon's stock price fell from more than $50 a share to as low as $26. By mid-2008, however, it was apparent that Amazon had emerged as the undisputed e-commerce champ and that its marketing of Internet services was winning acceptance among start-up firms as well as some major corporations. As a result, its stock returned to robust health – even in the 2008 bear market – with a price over $85 a share.

*Source*: Eryn Brown, 'Nine Ways to Win on the Web,' *Fortune*, May 24, 1999, pp. 112–25; Robert Hof, Debra Sparks, Ellen Neuborne, and Wendy Zellner, 'Can Amazon Make It?' *Business Week*, July 10, 2000, pp. 38–43; David Shook, 'Special Report: The 2002 E.Biz 25,' *Business Week Online* (www.businessweek.com), October 1, 2002; and Robert Hof, 'Amazon: Heading for a Hangover?' *Business Week*, December 16, 2002, p. 87.

### 15.3.4.3 Additional Considerations When Pioneering Global Markets

Whether the product-market a pioneer is trying to penetrate is domestic or foreign, many of the marketing tasks appropriate for increasing potential customers' awareness, willingness, and ability to buy the new product or service are largely the same. Of course, some of the tactical aspects of the pioneer's strategic marketing programme – such as specific product features, promotional appeals, or distribution channels – may have to be adjusted to fit different cultural, legal, or economic circumstances across national borders. For Bausch & Lomb to develop the Chinese market for contact lenses, for instance, it first had to develop an extensive training programme for the country's opticians and build a network of retail outlets, actions that were unnecessary in more developed markets.

Unless the firm already has an economic presence in a country via the manufacture or marketing of other products or services, however, a potential global pioneer faces at least one additional question: What mode of entry is most appropriate? Recall that in Module 13 we discussed three basic mechanisms for entering a foreign market – exporting through agent middlemen (using local manufacturers reps or distributors), contractual agreements such as licensing or franchise arrangements with local firms, or direct investment.

Exporting lowers the financial risk involved for the pioneer when entering an unfamiliar foreign market. Unfortunately, such arrangements also afford the pioneer relatively little control over the marketing and distribution of its product or service – activities that are critical for winning customer awareness and loyalty in a new market. At the other extreme, investing in a wholly owned subsidiary typically makes little sense until it becomes clear that the pioneering product will win customer acceptance. Consequently, intermediate modes of entry, such as licensing or forming a joint venture with a local firm in the host country, tend to be the preferred means of developing global markets for new products. Joint ventures are particularly appropriate in this regard because they avoid quotas and import restrictions or taxes, and they allow a pioneer to share financial risks while gaining local marketing expertise.[20] Thus Bausch & Lomb established a joint venture with Beijing Optical as a basis for building contact lens factories in China and for gaining access to Chinese opticians. Consequently, the firm has been able to develop and maintain a leading market share in the world's most heavily populated country with a modest investment of only about $20 million.

## 15.3.5 Marketing Programme Components for a Niche Penetration Strategy

Because the objectives of a niche penetration strategy are similar to but more narrowly focused than those of a mass-market strategy, the marketing programme elements are also likely to be similar under the two strategies. Obviously, however, the niche penetrator should keep its marketing efforts clearly focused on the target segment to gain as much impact as possible from its limited resources. This point is evident in the outline of programme components in Exhibit 15.5. For example, while a niche strategy calls for the same advertising, sales promotion, personal selling, and trade promotion activities as a mass-market programme, the former should use more selective media, call schedules, and channel designs to precisely direct those activities toward the target segment.

### 15.3.6 Marketing Programme Components for a Skimming Strategy

As Exhibit 15.5 suggests, one major difference between a skimming strategy and a mass-market penetration strategy involves pricing policies. A relatively high price is appropriate for a skimming strategy to increase margins and revenues, even though some price-sensitive customers may be reluctant to adopt the product at that price.[21] This also suggests that introductory promotional programmes might best focus on customer groups who are least sensitive to price and most likely to be early adopters of the new product. This can help hold down promotion costs and avoid wasting marketing efforts on less profitable market segments. Thus, in many consumer goods businesses, skimming strategies focus on relatively upscale customers, since they are often more likely to be early adopters and less sensitive to price.

Another critical element of a skimming strategy is the nature of the firm's continuing product-development efforts. A pioneer that plans to leave a market when competitors enter should not devote much effort to expanding its product line through line extensions or multiple package sizes. Instead, it should concentrate on the next generation of technology or on identifying new application segments, in other words, preparing its avenue of escape from the market.

Now that we have examined some strategies a pioneer might follow in entering a new market, we are left with two important marketing questions. The pioneer is by definition the early share leader in the new market; hence the first question is, What adjustments in strategy might be necessary for the pioneer to *maintain its leading share position* after competitors arrive on the scene? The second is, What marketing strategies might followers adopt *to take business away from the early leader and increase their relative share position* as the market grows? These two issues are the focus of the next module.

## Learning Summary

- Being the pioneer in a new product or service category gains the firm a number of potential advantages. But not all pioneers are able to sustain a leading position in the market as it grows. A pioneering firm stands the best chance for long-term share leadership and profitability when the market can be insulated from the rapid entry of competitors by patent protection or other means and when the firm has the necessary resources and competencies to capitalise on its first-mover advantages.
- Evidence suggests that pioneers who successfully capitalise on their first-mover advantage and sustain a leading competitive position (a) introduce a quality product and pay careful attention to quality control, (b) have the capacity to enter on a large scale or the resources to expand rapidly as the market grows, (c) back the introduction with substantial promotion to build awareness and trial, and (d) rapidly expand the product line to satisfy multiple customer segments.

- Followers can trump the pioneer in a new product category if they can enter with more capacity backed by substantially larger marketing expenditures, or by leapfrogging the first mover with superior technology, product quality, or customer service.
- Not all pioneers attempt to penetrate the mass market and remain the share leader as that market grows. Some adopt a strategy geared to making profits from specialised niche markets where they will face fewer direct competitors. Still others try to stay one jump ahead of competitors by introducing a stream of new products and withdrawing from older markets as they become more competitive. The appropriate strategy to adopt depends on the firm's resources and competencies, the strength of likely competitors, and the characteristics of the product and its target market.

## Review Questions

## Content Questions

15.1 Describe the subcategories of new products based on their degree of newness.

15.2 What are the potential sources of competitive advantages available to a pioneer?

15.3 What are the possible advantages of adopting a follower strategy?

15.4 What are the determinants of success for a pioneer strategy?

15.5 Discuss each of the three types of pioneer strategy.

15.6 What marketing activities should a firm engage in to increase customers' awareness and willingness to buy? And to increase the customers' ability to buy?

15.7 What marketing programme components are important for a skimming strategy?

## Multiple Choice Questions

15.8 A product category which is new to the company but not new to customers, because of the existence of competitive brands, is classified as what type of new product?

A. Cost reductions.
B. New product lines.
C. Additions to existing product lines.
D. Repositionings.
E. Improvements in existing products.

15.9 Pillsbury's entry into the instant breakfast product-market in the USA involves the need to create _____ demand. If Pillsbury decides to enter the Chinese market, where it is the pioneer, it must create _____ demand.

A. selective; primary.
B. primary; selective.
C. selective; selective.
D. primary; primary.
E. selective; primary and selective .

15.10 Which source of advantage to a pioneer is represented by the idea that the pioneer's brand can become a standard of reference to customers in terms of evaluating brands introduced later by competitors?

A. Distribution advantage.
B. Economies of scale advantage.
C. First choice of positioning strategy.
D. High switching costs.
E. Defining the rules of the game advantage.

15.11 The value of some kinds of goods and services to an individual consumer increases as a greater number of people adopt the product. Such products exhibit:

A. economies of scale.
B. vertical integration.
C. horizontal integration.
D. positive network effects.
E. economies of scope.

15.12 When it entered the personal computer market Compaq entered as a _____. Its strategy was to take advantage of IBM's _____.

A. pioneer; positioning.
B. follower; limited resources.
C. slow follower; marketing mistakes.
D. follower; positioning.
E. follower; product mistakes.

15.13 A pioneer who follows a broad product line marketing strategy may be attempting to:
- A. build share.
- B. satisfy emerging wants.
- C. develop a quality image.
- D. compete on a national basis.
- E. both A and B above.

15.14 Which element of marketing strategy suggests that the pioneer has sufficient manufacturing capacity to pursue a mass-market strategy on a national basis?
- A. Heavy promotional expenditures.
- B. Broad product line.
- C. High product quality.
- D. Large entry scale.
- E. Positioning strategy.

15.15 For 'new to the world' products, which marketing strategy is most consistent with a low introductory price?
- A. Skimming/early withdrawal.
- B. Niche penetration.
- C. Mass-market penetration.
- D. Any of the above.
- E. Only A and B above.

15.16 A company that 'hits fast, prices high, and gets out' before me-too products enter is practising a _____ strategy.
- A. niche penetration.
- B. vertical profit maximisation.
- C. mass-market penetration.
- D. new-to-the-world.
- E. skimming with early withdrawal.

15.17 _____ advertising to generate awareness is most likely to be associated with a _____ strategy.
- A. Limited; mass-market penetration.
- B. Limited; skimming/early withdrawal.
- C. Limited; niche penetration.
- D. Extensive; skimming/early withdrawal.
- E. Extensive; delayed withdrawal.

15.18 Which type of marketing strategy has as its primary objective to recover R&D and commercialisation costs as soon as possible?
- A. Mass-market penetration.
- B. Niche penetration.
- C. Harvesting strategy.
- D. Skimming and early withdrawal strategy.
- E. Defender strategy.

15.19 Penetration pricing increases customer's _____ when associated with a _____ strategic marketing programme.

A. willingness to buy; early withdrawal.
B. awareness; early withdrawal.
C. ability to buy; niche.
D. awareness; niche.
E. both B and D .

15.20 Usually, the best market entry strategy for a firm looking to pioneer an international market is:

A. export.
B. franchising.
C. joint venture.
D. direct investment.
E. none of the above.

## Application Questions and Cases

15.21 Minnetonka, Inc., is a relatively small firm that has pioneered the development of consumer health and beauty products – such as Softsoap and Check-Up plaque-fighting toothpaste – over recent years. What potential advantages does being the pioneer in new product-markets provide a firm like Minnetonka in an industry dominated by giants such as Procter & Gamble and Colgate-Palmolive?

15.22 Not all new market pioneers effectively take advantage of the potential benefits inherent in their early lead. What does the research evidence suggest that Minnetonka should do in relation to major elements of its marketing strategy to gain and maintain a leading share position in the new markets it enters?

15.23 Research shows that companies that increase profits mostly by cutting the costs of their new product entries have substantially lower profits than those that emphasise revenue growth with their new entries. How do you explain this finding?

15.24 Under what conditions do pioneer and follower strategies each have the greatest probability of long-term success?

15.25 With the exception of certain core businesses – such as adhesives and information-storage technology – the 3M Company has often followed a strategy of withdrawing from markets in which it was the pioneer after other competitors enter and profit margins start to decline. It typically does this by licensing products to other firms. Under what kinds of market and competitive situations is such a withdrawal strategy most appropriate? What kinds of products do you think 3M is most likely to license to other firms?

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# Module 16

# Marketing Strategies for Growth Markets

## Contents



## Nike versus Vans: The Battle for Jocks' Hearts and Soles[1]

Nike athletic shoes began life in 1964 – albeit under a different name – as a speciality product aimed at long-distance runners, a very narrow niche of the athletic footwear market. Phil Knight, a former distance runner at the University of Oregon, and his former coach Bill Bowerman believed that distance runners needed better shoes. With his wife's waffle iron and some latex, Bowerman developed the waffle outsole that would revolutionise the running shoe. Nike's new shoes were lighter and more flexible than competing shoes, with better lateral stability to protect against ankle sprains and more cushioning to help runners' bodies cope with miles and miles of repetitive impact.

The company struggled for years to strengthen its foothold in an industry dominated by much larger global competitors like Germany's Adidas. But in 1972 Nike finally gained the sporting world's attention when four of the top seven finishers in the Olympic marathon wore the firm's shoes. By 1974 Nike was America's best-selling brand of training shoe, and the Nike brand was on the way to stardom.

Having become number one in training shoes, Nike set its sights on achieving share leadership in the entire industry. As a first step toward accomplishing that goal, the company invested heavily in new product R&D and design efforts to expand its product line with offerings tailored to the needs and preferences of participants in a wide variety of other sports. It held down costs by outsourcing production of the new lines to a number of off-shore manufacturers. However, the firm maintained tight control over, and was much less frugal with, its marketing efforts. Nike spent heavily on endorsement deals with sport celebrities and on a series of stylish but edgy mass media ad campaigns to capture attention and build a strong brand image in its new target segments. It also constructed an extensive distribution network consisting largely of independent mass retailers and speciality chains like Footlocker.

In 1978, tennis great John McEnroe signed with the company and tennis shoes became a prominent part of the product line. In 1985, a promising Chicago Bulls rookie named Michael Jordan endorsed a line of Air Jordan shoes and apparel. By 1986, Nike's worldwide sales passed the billion-dollar mark and Nike had become the acknowledged technological leader in the footwear industry. Today, Nike offers a full line of shoes for virtually every athletic activity, it's the global leader in industry market share, and it dominates most segments of the market.

### *The Attack of the Global Competitors*

In recent years, however, Nike's overall share of the US market has slipped a bit. After reaching a peak of 47.5 per cent in 1997, it has dropped a per cent or two every year since. This has happened because some of Nike's global competitors – such as Adidas, Puma, New Balance, Skechers, and Vans – have challenged it in a number of small niche markets. Instead of copying Nike's emphasis on designing high-tech shoes to enhance athletic performance in specific sports, they have appealed to different life style segments by emphasising different product attributes and benefits. For instance, shoes offered by Puma, Skechers and Hilfiger appeal to younger customers by emphasising fashion, 'coolness' and limited availability. On the other hand, New Balance targets older customers, emphasises comfort and conservative design, and touts that it is 'Endorsed by No One.' But one of the more unusual – and successful – challenges to Nike's dominance has come from Vans in the skateboard segment.

In 1995 Nike made a concerted run at capturing a dominant share of the shoe and apparel purchases of skateboarders, but stubbed its toe. These days, the brand of choice among boarders is tiny Vans Inc. The Santa Fe Springs, California, company pioneered thick-soled slip-on sneakers able to absorb the shock of a five-foot leap on wheels. The firm nurtures its cool image with an offbeat marketing programme that forgoes media advertising and focuses instead on sponsorships, events, and other 'experience' activities that fit the skateboard culture. The centrepiece of these marketing efforts is the elaborate skateboard parks Vans is building at malls around the country. The company also gets some broader media exposure by sponsoring events such as the Vans Triple Crown, a showcase for alternative sports ranging from skateboarding to BMX biking that is broadcast by NBC Sports. As Vans' CEO Gary Schoenfeld points out, 'Our vision is not to hit our target audience over the head with ads, but to integrate ourselves into the places they are most likely to be.'

Because the skateboarding craze was hot during the first years of the 21st century, Vans enjoyed heady growth, with sales increases averaging 20 to 25 per cent per year. True, Vans still accounts for less than 3.5 per cent of an overall US athletic shoe market that is half-owned by Nike, but the firm's focus on alternative sports fanatics has built a loyal – and profitable – customer base.

While Vans would like to pursue growth by developing new products, it also wants to avoid offending loyal customers who love its maverick roots and outsider image. The company would rather preserve its dominance in a small but lucrative market niche than launch a risky and expensive battle for a bigger share of the entire market. Thus, the firm is experimenting with hiking boots, snowboard boots, and an expanded clothing line, but has steered clear of inline skates because skateboarders tend to see them as a wimpy offshoot.

And don't count Nike out of the skateboard segment just yet. The company is developing a line of high-performance shoes developed specifically for the sport's top pros. They're signing up those pros as endorsers and introducing ad campaigns in the skateboard world. Nike, in other words, is sticking to what it does best.

## Learning Objectives

The first section of this module examines both the opportunities and competitive risks often found in growing product-markets. The primary objective of the early share leader, usually the market pioneer, in a growth market is **share maintenance**. From a marketing perspective the firm must accomplish two important tasks: (1) retain repeat or replacement business from its existing customers and (2) continue to capture the major portion of sales to the growing number of new customers entering the market for the first time. The leader might use any of several marketing strategies to accomplish these objectives. It might try to build on its early scale and experience advantages to achieve low-cost production and reduce its prices. Alternatively, the leader might focus on rapid product improvements, expand its product line to appeal to newly emerging segments, or increase its marketing and sales efforts. The second section of this module explores marketing strategies – both defensive and offensive – that leaders might use to maintain a dominant market share in the face of continuing growth and increasing competition.

A challenger's strategic objective in a growth market is usually to build its share by expanding its sales faster than the overall market growth rate. Firms do this by stealing existing customers away from the leader or other competitors, capturing a larger share of new customers than the market leader, or both. Once again, challengers might use a number of strategies to accomplish these objectives. These include developing a superior product technology; differentiating through rapid product innovations, line extensions, or customer service; offering lower prices; or focusing on market niches where the leader is not well established. The third section details these and other **share-growth** strategies that market challengers use under different conditions.

The success of a firm's strategy during the growth stage is a critical determinant of its ability to reap profits, or even survive, as a product-market moves toward maturity. Unfortunately, the growth stage is often short; and increasingly rapid technological change and market fragmentation are causing it to become even shorter in many industries.[2] This shortening of the growth stage concerns many firms – particularly late entrants or those who fail to acquire a substantial market share – because as growth slows during the transition to maturity, there is often a shakeout of marginal competitors. Thus, when choosing marketing strategies for competing in a growing product-market, managers should keep one eye on building a competitive advantage that the business can sustain as growth slows and the market matures.

## 16.1 Opportunities and Risks in Growth Markets

Why are followers attracted to rapidly growing markets? Conventional wisdom suggests such markets present attractive opportunities for future profits because

- It is easier to gain share when a market is growing.
- Share gains are worth more in a growth market than in a mature market.
- Price competition is likely to be less intense.
- Early participation in a growth market is necessary to make sure that the firm keeps pace with the technology.

While generally valid, each of these premises may be seriously misleading for a particular business in a specific situation. Many followers attracted to a market by its rapid growth rate are likely to be shaken out later when growth slows because either the preceding premises did not hold or they could not exploit growth advantages sufficiently to build a sustainable competitive position.[3] By understanding the limitations of the assumptions about growth markets and the conditions under which they are most likely to hold, a manager can make better decisions about entering a market and the kind of marketing strategy likely to be most effective in doing so.

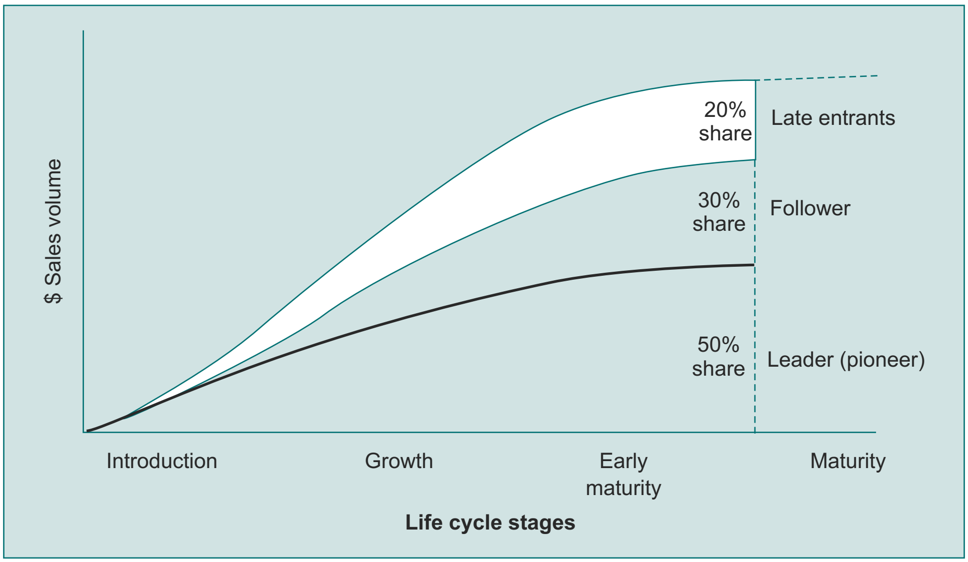
### 16.1.1 Gaining Share Is Easier

The premise that it is easier for a business to increase its share in a growing market is based on two arguments. First, there may be many potential new users who have no established brand loyalties or supplier commitments and who may have different needs or preferences than earlier adopters. Thus there may be gaps or undeveloped segments in the market. It is easier, then, for a new competitor to attract those potential new users than to convert customers in a mature market. Second, established competitors are less likely to react aggressively to market-share erosion as long as their sales continue to grow at a satisfactory rate.

There is some truth to the first argument. It usually is easier for a new entrant to attract first-time users than to take business away from entrenched competitors. To take full advantage of the situation, however, the new entrant must be able to develop a product offering that new customers perceive as more attractive than other alternatives, and it must have the marketing resources and competence to effectively persuade them of that fact. This can be difficult, especially when the pioneer has had months or years to influence potential customers' decision criteria and preferences.[4]

The notion that established competitors are less likely to react to share losses so long as their revenues are growing at an acceptable rate is more tenuous. It overlooks the fact that those competitors may have higher expectations for increased revenues when the market itself is growing. Capital investments and annual operating budgets are usually tied to those sales expectations; therefore, competitors are likely to react aggressively when sales fall below expected levels whether or not their absolute volumes continue to grow. This is particularly true given that increased competition will likely erode the leader's relative market share even though its volume may continue to increase. As illustrated by the hypothetical example in Exhibit 16.1, the leader's market share might drop from a high of 100 per cent at the beginning of the growth stage to 50 per cent by the maturity stage, even though the firm's absolute volume shows steady growth.

**Exhibit 16.1 Market shares of the leader and followers over the life cycle of a hypothetical market**




*Source*: From *Analysis for Strategic Market Decisions*, 1st edition, by G.S. Day, © 1986.

Industry leaders often react forcefully when their sales growth falls below industry levels, or when the industry's growth rate slows. For example, when growth in the personal computer market slumped in 2000 due to the dot-com crash and other factors, Dell Computers did not adjust its aggressive sales growth objective. Instead, it launched a brutal price war aimed at taking more business away from competitors in order to achieve its goal. Because Dell's focus on direct selling over the Internet, its build-to-order manufacturing system, and its tightly integrated supply chain made it the undisputed low-cost producer in the industry, Dell was able to slash gross margins from 21.3 per cent in mid-2000 to 17.5 per cent in mid-2001 and still make money. As a result, Dell's leading share of the global PC market increased from 10 per cent to 13 per cent in 2001, rose another three points in 2002, and continued to grow until shortcomings in new product development and customer service opened the door for competitors such as Lenovo, Acer and Hewlett-Packard to challenge their lead.[5]

## 16.1.2 Share Gains Are Worth More

The premise that share gains are more valuable when the market is growing stems from the expectation that the earnings produced by each share point continue to expand as the market expands. The implicit assumption in this argument, of course, is that the business can hold its relative share as the market grows. The validity of such an assumption depends on a number of factors, including the following:

- *The existence of positive network effects.* As we saw in the previous module, pioneers in new product-markets enjoy several potential competitive advantages that they can – but don't always manage to – leverage as the market grows. For information-based products, such as computer software or Internet auction sites, one of the most important such advantage is the existence of positive network effects, the tendency for the product to become more valuable to users as the number of adopters grows. Such network effects increase the likelihood that an early share leader can sustain, and even increase, its relative share as the market grows. As Microsoft was able to license its Windows operating system to a growing number of computer manufacturers, for example, software developers created more and more applications to run on Windows, which made Windows even more attractive to later computer buyers and helped Microsoft expand its already commanding market share.
- *Future changes in technology or other key success factors.* On the other hand, if the rules of the game change, the competencies a firm relied on to capture share may no longer be adequate to maintain that share. For instance, Sony was the pioneer and early share leader in the videocassette recorder industry with its Betamax technology. But Matsushita's longer-playing and lower-priced VHS format equipment ultimately proved much more popular with consumers, captured a commanding portion of the market, and dethroned Sony as industry leader.
- *Future competitive structure of the industry.* The number of firms that ultimately decide to compete for a share of the market may turn out to be larger than the early entrants anticipate, particularly if there are few barriers to entry. The sheer weight of numbers can make it difficult for any single competitor to maintain a substantial relative share of the total market.
- *Future fragmentation of the market.* As the market expands, it may fragment into numerous small segments, particularly if potential customers have relatively heterogeneous functional, distribution, or service needs. When such fragmentation occurs – as it appears to be doing in the US athletic shoe market – the portion in which a given competitor competes may shrink as segments splinter away.

In addition to these possible changes in future market conditions, a firm's ability to hold its early gains in market share also depends on how it obtained them. If a firm captures share through short-term promotions or price cuts that competitors can easily match and that may tarnish its image among customers, its gains may be short-lived.

### 16.1.3 Price Competition Is Likely to Be Less Intense

In many rapidly growing markets demand exceeds supply. The market exerts little pressure on prices initially; the excess demand may even support a price premium. Thus, early entry provides a good opportunity for a firm to recover its initial product development and commercialisation investment relatively quickly. New customers also may be willing to pay a premium for technical service as they learn how to make full use of the new product. In contrast, as the market matures and customers gain more experience, the premium a firm can charge without losing market share slowly shrinks; it eventually may disappear entirely.[6]

However, this scenario does not hold true in every developing product-market. If there are few barriers to entry or if the adoption process is protracted and new customers enter the market slowly, demand may not exceed supply – at least not for very long. Also, the pioneer, or one of the earliest followers, might adopt a penetration strategy and set its initial prices relatively low to move quickly down the experience curve and discourage other potential competitors from entering the market.

### 16.1.4 Early Entry Is Necessary to Maintain Technical Expertise

In high-tech industries early involvement in new product categories may be critical for staying abreast of technology. The early experience gained in developing the first generation of products and in helping customers apply the new technology can put the firm in a strong position for developing the next generation of superior products. Later entrants, lacking such customer contact and production and R&D experience, are likely to be at a disadvantage.

There is substantial wisdom in these arguments. Sometimes, however, an early commitment to a specific technology can turn out to be a liability. This is particularly true when multiple unrelated technologies might serve a market or when a newly emerging technology might replace the current one. Once a firm is committed to one technology, adopting a new one can be difficult. Management is often reluctant to abandon a technology in which it has made substantial investments, and it might worry that a rapid shift to a new technology will upset present customers. As a result, early commitment to a technology has become increasingly problematic because of more rapid rates of technological change.

## 16.2 Growth-Market Strategies for Market Leaders

For the share leader in a growing market, of course, the question of the relative advantages versus risks of market entry is moot. The leader is typically the pioneer, or at least one of the first entrants, who developed the product-market in the first place. Often, that firm's strategic objective is to maintain its leading share position in the face of increasing competition as the market expands. Share maintenance may not seem like a very aggressive objective, because it implies the business is merely trying to stay even rather than forge ahead. But two important facts must be kept in mind.

First, the dynamics of a growth market – including the increasing number of competitors, the fragmentation of market segments, and the threat of product innovation from within and outside the industry – make maintaining an early lead in relative market share very difficult. The continuing need for investment to finance growth, the likely negative cash flows that result, and the threat of governmental antitrust action can make it even more difficult. For example, 31 per cent of the 877 market-share leaders in the PIMS database experienced losses in relative share, and leaders were especially likely to suffer this fate when their market shares were very large.[7]

Second, a firm can maintain its current share position in a growth market only if its sales volume continues to grow at a rate equal to that of the overall market, enabling the firm to stay even in absolute market share. It may, however, be able to maintain a relative share lead even if its volume growth is less than the industry's.

## 16.2.1 Marketing Objectives for Share Leaders

Share maintenance for a market leader involves two important marketing objectives. First, the firm must retain its current customers, ensuring that those customers remain brand loyal when making repeat or replacement purchases. This is particularly critical for firms in consumer nondurable, service, and industrial materials and components industries where a substantial portion of total sales volume consists of repeat purchases. Second, the firm must *stimulate selective demand among later adopters* to ensure that it captures a large share of the continuing growth in industry sales.

In some cases the market leader might pursue a third objective: stimulating primary demand to help speed up overall market growth. This can be particularly important in product-markets where the adoption process is protracted because of the technical sophistication of the new product, high switching costs for potential customers, or positive network effects.

The market leader is the logical one to stimulate market growth in such situations; it has the most to gain from increased volume, assuming it can maintain its relative share of that volume. However, expanding total demand – by promoting new uses for the product or stimulating existing customers' usage and repeat purchase rates – is often more critical near the end of the growth stage and early in the maturity stage of a product's life cycle. Consequently, we discuss marketing actions appropriate to this objective in the next module.

## 16.2.2 Marketing Actions and Strategies to Achieve Share-Maintenance Objectives

A business might take a variety of marketing actions to maintain a leading share position in a growing market. Exhibit 16.2 outlines a lengthy, though not exhaustive, list of such actions and their specific marketing objectives. Because share maintenance involves multiple objectives, and different marketing actions may be needed to achieve each one, a strategic marketing programme usually integrates a mix of the actions outlined in the exhibit.

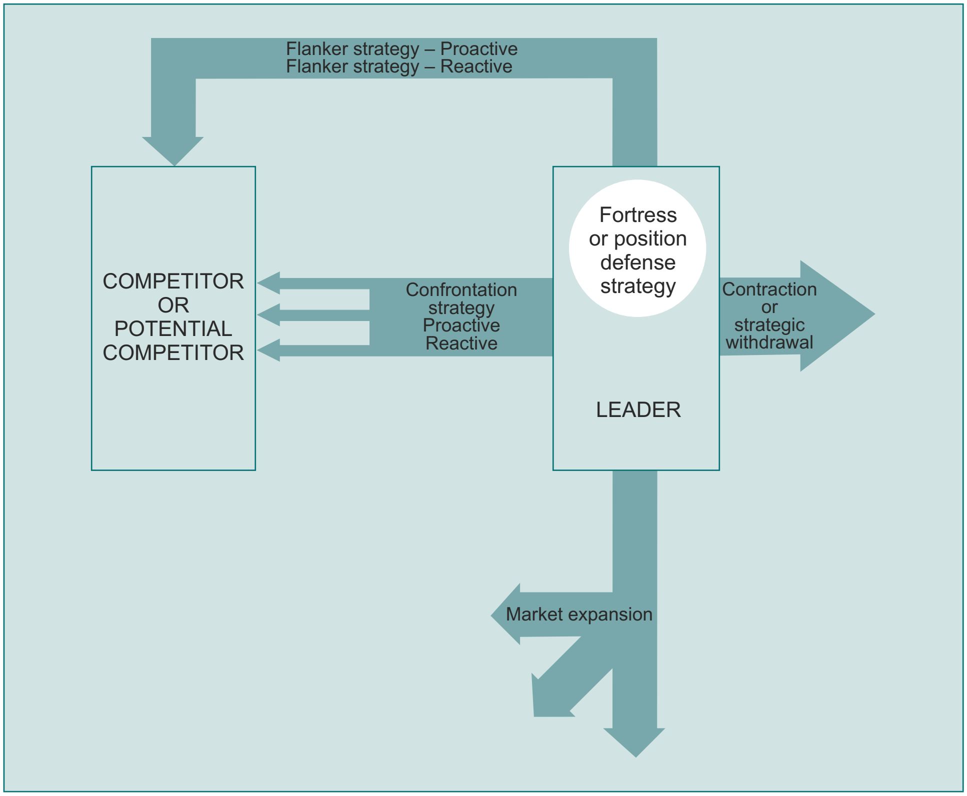
**Exhibit 16.2** **Marketing actions to achieve share-maintenance objectives**

| Marketing objectives | Possible marketing actions |
|---|---|
| *Retain current customers by:* | |
| • Maintaining/improving satisfaction and loyalty | • Increase attention to quality control as output expands.<br>• Continue product modification and improvement efforts to increase customer benefits and/or reduce costs.<br>• Focus advertising on stimulation of selective demand; stress product's superior features and benefits; reminder advertising.<br>• Increase salesforce's servicing of current accounts; consider formation of national or key account representatives to major customers; consider replacing independent manufacturer's reps with company salespeople where appropriate.<br>• Expand postsale service capabilities; develop or expand company's own service force, or develop training programmes for distributors' and dealers' service people; expand parts inventory; consider development of customer service hotline. |
| • Encourage/simplify repeat purchase | • Expand production capacity in advance of increasing demand to avoid stockouts.<br>• Improve inventory control and logistics systems to reduce delivery times.<br>• Continue to build distribution channels; use periodic trade promotions to gain more extensive retail coverage and maintain shelf facings; strengthen relationships with strongest distributors/dealers.<br>• Consider negotiating long-term requirements contracts with major customers.<br>• Consider developing automatic reorder systems for major customers. |
| • Reduce attractiveness of switching | • Develop a second brand or product line with features or price more appealing to a specific segment of current customers (*flanker strategy – see* Exhibit 17.9 and Exhibit 17.10).<br>• Develop multiple-line extensions or brand offerings targeted to the needs of several user segments within the market (*market expansion*).<br>• Meet or beat lower prices or heavier promotional efforts by competitors – or try to pre-empt such efforts by potential competitors – when necessary to retain customers and when lower unit costs allow (*confrontation strategy*). |
| *Stimulate selective demand among later adopters by:* | |
| • Head-to-head positioning against more competitive offering or potential offerings | • Develop a second brand or product line with features or price more appealing to a specific segment of potential customers (*flanker strategy*).<br>• Make product modifications or improvements to match or beat superior competitive offerings (*confrontation strategy*). |

| Marketing objectives | Possible marketing actions |
|---|---|
| | • Meet or beat lower prices or heavier promotional efforts by competitors when necessary to retain customers and when lower unit costs allow (*confrontation strategy*).<br>• When resources are limited relative to competitor's, consider withdrawing from smaller or slower-growing segments to focus product development and promotional efforts on higher-potential segments threatened by competitor (*contraction or strategic-withdrawal strategy*). |
| • Differentiated positioning against competitive offerings or potential offerings | • Develop multiple-line extensions or brand offerings targeted to the needs of various potential user applications, or geographical segments within the market (*market expansion*).<br>• Build unique distribution channels more effectively to reach specific segments of potential customers (*market expansion strategy*).<br>• Design multiple advertising and/or sales promotion campaigns targeted at specific segments of potential customers (*market-expansion strategy*). |

Not all the actions summarised in Exhibit 16.2 are consistent with one another. It would be unusual, for instance, for a business to invest heavily in new product improvements and promotion to enhance its product's high-quality image and simultaneously slash prices, unless it was trying to drive out weaker competitors in the short run with an eye on higher profits in the future. Thus, the activities outlined in Exhibit 16.2 cluster into five internally consistent strategies that a market leader might employ, singly or in combination, to maintain its leading share position: a **fortress**, or **position defence**, **strategy**; a **flanker strategy**; a **confrontation strategy**; a **market expansion strategy**; and a **contraction**, or **strategic withdrawal, strategy**.

**Exhibit 16.3 Strategic choices for share leaders in growth markets**




*Source*: Adapted from P. Kotler and R. Singh, 'Marketing Warfare in the 1980s', *Journal of Business Strategy*, Winter 1981, pp. 30–41. Reprinted with permission, EC Media Group, Eleven Penn Plaza, New York, NY 10001.

Exhibit 16.3 diagrams this set of strategies. It is consistent with what a number of military strategists and some marketing authorities have identified as common defensive strategies.[8] To think of them as strictly defensive, though, can be misleading. Companies can use some of these strategies offensively to pre-empt expected future actions by potential competitors. Or they can use them to capture an even larger share of future new customers.

Which, or what combination, of these five strategies is most appropriate for a particular product-market depends on (1) the market's size and its customers' characteristics, (2) the number and relative strengths of the competitors or potential competitors in that market, and (3) the leader's own resources and competencies. Exhibit 16.4 outlines the situations in which each strategy is most appropriate and the primary objectives for which they are best suited.

**Exhibit 16.4 Marketing objectives and strategies for share leaders in growth markets**

| | Share-maintenance strategies | | | | |
|---|---|---|---|---|---|
| **Situational variables** | **Fortress or position defence** | **Flanker** | **Confrontation** | **Market expansion** | **Contraction or strategic withdrawal** |
| Primary objective | Increase satisfaction, loyalty and repeat purchase among current customers by building on existing strengths; appeal to late adopters with same attributes and benefits offered to early adopters. | Protect against loss of specific segment of current customers by developing a second entry that covers a weakness in original; improve ability to attract new customers with needs or purchase criteria different from those of early adopters. | Protect against loss of share among current customers by meeting or beating a head-to-head competitive offering; improve ability to win new customers who might otherwise be attracted to competitor's offering. | Increase ability to attract new customers by developing new product offerings or line extensions aimed at a variety of new applications and user segments; improve ability to retain current customers as market fragments. | Increase ability to attract new customers in selected high-growth segments by focusing offerings and resources on those segments; withdraw from smaller or slower-growing segments to conserve resources. |
| Market characteristics | Relatively homogeneous market with respect to customer needs and purchase criteria; strong preference for leader's product among largest segment of customers. | Two or more major market segments with distinct needs or purchase criteria. | Relatively homogeneous market with respect to customers' needs and purchase criteria; little preference for, or loyalty towards, leader's product among largest segment of customers. | Relatively heterogeneous market with respect to customers' needs and purchase criteria; multiple product uses requiring different product or service attributes. | Relatively heterogeneous market with respect to customers' needs, purchase criteria and growth potential; multiple product uses requiring different product or service attributes. |
| Competitors' characteristics | Current and potential competitors have relatively limited resources and competencies. | One or more current or potential competitors with sufficient resources and competencies to effectively implement a differentiation strategy. | One or more current or potential competitors with sufficient resources and competencies to effectively implement a head-to-head strategy. | Current and potential competitors have relatively limited resources and competencies, particularly with respect to R&D and marketing. | One or more current or potential competitors with sufficient resources and competencies to present a strong challenge in one or more growth segments. |
| Firm's characteristics | Current product offering enjoys high awareness and preference among major segment of current and potential customers; firm has marketing and R&D resources and competencies equal to or greater than those of any current or potential competitor. | Current product offering perceived as weak on at least one attribute by a major segment of current or potential customers; firm has sufficient R&D and marketing resources to introduce and support a second offering aimed at the disaffected segment. | Current product offering suffers low awareness, preference and/or loyalty among major segment of current or potential customers; firm has R&D and marketing resources and competencies equal to or greater than those of any current or potential competitor. | No current offerings in one or more potential applications segments; firm has marketing and R&D resources and competencies equal to or greater than those of any current or potential competitor. | Current product offering suffers low awareness, preference and/or loyalty among current or potential customers in one or more major growth segments; firm's R&D and marketing resources and competencies are limited relative to those of one or more competitors. |

## 16.2.3 Fortress, or Position Defence, Strategy

The most basic defensive strategy is to continually strengthen a strongly held current position – to build an impregnable fortress capable of repelling attacks by current or future competitors. This strategy is nearly always part of a leader's share-maintenance efforts. By shoring up an already strong position, the firm can improve the satisfaction of current customers while increasing the attractiveness of its offering to new customers with needs and characteristics similar to those of earlier adopters.

Strengthening the firm's position makes particularly good sense when current and potential customers have relatively homogeneous needs and desires and the firm's offering already enjoys a high level of awareness and preference in the mass market. In some homogeneous markets, a well-implemented position defence strategy may be all that is needed for share maintenance.

Most of the marketing actions listed in Exhibit 16.2 as being relevant for retaining current customers might be incorporated into a position defence strategy. Anything the business can do to improve customer satisfaction and loyalty and encourage and simplify repeat purchasing should help the firm protect its current customer base and make its offering more attractive to new customers. Some of the specific actions appropriate for accomplishing these two objectives are discussed in more detail below.

### 16.2.3.1 Actions to Improve Customer Satisfaction and Loyalty

The rapid expansion of output necessary to keep up with a growth market often can lead to quality control problems for the market leader. As new plant, equipment, and personnel are quickly brought on line, bugs can suddenly appear in the production process. Thus, the leader must pay particular attention to quality control during this phase. Most customers have only limited, if any, positive past experiences with the new brand to offset their disappointment when a purchase does not live up to expectations.

Perhaps the most obvious way a leader can strengthen its position is to continue to modify and improve its product. This can reduce the opportunities for competitors to differentiate their products by designing in features or performance levels the leader does not offer. The leader might also try to reduce unit costs to discourage low-price competition.

The leader should take steps to improve not only the physical product but customers' perceptions of it as well. As competitors enter or prepare to enter the market, the leader's advertising and sales promotion emphasis should shift from stimulating primary demand to building selective demand for the company's brand. This usually involves creating appeals that emphasise the brand's superior features and benefits. While the leader may continue sales promotion efforts aimed at stimulating trial among later adopters, some of those efforts might be shifted toward encouraging repeat purchases among existing customers. For instance, it might include cents-off coupons inside the package to give customers a price break on their next purchases of the brand.

For industrial goods, some salesforce efforts should shift from prospecting for new accounts to servicing existing customers. Firms that relied on independent manufacturer's reps to introduce their new product might consider replacing them with company salespeople to increase the customer service orientation of their sales efforts. Firms whose own salespeople introduced the product might reorganise their salesforces into specialised groups focused on major industries or user segments. Or they might assign key account representatives, or cross-functional account teams, to service their largest customers.

Finally, a leader can strengthen its position as the market grows by giving increased attention to postsale service. Rapid growth in demand not only can outstrip a firm's ability to produce a high-quality product, but it also can overload the firm's ability to service customers. This can lead to a loss of existing customers as well as negative word of mouth that might inhibit the firm's ability to attract new users. Thus, the growth phase often requires increased investments to expand the firm's parts inventory, hire and train service personnel and dealers, improve the information content on the firm's website, and closely monitor and respond to any problems or complaints reported to the company's call centre or on customer blogs.[9]

#### 16.2.3.2 Actions to Encourage and Simplify Repeat Purchasing

One of the most critical actions a leader must take to ensure that customers continue buying its product is to maximise its availability. It must reduce stockouts on retail store shelves or shorten delivery times for industrial goods. To do this, the firm must invest in plant and equipment to expand capacity in advance of demand, and it must implement adequate inventory control and logistics systems to provide a steady flow of goods through the distribution system. The firm also should continue to build its distribution channels. In some cases, a firm might even vertically integrate parts of its distribution system – such as building its own warehouses, as Amazon.com and several other e-retailers have done recently – to gain better control over order fulfilment activities and ensure quick and reliable deliveries.

Some market leaders, particularly in industrial goods markets, can take more proactive steps to turn their major customers into captives and help guarantee future purchases. For example, a firm might negotiate requirements contracts or guaranteed price agreements with its customers to ensure future purchases, or it might tie them into a computerised reorder system or a logistical alliance supply-chain relationship. Such actions are all aimed at increasing customers' repeat purchases and loyalty in order to maximise their lifetime value. While it makes good sense to begin building strong customer relationships right from the beginning, they become even more crucial as the market matures and competition to win over established customers becomes more intense. Consequently, we'll have more to say about building and managing customer relationships in the next module.

### 16.2.4 Flanker Strategy

One shortcoming of a fortress strategy is that a challenger might simply choose to bypass the leader's fortress and try to capture territory where the leader has not yet established a strong presence. This can represent a particular threat when the market is fragmented into major segments with different needs and preferences and the leader's current brand does not meet the needs of one or more of those segments. A competitor with sufficient resources and competencies can develop a differentiated product offering to appeal to the segment where the leader is weak and thereby capture a substantial share of the overall market.

To defend against an attack directed at a weakness in its current offering (its exposed flank), a leader might develop a second brand (a **flanker** or **fighting brand**) to compete directly against the challenger's offering. This might involve trading up, where the leader develops a high-quality brand offered at a higher price to appeal to the prestige segment of the market. This was Toyota's rationale for introducing its Lexus brand of luxury automobiles, for instance.

More commonly, though, a flanker brand is a lower-quality product designed to appeal to a low-price segment to protect the leader's primary brand from direct price competition. Thus, Toyota introduced the Scion brand in the US market in 2003, a line of cars that appeals to young car buyers looking for good quality, funky design, low prices, and no-hassle shopping. The Scion brand is an attempt to insulate Toyota cars from low-price competitors and to establish a presence among young, first-time buyers who might 'trade up' to more expensive Toyota models in the future.

A flanker strategy is always used in conjunction with a position defence strategy. The leader simultaneously strengthens its primary brand while introducing a flanker to compete in segments where the primary brand is vulnerable. This suggests that a flanker strategy is appropriate only when the firm has sufficient resources to develop and fully support two or more entries. After all, a flanker is of little value if it is so lightly supported that a competitor can easily wipe it out.

### 16.2.5 Confrontation Strategy

Suppose a competitor chooses to attack the leader head to head and attempts to steal customers in the leader's main target market. If the leader has established a strong position and attained a high level of preference and loyalty among customers and the trade, it may be able to sit back and wait for the competitor to fail. In many cases, though, the leader's brand is not strong enough to withstand a frontal assault from a well-funded, competent competitor. Even mighty IBM, for instance, lost 20 market-share points in the commercial PC market during the mid-1980s to competitors such as Compaq, whose machines cost about the same but offered features or performance levels that were better, and to the clones who offered IBM-compatible machines at much lower prices. Later, the firm's share of the PC market eroded further as companies such as Dell and Gateway introduced more convenient and efficient Internet ordering and direct distribution systems and cut prices even more.

In such situations, the leader may have no choice but to confront the competitive threat directly. If the leader's competitive intelligence is good, it may decide to move proactively and change its marketing programme before a suspected competitive challenge occurs. A confrontational strategy, though, is more commonly reactive. The leader usually decides to meet or beat the attractive features of a competitor's offering – by making product improvements, increasing promotional efforts, or lowering prices – only after the challenger's success has become obvious.

Simply meeting the improved features or lower price of a challenger, however, does nothing to reestablish a sustainable competitive advantage for the leader. And a confrontation based largely on lowering prices creates an additional problem of shrinking margins for all concerned.[10] Unless decreased prices generate substantial new industry volume and the leader's production costs fall with that increasing volume, the leader may be better off responding to price threats with increased promotion or product improvements while trying to maintain its profit margins. Evidence also suggests that in product-markets with high repeat-purchase rates or a protracted diffusion process, the leader may be wise to adopt a penetration pricing policy in the first place. This would strengthen its share position and might pre-empt low-price competitors from entering.[11]

The leader can avoid the problems of a confrontation strategy by reestablishing the competitive advantage eroded by challengers' frontal attacks. But this typically requires additional investments in process improvements aimed at reducing unit costs, improvements in product quality or customer service, or even the development of the next generation of improved products to offer customers greater value for their dollars.

### 16.2.6 Market Expansion Strategy

A market expansion strategy is a more aggressive and proactive version of the flanker strategy. Here the leader defends its relative market share by expanding into a number of market segments. This strategy's primary objective is to capture a large share of new customer groups who may prefer something different from the firm's initial offering, protecting the firm from future competitive threats from a number of directions. Such a strategy is particularly appropriate in fragmented markets if the leader has the resources to undertake multiple product development and marketing efforts.

The most obvious way a leader can implement a market expansion strategy is to develop line extensions, new brands, or even alternative product forms utilising similar technologies to appeal to multiple market segments. For instance, Nokia has become the leading seller of cellular phones in both India and China by developing phones with unique features tailored to those developing nations' customers, such as phones with dust covers and a slip-free grip for use in scorching summer weather, software in seven regional languages for non-Hindi speakers, phones that respond to Chinese characters written with a stylus, and phones that retail for as little as $30. Consequently, Nokia′s market share grew to an estimate 46 per cent in Asia and a whopping 66 per cent in Africa in 2008.[12]

A less-expensive way to appeal to a variety of customer segments is to retain the basic product but vary other elements of the marketing programme to make it relatively more attractive to specific users. Thus, a leader might create specialised salesforces to deal with the unique concerns of different user groups. Or it might offer different ancillary services to different types of customers or tailor sales promotion efforts to different segments. Thus, performing arts groups often promote reduced ticket prices, transportation services, and other inducements to attract senior citizens and students to matinee performances.

### 16.2.7 Contraction, or Strategic Withdrawal, Strategy

In some highly fragmented markets, a leader may be unable to defend itself adequately in all segments. This is particularly likely when newly emerging competitors have more resources than the leader. The firm may then have to reduce or abandon its efforts in some segments to focus on areas where it enjoys the greatest relative advantages or that have the greatest potential for future growth. Even some very large firms may decide that certain segments are not profitable enough to continue pursuing. As we saw in Module 1, for instance, Samsung has withdrawn from the most price-sensitive consumer electronics segments to concentrate on higher-margin products emphasising cutting-edge technology and hip design.

## 16.3 Share-Growth Strategies for Followers

### 16.3.1 Marketing Objectives for Followers

Not all late entrants to a growing product-market have illusions about eventually surpassing the leader and capturing a dominant market share. Some competitors, particularly those with limited resources and competencies, may simply seek to build a small but profitable business within a specialised segment of the larger market that earlier entrants have overlooked, as Vans has done with great success in the skateboarder segment of the athletic shoe market. As we have seen, this kind of *niche strategy* is one of the few entry options that small, late entrants can pursue with a reasonable degree of success. If a firm can successfully build a profitable business in a small segment while avoiding direct competition with larger competitors, it often can survive the shakeout period near the end of the growth stage and remain profitable throughout the maturity stage.

Many followers, particularly larger firms entering a product-market shortly after the pioneer, have more grandiose objectives. They often seek to displace the leader or at least to become a powerful competitor within the total market. Thus, their major marketing objective is to attain *share growth*, and the size of the increased relative share such challengers seek is usually substantial. For instance, when Haier, the Chinese appliance manufacturer, started making refrigerators just two decades ago, it set its sights on becoming a global share leader even though the category was dominated by large international brands like Whirlpool, Electrolux, and General Electric. Today, Haier is the leader in its home market with a 29 per cent share, and is number two worldwide behind Whirlpool.[13]

### 16.3.2 Marketing Actions and Strategies to Achieve Share Growth

A challenger with visions of taking over the leading share position in an industry has two basic strategic options, each involving somewhat different marketing objectives and actions. Where the share leader and perhaps some other early followers have already penetrated a large portion of the potential market, a challenger may have no choice but to *steal away some of the repeat purchase or replacement demand from the competitors' current customers*. As Exhibit 16.5 indicates, the challenger can attempt this through marketing activities that give it an advantage in a head-to-head confrontation with a target competitor. Or it can attempt to leapfrog over the leader by developing a new generation of products with enough benefits to induce customers to trade in their existing brand for a new one. Secondarily, such actions also may help the challenger attract a larger share of late adopters in the mass market.

**Exhibit 16.5 Marketing actions to achieve share-growth objectives**

| Marketing objectives | Possible marketing actions |
|---|---|
| *Capture repeat/replacement purchases from current customers of the leader or other target competitor by:* | |
| • Head-to-head positioning against competitor's offering in primary target market. | • Develop products with features and/or performance levels superior to those of the target competitor.<br>• Draw on superior product design, process engineering and supplier relationships to achieve lower unit costs.<br>• Set prices below target competitor's for comparable level of quality or performance, but only if low-cost position is achieved.<br>• Outspend the target competitor on promotion aimed at stimulating selective demand:<br>– Comparative advertising appeals directed at gaining a more favourable positioning than the target competitor's brand enjoys among customers in the mass market.<br>– Sales promotions to encourage trial if offering's quality or performance is perceptively better than target competitor's, or to induce brand switching.<br>– Build more extensive and/or better-trained salesforce than target competitor's.<br>• Outspend the target competitor on trade promotion to attain more extensive retail coverage, better shelf space and/or representation by the best distributors/dealers.<br>• Outperform the target competitor on customer service:<br>– Develop superior production scheduling, inventory control and logistics systems to minimise delivery times and stockouts.<br>– Develop superior postsale service capabilities; build a more extensive company service force, or provide better training programmes for distributor/dealer service people than those of target competitor. |
| • Technological differentiation from target competitor's offering in its primary target market. | • Develop a new generation of products based on different technology that offers superior performance or additional benefits desired by current and potential customers in the mass market (*leapfrog strategy*).<br>• Build awareness, preference and replacement demand through heavy introductory promotion:<br>– Comparative advertising stressing product's superiority.<br>– Sales promotions to stimulate trial or encourage switching.<br>– Extensive, well-trained salesforce; heavy use of product demonstrations in sales presentations.<br>• Build adequate distribution through trade promotions and dealer training programmes. |
| *Stimulate selective demand among later adopters by:* | |
| • Head-to-head positioning against target competitor's offering in established market segments. | • See preceding actions.<br>• Develop a differentiated brand or product line with unique features or price that is more appealing to a major segment of potential customers whose needs are not met by existing offerings (*flanking strategy*). |

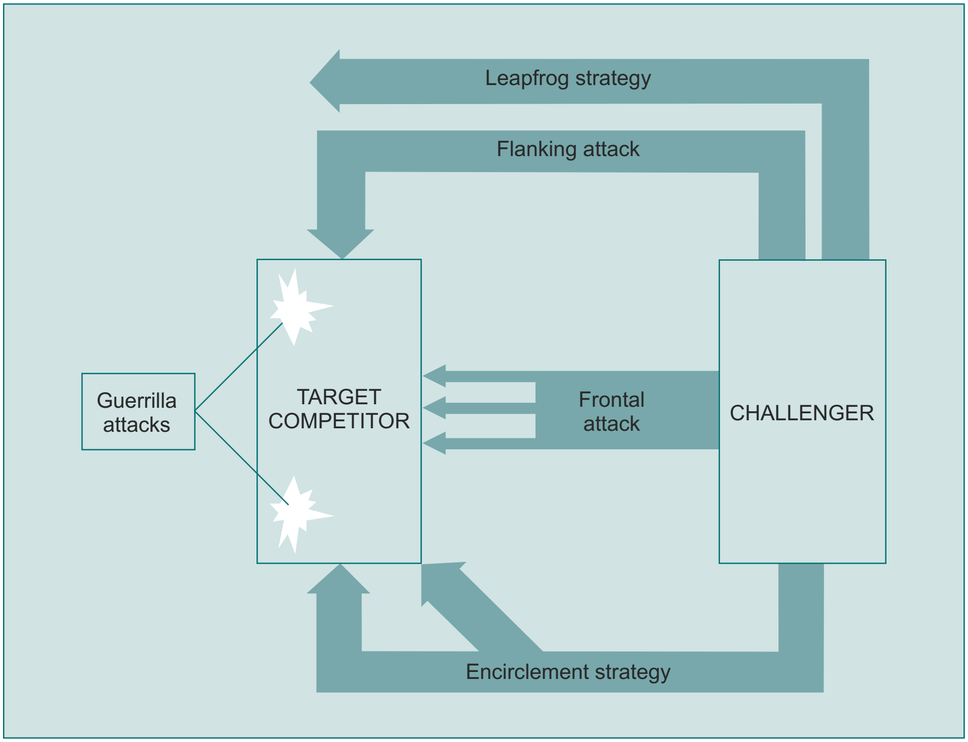
| Marketing objectives | Possible marketing actions |
|---|---|
| • Differentiated positioning focused on untapped or underdeveloped segments. | Or<br>• Develop multiple line extensions or brand offerings with features or prices targeted to the unique needs and preferences of several smaller potential applications or regional segments (*encirclement strategy*).<br>• Design advertising, personal selling and/or sales promotion campaigns that address specific interests and concerns of potential customers in one or multiple underdeveloped segments to stimulate selective demand.<br>• Build unique distribution channels to more effectively reach potential customers in one or multiple underdeveloped segments.<br>• Design service programmes to reduce the perceived risks of trial and/or solve the unique problems faced by potential customers in one or multiple underdeveloped segments (e.g. systems engineering, installation, operator training or extended warranties). |

If the market is relatively early in the growth phase and no previous entrant has captured a commanding share of potential customers, the challenger can focus on *attracting a larger share of potential new customers* who enter the market for the first time. This also may be a viable option when the overall market is heterogeneous and fragmented and the current share leader has established a strong position in only one or a few segments. In either case, the primary marketing activities for increasing share via this approach should aim at *differentiating* the challenger's offering from those of existing competitors by making it more appealing to new customers in untapped or underdeveloped market segments.

Once again, Exhibit 16.5's list of possible marketing actions for challengers is not exhaustive, and it contains actions that do not always fit well together. The activities that do fit tend to cluster into four major strategies that a challenger might use singly or in combination to secure growth in its relative market share. As Exhibit 16.6 indicates, these four share-growth strategies are *frontal attack, leapfrog strategy, flanking attack* and *encirclement*. Most of these strategies are basically mirror images of the share-maintenance strategies discussed earlier.

Which, or what combination, of these four strategies is best for a particular challenger depends on market characteristics, the existing four current positions and strengths, and the challenger's own resources and competencies. The situations in which each strategy is likely to work best are briefly outlined in Exhibit 16.7 and discussed in the following sections.

**Exhibit 16.6 Strategic choices for challengers in growth markets**




*Source*: Adapted from P. Kotler and R. Singh, 'Marketing Warfare in the 1980s', *Journal of Business Strategy*, Winter 1981, pp. 30–41. Reprinted with permission, EC Media Group, Eleven Penn Plaza, New York, NY 10001.

## 16.3.3 Deciding Whom to Attack

When more than one competitor is already established in the market, a challenger must decide which competitor, if any, to target. There are several options:

- *Attack the market-share leader within its primary target market.* As we shall see, this typically involves either a *frontal assault* or an attempt to *leapfrog* the leader through the development of superior technology or product design. It may seem logical to try to win customers away from the competitor with the most customers to lose, but this can be a dangerous strategy unless the challenger has superior resources and competencies that can be converted into a sustainable advantage. In some cases, however, a smaller challenger may be able to avoid disastrous retaliation by confronting the leader only occasionally in limited geographic territories through a series of *guerrilla attacks*.
- *Attack another follower who has an established position within a major market segment.* This also usually involves a *frontal assault*, but it may be easier for the challenger to gain a sustainable advantage if the target competitor is not as well established as the market leader in the minds and buying habits of customers.

- *Attack one or more smaller competitors who have only limited resources*. Because smaller competitors usually hold only a small share of the total market, this may seem like an inefficient way to attain substantial share increases. But by focusing on several small regional competitors one at a time, a challenger can sometimes achieve major gains without inviting retaliation from stronger firms. For example, by first challenging and ultimately acquiring a series of smaller regional manufacturers, Borden managed to capture the leading share of the fragmented US pasta market.
- *Avoid direct attacks on any established competitor*. In fragmented markets in which the leader or other major competitors are not currently satisfying one or more segments, a challenger is often best advised to 'hit 'em where they ain't.' This usually involves either a flanking or an encirclement strategy, with the challenger developing differentiated product offerings targeted at one large or several smaller segments in which no competitor currently holds a strong position. Thus, Vans has profited in the athletic shoe market by focusing on small alternative sports whose adherents do not find the 'mainstream' image of Nike and other major brands very appealing.

Deciding which competitor to attack necessitates a comparison of relative strengths and weaknesses, a critical first step in developing an effective share-growth strategy. It also can help limit the scope of the battlefield, a particularly important consideration for challengers with limited resources.

**Exhibit 16.7 Marketing objectives and strategies for challengers in growth markets**

| | Share-growth strategies | | | |
|---|---|---|---|---|
| **Situational variables** | **Frontal attack** | **Leapfrog** | **Flank attack** | **Encirclement** |
| Primary objective | Capture substantial repeat/replacement purchases from target competitor's current customers; attract new customers among later adopters by offering lower price or more attractive features. | Induce current customers in mass market to replace their current brand with superior new offering; attract new customers by providing enhanced benefits. | Attract substantial share of new customers in one or more major segments where customers' needs are different from those of early adopters in the mass market. | Attract a substantial share of new customers in a variety of smaller, specialised segments where customers' needs or preferences differ from those of early adopters in the mass market. |
| Market characteristics | Relatively homogeneous market with respect to customers' needs and purchase criteria; relatively little preference or loyalty for existing brands. | Relatively homogeneous market with respect to customers' needs and purchase criteria, but some needs or criteria not currently met by existing brands. | Two or more major segments with distinct needs and purchase criteria; needs of customers in at least one segment not currently met by existing brands. | Relatively heterogeneous market with a number of small, specialised segments; needs and preferences of customers in some segments not currently satisfied by competing brands. |
| Competitors' characteristics | Target competitor has relatively limited resources and competencies, particularly in marketing and R&D; would probably be vulnerable to direct attack. | One or more current competitors have relatively strong resources and competencies in marketing, but relatively unsophisticated technology and limited R&D competencies. | Target competitor has relatively strong resources and competencies, particularly in marketing and R&D; would probably be able to withstand direct attack. | One or more competitors have relatively strong marketing, R&D resources and competencies and/or lower costs; could probably withstand a direct attack. |
| Firm's characteristics | Firm has stronger resources and competencies in R&D and marketing and/or lower operating costs than target competitor. | Firm has proprietary technology superior to that of competitors; firm has necessary marketing and production resources to stimulate and meet primary demand for new generation of products. | Firm's resources and competencies are limited, but sufficient to effectively penetrate and serve at least one major market segment. | Firm has marketing, R&D and production resources and competencies necessary to serve multiple smaller segments; firm has decentralised and adaptable management structure. |

## 16.3.4 Frontal Attack Strategy

Where the market for a product category is relatively homogeneous, with few untapped segments and at least one well-established competitor, a follower wanting to capture an increased market share may have little choice but to tackle a major competitor head-on. Such an approach is most likely to succeed when most existing customers do not have strong brand preferences or loyalties, the target competitor's product does not benefit from positive network effects, and the challenger's resources and competencies – particularly in marketing – are greater than the target competitor's. But even superior resources are no guarantee of success if the challenger's assault merely imitates the target competitor's offering.

To successfully implement a frontal attack, a challenger should seek one or more ways to achieve a sustainable advantage over the target competitor. As discussed earlier, such an advantage is usually based on attaining lower costs or a differentiated position in the market. If the challenger has a cost advantage, it can cut prices to lure away the target competitor's customers – as Ryanair has done in the European air travel market – or it can maintain a similar price but engage in more extensive promotion.

Challenging a leader solely on the basis of low price is a highway to disaster, however, unless the challenger really does have a sustainable cost advantage. Otherwise, the leader might simply match the lower prices until the challenger is driven from the market. The problem is that initially a challenger is often at a cost *disadvantage* because of the experience-curve effects established competitors have accumulated. The challenger must have offsetting advantages such as superior production technology, established relations with low-cost suppliers, the ability to share production facilities or marketing efforts across multiple SBUs, or other sources of synergy before a low-price assault makes sense.

A similar caveat applies to frontal assaults based solely on heftier promotional budgets. Unless the target competitor's resources are substantially more limited than the challenger's, it can retaliate against any attempt to win away customers through more extensive advertising or attractive sales and trade promotions.

One possible exception to this limitation of greater promotional effort is the use of a more extensive and better-trained salesforce to gain a competitive advantage. A knowledgeable salesperson's technical advice and problem-solving abilities can give additional value to a firm's product offering, particularly in newly developing high-tech industries.

In general, the best way for a challenger to effectively implement a frontal attack is to differentiate its product or associated services in ways that better meet the needs and preferences of many customers in the mass market. If the challenger can support those meaningful product differences with strong promotion or an attractive price, so much the better, but usually the unique features or services offered are the foundation for a sustainable advantage. For example, Dell has been successful as a follower in the PC market by offering *both* superior customer service and low prices. Customers can design their own computers on the company's website, get exactly the features they want, and have the equipment delivered to their doors in two or three days. Such excellent service is possible, in large part, due to the close coordination between Dell and its suppliers, coordination that minimises inventories of parts and finished computers, thereby lowering costs and prices, and maximises manufacturing flexibility and delivery speed. Dell's competitive advantage has proven to be sustainable, too, because its alliances with suppliers took years to develop and are hard for its competitors to match.

In recent years, however, Dell's aggressive cost cutting in order to pursue share growth via ever-lower prices caused the firm to reduce its investments in things like R&D and technical training for customer support personnel. Subsequent shortcomings in Dell's new-product development and customer service opened the door for competitors like Hewlett-Packard, Lenovo, and Acer to challenge its lead. The lesson once again is that low price alone is not a good way to capture or hold a leading share position unless customers also perceive they are receiving good value for that price.

Variables that might limit the competitor's willingness or ability to retaliate can also improve the chances for successful frontal attack. For instance, a target competitor with a reputation for high product quality may be loath to cut prices in response to a lower-priced challenger for fear of cheapening its brand's image. And a competitor pursuing high ROI or cash flow objectives may be reluctant to increase its promotion or R&D expenditures in the short run to fend off an attack.[14]

### 16.3.5 Leapfrog Strategy

A challenger stands the best chance of attracting repeat or replacement purchases from a competitor's current customers when it can offer a product that is attractively differentiated from the competitor's offerings. The odds of success might be even greater if the challenger can offer a far superior product based on advanced technology or a more sophisticated design. This is the essence of a leapfrog strategy. It is an attempt to gain a significant advantage over the existing competition by introducing a new generation of products that significantly outperform or offer more desirable customer benefits than do existing brands. For example, the introduction of reasonably priced video cameras by Sony and other Japanese electronics manufacturers largely took over the market for home movie equipment and a large share of the market for Polaroid's self-developing photography equipment as well. And now digital cameras are doing the same thing to the video market.

In addition, such a strategy often inhibits quick retaliation by established competitors. Firms that have achieved some success with one technology – or that have committed substantial resources to plant and equipment dedicated to a current product – are often reluctant to switch to a new one because of the large investments involved or a fear of disrupting current customers.

A leapfrog strategy is not viable for all challengers. To be successful, the challenger must have technology superior to that of established competitors as well as the product and process engineering capabilities to turn that technology into an appealing product. Also, the challenger must have the marketing resources to effectively promote its new products and convince customers already committed to an earlier technology that the new product offers sufficient benefits to justify the costs of switching.

### 16.3.6 Flanking and Encirclement Strategies

The military historian B. H. Liddell-Hart, after analysing battles ranging from the Greek Wars to World War I, determined that only 6 out of 280 victories were the result of a frontal attack.[15] He concluded that it is usually wiser to avoid attacking an established adversary's point of strength and to focus instead on an area of weakness in his defences. This is the basic premise behind flanking and encirclement strategies. They both seek to avoid direct confrontations by focusing on market segments whose needs are not being satisfied by existing brands and where no current competitor has a strongly held position.

### 16.3.6.1 Flank Attack

A flank attack is appropriate when the market can be broken into two or more large segments, when the leader and/or other major competitors hold a strong position in the primary segment, and when no existing brand fully satisfies the needs of customers in at least one other segment. A challenger may be able to capture a significant share of the total market by concentrating primarily on one large untapped segment. This usually involves developing product features or services tailored to the needs and preferences of the targeted customers, together with appropriate promotional and pricing policies to quickly build selective demand. Japanese auto companies, for instance, penetrated the US car market by focusing on the low-price segment, where domestic manufacturers' offerings were limited. Domestic car manufacturers were relatively unconcerned by this flanking action at first. They failed to retaliate very aggressively because the Japanese were pursuing a segment they considered to be small and unprofitable. History proved them wrong.

In some cases, a successful flank attack need not involve unique product features. Instead, a challenger can sometimes meet the special needs of an untapped segment by providing specially designed customer services or distribution channels. For instance, Apple's iTunes music store has captured more than 5 per cent of the global recorded music market by offering a convenient (and legal) way for Web-savvy consumers to locate and download songs for their personal music libraries.

Other examples, as Exhibit 16.8 recounts, are provided by small farmers' cooperatives that have stolen substantial market share from much bigger competitors by delivering high-quality products and emphasising a folksy, healthful, or environmentally friendly image.

**Exhibit 16.8 Small farmers' coops squeeze big rivals**

When a little-known farmers' cooperative called Citrus World Inc. started to market its own brand of pasteurised orange juice, it looked like an improbable player in the $3 billion juice market. Citrus World, an 800-employee operation in rural Florida, was up against a couple of established giants: Seagram Co., owner of the Tropicana brand, and Coca-Cola Co., with its Minute Maid line.

But Citrus World knew exactly what to do: Squeeze that folksy image for all it was worth. To sell its Florida's Natural brand, it ordered TV commercials featuring sunburned farmers gulping down juice. In one ad, growers holding boxes of oranges hold a 'stockholders' meeting' in the back of a truck. Other workers cut 'overheads' by chopping a branch from an orange tree.

Thanks to catchy ads, a quality product, and aggressive pricing, Citrus World made a splash. In the mid-1990s Florida's Natural knocked Minute Maid out of the number two spot in the rapidly growing market for 'premium,' or pasteurised, not-from-concentrate orange juice, and the brand experienced a larger percentage sales increase than Tropicana. While Citrus World attacked its larger rivals' exposed flanks, in part, by offering lower prices, its success also demonstrates that a substantial segment of consumers prefers to deal with what they perceive to be small, 'underdog' companies. Other agricultural cooperatives have adapted to this insight in various ways. Ocean Spray's cranberry growers have emphasised the development and promotion of healthful and low-calorie snacks and juices to combat PepsiCo, Coca-Cola, and other large juice marketers. And a number of small Central and South American coops sell 'fair-trade' coffee in the US and European markets by offering high-quality beans grown with environmentally friendly methods in return for a premium price for the growers.

*Sources:* **Yumiko Ono, 'A Pulp Tale: Juice Co-op Squeezes Big Rivals,'** *The Wall Street Journal*, **January 30, 1996, p. B1; and Aaron Pressman, 'Ocean Spray's Creative Juices,'** *BusinessWeek*, **May 15, 2006, pp. 88–90.**

#### 16.3.6.2 Encirclement

An encirclement strategy involves targeting several smaller untapped or underdeveloped segments in the market simultaneously. The idea is to surround the leader's brand with a variety of offerings aimed at several peripheral segments. This strategy makes most sense when the market is fragmented into many different applications segments or geographical regions with somewhat unique needs or tastes.

Once again, this strategy usually involves developing a varied line of products with features tailored to the needs of different segments. Rather than try to compete with Coke and Pepsi in the soft drink market, for example, Cadbury-Schweppes offers a wide variety of flavours such as cream soda, root beer, and ginger ale – almost anything but cola – to appeal to small groups of customers with unique tastes. Similarly, Vans is trying to expand its foothold in the athletic shoe industry by targeting several niche segments of enthusiasts in other alternative sports – such as snowboarding – where the brand's youthful 'outsider' image might be appealing and where the firm's larger competitors are not well established.

### 16.3.7 Supporting Evidence

Several studies conducted with the PIMS database provide empirical support for many of the managerial prescriptions we have discussed.[16] These studies compare businesses that achieved high market shares during the growth stage of the product life cycle, or that increased their market shares over time, with low-share businesses. As shown in Exhibit 16.9, the marketing programmes and activities of businesses that successfully achieved increased market share differed from their less-successful counterparts in the following ways:

**Exhibit 16.9 Strategic changes made by challengers that gained and those that lost market share**

| Strategic changes | Share-gaining challengers | Share-losing challengers |
|---|---|---|
| Relative product quality scores | +1.8 | −0.6 |
| New products as a percentage of sales | +0.1 | −0.5 |
| Relative price | +0.3 | +0.2 |
| Marketing expenditures (adjusted for market growth) | | |
| Salesforce | +9.0% | −8.0% |
| Advertising: | | |
| Consumer products | +13.0% | −9.0% |
| Industrial products | −1.0 | −14.0 |

| Strategic changes | Share-gaining challengers | Share-losing challengers |
|---|---|---|
| Promotion: | | |
| Consumer products | +13.0% | −5.0% |
| Industrial products | +7.0 | −10.0 |

*Source*: Adapted from Robert D. Buzzell and Bradley T. Gale, *The PIMS Principles: Linking Strategy to Performance* (New York: Free Press, 1987), p. 190.

- Businesses that increased the quality of their products relative to those of competitors achieved greater share increases than businesses whose product quality remained constant or declined.
- Share-gaining businesses typically developed and added more new products, line extensions, or product modifications to their line than share-losing businesses.
- Share-gaining businesses tended to increase their marketing expenditures faster than the rate of market growth. Increases in both salesforce and sales promotion expenditures were effective for producing share gains in both consumer and industrial goods businesses. Increased advertising expenditures were effective for producing share gains primarily in consumer goods businesses.
- Surprisingly, there was little difference in the relative prices charged between firms that gained and those that lost market share.

These findings are consistent with many of our earlier observations. For instance, they underline the folly of launching a frontal attack solely on the basis of lower price. Unless the challenger has substantially lower unit costs or the leader is inhibited from cutting its own prices for some reason, the challenger's price cuts are likely to be retaliated against and will generate few new customers. On the other hand, frontal, leapfrog, flanking, or encirclement attacks based on product improvements tailored to specific segments are more likely to succeed, particularly when the challenger supports those attacks with substantial promotional efforts.

Regardless of the strategies pursued by market leaders and challengers during a product-market's growth stage, the competitive situation often changes as the market matures and its growth rate slows. In the next module, we examine the environmental changes that occur as a market matures and the marketing strategies that firms might use to adapt to those changes.

## Learning Summary

- If the market leader wants to maintain its number-one share position as the product category moves through rapid growth, it must focus on two important objectives: (1) retaining its current customers and (2) stimulating selective demand among later adopters.
- Marketing strategies a leader might adopt to defend its relative share as the product category grows include position defence, flanker, confrontation, market expansion, and contraction. The best one to choose depends on the homogeneity of the market and the firm's resources and competencies relative to potential competitors.

- For a challenger to increase its market share relative to the established leader, it must differentiate its offering by delivering superior product benefits, better service, or a lower price. Challenging the leader solely on the basis of price, however, is a good way to start a price war and can be a highway to disaster unless the challenger has a sustainable cost advantage.
- Smaller challengers often try to avoid direct confrontations with the share leader by pursuing flanker, encirclement, or guerrilla attack strategies that focus on market segments where the leader is not well established.

# Review Questions

## Content Questions

16.1 Discuss the marketing actions and strategies to achieve the share-maintenance objectives of a market leader.

16.2 What marketing activities and strategies are needed for a challenger to achieve share growth?

## Multiple Choice Questions

16.3 Conventional wisdom suggests that rapidly growing markets present attractive opportunities for future profits for each of the following reasons EXCEPT:

A. there is less risk of industry overcapacity.
B. it is easier to gain share in a growing market.
C. share gains are worth more in a growth market.
D. price competition is less likely to be intense.
E. early participation in a growth market is necessary to make sure that the firm keeps pace with technology.

16.4 The text describes internally consistent strategies that a market leader might employ to maintain its leading share position as:

A. fortress (position defence), flanker, confrontation, market-expansion and contraction (withdrawal) strategies.
B. frontal attack, leapfrog, flanking attack and encirclement.
C. fortress, flanker, confrontation and encirclement.
D. frontal attack, leapfrog, flanking attack, market expansion and contraction.
E. fortress, leapfrog, confrontation, encirclement and expansion.

16.5 Marketing actions particularly aimed at head-to-head positioning against competitive offerings or potential offerings include:

A. making product modifications or improvements to match or beat superior competitive offerings and meeting or beating prices or promotion.
B. increasing attention to quality control and focusing advertising on selective demand.
C. expanding production capacity and improving inventory control.
D. developing a second brand or product line and developing multiple line extensions.
E. building unique distribution channels and multiple advertising and sales promotion campaigns.

16.6 Strategies most appropriate for a market leader attempting to maintain its share lead depend upon:

A. market size.
B. competitor characteristics.
C. number of competitors.
D. the leader's own resources.
E. all of the above factors.

16.7 Tide detergent's repeated product improvements, such as adding 'blue crystals' and similar moves, are probably an example of a _____ share maintenance strategy.

A. fortress (position defence).
B. flanker.
C. confrontation.
D. market expansion.
E. contraction (strategic withdrawal).

16.8 Increasing satisfaction, loyalty and repeat purchase among current customers is an objective primarily associated with the _____ share maintenance strategy:

A. fortress (position defence).
B. flanker.
C. confrontation.
D. market expansion.
E. contraction (withdrawal).

16.9 Firms following a 'fortress' strategy may have as one of their objectives:

A. to increase its customer base by focusing its resources on high growth segments.
B. to increase its customer base by focusing on creating new products.
C. to protect against losses of customers by beating its competitors' prices.
D. to protect against losses of customers by developing its own second entry.
E. to increase the rate of purchase of its current customers.

16.10 Which type of marketing strategy is represented by a company which develops a second brand with a price which is more appealing to a specific segment of its current customers who are purchasing one of its existing brands?

A. Suicide squeeze strategy.
B. Market expansion strategy.
C. Flanker strategy.
D. Confrontation strategy.
E. Analyser strategy.

16.11 A major auto tyre manufacturer, which already produces a premium tyre, decides to produce a low-price branded tyre as well. It is probably practising a _____ share maintenance strategy.

A. fortress (position defence).
B. confrontation.
C. contraction (strategic withdrawal).
D. flanker.
E. market expansion.

16.12 In its continual efforts to fend off MCI and Sprint, AT&T has employed a _____ marketing strategy which has essentially _____ their attacks.

A. market expansion; stopped.
B. market expansion; neutralised the effectiveness of.
C. avoidance; neutralised the effectiveness of.
D. confrontation; neutralised the effectiveness of.
E. confrontation; stopped.

16.13 When one company meets the price reductions of a direct competitor, it is pursuing a _____ share maintenance strategy.

A. fortress (position defence).
B. confrontation.
C. contraction (strategic withdrawal).
D. market expansion.
E. flanker.

16.14 A confrontation strategy involves:

A. a direct attack on a competitor's product-market.
B. an indirect attack on a competitor's product-market.
C. identification of new product-market opportunities.
D. protection by the share leader of its primary product-market domain.
E. a deliberate effort to reduce product-market domain.

16.15 Which type of marketing strategy is represented by a company which develops additions to one of its existing product lines in order to better satisfy the needs of different segments of users in the market?

A. Market expansion.
B. Confrontation strategy.
C. Strategic withdrawal strategy.
D. Analyser strategy.
E. None of the above.

16.16 Firms following a 'frontal' strategy may have as one of their objectives:

A. to increase its sales by stealing competitor's customers.
B. to increase its sales by getting customers to trade up.
C. to increase share of new customers who have different needs.
D. to increase share of customers in different segments who have different needs.
E. to increase the rate of purchase of its current customers.

16.17 When, a few years ago, Toyota introduced its top-of-the-line Lexus LS 400, it was likely pursuing which share-growth strategy?

A. Flanker.
B. Frontal.
C. Encirclement.
D. Leapfrog.
E. The type of attack is contingent on the market segment Toyota was targeting.

16.18 Share-growth strategies described in the text include:

A. fortress (position defence), flanker, confrontation, market expansion and contraction (withdrawal).
B. frontal attack, leapfrog, flanking attack and encirclement.
C. fortress, flanker, confrontation and encirclement.
D. frontal attack, leapfrog, flanking attack, market expansion and contraction.
E. fortress, leapfrog, confrontation, encirclement and expansion.

16.19 What type of marketing strategy did Honda Motor Company use in the early 1960s when it introduced a small, low-priced sedan into the California market?

A. Flank attack.
B. Encirclement.
C. Leapfrog.
D. None of the above.
E. Both A and C above.

16.20 Firms following a 'leapfrog' strategy may have as one of their objectives:

A. to increase sales by stealing competitors' customers.
B. to increase sales by getting customers to trade up.
C. to increase their share of new customers who have different needs.
D. to increase their share of customers in different segments who have different needs.
E. to increase the rate of purchase of their current customers.

16.21 The market characteristics facing firms following a 'flank' strategy are:

A. relative homogeneity in one segment.
B. relative homogeneity in multiple segments.
C. two or more distinct segments.
D. relative heterogeneity in one segment.
E. relative heterogeneity in multiple segments.

16.22 The market characteristics facing firms following an 'encirclement' strategy are:

A. relative homogeneity in one segment.
B. relative homogeneity in multiple segments.
C. two or more distinct segments.
D. relative heterogeneity in one segment.
E. relative heterogeneity in multiple segments.

## Application Questions and Cases

16.23 Stouffer's Foods holds a commanding share of the growing market for low-calorie frozen entrées with its Lean Cuisine product line. To maintain its lead as the market continues to grow, what strategic marketing objectives should Stouffer focus on and why?

16.24 Given your answer to Question 16.23, which specific marketing actions would you recommend for accomplishing Stouffer's objectives? Be specific with regard to each of the 4 Ps in the firm's marketing programme.

16.25 A number of years ago General Foods' Cool Whip frozen dessert topping held nearly a two-thirds share of the market, but it was gradually losing share to low-priced private label competitors in many regional markets. Describe two strategies that General Foods might have adopted to defend its leading share position and the marketing actions necessary to implement them. Which of the two would you recommend and why?

16.26 How would you characterise the early strategies of the major Japanese auto makers (e.g., Toyota, Nissan, and Honda) when they first entered the US auto market in the 1960s and 1970s? What marketing variables do you think were critical to the ultimate success of their strategies?

16.27 If you had been the top marketing executive at General Motors during the early years of the Japanese invasion of the US car market, which strategy would you have recommended to defend GM's leading market share against this new competitive threat? Why do you think GM failed to adopt such a strategy at the time?

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# Module 17

# Marketing Strategies for Mature and Declining Markets

## Contents



## Johnson Controls: Making Money in Mature Markets[1]

At first glance, Johnson Controls Inc. in Glendale, Wisconsin, appears to be the epitome of a staid, slow-growing, 'old-economy' company. After all, the firm's success and future survival depend on several product and service categories that have not experienced very much growth in the domestic market in recent years. Johnson's major businesses include batteries, seats, and other internal components for automobiles; heating and cooling equipment for large commercial buildings and schools; and facilities management services.

But first glances can be deceiving. The firm's managers have developed a four-pronged strategy for making money in such mature markets. First, Johnson has acquired a number of weaker competitors in each of its product categories over the years in order to gain market share and remove excess capacity. Second, the firm has expanded sales volume by moving aggressively into global markets. The firm now operates in 500 different locations around the world.

Most important, the firm has nurtured close relationships with established customers such as Daimler-Chrysler, BMW, Toyota and Ford. Those relationships, in turn, have enabled Johnson to maintain solid profit margins by improving customer retention and gaining operating efficiencies via logistical alliances, just-in-time delivery systems, and other process improvements. Finally, the firm's close customer relationships have provided it with market intelligence and facilitated joint development projects, both of which have helped the firm gain additional revenue from the introduction of new product and service offerings targeted at those customers.

A strong balance sheet and a long-term perspective have helped Johnson build market share – and expand into foreign countries – through the acquisition of competitors. In some cases, the firm has snapped up firms with product or service offerings that complement and extend Johnson's own product line in one of its established target markets. For instance, the firm spent $167 million to acquire Pan Am's World Services division, a facility management operation that does everything from mow the lawn to run the cafeteria. That acquisition, when combined with Johnson's existing heating and cooling systems business and some new products and services developed internally, turned the company into a full-service facilities operator. Johnson can now manage a client's entire building while offering highly customised heating and cooling systems and controls that minimise energy use. This combination of customised products and full service has both expanded the company's share of the commercial real estate market and enabled it to maintain relatively high margins in a highly competitive business.

In other businesses, Johnson has combined the economies of scale generated through savvy acquisitions with the knowledge gained from close customer relationships to both develop new products and drive down operating costs. For example, Johnson has become the leading worldwide supplier of automotive seating and interior systems, such as floor consoles and instrument panels, by assisting manufacturers with the design and development, as well as the manufacture, of such components. As one engineer at Daimler-Chrysler pointed out, 'Johnson is able to completely integrate the design, development, and manufacture of [our] seats,' and do it for less than the auto companies could.

On the design side, Johnson Controls has maintained its own industrial design department for many years. The firm's European design centre in Cologne, Germany, alone has 70 staff members, more than the interior design teams of many carmakers. The centre includes an in-house market research department to help identify trends in consumer tastes in European markets, and pre-test consumer reactions to possible design innovations.

On the manufacturing side, by closely coordinating inventories and production schedules, Johnson has reduced costs even further for both its customers and itself. For instance, by locating its plants close to a customer's production facility, Johnson is able to assemble seats to order, load them on a truck in a sequence that matches the cars coming down the assembly line, and deliver them to the customer all in as little as 90 minutes.

Despite the maturity of its markets, Johnson's strategy is paying off, in terms of both revenue growth and profits. In recent years the firm has experienced substantial annual revenue growth, with sales increasing from about $10 billion in 1996 to more than $34 billion in 2007. At the same time, the firm has increased annual dividends paid to shareholders for more than 32 years, and in 2007 it earned a 16 per cent return on shareholder equity before restructuring charges.

## Learning Objectives

Many managers, particularly those in marketing, seem obsessed with growth. Their objectives tend to emphasise annual increases in sales volume, market share, or both. But the biggest challenge for many managers in developed nations in future years will be making money in markets that grow slowly, if at all. The majority of product-markets in those nations are in the mature or decline stages of their life cycles. And as accelerating rates of technological and social change continue to shorten such life cycles, today's innovations will move from growth to maturity – and ultimately to decline – ever faster.

A period of competitive turbulence almost always accompanies the transition from market growth to maturity in an industry. This period often begins after approximately half the potential customers have adopted the product and the rate of sales growth starts to decline. As the growth rate slows, many competitors tend to overestimate future sales volume and consequently end up developing too much production capacity. Competition becomes more intense as firms battle to increase sales volume to cover their high fixed costs and maintain profitability. As a result, such transition periods are commonly accompanied by a **shakeout** during which weaker businesses fail, withdraw from the industry, or are acquired by other firms.

### Challenges in Mature Markets

Businesses that survive the shakeout face new challenges as market growth stagnates. As a market matures, total volume stabilises; replacement purchases rather than first-time buyers account for the vast majority of that volume. A primary marketing objective of all competitors in mature markets, therefore, is simply to hold their existing customers – to sustain a meaningful competitive advantage that will help ensure the continued satisfaction and loyalty of those customers. Thus, a product's financial success during the mature life cycle stage depends heavily on the firm's ability to achieve and sustain a lower delivered cost or some perceived product quality or customer-service superiority.

Some firms tend to passively defend mature products while using the bulk of the revenues produced by those items to develop and aggressively market new products with more growth potential. This can be shortsighted, however. All segments of a market and all brands in an industry do not necessarily reach maturity at the same time. Thus, a share leader in a mature industry might build on a cost or product differentiation advantage and pursue a marketing strategy aimed at increasing volume by promoting new uses for an old product or by encouraging current customers to buy and use the product more often. Therefore, this module examines basic business strategies necessary for survival in mature markets and marketing strategies a firm might use to extend a brand's sales and profits.

### Challenges in Declining Markets

Eventually, technological advances; changing customer demographics, tastes, or lifestyles; and development of substitutes result in declining demand for most product forms and brands. As a product starts to decline, managers face the critical question of whether to divest or liquidate the business. Unfortunately, firms sometimes support dying products too long at the expense of current profitability and the aggressive pursuit of future breadwinners.

An appropriate marketing strategy, however, can produce substantial sales and profits even in a declining market. If few exit barriers exist, an industry leader might attempt to increase market share via aggressive pricing or promotion policies aimed at driving out weaker competitors. Or it might try to consolidate the industry. Alternatively, a firm might decide to harvest a mature product by maximising cash flow and profit over the product's remaining life. The last section of this module examines specific marketing strategies for gaining the greatest possible returns from products approaching the end of their life cycle.

## 17.1 Shakeout: The Transition from Market Growth to Maturity

### 17.1.1 Characteristics of the Transition Period

The transition from market growth to maturity typically begins when the market is still growing but the rate of growth starts to decline. This slackening of the growth rate either sparks or occurs simultaneously with other changes in the market and competitive environment. As mentioned earlier, such changes typically include the appearance of excess capacity, increased difficulty of maintaining product differentiation, increased intensity of competition, and growing pressures on costs and profits. Consequently, weaker members of the industry often fail or are acquired by larger competitors during this shakeout stage.

### 17.1.2 Strategic Traps during the Transition

A business's ability to survive the transition from market growth to maturity depends to a great extent on whether it can avoid some common strategic traps.[2] Four such traps are summarised in Exhibit 17.1.[2]

**Exhibit 17.1 Common strategic traps firms can fall into during the shakeout period**

1. Failure to anticipate transition from growth to maturity.
   - Firms may make overly optimistic forecasts of future sales volume.
   - As a result, they expand too rapidly and production capacity overshoots demand as growth slows.
   - Their excess capacity leads to higher costs per unit.
   - Consequently, they must cut prices or increase promotion in an attempt to increase their volume.
2. No clear competitive advantage as growth slows.
   - Many firms can succeed without a strong competitive advantage during periods of rapid growth.
   - However, firms that do not have the lowest costs or a superior offering in terms of product quality or service can have difficulty sustaining their market share and volume as growth slows and competition intensifies.
3. Assumption that an early advantage will insulate the firm from price or service competition.
   - In many cases, technological differentials become smaller as more competitors enter and initiate product improvements as an industry approaches maturity.
   - If customers perceive that the quality of competing brands has become more equal, they are likely to attach greater importance to price or service differences.

   - Failure to detect such trends can cause an early leader to be complacent and slow to respond to competitive threats.
4. Sacrificing market share in favour of short-run profit.
   - A firm may cut marketing or R&D budgets or forgo other expenditures in order to maintain its historical level of profitability even though industry profits tend to fall during the transition period.
   - This can cause long-run erosion of market share and further increases in unit costs as the industry matures.

The most obvious trap is simply the failure to recognise the events signaling the beginning of the shakeout period. The best way to minimise the impact of slowing growth is to accurately forecast the slowdown in sales and hold the firm's production capacity to a sustainable level. For both industrial and consumer durable goods markets, models can forecast when replacement sales will begin to outweigh first-time purchases, a common signal that a market is beginning to mature.[3] But in consumer nondurable markets – particularly those where growth slows because of shifting consumer preferences or the emergence of substitute products – the start of the transition period can be nearly impossible to predict.

A second strategic trap is for a business to get caught in the middle during the transition period without a clear strategic advantage. A business may survive and prosper during the growth stage even though it has neither differentiated its offering from competitors nor attained the lowest-cost position in its industry. But during the transition period, such is not the case.

A third trap is the failure to recognise the declining importance of product differentiation and the increasing importance of price or service. Businesses that have built their success on technological superiority or other forms of product differentiation often disdain aggressive pricing or marketing practices even though such differentiation typically erodes as markets mature.[4] As a result, such firms may delay meeting their more aggressive competitors head-on and end up losing market share, as Hewlett-Packard and Compaq both discovered in the wake of Dell's aggressive pricing policies as the personal computer market slumped in 2000.

Why should a firm not put off responding to the more aggressive pricing or marketing actions of its competitors? Because doing so may lead to a fourth trap – giving up market share too easily in favour of short-run profit. Many businesses try to maintain the profitability of the recent past as markets enter the transition period. They usually do this at the expense of market share or by forgoing marketing, R&D, and other investments crucial for maintaining future market position. While some smaller firms with limited resources may have no choice, this tendency can be seriously shortsighted, particularly if economies of scale are crucial for the business's continued success during market maturity.

## 17.2 Strategic Choices in Mature Markets

The maturity phase of an industry's life cycle is often depicted as one of stability characterised by few changes in the market shares of leading competitors and steady prices. The industry leaders, because of their low per-unit costs and little need to make any further investments, enjoy high profits and positive cash flows. These cash flows are harvested and diverted to other SBUs or products in the firm's portfolio that promise greater future growth.

Unfortunately, this conventional scenario provides an overly simplistic description of the situation businesses face in most mature markets. For one thing, it is not always easy to tell when a market has reached maturity. Variations in brands, marketing programmes, and customer groups can mean that different brands and market segments reach maturity at different times.

Further, as the maturity stage progresses, a variety of threats and opportunities can disrupt an industry's stability. Shifts in customer needs or preferences, product substitutes, increased raw material costs, changes in government regulations, or factors such as the entry of low-cost foreign producers or mergers and acquisitions can threaten individual competitors and even throw the entire industry into early decline. Consider, for instance, the competitive position of Kodak, a brand that dominated the world market for photographic film for decades. First, the appearance of high-quality foreign competitors such as Fuji Film and then the development of digital cameras eroded the size of the film market and Kodak's sales revenues.

On the positive side, such changes also can open new growth opportunities in mature industries. Product improvements (such as the development of high-fibre nutritional cereals), advances in process technology (the creation of minimills for steel production), falling raw materials costs, increased prices for close substitutes, or environmental changes all can provide opportunities for a firm to dramatically increase its sales and profits. An entire industry can even experience a period of renewed growth.

Discontinuities during industry maturity suggest that it is dangerously shortsighted for a firm to simply milk its cash cows. Even industry followers can substantially improve volume, share, and profitability during industry maturity if they can adjust their marketing objectives and programmes to fit the new opportunities that arise.[5] Thus, success in mature markets requires two sets of strategic actions: (1) the development of a well-implemented business strategy to sustain a competitive advantage, customer satisfaction, and loyalty and (2) flexible and creative marketing programmes geared to pursue growth or profit opportunities as conditions change in specific product-markets.

### 17.2.1 Strategies for Maintaining Competitive Advantage

As discussed in Module 3, both *analyser* and *defender strategies* may be appropriate for units with a leading, or at least a profitable, share of one or more major segments in a mature industry. Analysers and defenders are both concerned with maintaining a strong share position in established product-markets. But analysers also do some product and market development to avoid being leapfrogged by competitors with more advanced products or being left behind in new applications segments. On the other hand, defenders may initiate some product improvements or line extensions to protect and strengthen their position in existing markets, but they spend relatively little on new product R&D. Thus, an analyser strategy is most appropriate for developed industries that are still experiencing some technological change and may have opportunities for continued growth, such as the computer and commercial aircraft industries. The defender strategy works best in industries where the basic technology is not very complex or is unlikely to change dramatically in the short run, as in the food industry.

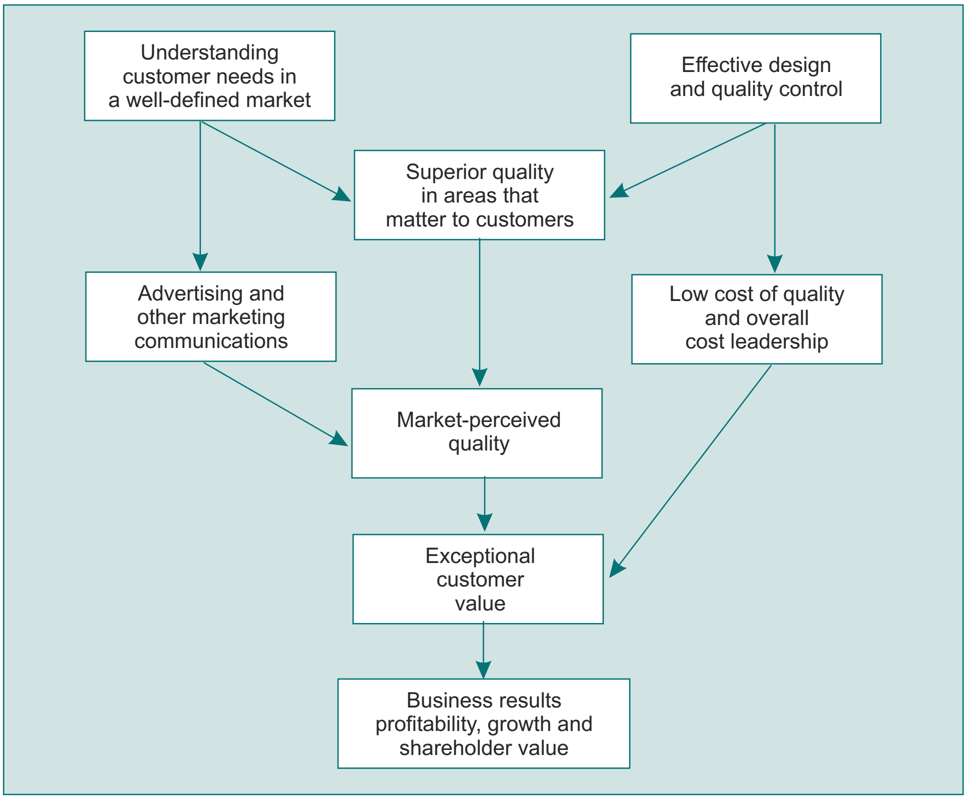
Both analysers and defenders can attempt to sustain a competitive advantage in established product-markets through *differentiation* of their product offering (either on the basis of superior quality or service) or by maintaining a low-cost position. Evidence suggests the ability to maintain either a strongly differentiated or a low-cost position continues to be a critical determinant of success throughout both the transition and the maturity stage. One study examined the competitive strategies pursued by the two leading firms (in terms of return on investment) in eight mature industries characterised by slow growth and intense competition. In each industry, the two leading firms offered either the lowest relative delivered cost or high relative product differentiation.[6] Similarly, more recent observations by Treacy and Wiersema found that market leaders tend to pursue one of three strategic disciplines. They either stress operational excellence, which typically translates into lower costs, or differentiate themselves through product leadership or customer intimacy and superior service.[7]

Generally, it is difficult for a single business to pursue both low-cost and differentiation strategies at the same time. For instance, businesses taking the low-cost approach typically compete primarily by offering the lowest prices in the industry. Such prices allow little room for the firm to make the investments or cover the costs inherent in maintaining superior product quality, performance, or service over time.

Of course, improvements in quality – especially the reduction of product defects via improved production and procurement processes – can also reduce a product's cost, as advocates of 'six sigma' programmes point out. There is some evidence, however, that efforts aimed at improving quality in order to increase the benefits customers associate with the product, and thereby produce increased sales and market share, generate greater financial returns for a firm than quality improvement efforts focused mainly on cost reduction.[8] Therefore, in the following sections we discuss quality improvement efforts aimed at differentiating a firm's offering and making it more appealing to customers separately from methods for reducing an offering's cost.

It is important to keep in mind, however, that pursuit of a low-cost strategy does not mean that a business can ignore the delivery of desirable benefits to the customer. Similarly, customers will not pay an unlimited price premium for superior quality or service, no matter how superior it is. In both consumer and commercial markets customers seek good value for the money, either a solid, no-frills product or service at an outstanding price or an offering whose higher price is justified by the superior benefits it delivers on one or more dimensions.[9] Thus, even low-cost producers should continually seek ways to improve the quality and performance of their offerings within the financial constraints of their competitive strategy. And even differentiated defenders should continually work to improve efficiency without sacrificing product quality or performance. This point is clearly illustrated in the diagram of the customer value management process in Exhibit 17.2, which shows that actions to improve customers' perceptions of quality (whether of goods or service) and to reduce costs both impact customer value. The critical strategic questions facing the marketing manager, then, are: How can a business continue to differentiate its offerings and justify a premium price as its market matures and becomes more competitive? and How can businesses, particularly those pursuing low-cost strategies, continue to reduce their costs and improve their efficiency as their markets mature?

**Exhibit 17.2 The process of customer value management**

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## 17.2.2 Methods of Differentiation

At the most basic level, a business can attempt to differentiate its offering from competitors' by offering either superior product quality, superior service, or both. The problem is that *quality* and *service* may be defined in a variety of different ways by customers.

### 17.2.2.1 Dimensions of Product Quality[10]

To maintain a competitive advantage in product quality, a firm must understand what *dimensions customers perceive to underlie differences across products* within a given category. One authority has identified eight such dimensions of product quality. These are summarised in Exhibit 17.3 and discussed next.

**Exhibit 17.3 Dimensions of product quality**

| | |
|---|---|
| • Performance | How well does the washing machine wash clothes? |
| • Durability | How long will the lawnmower last? |
| • Conformance with specifications | What is the incidence of product defects? |
| • Features | Does an airline flight offer a movie and dinner? |
| • Reliability | Will each visit to a restaurant result in consistent quality? What percentage of the time will a product perform satisfactorily? |
| • Serviceability | Is the product easy to service? Is the service system efficient, competent and convenient? |
| • Fit and finish | Does the product look and feel like a quality product? |
| • Brand name | Is this a name that customers associate with quality? What is the brand's image? |

*Source*: Adapted from David A. Garvin, 'What Does "Product Quality" Really Mean?', *Sloan Management Review*, Fall 1984, pp. 25–43. 

European manufacturers of prestige automobiles, such as Mercedes-Benz and Porsche, have emphasised the first dimension of product quality – **functional performance**. These automakers have designed cars that provide excellent performance on such attributes as handling, acceleration, and comfort. Volvo, on the other hand, has emphasised and aggressively promoted a different quality dimension – **durability** (and the related attribute of safety). A third quality dimension, **conformance to specifications**, or the absence of defects, has been a major focus of the Japanese automakers. Until recent years, American carmakers relied heavily on broad product lines and a wide **variety of features**, both standard and optional, to offset their shortcomings on some of the other quality dimensions.

The **reliability** quality dimension can refer to the consistency of performance from purchase to purchase or to a product's uptime, the percentage of time that it can perform satisfactorily over its life. Tandem Computers has maintained a competitive advantage based on reliability by designing computers with several processors that work in tandem, so that if one fails, the only impact is the slowing of low-priority tasks. IBM had difficulty matching Tandem's reliability because its operating system was not easily adapted to the multiple-processor concept. Consequently, Tandem has maintained a strong position in market segments consisting of large-scale computer users, such as financial institutions and large retailers, for whom system downtime is particularly undesirable.

The quality dimension of **serviceability** refers to a customer's ability to obtain prompt and competent service when the product does break down. For example, Caterpillar has long differentiated itself with a parts and service organisation dedicated to providing '24-hour parts service anywhere in the world.'

Many of these quality dimensions can be difficult for customers to evaluate, particularly for consumer products. As a result, consumers often generalise from quality dimensions that are more visual or qualitative. Thus, the **fit and finish** dimension can help convince consumers that a product is of high quality. They tend to perceive attractive and well-designed products as generally high in quality, as witnessed by the success of the Krups line of small appliances. Similarly, the **quality reputation of the brand name**, and the promotional activities that sustain that reputation, can strongly influence consumers' perceptions of a product's quality.[11] A brand's quality reputation together with psychological factors such as name recognition and loyalty substantially determine a brand's **equity** – the perceived value customers associate with a particular brand name and its logo or symbol.[12] To successfully pursue a differentiation strategy based on quality, then, a business must understand what dimensions or cues its potential customers use to judge quality, and it should pay particular attention to some of the less-concrete but more visible and symbolic attributes of the product.

#### 17.2.2.2 Dimensions of Service Quality

Customers also judge the quality of the service they receive on multiple dimensions. A number of such dimensions of perceived service quality have been identified by a series of studies conducted across diverse industries such as retail banking and appliance repair, and five of those dimensions are listed and briefly defined in Exhibit 17.4.[13]

**Exhibit 17.4 Dimensions of service quality**

| | |
|---|---|
| • Tangibles | Appearance of physical facilities, equipment, personnel and communications materials. |
| • Reliability | Ability to perform the promised service dependably and accurately. |
| • Responsiveness | Willingness to help customers and provide prompt service. |
| • Assurance | Knowledge and courtesy of employees and their ability to convey trust and confidence. |
| • Empathy | Caring, individualised attention the firm provides its customers. |

*Source*: Valerie A. Zeithaml, A. Parasuraman and Leonard L. Berry, *Delivering Quality Service: Balancing Customer Perceptions and Expectations* (New York: Free Press, 1990), p. 26.

The quality dimensions listed in Exhibit 17.4 apply specifically to service businesses, but most of them are also relevant for judging the service component of a product offering. This pertains to both the objective performance dimensions of the service delivery system, such as its **reliability** and **responsiveness**, as well as to elements of the performance of service personnel, such as their **empathy** and level of **assurance**.

The results of a number of surveys suggest that customers perceive all five dimensions of service quality to be very important regardless of the kind of service being evaluated. As Exhibit 17.5 indicates, customers of four different kinds of services gave reliability, responsiveness, assurance, and empathy mean importance ratings of more than 9 on a 10-point rating scale. And though the mean ratings for tangibles were somewhat lower in comparison, they still fell toward the upper end of the scale, ranging from 7.14 to 8.56.

**Exhibit 17.5** **Perceived importance of service quality dimensions in four different industries**

| | Mean importance rating on 10-point scale* | Percentage of respondents indicating dimension is most important |
|---|---|---|
| Credit-card customers (*n* = 187) | | |
| Tangibles | 7.43 | 0.6 |
| Reliability | 9.45 | 48.6 |
| Responsiveness | 9.37 | 19.8 |
| Assurance | 9.25 | 17.5 |
| Empathy | 9.09 | 13.6 |
| Repair-and-maintenance customers (*n* = 183) | | |
| Tangibles | 8.48 | 1.2 |
| Reliability | 9.64 | 57.2 |
| Responsiveness | 9.54 | 19.9 |
| Assurance | 9.62 | 12.0 |
| Empathy | 9.30 | 9.6 |
| Long-distance telephone customers (*n* = 184) | | |
| Tangibles | 7.14 | 0.6 |
| Reliability | 9.67 | 60.6 |
| Responsiveness | 9.57 | 16.0 |
| Assurance | 9.29 | 12.6 |
| Empathy | 9.25 | 10.3 |
| Bank customers (*n* = 177) | | |
| Tangibles | 8.56 | 1.1 |
| Reliability | 9.44 | 42.1 |
| Responsiveness | 9.34 | 18.0 |
| Assurance | 9.18 | 13.6 |
| Empathy | 9.30 | 25.1 |

* Scale ranges from 1 (not at all important) to 10 (extremely important).

*Source*: Reprinted with permission of The Free Press, a Division of Macmillan, Inc., from *Delivering Quality Service: Balancing Customer Perceptions and Expectations*, by Valerie A. Zeithaml, A. Parasuraman, and Leonard L. Berry. Copyright © 1990 by The Free Press.

The same respondents also were asked which of the five dimensions they would choose as being the most critical in their assessment of service quality. Their responses, which are shown in Exhibit 17.5, suggest that reliability is the most important aspect of service quality to the greatest number of customers.

## 17.2.3 Are the Dimensions the Same for Service Quality on the Internet?

Some of the researchers who identified the dimensions of service quality listed in Exhibit 17.4 have also studied whether service quality on the Internet has the same or different underlying dimensions. They defined online service quality as the extent to which a website facilitates efficient and effective shopping, purchasing, and delivery. They identified 11 dimensions of perceived e-service quality: access, ease of navigation, efficiency, flexibility, reliability, personalisation, security/privacy, responsiveness, assurance/trust, site aesthetics, and price knowledge.[14]

While e-service quality obviously has more underlying dimensions, some of the most important of those dimensions are the same online as offline, such as reliability and responsiveness. This helps explain why e-tailers like Amazon.com have spent millions building distribution centres geared toward improving the reliability of their order fulfilment activities.

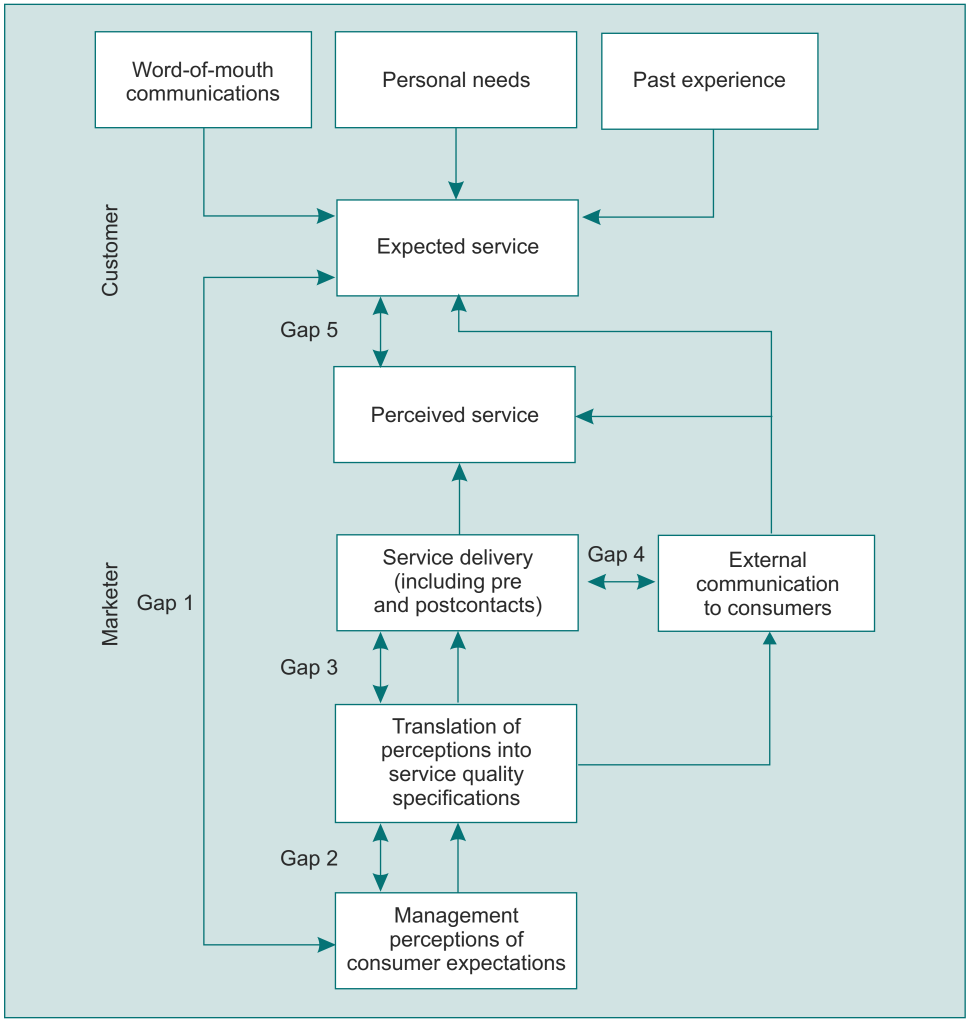
On the other hand, some dimensions that are important offline are not as crucial on the Internet. Empathy, for example, doesn't appear to be a major concern for online customers, unless they are having problems on some of the other service dimensions.

The key to a differentiation strategy based on providing superior service is to meet or exceed target customers' service quality expectations and to do it more consistently than competitors. The problem is that sometimes managers underestimate the level of those customer expectations, and sometimes those expectations can be unrealistically high. Therefore, a firm needs to clearly identify target customers' desires with respect to service quality and to clearly define and communicate what level of service they intend to deliver. When this is done, customers have a more realistic idea of what to expect and are less likely to be disappointed with the service they receive.

### 17.2.3.1 Improving Customer Perceptions of Service Quality

The major factors that determine a customer's expectations and perceptions concerning service quality – and five gaps that can lead to dissatisfaction with service delivery – are outlined in Exhibit 17.6 and discussed next.

**Exhibit 17.6 Determinants of perceived service quality**




*Source*: Reprinted from A. Parasuraman, Valarie A. Zeithaml, and Leonard L. Berry, 'A Conceptual Model of Service Quality and Its Implications for Future Research,' *Journal of Marketing*, Fall 1985, p. 44. Published by the American Marketing Association. Reprinted with permission.

1. **Gap between the customer's expectations and the marketer's perceptions.** Managers do not always have an accurate understanding of what customers want or how they will evaluate a firm's service efforts. The first step in providing good service is to collect information – through customer surveys, evaluations of customer complaints, or other methods – to determine what service attributes customers consider important.
2. **Gap between management perceptions and service quality specifications.** Even when management has a clear understanding of what customers want, that understanding might not get translated into effective operating standards. A

firm's policies concerning customer service may be unclear, poorly communicated to employees, or haphazardly enforced. Unless a firm's employees know what the company's service policies are and believe that management is seriously committed to those standards, their performance is likely to fall short of desired levels.

3. **Gap between service quality specifications and service delivery.** Lip service by management is not enough to produce high-quality service. High standards must be backed by the programmes, resources, and rewards necessary to enable and encourage employees to deliver good service. Employees must be provided with the training, equipment, and time necessary to deliver good service. Their service performance must be measured and evaluated. And good performance must be rewarded by making it part of the criteria for pay raises or promotions, or by other more direct inducements, in order to motivate the additional effort good service requires.
4. **Gap between service delivery and external communications.** Even good service performance may disappoint some customers if the firm's marketing communications cause them to have unrealistically high expectations. If the photographs in a vacation resort's advertising and brochures make the rooms look more spacious and luxurious than they really are, for instance, first-time customers are likely to be disappointed no matter how clean or well-tended those rooms are kept by the resort's staff.
5. **Gap between perceived service and expected service.** This results when management fails to close one or more of the other four gaps. It is this difference between a customer's expectations and his or her actual experience with the firm that leads to dissatisfaction.

The above discussion suggests a number of actions management can take to close the possible gaps and improve customer satisfaction with a company's service.[15] Achieving and sustaining high levels of service quality can present difficult implementation problems, however, because it usually involves the coordination of efforts of many employees from different functional departments and organisational levels. Some of these coordination problems are examined in Module 18.

## 17.2.4 Methods of Maintaining a Low-Cost Position

Moving down the experience curve is the most commonly discussed method of achieving and sustaining a low-cost position in an industry. But a firm does not necessarily need a large relative market share to implement a low-cost strategy. For instance, Johnson Controls relies on close alliances with customers, as well as economies of scale, to hold down its inventory and distribution costs. And Michael Dell, as a small follower in the personal computer industry, managed to achieve costs below those of much larger competitors by developing logistical alliances with suppliers and an innovative, Internet-based direct distribution channel.

Some other means for obtaining a sustainable cost advantage include producing a no-frills product, creating an innovative product design, finding cheaper raw materials, automating or outsourcing production, developing low-cost distribution channels, and reducing overhead.[16]

#### 17.2.4.1 A No-Frills Product

A direct approach to obtaining a low-cost position involves simply removing all frills and extras from the basic product or service. Thus, Ryanair's flights from secondary airports, warehouse furniture stores, legal services clinics, and grocery stores selling canned goods out of crates all offer lower costs and prices than their competitors. This lower production cost is often sustainable because established differentiated competitors find it difficult to stop offering features and services their customers have come to expect. However, those established firms may lower their own prices in the short run – even to the point of suffering losses – in an attempt to drive out a no-frills competitor that poses a serious threat. Thus, a firm considering a no-frills strategy needs the resources to withstand a possible price war.[17]

#### 17.2.4.2 Innovative Product Design

A simplified product design and standardised component parts also can lead to cost advantages. In the office copier industry, for instance, Japanese firms – such as Canon – overcame substantial entry barriers by designing extremely simple copiers, with a fraction of the number of parts in the design used by market-leading Xerox.

#### 17.2.4.3 Cheaper Raw Materials

A firm with the foresight to acquire or the creativity to find a way to use relatively cheap raw materials also can gain a sustainable cost advantage. For example, Fort Howard Paper achieved an advantage by being the first major US papermaker to rely exclusively on recycled pulp. While the finished product was not so high in quality as paper from virgin wood, Fort Howard's lower cost gave it a competitive edge in the price-sensitive commercial market for toilet paper and other such products used in hotels, restaurants, and office buildings.

#### 17.2.4.4 Innovative Production Processes

Although low-cost defender businesses typically spend little on *product R&D*, they often continue to devote substantial sums to *process R&D*. Innovations in the production process, including the development of automated or computer-controlled processes, can help them sustain cost advantages over competitors.

In some labour-intensive industries, a business can achieve a cost advantage, at least in the short term, by gaining access to inexpensive labour. This is usually achieved by moving all or part of the production process to countries with low wage rates, such as China or Mexico. Unfortunately, because such moves are relatively easy to emulate, this kind of cost advantage may not be sustainable.[18] Also, as developing nations become increasingly successful economically, wages and other operating costs tend to rise, thereby reducing the cost advantages of outsourcing to those countries.[19]

#### 17.2.4.5 Low-Cost Distribution

When distribution accounts for a relatively high proportion of a product's total delivered cost, a firm might gain a substantial advantage by developing lower-cost alternative channels. Typically, this involves eliminating, or shifting to the customer, some of the functions performed by traditional channels in return for a lower price. In the consumer banking industry, for example, automated teller machines have helped reduce labour costs and investment in bricks-and-mortar branch banks. But they also have reduced the amount of personalised service banks provide to their customers, which may help explain why average customer satisfaction with banks fell by more than 8 per cent from the mid-1990s to the early years of this century.[20]

#### 17.2.4.6 Reductions in Overhead

Successfully sustaining a low-cost strategy requires that the firm pare and control its major overhead costs as quickly as possible as its industry matures. Many US companies learned this lesson the hard way during the 1980s when high costs of old plants, labour, and large inventories left them vulnerable to more efficient foreign competitors and to corporate raiders.

### 17.2.5 Customers' Satisfaction and Loyalty Are Crucial for Maximising Their Lifetime Value

Analyser, and particularly defender, businesses are mostly concerned with protecting their existing positions in one or more mature market segments and maximising profitability over the remaining life of those product-markets. Thus, financial dimensions of performance, such as return on investment and cash flow, are usually of greater interest to such businesses than are more growth-oriented dimensions, such as volume increases or new product success. Businesses can achieve such financial objectives by either successfully differentiating their offerings or maintaining a low-cost position.

While the primary emphasis in many businesses during the early 1990s was on improving efficiency through downsizing and reengineering, there is substantial evidence that firms with superior quality goods and services also obtain higher returns on investment than do businesses with average or below average offerings.[21] The lesson to be learned, then, is that the choice between a differentiation or a low-cost strategy is probably not the critical determinant of success in mature markets. What is critical is that a business *continually works to improve the value* of its offerings – by either improving product or service quality, reducing costs, or some combination – as a basis for maintaining its customer base as its markets mature and become increasingly competitive.

#### 17.2.5.1 Measuring Customer Satisfaction

To gain the knowledge necessary to continually improve the value of their offerings to customers, firms must understand how satisfied existing and potential customers are with their current offerings. This focus on customer satisfaction has become increasingly important as more firms question whether all attempts to improve *absolute* quality of their products and services generate sufficient additional sales and profits to justify their cost. This growing concern with the economic 'return on quality' has motivated firms to ask which dimensions of product or service quality are most important to customers and which dimensions customers might be willing to sacrifice for lower prices. For instance, United Parcel Service recently discovered that many of its customers wanted more time to interact with the company's drivers in order to seek advice on their shipping problems, and they were willing to put up with slightly slower delivery times in return. Consequently, UPS now allows its drivers an additional 30 minutes a day to spend at their discretion to strengthen ties with customers and perhaps bring in new sales.[22]

Because lengthy questionnaires often suffer from low response rates and can be subject to varying interpretations by different managers, some companies employ simple overall measures of customer satisfaction. Perhaps the most popular of these is the single question measure proposed by Fred Reichheld:23 'On a scale of zero to 10, how likely is it that you would recommend us to your friends or colleagues?' While such measures are simple for customers to answer and make it easy for managers to identify trends in satisfaction over time, they don't provide any information about *why* customers are either happy or disappointed with a firm's product or service. Indeed, if a substantial portion of respondents turn out to be 'detractors' who would advise their friends against purchasing the product, the firm would need to conduct a second, more detailed survey to find the source of their dissatisfaction and how it might be dealt with. For example, General Electric Healthcare's European Services business, which maintains hospital imaging equipment, had to ask managers to follow up with dissatisfied customers in order to discover that a chief source of irritation was slow response times from GE engineers. Once the firm overhauled its call centre and put more specialist engineers in the field, its satisfaction score on the 'would you recommend us?' measure jumped by 10 to 15 points.

To be useful analytical tools, then, measures of customer satisfaction should examine both (1) customers' *expectations and preferences* concerning the various dimensions of product and service quality (such as product performance, features, reliability, on-time delivery, competence of service personnel, and so on) and (2) their *perceptions* concerning how well the firm is meeting those expectations. Any gaps where customer expectations exceed their recent experiences may indicate fruitful areas for the firm to work at improving customer value and satisfaction. Of course, such measurements must be made periodically to determine whether the actions taken have been effective.[24]

#### 17.2.5.2 Improving Customer Retention and Loyalty

Maintaining the loyalty of existing customers is crucial for a business's profitability. This is especially true as markets mature because loyal customers become more profitable over time. The firm not only avoids the high costs associated with trying to acquire replacement customers in an increasingly competitive market, but it also benefits because loyal customers (1) tend to concentrate their purchases, thus leading to larger volumes and lower selling and distribution costs; (2) provide positive word-of-mouth and customer referrals; and (3) may be willing to pay premium prices for the value they receive.[25]

Periodic measurement of customer satisfaction is important because a dissatisfied customer is unlikely to remain loyal over time. Unfortunately, the reverse is not always true: Customers who describe themselves as satisfied are not necessarily loyal. Indeed, one author estimates that 60 to 80 per cent of customer defectors in most businesses said they were 'satisfied' or 'very satisfied' on the last customer survey before their defection.[26] In the interim, perhaps competitors improved their offerings, the customer's requirements changed, or other environmental factors shifted. Companies that measure customer satisfaction should be commended – but urged not to stop there. Satisfaction measures need to be supplemented with examinations of customer *behaviour*, such as measures of the annual retention rate, frequency of purchases, and the percentage of a customer's total purchases captured by the firm.

Most important, any problems or complaints reported to the company's call centre or on customer blogs should be closely monitored and responded to,[27] and defecting customers should be studied in detail to discover why the firm failed to provide sufficient value to retain their loyalty. Such failures often provide more valuable information than satisfaction measures because they stand out as a clear, understandable message telling the organisation exactly where improvements are needed.

#### 17.2.5.3 Are All Customers Equally Valuable?[28]

While improving customer loyalty is crucial for maintaining market share and profitability as markets mature, an increasing number of companies are asking whether every customer's loyalty is worthy of the same level of effort and expense. In these firms, technology is creating a new business model that alters the level of service and benefits provided to a customer based on projections of that customer's value to the firm. With the development of extensive customer databases, it is possible for companies to measure what different levels of customer service cost on an individual level. They also can know how much business a particular customer has generated in the past, estimate what she or he is likely to buy in the future, and calculate a rate of return for that individual for different levels of service.

The ability of firms to tailor different levels of service and benefits to different customers based on each person's potential to produce a profit has been facilitated by the growing popularity of the Internet. The Web has made it easier to track and measure individual transactions across businesses. It also has provided firms with new, low-cost service options; people can now serve themselves at their own convenience, but they have to accept little or no human contact in return.

The end result of this trend toward individually tailored service levels could be an increased stratification of consumer society. The top tier may enjoy unprecedented levels of personal attention. But those who fall below a certain level of profitability for too long may face increased service fees or receive reduced levels of service and benefits. For example, some credit-card companies now charge higher annual fees to customers who do not rack up some minimum level of interest charges during the year. In other firms, call centre personnel route customers to different queues. Big spenders are turned over to high-level problem solvers while less profitable customers may never speak to a live person. Finally, choice customers may get fees waived or receive promotional discounts based on the value of their business, while less valuable customers may never know the promotions exist.[29]

The segmentation of customers based on projections of their value and the tailoring of different service levels and benefits to those segments raise both ethical and strategic questions, some of which are explored in Exhibit 17.7. One possible way for a firm to resolve some of the dilemmas involved in dealing with less profitable customers is to find ways to increase their lifetime value by increasing the frequency and/or volume of their purchases. This is one strategy examined in detail in the following section.

**Exhibit 17.7 Pros and cons of varying service levels according to customers' profitability**

From a purely economic viewpoint, tailoring different levels of service and benefits to different customer segments depending on their profitability makes sense, at least in the short run. In an era when labour costs are increasing while many markets, especially mature ones, are getting more competitive, many firms argue they cannot afford to provide extensive hands-on service to everyone. Companies also point out that they're often delivering a wider range of products and services than ever before, including more ways for customers to handle transactions. Thanks to the Internet, for example, consumers have better tools to conveniently serve themselves. And finally, service segmentation may actually produce some positive benefits for customers – more personalised service for the best customers and, in many cases, lower overall costs and prices for everyone else.

For instance, Fidelity Investments now gets about 550 000 website visits each day and more than 700 000 daily phone calls, three-quarters of which go to automated systems that cost the company less than a dollar each, including research and development costs. The rest are handled by human operators, at a cost of about $13 per call.

From an ethical standpoint, however, many people question the inherent fairness and potential invasion of privacy involved in using a wealth of personal information about individual consumers as a basis for withholding services or benefits from some of them, especially when such practices are largely invisible to the consumer. You don't know when you're being shuttled to a different telephone queue or sales promotion. You don't know what benefits you're missing or what additional fees you're being charged. Some argue that this lack of transparency is unfair because it deprives consumers of the opportunity to take actions, such as concentrating their purchases with a single supplier, switching companies, or paying a service fee, that would enable them to acquire the additional services and benefits they are currently denied.

From a strategic view, there are also some potential dangers in cutting services and benefits to customers who have not generated profits in the past. For one thing, past behaviour is not necessarily an accurate indicator of a customer's future lifetime value. The life situations and spending habits of some customer groups – college students, for instance – can change dramatically over time. In addition, looking only at a customer's purchases may overlook some indirect ways that customer affects the firm's revenues, such as positive word-of-mouth recommendations and referrals to other potential buyers. And some customers may not be spending much with a company precisely because of the lousy service they have received as a result of not spending very much with that company. Instead of simply writing off low-volume customers, it may make more strategic sense to first attempt to convert them into high-volume customers by targeting them for additional promotions, by trying to sell complementary goods and services, or by instituting loyalty programmes (e.g., the airlines' frequent-flier programmes).

Finally, by debasing the satisfaction and loyalty of low-volume customers, firms risk losing those customers to competitors. In a mature industry, particularly one with substantial economies of scale, such a loss of market share can increase unit costs and reduce the profitability of those high-volume customers that do remain loyal. And a creative competitor may find ways to make other firms' cast-off customers very profitable after all.

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## 17.3 Marketing Strategies for Mature Markets

### 17.3.1 Strategies for Maintaining Current Market Share

Since markets can remain in the maturity stage for decades, milking or harvesting mature product-markets by maximising short-run profits makes little sense. Pursuing such an objective typically involves substantial cuts in marketing and R&D expenses, which can lead to premature losses of volume and market share and lower profits in the longer term. The business should strive during the early years of market maturity to *maximise the flow of profits over the remaining life of the product-market*. Thus, the most critical marketing objective is to *maintain and protect the business's market share*. In a mature market where few new customers buy the product for the first time, the business must continue to win its share of repeat purchases from existing customers.

In Module 16, we discussed a number of marketing strategies that businesses might use to maintain their market share in growth markets. Many of those same strategies continue to be relevant for holding on to customers as markets mature, particularly for those firms that survived the shakeout period with a relatively strong share position. The most obvious strategy for such share leaders is simply to continue strengthening their position through a *fortress defence*. Recall that such a strategy involves two sets of marketing actions: those aimed at improving customer satisfaction and loyalty and those intended to encourage and simplify repeat purchasing. Actions like those discussed earlier for improving the quality of a firm's offering and for reducing costs suggest ways to increase customer satisfaction and loyalty. Similarly, improvements to service quality, such as just-in-time delivery arrangements or computerised reordering systems, can help encourage repeat purchases.

Since markets often become more fragmented as they grow and mature, share leaders also may have to expand their product lines, or add one or more *flanker* brands, to protect their position against competitive inroads. Thus, Johnson Controls has strengthened its position in the commercial facilities management arena by expanding its array of services through a combination of acquisitions and continued internal development. Many of those new services were developed in response to changing customer desires or emerging environmental trends, such as the growing demand for 'greener' commercial buildings with more sustainable energy requirements and a smaller impact on the natural environment.

Small-share competitors also can earn substantial profits in a mature market. To do so, however, it is often wise for them to focus on strategies that avoid prolonged direct confrontations with larger share leaders. A *niche strategy* can be particularly effective when the target segment is too small to appeal to larger competitors or when the smaller firm can establish a strong differential advantage or brand preference in the segment. For instance, with only 50 hotels worldwide, the Four Seasons chain is a small player in the lodging industry. But by focusing on the high end of the business travel market, the chain has grown and prospered. The chain's hotels differentiate themselves by offering a wide range of amenities, such as free overnight shoeshines, that are important to business travellers. Thus, while they charge relatively high prices, they also are seen as delivering good value.

### 17.3.2 Strategies for Extending Volume Growth

Market maturity is defined by a flattening of the growth rate. In some instances growth slows for structural reasons, such as the emergence of substitute products or a shift in customer preferences. Marketers can do little to revitalise the market under such conditions. But in some cases a market only *appears* to be mature because of the limitations of current marketing programmes, such as target segments that are too narrowly defined or limited product offerings. Here, more innovative or aggressive marketing strategies might successfully extend the market's life cycle into a period of renewed growth. Thus, *stimulating additional volume* growth can be an important secondary objective under such circumstances, particularly for industry share leaders because they often can capture a relatively large share of any additional volume generated.

A firm might pursue several different marketing strategies – either singly or in combination – to squeeze additional volume from a mature market. These include an *increased penetration strategy, an extended use strategy*, and a *market expansion strategy*. Exhibit 17.8 summarises the environmental situations where each of these strategies is most appropriate and the objectives each is best suited for accomplishing. Exhibit 17.9 then outlines specific marketing actions a firm might employ to implement each of the strategies, as discussed in more detail in the following paragraphs.

**Exhibit 17.8 Situational determinants of appropriate marketing objectives and strategies for extending growth in mature markets**

| | Growth-extension strategies | | |
|---|---|---|---|
| **Situational variables** | **Increased penetration** | **Extended use** | **Market expansion** |
| Primary objective | Increase the proportion of users by converting current nonusers in one or more major market segments. | Increase the amount of product used by the average customer by increasing frequency of use or developing new and more varied ways to use the product. | Expand the number of potential customers by targeting underdeveloped geographic areas or applications segments. |
| Market characteristics | Relatively low penetration in one or more segments (i.e. low percentage of potential users have adopted the product); relatively homogeneous market with only a few large segments. | Relatively high penetration but low frequency of use in one or more major segments; product used in only limited ways or for special occasions; relatively homogeneous market with only a few large segments. | Relatively heterogeneous market with a variety of segments; some geographic areas, including foreign countries, with low penetration; some product applications underdeveloped. |
| Competitor characteristics | Competitors hold relatively small market shares; comparatively limited resources or competencies make it unlikely they will steal a significant portion of converted nonusers. | Competitors hold relatively small market shares; comparatively limited resources or competencies make it unlikely their brands will be purchased for newly developed uses. | Competitors hold relatively small market shares; have insufficient resources or competencies to pre-empt underdeveloped geographic areas or applications segments. |
| Firm characteristics | A market share leader in the industry; has R&D and marketing competencies to produce product modifications or line extensions; has promotional resources to stimulate primary demand among current nonusers. | A market share leader in the industry; has marketing competencies and resources to develop and promote new uses. | A market share leader in the industry; has marketing and distribution competencies and resources to develop new global markets or applications segments. |

**Exhibit 17.9 Possible marketing actions for accomplishing growth-extension objectives**

| Marketing strategy and objectives | Possible marketing actions |
|---|---|
| *Increased penetration* | |
| Convert current non-users in target segment into users | • Enhance product's value by adding features, benefits or services.<br>• Enhance product's value by including it in the design of integrated systems.<br>• Stimulate additional primary demand through promotional efforts stressing new features or benefits:<br>– Advertising through selective media aimed at the target segment.<br>– Sales promotions directed at stimulating trial among current nonusers (e.g. tie-ins with other products).<br>– Some sales efforts redirected towards new account generation; perhaps by assigning some sales personnel as account development reps or by offering incentives for new account sales.<br>• Improve product's availability by developing innovative distribution systems. |
| *Extended use* | |
| Increase frequency of use among current users | • Move storage of the product closer to the point of end use by offering additional package sizes or designs.<br>• Encourage larger volume purchases (for non-perishable products):<br>– Offer quantity discounts.<br>– Offer consumer promotions to stimulate volume purchases or more frequent use (e.g. multipack deals, frequent flier programmes).<br>• Reminder advertising stressing basic product benefits for a variety of usage occasions. |
| Encourage a wider variety of uses among current users | • Develop line extensions suitable for additional uses or applications.<br>• Develop and promote new uses, applications or recipes for the basic product.<br>– Include information about new applications/recipes on package.<br>– Develop extended-use advertising campaign, particularly with print media.<br>– Communicate new application ideas through sales presentations to current customers.<br>• Encourage new uses through sales promotions (e.g. tie-ins with complementary products). |
| *Market expansion* | |
| Develop differentiated positioning focused on untapped or underdeveloped segments | • Develop a differentiated flanker brand or product line with unique features or price that is more appealing to a segment of potential customers whose needs are not met by existing offerings.<br>Or<br>• Develop multiple line extensions or brand offerings with features or prices targeted to the unique needs and preferences of several smaller potential applications or regional segments.<br>• Consider producing for private labels. |

| Marketing strategy and objectives | Possible marketing actions |
|---|---|
| | • Design advertising, personal selling and/or sales promotion campaigns that address specific interests and concerns of potential customers in one or multiple underdeveloped segments to stimulate selective demand.<br>• Build unique distribution channels to more effectively reach potential customers in one or multiple underdeveloped segments.<br>• Design service programmes to reduce the perceived risks of trial and/or solve the unique problems faced by potential customers in one or multiple underdeveloped segments (e.g. systems engineering, installation, operator trailing, extended warranties).<br>• Enter global markets where product category is in an earlier stage of its life cycle. |

### 17.3.2.1 Increased Penetration Strategy

The total sales volume produced by a target segment of customers is a function of (1) the number of potential customers in the segment; (2) the product's penetration of that segment, that is, the proportion of potential customers who actually use the product; and (3) the average frequency with which customers consume the product and make another purchase. Where usage frequency is quite high among current customers but only a relatively small portion of all potential users actually buy the product, a firm might aim at increasing market penetration. It is an appropriate strategy for an industry's share leader because such firms can more likely gain and retain a substantial share of new customers than smaller firms with less-well-known brands.

The secret to a successful increased penetration strategy lies in discovering why nonusers are uninterested in the product. Very often the product does not offer sufficient value from the potential customer's view to justify the effort or expense involved in buying and using it. One obvious solution to such a problem is to enhance the product's value to potential customers by adding features or benefits, usually via line extensions.

Another way to add value to a product is to develop and sell integrated systems that help improve the basic product's performance or ease of use. For instance, instead of simply selling control mechanisms for heating and cooling systems, Johnson Controls offers integrated facilities management programmes designed to lower the total costs of operating a commercial building.

A firm also may enhance a product's value by offering services that improve its performance or ease of use for the potential customer. Since it is unlikely that people who do not know how to knit will ever buy yarn or knitting needles, for example, most yarn shops offer free knitting lessons.

Product modifications or line extensions, however, will not attract nonusers unless the enhanced benefits are effectively promoted. For industrial goods, this may mean redirecting some sales efforts toward nonusers. The firm may offer additional incentives for new account sales or assign specific salespeople to call on targeted nonusers and convert them into new customers. For consumer goods, some combination of advertising to stimulate primary demand in the target segment and sales promotions to encourage trial, such as free samples or tie-in promotions with complementary products that nonusers currently buy, can be effective.

Finally, some potential customers may be having trouble finding the product due to limited distribution, or the product's benefits may simply be too modest to justify much purchasing effort. In such cases, expanding distribution or developing more convenient and accessible channels may help expand market penetration. For example, few travellers are so leery of flying that they would go through the effort of calling an insurance agent to buy an accident policy for a single flight. But the sales of such policies are greatly increased by making them conveniently available through vending machines in airport terminals.

### 17.3.2.2 Extended Use Strategy

Some years ago, the manager of General Foods' Cool Whip frozen dessert topping discovered through marketing research that nearly three-quarters of all US households used the product, but the average consumer used it only four times per year and served it on only 7 per cent of all toppable desserts. In situations of good market penetration but low frequency of use, an extended use strategy may increase volume. This was particularly true in the Cool Whip case; the relatively large and homogeneous target market consisted for the most part of a single mass-market segment. Also, General Foods held nearly a two-thirds share of the frozen topping market, and it had the marketing resources and competencies to capture most of the additional volume that an extended use strategy might generate.

One effective approach for stimulating increased frequency of use is to move product inventories closer to the point of use. This approach works particularly well with low-involvement consumer goods. Marketers know that most consumers are unlikely to expend any additional time or effort to obtain such products when they are ready to use them. If there is no Cool Whip in the refrigerator when the consumer is preparing dessert, for instance, he or she is unlikely to run to the store immediately and probably will serve the dessert without topping.

One obvious way to move inventory closer to the point of consumption is to offer larger package sizes. The more customers buy at one time, the less likely they are to be out of stock when a usage opportunity arises. This approach can backfire, though, for a perishable product or one that consumers perceive to be an impulse indulgence. Thus, most superpremium ice creams, such as Häagen-Dazs, are sold in small pint containers; most consumers want to avoid the temptation of having large quantities of such a high-calorie indulgence too readily available.

The design of a package also can help increase use frequency by making the product more convenient or easy to use. Examples include single-serving packages of pudding or salad to pack in lunches, packages of paper cups that include a convenient dispenser, and frozen-food packages that can go directly into a microwave oven.

Various sales promotion programmes also help move inventories of a product closer to the point of use by encouraging larger volume purchases. Marketers commonly offer quantity discounts for this purpose in selling industrial goods. For consumer products, multi-item discounts or two-for-one deals serve the same purpose. Promotional programmes also encourage greater frequency of use and increase customer loyalty in many service industries. Consider, for instance, the frequent-flier programmes offered by major airlines.

Sometimes the product's characteristics inhibit customers from using it more frequently. If marketers can change those characteristics, such as difficulty of preparation or high calories, a new line extension might encourage customers to use more of the product or to use it more often. Microwave waffles and low-calorie salad dressings are examples of such line extensions. For industrial goods, however, firms may have to develop new technology to overcome a product's limitations for some applications. For instance, Johnson Controls recently acquired Prince Automotive to gain the expertise necessary to develop instrument panels and consoles incorporating the sophisticated electronics desired by top-end manufacturers such as BMW and Mercedes-Benz.

Finally, advertising can sometimes effectively increase use frequency by simply reminding customers to use the product more often. For instance, General Foods conducted a reminder campaign for Jell-O pudding that featured Bill Cosby asking, 'When was the last time you served pudding, Mom?'

Another approach for extending use among current customers involves finding and promoting new functional uses for the product. Jell-O gelatin is a classic example, having generated substantial new sales volume over the years by promoting the use of Jell-O as an ingredient in salads, pie fillings, and other dishes.

Firms promote new ways to use a product through a variety of methods. For industrial products, firms send technical advisories about new applications to the salesforce to present to their customers during regular sales calls. For consumer products, new use suggestions or recipes may be included on the package, in an advertising campaign, or on the firm's website. Sales promotions, such as including cents-off coupons in ads featuring a new recipe, encourage customers to try a new application. In some cases, slightly modified line extensions might encourage customers to use the product in different ways. Thus, Kraft introduced a jalapeño-flavoured Cheese-Whiz in a microwavable container and promoted the product as an easy-to-prepare topping for nachos.

#### 17.3.2.3 Market Expansion Strategy

In a mature industry with a fragmented and heterogeneous market where some segments are less well developed than others, a market expansion strategy may generate substantial additional volume growth. Such a strategy aims at gaining new customers by targeting new or underdeveloped geographic markets (either regional or foreign) or new customer segments. Once again, share leaders tend to be best suited for implementing this strategy. But even smaller competitors can employ such a strategy successfully if they focus on relatively small or specialised market niches.

Pursuing market expansion by strengthening a firm's position in new or underdeveloped **domestic geographic markets** can lead to experience-curve benefits and operating synergies. The firm can rely on largely the same expertise and technology, and perhaps even the same production and distribution facilities, it has already developed. Unfortunately, domestic geographic expansion is often not viable in a mature industry because the share leaders usually have attained national market coverage. Smaller regional competitors, on the other hand, might consider domestic geographic expansion a means for improving their volume and share position. However, such a move risks retaliation from the large national brands as well as from entrenched regional competitors in the prospective new territory.

To get around the retaliation problem, a regional producer might try to expand through the acquisition of small producers in other regions. This can be a viable option when (1) the low profitability of some regional producers enables the acquiring firm to buy their assets for less than the replacement cost of the capacity involved and (2) synergies gained by combining regional operations and the infusion of resources from the acquiring firm can improve the effectiveness and profitability of the acquired producers. For example, Clear Channel Worldwide, founded in 1972, and which was by 2003 the fourth largest media company in the world behind Disney, Time Warner, and Viacom/CBS, got its start when the founders Lowry Mays and Billy Joe McCombs acquired an unprofitable country-music radio station in San Antonio, Texas. It then grew, first by slowly buying over other radio stations in a variety of US states, and then by acquiring small, struggling TV stations and outdoor advertising companies. Clear Channel's strategy was to buy radio, TV and outdoor advertising properties with operations in many of the same local markets; share facilities and staff to cut costs; improve programming; and sell advertising to customers in packages for all three media simultaneously. As a result the company achieved significant cost savings and boosted profit margins.

In a different approach to domestic market expansion, the firm identifies and develops entirely **new customer** or **application segments**. Sometimes the firm can effectively reach new customer segments by simply expanding the distribution system without changing the product's characteristics or the other marketing-mix elements. A sporting goods manufacturer that sells its products to consumers through retail stores, for instance, might expand into the commercial market consisting of schools and amateur and professional sports teams by establishing a direct salesforce. In most instances, though, developing new market segments requires modifying the product to make it more suitable for the application or to provide more of the benefits desired by customers in the new segment.

One final possibility for domestic market expansion is to produce **private-label brands** for large retailers. Firms whose own brands hold relatively weak positions and who have excess production capacity find this a particularly attractive option. Private labelling allows such firms to gain access to established customer segments without making substantial marketing expenditures, thus increasing the firm's volume and lowering its per-unit costs. However, since private labels typically compete with low prices and their sponsors usually have strong bargaining power, producing private labels is often not a very profitable option unless a manufacturer already has a relatively low-cost position in the industry. It also can be a risky strategy, particularly for the smaller firm, because reliance on one or a few large private-label customers can result in drastic volume reductions and unit-cost increases should those customers decide to switch suppliers.[30]

### 17.3.2.4 Global Market Expansion – Sequential Strategies

For firms with leading positions in mature domestic markets, less-developed markets in foreign countries often present the most viable opportunities for geographic expansion. As discussed in previous modules, firms can enter foreign markets in a variety of ways, from simply relying on import agents to developing joint ventures to establishing wholly owned subsidiaries – as Johnson Controls has done by acquiring automotive seat and battery manufacturers in Europe.

Regardless of which mode of entry a firm chooses, it can follow a number of different routes when pursuing global expansion.[31] By *route* we mean the sequence or order in which the firm enters global markets. Japanese companies provide illustrations of different global expansion paths. The most common expansion route involves moving from Japan to developing countries to developed countries. They used this path, for example, with automobiles (Toyota), consumer electronics (National), watches (Seiko), cameras (Minolta), and home appliances, steel, and petrochemicals. This routing reduced manufacturing costs and enabled them to gain marketing experience. In penetrating the US market, the Japanese obtained further economies of scale and gained recognition for their products, which made penetration of European markets easier.

A second type of *expansion path* has been used primarily for high-tech products such as computers and semiconductors. For the Japanese it consists of first securing their home market and then targeting developed countries. Japan largely ignored developing countries in this strategy because of their small demand for high-tech products. When demand increased to a point where developing countries became 'interesting,' Japanese producers quickly entered and established strong market positions using price cuts of up to 50 per cent.

A home market – developed markets – developing markets sequence is also usually appropriate for discretionary goods such as soft drinks, convenience foods, or cosmetics. Coca-Cola, for instance, believes that as disposable incomes and discretionary expenditures grow in the countries of South America, Asia, and Africa those markets will drive much of the company's future growth. Similarly, firms such as the French cosmetics giant L'Oréal have positioned a number of different 'world brands' – including Ralph Lauren perfumes, L'Oréal hair products, and Maybelline and Helena Rubinstein cosmetics – to convey the allure of different cultures to developing markets around the world.[32]

## 17.4 Strategies for Declining Markets

Most products eventually enter a decline phase in their life cycles. As sales decline, excess capacity once again develops. As the remaining competitors fight to hold volume in the face of falling sales, industry profits erode. Consequently, conventional wisdom suggests that firms should either divest declining products quickly or harvest them to maximise short-term profits. Not all markets decline in the same way or at the same speed, however; nor do all firms have the same competitive strengths and weaknesses within those markets. Therefore, as in most other situations, the relative attractiveness of the declining product-market and the business's competitive position within it should dictate the appropriate strategy.

### 17.4.1 Relative Attractiveness of Declining Markets

Although US high school enrolment declined by about 2 million students from its peak in 1976 through the early 1990s, Jostens, Inc., the leading manufacturer of class rings and other school merchandise, achieved annual increases in revenues and profits every year during that period. One reason for the firm's success was that it saw the market decline coming and prepared for it by improving the efficiency of its operations and developing marketing programmes that were effective at persuading a larger proportion of students to buy class rings.

Jostens' experience shows that some declining product-markets can offer attractive opportunities well into the future, at least for one or a few strong competitors. In other product-markets, particularly those where decline is the result of customers switching to a new technology (e.g., more students buying personal computers instead of portable typewriters), the potential for continued profits during the decline stage is more bleak.

Three sets of factors help determine the strategic attractiveness of declining product-markets: *conditions of demand*, including the rate and certainty of future declines in volume; *exit barriers*, or the ease with which weaker competitors can leave the market; and factors affecting the *intensity of future competitive rivalry* within the market.[33] The impact of these variables on the attractiveness of declining market environments is summarised in Exhibit 17.10 and discussed below.

#### 17.4.1.1 Conditions of Demand

Demand in a product-market declines for a number of reasons. Technological advances produce substitute products (such as electronic calculators for slide rules), often with higher quality or lower cost. Demographic shifts lead to a shrinking target market (baby foods). Customers' needs, tastes, or lifestyles change (the falling consumption of beef). Finally, the cost of inputs or complementary products rises and shrinks demand (the effects of rising gasoline prices on sales of recreational vehicles).

**Exhibit 17.10 Factors affecting the attractiveness of declining market environments**

| | **Environmental attractiveness** | |
|---|---|---|
| | **Hospitable** | **Inhospitable** |
| *Conditions of demand* | | |
| Speed of decline | Very slow | Rapid or erratic |
| Certainty of decline | 100 per cent certain predictable patterns | Great uncertainty, erratic patterns |
| Pockets of enduring demand | Several or major ones | No niches |
| Product differentiation | Brand loyalty | Commodity-like products |
| Price stability | Stable, price premiums attainable | Very unstable, pricing below costs |

| | Environmental attractiveness | |
|---|---|---|
| | **Hospitable** | **Inhospitable** |
| *Exit barriers* | | |
| Reinvestment requirements | None | High, often mandatory and involving capital assets |
| Excess capacity | Little | Substantial |
| Asset age | Mostly old assets | Sizeable new assets and old ones not retired |
| Resale markets for assets | Easy to convert or sell | No markets available, substantial costs to retire |
| Shared facilities | Few free-standing plants | Substantial and interconnected with important businesses |
| Vertical integration | Little | Substantial |
| Single-product competitors | None | Several large companies |
| *Rivalry determinants* | | |
| Customer industries | Fragmented, weak | Strong bargaining power |
| Customer switching costs | High | Minimal |
| Diseconomies of scale | None | Substantial penalty |
| Dissimilar strategic groups | Few | Several in same target markets |

*Source*: Kathryn Rudie Harrigan and Michael E. Porter, 'End-Game Strategies for Declining Industries', *Harvard Business Review*, July–August 1983, p. 117.

The cause of a decline in demand can affect both the rate and the predictability of that decline. A fall in sales due to a demographic shift, for instance, is likely to be gradual, whereas the switch to a technically superior substitute can be abrupt. Similarly, the fall in demand as customers switch to a better substitute is predictable, while a decline in sales due to a change in tastes is not.

As Exhibit 17.10 indicates, both the rate and certainty of sales decline are demand characteristics that affect a market's attractiveness. A slow and gradual decline allows an orderly withdrawal of weaker competitors. Overcapacity does not become excessive and lead to predatory competitive behaviour, and the competitors who remain are more likely to make profits than in a quick or erratic decline. Also, when most industry managers believe market decline is predictable and certain, reduction of capacity is more likely to be orderly than when they feel substantial uncertainty about whether demand might level off or even become revitalised.

Not all segments of a market decline at the same time or at the same rate. The number and size of enduring niches or pockets of demand and the customer purchase behaviour within them also influence the continuing attractiveness of the market. When the demand pockets are large or numerous and the customers in those niches are brand loyal and relatively insensitive to price, competitors with large shares and differentiated products can continue to make substantial profits. For example, even though the market for cigars shrank for years, there continued to be a sizable number of smokers who bought premium-quality cigars. Those firms with well-established positions at the premium end of the cigar industry have continued to earn above-average returns. And recently, the cigar market has been growing again.

#### 17.4.1.2 Exit Barriers

The higher the exit barriers, the less hospitable a product-market will be during the decline phase of its life cycle. When weaker competitors find it hard to leave a product-market as demand falls, excess capacity develops and firms engage in aggressive pricing or promotional efforts to try to prop up their volume and hold down unit costs. Thus, exit barriers lead to competitive volatility.

Once again, Exhibit 17.10 indicates that a variety of factors influence the ease with which businesses can exit an industry. One critical consideration involves the amount of highly specialised assets. Assets unique to a given business are difficult to divest because of their low liquidation value. The only potential buyers for such assets are other firms who would use them for a similar purpose, which is unlikely in a declining industry. Thus, the firm may have little choice but to remain in the business or to sell the assets for their scrap value. This option is particularly unattractive when the assets are relatively new and not fully depreciated.

Another major exit barrier occurs when the assets or resources of the declining business intertwine with the firm's other business units, either through shared facilities and programmes or through vertical integration. Exit from the declining business might shut down shared production facilities, lower salesforce commissions, damage customer relations, and increase unit costs in the firm's other businesses to a point that damages their profitability. Emotional factors also can act as exit barriers. Managers often feel reluctant to admit failure by divesting a business even though it no longer produces acceptable returns. This is especially true when the business played an important role in the firm's history and it houses a large number of senior managers.

#### 17.4.1.3 Intensity of Future Competitive Rivalry

Even when substantial pockets of continuing demand remain within a declining business, it may not be wise for a firm to pursue them in the face of future intense competitive rivalry. In addition to exit barriers, other factors also affect the ability of the remaining firms to avoid intense price competition and maintain reasonable margins: size and bargaining power of the customers who continue to buy the product; customers' ability to switch to substitute products or to alternative suppliers; and any potential diseconomies of scale involved in capturing an increased share of the remaining volume.

### 17.4.2 Divestment or Liquidation

When the market environment in a declining industry is unattractive or a business has a relatively weak competitive position, the firm may recover more of its investment by selling the business in the early stages of decline rather than later. The earlier the business is sold, the more uncertain potential buyers are likely to be about the future direction of demand in the industry and thus the more likely that a willing buyer can be found. Thus, Raytheon sold its vacuum-tube business in the early

1960s even though transistors had just begun replacing tubes in radios and TV sets and there was still a strong replacement demand for tubes. By moving early, the firm achieved a much higher liquidation value than companies that tried to unload their tube-making facilities in the 1970s when the industry was clearly in its twilight years.[34]

Of course, the firm that divests early runs the risk that its forecast of the industry's future may be wrong. Also, quick divestment may not be possible if the firm faces high exit barriers, such as interdependencies across business units or customer expectations of continued product availability. By planning early for departure, however, the firm may be able to reduce some of those barriers before the liquidation is necessary.

### 17.4.3 Marketing Strategies for Remaining Competitors

Conventional wisdom suggests that a business remaining in a declining product-market should pursue a harvesting strategy aimed at maximising its cash flow in the short run. But such businesses also have other strategic options. They might attempt to maintain their position as the market declines, improve their position to become the profitable survivor, or focus efforts on one or more remaining demand pockets or market niches. Once again, the appropriateness of these strategies depends on factors affecting the attractiveness of the declining market and on the business's competitive strengths and weaknesses. Exhibit 17.11 summarises the situational determinants of the appropriateness of each strategy. Some of the marketing actions a firm might take to implement them are discussed next and listed in Exhibit 17.12.

**Exhibit 17.11 Situational determinants of appropriate marketing objectives and strategies for declining markets**

| | **Strategies for declining markets** | | | |
|---|---|---|---|---|
| **Situational variables** | **Harvesting** | **Maintenance** | **Profitable survivor** | **Niche** |
| Primary objective | Maximise short-term cash flow; maintain or increase margins even at the expense of a slow decline in market share. | Maintain share in short term as market declines, even if margins must be sacrificed. | Increase share of the declining market with an eye to future profits; encourage weaker competitors to leave. | Focus on strengthening position in one or a few relatively substantial segments with potential for future profits. |
| Market characteristics | Future market decline is certain, but likely to occur at a slow and steady rate. | Market has experienced recent declines, but future direction and attractiveness are currently hard to predict. | Future market decline is certain, but likely to occur at a slow and steady rate; substantial pockets of demand will continue to exist. | Overall market may decline quickly, but one or more segments will remain as demand pockets or will decay slowly. |

| Situational variables | Strategies for declining markets: Harvesting | Maintenance | Profitable survivor | Niche |
|---|---|---|---|---|
| Competitor characteristics | Few strong competitors; low exit barriers; future rivalry not likely to be intense. | Few strong competitors, but intensity of future rivalry is hard to predict. | Few strong competitors; exit barriers are low or can be reduced by firm's intervention. | One or more stronger competitors in mass market, but not in the target segment. |
| Firm's characteristics | Has a leading share position; has a substantial proportion of loyal customers who are likely to continue buying brand even if marketing support is reduced. | Has a leading share of the market and a relatively strong competitive position. | Has a leading share of the market and a strong competitive position; has superior resources or competencies necessary to encourage competitors to leave or to acquire them. | Has a sustainable competitive advantage in target segment, but overall resources may be limited. |

**Exhibit 17.12 Possible marketing actions appropriate for different strategies in declining markets**

| Marketing strategy and objectives | Possible marketing actions |
|---|---|
| *Harvesting strategy* | |
| Maximise short-term cash flow; maintain or increase margins even at the expense of market-share decline. | • Eliminate R&D expenditures and capital investments related to the business.<br>• Reduce marketing and sales budgets.<br>– Greatly reduce or eliminate advertising and sales promotion expenditures, with the possible exception of periodic reminder advertising targeted at current customers.<br>– Reduce trade promotions to minimum level necessary to prevent rapid loss of distribution coverage.<br>– Focus salesforce efforts on attaining repeat purchases from current customers.<br>• Seek ways to reduce production costs, even at the expense of slow erosion in product quality.<br>• Raise price if necessary to maintain margins. |
| *Maintenance strategy* | |
| Maintain market share for the short term, even at the expense of margins. | • Continue product and process R&D expenditures in short term aimed at maintaining or improving product quality.<br>• Continue maintenance levels of advertising and sales promotion targeted at current users.<br>• Continue trade promotion at levels sufficient to avoid any reduction in distribution coverage. |

| Marketing strategy and objectives | Possible marketing actions |
| --- | --- |
| | • Focus salesforce efforts on attaining repeat purchases from current users.<br>• Lower prices if necessary to maintain share, even at the expense of reduced margins. |
| *Profitable survivor strategy*<br>Increase share of the declining market; encourage weaker competitors to leave. | • Signal competitors that firm intends to remain in industry and pursue an increased share.<br>– Maintain or increase advertising and sales promotion budgets.<br>– Maintain or increase distribution coverage through aggressive trade promotion.<br>– Focus some salesforce effort on winning away competitors' customers<br>– Continue product and process R&D to seek product improvements or cost reductions.<br>• Consider introducing line extensions to appeal to remaining demand segments.<br>• Lower prices if necessary to increase share, even at the expense of short-term margins.<br>• Consider agreements to produce replacement parts or private labels for smaller competitors considering getting out of production. |
| *Niche strategy*<br>Strengthen share position in one or a few segments with potential for continued profit. | • Continue product and process R&D aimed at product improvements or modifications that will appeal to target segment(s).<br>• Consider producing for private labels in order to maintain volume and hold down unit costs.<br>• Focus advertising, sales promotion and personal selling campaigns on customers in target segment(s); stress appeals of greatest importance to those customers.<br>• Maintain distribution channels appropriate for reaching target segment; seek unique channel arrangements to more effectively reach customers in target segment(s).<br>• Design service programmes that address unique concerns/problems of customers in the target segment(s). |

### 17.4.3.1 Harvesting Strategy

The objective of a harvesting or milking strategy is to generate cash quickly by maximising cash flow over a relatively short term. This typically involves avoiding any additional investment in the business, greatly reducing operating (including marketing) expenses, and perhaps raising prices. Since the firm usually expects to ultimately divest or abandon the business, some loss of sales and market share during the pursuit of this strategy is likely. The trick is to hold the business's volume and share declines to a relatively slow and steady rate. A precipitous and premature loss of share would limit the total amount of cash the business could generate during the market's decline.

A harvesting strategy is most appropriate for a firm holding a relatively strong competitive position in the market at the start of the decline and a cadre of current customers likely to continue buying the brand even after marketing support is reduced. Such a strategy also works best when the market's decline is inevitable but likely to occur at a relatively slow and steady rate and when rivalry among remaining competitors is not likely to be very intense. Such conditions enable the business to maintain adequate price levels and profit margins as volume gradually falls.

Implementing a harvesting strategy means avoiding any additional long-term investments in plant, equipment, or R&D. It also necessitates substantial cuts in operating expenditures for marketing activities. This often means that the firm should greatly reduce the number of models or package sizes in its product line to reduce inventory and manufacturing costs.

The business should improve the efficiency of sales and distribution. For instance, an industrial goods manufacturer might service its smaller accounts through telemarketing or a website rather than a field salesforce or assign its smaller customers to agent middlemen. For consumer goods, the business might move to more selective distribution by concentrating its efforts on the larger retail chains.

The firm would likely reduce advertising and promotion expenditures, usually to the minimum level necessary to retain adequate distribution. Finally, the business should attempt to maintain or perhaps even increase its price levels to increase margins.

#### 17.4.3.2 Maintenance Strategy

In markets where future volume trends are highly uncertain, a business with a leading share position might consider pursuing a strategy aimed at maintaining its market share, at least until the market's future becomes more predictable. In such a maintenance strategy, the business continues to pursue the same strategy that brought it success during the market's mature stage. This approach often results in reduced margins and profits in the short term, though, because firms usually must reduce prices or increase marketing expenditures to hold share in the face of declining industry volume. Thus, a firm should consider share maintenance an interim strategy. Once it becomes clear that the market will continue to decline, the business should switch to a different strategy that will provide better cash flows and return on investment over the market's remaining life.

#### 17.4.3.3 Profitable Survivor Strategy

An aggressive alternative for a business with a strong share position and a sustainable competitive advantage in a declining product-market is to invest enough to increase its share position and establish itself as the industry leader for the remainder of the market's decline. This kind of strategy makes most sense when the firm expects a gradual decline in market demand or when substantial pockets of continuing demand are likely well into the future. It is also an attractive strategy when a firm's declining business is closely intertwined with other SBUs through shared facilities and programmes or common customer segments.

A strong competitor often can improve its share position in a declining market at relatively low cost because other competitors may be harvesting their businesses or preparing to exit. The key to the success of such a strategy is to encourage other competitors to leave the market early. Once the firm has achieved a strong and unchallenged position, it can switch to a harvesting strategy and reap substantial profits over the remaining life of the product-market.

A firm might encourage smaller competitors to abandon the industry by being visible and explicit about its commitment to become the leading survivor. It should aggressively seek increased market share, either by cutting prices or by increasing advertising and promotion expenditures. It also might introduce line extensions aimed at remaining pockets of demand to make it more difficult for smaller competitors to find profitable niches. Finally, the firm might act to reduce its competitors' exit barriers, making it easier for them to leave the industry. This could involve taking over competitors' long-term contracts, agreeing to supply spare parts or to service their products in the field, or providing them with components or private-label products. For instance, large regional bakeries have encouraged grocery chains to abandon their own bakery operations by supplying them with private-label baked goods.

The ultimate way to remove competitors' exit barriers is to purchase their operations and either improve their efficiency or remove them from the industry to avoid excess capacity. With continued decline in industry sales a certainty, smaller competitors may be forced to sell their assets at a book value price low enough for the survivor to reap high returns on its investment, as Clear Channel did on its acquisitions of smaller media companies during the 1970s, 1980s and 1990s.

### 17.4.3.4 Niche Strategy

Even when most segments of an industry are expected to decline rapidly, a niche strategy may still be viable if one or more substantial segments will either remain as stable pockets of demand or decay slowly. The business pursuing such a strategy should have a strong competitive position in the target segment or be able to build a sustainable competitive advantage relatively quickly to pre-empt competitors. This is one strategy that even smaller competitors can sometimes successfully pursue, because they can focus the required assets and resources on a limited portion of the total market. The marketing actions a business might take to strengthen and preserve its position in a target niche are similar to those discussed earlier concerning niche strategies in mature markets.

## Learning Summary

- Strategic choices in mature, or even declining, markets are by no means always bleak. Many of the world's most profitable companies operate largely in such markets.

- A critical marketing objective for all competitors in a mature market is to maintain the loyalty of existing customers. To accomplish that goal, firms must pursue improvements in the perceived value those customers receive from their offerings – either by differentiating themselves on the basis of superior quality or service, by lowering costs and prices, or both.
- An important secondary objective for some firms, particularly share leaders, in mature markets is to stimulate further volume growth by taking actions to convert nonusers into users, to increase use frequency among current users, or to expand into untapped or underdeveloped markets.
- Declining markets can still offer attractive opportunities for sales revenues and profits. Their attractiveness – and the appropriate marketing strategy to follow – depends on, among other things, the pace and certainty of market decline, the presence of exit barriers, the firm's competitive strengths, and the likely intensity of future competition.

## Review Questions

## Content Questions

17.1 Success in mature markets requires two sets of strategic actions. What are they?

17.2 What strategy options are available to both analysers and defenders in their attempt to sustain a competitive advantage in mature markets?

17.3 What dimensions do customers use to perceive underlying differences across products in a given category?

17.4 What dimensions do customers use to judge the quality of the services they receive?

17.5 What are the more important ways in which a company can improve customer perceptions of service quality?

17.6 Discuss briefly the various ways a firm can maintain a low-cost position.

17.7 What should a firm strive to achieve during the early years of market maturity?

17.8 Discuss the strategies that can be used to extend the volume growth of products.

17.9 Discuss briefly how a firm can use sequential strategies to expand a global market.

17.10 What are the three sets of factors that help determine the strategic attractiveness of declining product-markets?

17.11 Discuss briefly the strategic options possible in declining markets.

## Multiple Choice Questions

17.12 When the growth rate in a product-market declines and weaker businesses fail, withdraw from the industry or are acquired by other companies, this phenomenon is called:

A. harvesting.
B. shakeout.
C. market penetration.
D. a niche strategy.
E. low-cost efficiency.

17.13 When the product-market growth rate declines and companies acquire weaker brands, this is called:

A. consolidation.
B. niching.
C. harvesting.
D. defending.
E. a fortress strategy.

17.14 Firms following a low-cost strategy in mature markets should:

A. focus exclusively on enhancing their operational efficiency.
B. raise their prices to increase profitability.
C. expand by acquiring less efficient brands.
D. focus on differentiating their offerings within the constraints of their strategy.
E. introduce a superior, high-priced flanker brand.

17.15 Understanding the differences consumers perceive across competitive product offerings is primary to developing:

A. product reliability.
B. product differentiation.
C. an analyser strategy.
D. R&D conformance and specifications.
E. a product quality based competitive advantage.

17.16 Asking the questions, 'How well does this clothes dryer dry wet clothes?' or 'Does this flight show a movie?' are examples of:

A. durability and features, respectively.
B. serviceability and performance, respectively.
C. reliability and features, respectively.
D. performance and features, respectively.
E. features and performance, respectively.

17.17 Asking the questions, 'Will the answering machine record my calls this time?' and 'How long will this refrigerator last?' are examples of:

A. durability and features, respectively.
B. performance and reliability, respectively.
C. reliability and features, respectively.
D. reliability and durability, respectively.
E. durability and performance, respectively.

17.18 Which dimension of product quality attempts to answer the question: 'Does this new Ford Escort car look and feel like a high-quality product?'

A. Reliability.
B. Performance.
C. Brand name.
D. Fit and finish.
E. Features.

17.19 The tag line of an airline's television advertisements was, 'We love to fly and it shows', which followed scenes of caring stewardesses and pilots attending to customers' needs. This illustrates what service-quality dimension?

A. Responsiveness.
B. Reliability.
C. Empathy.
D. Assurance.
E. Performance.

17.20 When Pizza Hut promised to provide its lunch time customers with a small pizza in 5 minutes or it would be free, it was trying to enforce which service quality dimension?

A. Responsiveness.
B. Reliability.
C. Empathy.
D. Assurance.
E. Performance.

17.21 An advertisement for a car repair shop that features a mechanic who claims to inspect your car's brakes carefully and to do the repairs 'just right', is trying to illustrate which service quality
dimension?

A. Responsiveness.
B. Reliability.
C. Empathy.
D. Assurance.
E. Performance.

17.22 A restaurant advertisement that promises 'the same great meals every time you come' is trying to illustrate which service quality dimension?

A. Responsiveness.
B. Reliability.
C. Empathy.
D. Assurance.
E. Performance.

17.23 As a dimension of service quality, empathy is defined by:

A. the believability and honesty of employees.
B. the friendliness of customer contact.
C. keeping the customers informed in language they can understand.
D. the amount of caring, individualised attention the firm provides to its customers.
E. the ability to perform the promised service properly the first time.

17.24 Responding to research that suggests consumers want brighter lobbies, Citibank doubles the wattage of the bulbs in its banks' lobbies, but now customers say the lobbies are glaringly harsh. This illustrates which service quality gap?

A. Customer's expectations and marketers perceptions.
B. Management's perceptions and service quality specifications.
C. Service quality specifications and service delivery.
D. Service delivery and external communications.
E. Perceived and expected service

17.25 Responding to complaints about the time it took to get served, the management of a local restaurant developed a policy that customers must be approached by their server within three minutes of being seated. The fact that the problem remains probably illustrates which service-quality gap?

A. Customer's expectations and marketer's perceptions.
B. Management's perceptions and service-quality specifications.
C. Service-quality specifications and service delivery.
D. Service delivery and external communications.
E. Perceived and expected service.

17.26 The gap between service delivery and external communications is best illustrated by a situation where:

A. a bank advertises friendly tellers and, in fact, tellers are regularly discourteous.
B. bank executives think customers want friendly tellers when, in fact, they value convenience more.
C. managers fail to specify actions tellers should take to appear friendly.
D. bank tellers know what is expected of them in terms of friendliness, but lack incentives to comply.
E. bank tellers are not as friendly as customers hoped they would be.

17.27 Management has diligently attended to all of its customers' service-quality complaints, but its customers are still dissatisfied. This illustrates which service-quality gap?

A. Customers' expectations and marketer's perceptions.
B. Management's perceptions and service-quality specifications.
C. Service-quality specifications and service delivery.
D. Service delivery and external communications.
E. Perceived and expected service.

17.28 Consumers develop their expectations of service quality from:

A. past experiences.
B. word-of-mouth communications.
C. personal needs.
D. all of the above.
E. only A and B above.

17.29 In terms of the service-quality model, which of the following is an example of an external communication?

A. Past experiences.
B. Word-of-mouth communications.
C. A newspaper coupon.
D. A billboard claiming 'fastest service in town'.
E. All of the above.

17.30 All of the following are ways to maintain a low-cost position EXCEPT:

A. shorter production runs.
B. lower overhead.
C. innovative product features.
D. low-cost distribution methods.
E. low-cost sources of supply.

17.31 A strategy designed to increase the proportion of users by converting current nonusers in one or more major market segments is a(n) _____ growth-extension strategy.

A. increased-penetration.
B. profitable-survivor.
C. extended-use.
D. maintenance.
E. market-expansion.

17.32 Increasing the amount of product used by the average customer by increasing the frequency of use or developing new and more varied ways to use the product is a(n) _____ growth-extension strategy.

A. increased-penetration.
B. profitable-survivor.
C. market-expansion.
D. maintenance.
E. extended-use.

17.33 An appliance manufacturer that advertises its microwave ovens to laggards (who have not previously purchased a microwave) is attempting a(n) _____ growth-extension strategy.

A. maintenance.
B. extended-use.
C. increased-penetration.
D. niche.
E. market-expansion.

17.34 A hair shampoo maker who tries, through his advertising, to encourage users to shampoo twice instead of only once per day is pursuing a(n) _____ growth-extension strategy:

A. maintenance.
B. niche.
C. extended use.
D. market expansion.
E. increased penetration.

17.35 A market-expansion growth-extension strategy is exemplified by the baby food manufacturing firm that:

A. attempts to convince parents in the domestic market who prepare their own baby's food to purchase commercial food.
B. attempts to persuade parents to increase the amount of commercially prepared baby food they feed their children.
C. focuses on a niche in the baby food market.
D. selectively withdraws from several areas of the commercial baby food market.
E. attempts to export to countries that do not presently use commercial baby food.

17.36 Offering larger package sizes:

A. moves product inventories closer to the point of use because customers are less likely to be out of stock when a usage opportunity arises.
B. moves product inventories closer to the point of use because customers are more likely to buy multiple packages.
C. moves product inventories farther away from point of use because customers are likely to come into retail outlets that carry the merchandise less often.
D. moves product inventories farther away from the point of use because large containers are less convenient.
E. does not affect the distance of inventories from the point of use.

17.37 The most common global expansion route was the one followed by such firms as Toyota and Seiko. The path is: home market then markets in _____ and _____.

A. the same continent; markets in other continents.
B. developing nations; markets in developed nations.
C. developed nations; markets in developing nations.
D. Western cultures; markets in Eastern cultures.
E. Eastern cultures; markets in Western cultures.

17.38 Market expansion through private-label production is a particularly attractive option for firms:

A. whose own brands hold a relatively weak position and which have excess production capacity.
B. whose own brands hold a relatively strong position and which have excess production capacity.
C. whose own brands hold a relatively weak position and which are operating at near-full capacity.
D. whose own brands hold a relatively strong brand and which have excess production capacity.
E. regardless of brand or production situation.

17.39 Maximising short-term cash flow is the primary objective of a _____ strategy.

A. harvesting.
B. maintenance.
C. profitable survivor.
D. niche.
E. differentiation.

17.40 A _____ strategy seeks to maintain share in the short term as the market declines, even if margins must be sacrificed.

A. harvesting.
B. profitable survivor.
C. maintenance.
D. niche.
E. differentiation.

17.41 When following a niche strategy in a rapidly declining market, a firm tends to focus on strengthening its position in one or a few relatively substantial segments. This often entails:

A. increasing advertising levels to make customers aware of all possible benefits.
B. raising prices to maintain profits.
C. lowering prices to increase share.
D. increasing R&D spending to keep the offerings current.
E. increasing R&D spending to keep costs down.

## Application Questions and Cases

17.42 A leading European airline has asked you, a consultant, to suggest areas the company should emphasise to differentiate itself from competing airlines. In so doing, you are told to assume that the airline would continue to be price competitive.

17.43 After completing your assignment from the European airline, you are asked to develop a procedure by which the company can measure customer loyalty and customer satisfaction. Outline your plan for measuring each of these two areas.

17.44 A Japanese company is one of the lowest-cost producers in the office copier industry, even though its market share and production volume is smaller than those of the industry leader, Xerox. How is it possible for a relatively small-volume producer to achieve a low-delivered-cost position?

17.45 During the 1980s and into the 1990s, McDonald's – which had attained several decades of outstanding growth by selling burgers and fries to American families with young children – aggressively sought franchisees in foreign countries, including Russia and China. The firm also introduced a wide variety of new product lines and line extensions (breakfast items like Egg McMuffin and hash brown potatoes, salads, Chicken McNuggets, McChicken sandwiches, etc.). What was the strategic rationale for these moves?

17.46 As McDonald's growth in the US market slowed, the firm first sought expansion into other North American and Western European countries. Subsequently, the firm has begun to expand into Latin America, Eastern Europe and Asia. How would you describe this route or sequence of global expansion? What demographic, economic and/or cultural factors might help explain such a pattern of market expansion?

17.47 The J. B. Kunz corporation, the leading manufacturer of passbooks for financial institutions, saw its market gradually decline during the 1970s and 1980s because the switch to electronic banking was making its product superfluous. Nevertheless, the firm bought up the assets of a number of smaller competitors, greatly increased its market share within its industry and managed to earn a very high return on investment. What kind of strategy was the company pursuing? Why do you think the firm was able to achieve a high ROI in the face of industry decline?

17.48 While we have seen that a business may have a number of other strategic options, the conventional wisdom suggests that a declining business should be either divested or harvested for maximum cash flow. Under what kinds of market and competitive conditions do each of these two conventional strategies make good sense? What kinds of marketing actions are typically involved in successfully implementing a harvesting strategy?

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# PART 5

# Implementation and Control

# Module 18

# Organising and Planning for Effective Implementation

## Contents



## Hewlett-Packard – Reorganising to Implement a New Strategy[1]

Throughout most of the 1990s, Hewlett-Packard was one of the most successful and admired firms in the global computer industry. A primary reason for HP's success during that period was its organisation structure. The firm was managed like a conglomerate of small ventures, each responsible for its own success. More than 130 business units were focused on specific product lines such as UNIX computers or inkjet printers, each employing fewer than 1500 people. And each SBU was granted substantial autonomy to pursue its own product and market development activities and to reinvest the capital generated by the unit.

Within HP's business units there was a heavy reliance on cross-functional teams. The PC unit, for example, was organised into small teams focused on different customer segments. The salesforce, too, was organised into teams focused on major accounts or application segments. HP's decentralised, team-based structure helped the firm stay in touch with changing customer needs and technical developments in each product category. And the SBUs were flexible enough to respond to those changes quickly. The result was a constant stream of product improvements and line extensions. More than half of the company's sales in 1995, for example, came from products that were not in existence two years earlier.

### *The Internet Changed the Firm's Market Environment*

Paradoxically, the decentralised and flexible structure that enabled HP to be so successful at developing new generations of PCs and printers made it difficult for the firm to respond quickly to changes in the market environment brought about by the growing popularity of the Internet. For instance, as firms embraced the World Wide Web, system integration became critical. A company's computers, servers, routers, and software all had to be designed – often with the help of experienced consultants – to work together seamlessly, both internally and with the Internet itself. Unfortunately, while the narrow product focus and high level of autonomy of HP's business units had enabled them to move quickly and creatively when bringing out the next generation of offerings within their own product domains, it hindered their ability to coordinate efforts across product categories. Consequently, while old competitors such as IBM and new ones such as Sun Microsystems were designing and selling integrated e-business systems, HP lacked the internal coordination mechanisms necessary to do so.

The autonomy and financial independence of HP's many business units also caused difficulty in developing innovative new technologies not directly related to an existing product category. A decision to devote substantial resources to a technology that fell outside the domain of existing SBUs required the consensus of the various unit managers; and gaining that consensus could take months or years, thereby giving competitors a head start. Worse, some promising new Internet technologies were never developed because the necessary consensus was never achieved.

As a result of the firm's lack of coordination and strategic focus, HP missed much of the early growth in Internet hardware, software, and e-services markets that occurred in the late 1990s. Sales and profits began to stagnate, the firm's share price dropped dramatically, and management got the message.

### *Reorganising to Implement a New Strategy*

One of the first steps toward correcting the problem taken by HP's board of directors was to bring in a new CEO from outside the company. Carly Fiorina was hired away from Lucent Technologies, where she had gained substantial experience developing and marketing gear for the new economy. Fiorina and other top managers quickly took several actions aimed at improving the coordination and sharpening the strategic focus of the company. They created four divisions – each headed by a divisional manager with CEO-like powers – to provide closer coordination and oversight for businesses making complementary goods and services without constraining their entrepreneurial spirit. For example, the UNIX computer and software and support units are now components of an Enterprise Computing Solutions Division, which is charged with combining computers and software into simple problem-solving packages for buyers, such as technology for helping small businesses set up shop on the Web.

Other steps aimed at improving the coordination of HP's Internet-related goods and services include increasing emphasis on e-commerce consulting services aimed at designing customised solutions for customers that utilise a wide range of HP hardware and software, changes in the compensation and reward system that increase the proportion of managers' pay tied to company sales and profit performance via bonuses and stock options, and a $100 million advertising campaign aimed at increasing customer awareness of the full range of Internet goods and services HP offers and improving the company's image as an e-commerce provider.

Finally, Fiorina created a new organisational entity, the E-Services Solutions Group, whose domain cuts across all of the other business units and divisions in the company. Its charge is to get the various business units to work in innovative ways with each other – and with outside partners – to develop new Web-based goods, services, and ways of doing business. The manager of the new group given a lot of authority to create, invest in, or acquire interesting Internet start-ups. And a large chunk of HP's $4 billion R&D budget was directed toward the development of new e-commerce systems and services. For example, the firm's research lab at Bristol, UK – its main research site in Europe – was directed to focus its efforts on e-services and e-publishing.

## Learning Objectives

This module examines several questions related to the issue of **organisational fit** – the fit between a business's competitive and marketing strategies and the organisational structures, policies, processes, and plans necessary to effectively implement those strategies.

- For companies with multiple business units or product lines, what is the appropriate administrative relationship between corporate headquarters and the individual SBUs? How much autonomy should business unit managers be given to make their own strategic decisions, how much control should they have over the SBU's resources and programmes, and how should they be evaluated and rewarded?
- Within a given business unit, whether it's part of a larger corporation or a one-product entrepreneurial start-up, what organisational structures and coordination mechanisms are most appropriate for implementing different competitive strategies? Answering this question involves decisions about variables such as the desired level of technical competence of the various functional departments within the business, the manner in which resources are allocated across those functions, and the mechanisms used to coordinate and resolve conflicts among the departments.
- How should organisational structures and policies be adjusted, if at all, as an organisation moves into international markets?

However, even if a business has crafted brilliant competitive and marketing strategies, and it has the necessary organisational arrangements and wherewithal to implement them, implementation is unlikely to be very effective unless all of the business's people are following the same plan. This fact underlines the importance of developing formal, written marketing plans to document all the decisions made in formulating the intended strategy for a given good or service so it can be clearly communicated to everyone responsible for its implementation and to firmly establish who is responsible for doing what and when.

This module examines the content of effective marketing plans in more detail and review the many strategic decisions involved in formulating that content. The purpose of these planning decisions is to lay a well-conceived foundation that permits effective implementation of the marketing strategy. While good planning is important, effective implementation is crucial.

## 18.1 Designing Appropriate Administrative Relationships for the Implementation of Different Competitive Strategies

In Module 3 we pointed out that businesses, whether small independent firms or units within a larger corporation, compete in different ways depending on their intended rate of new product-market development (i.e., prospectors versus analysers versus defenders) and whether they seek an advantage by differentiating themselves via superior product or service quality or by being the low-cost producer. For example, during the mid-1990s many of Hewlett-Packard's business units could be characterised as differentiated analysers. They were defending well-established share positions within their product domains by offering quality products while simultaneously investing in the development of more technically advanced product improvements and line extensions.

The chosen competitive strategy tends to influence the marketing strategies pursued by individual product offerings within the business unit, at least in the short term. The differentiated analyser strategies of Hewlett-Packard's businesses, for instance, demanded a willingness to cannibalise existing products in order to ensure the future. Consequently, the advertising and promotion budgets for many older products were slashed as more technically advanced models were introduced.

Because different competitive strategies seek to satisfy customers and gain a sustainable advantage in varying ways, different organisational structures, policies, and resources are necessary to effectively implement them.[2] For one thing, the administrative relationships between the unit and corporate headquarters influence the ability of SBU managers, including its marketing personnel, to implement specific competitive and marketing strategies successfully. This section examines three aspects of the corporate business unit relationship that can affect the SBU's success in implementing a particular competitive strategy:

1. The degree of autonomy provided each business unit manager.
2. The degree to which the business unit shares functional programmes and facilities with other units.
3. The manner in which the corporation evaluates and rewards the performance of its SBU managers.

Exhibit 18.1 itemises the appropriate marketing policies and strategies for each of the four business strategies we discussed in Module 3 – prospector, analyser, differentiated defender and low-cost defender.

**Exhibit 18.1 The fit between business strategies and marketing programmes**

| Appropriate marketing policies and strategies | Business strategies: Prospector | Analyser | Differentiated defender | Low-cost defender |
|---|---|---|---|---|
| Product and service policies | Broad, technically sophisticated product lines; moderate to high quality and levels of service; especially sales engineering services. | Moderately broad and technically sophisticated product lines; service levels and quality indeterminate. | Relatively narrow but high-quality and technically sophisticated product lines; high quality and levels of service. | Narrow, less technically sophisticated product lines; relatively low levels of quality and service. |
| Price policy | Relatively high prices. | Relatively high prices. | Relatively high prices. | Relatively low to competitive prices. |
| Distribution policies | Little forward vertical integration; relatively high trade-promotion expenses as a percentage of sales. | Degree of forward vertical integration non-determinant; moderate to high trade promotion expenses as a percentage of sales. | Relatively high degree of forward vertical integration; low trade promotion expenses as a percentage of sales. | Degree of forward vertical integration non-determinant; low trade-promotion expenses as a percentage of sales. |
| Promotion policies | High advertising, sales promotion, and salesforce expenditures as a percentage of sales. | Moderate advertising and sales promotion expenditures as a percentage of sales; salesforce expenditures indeterminate. | Relatively low advertising and sales-promotion expenditures as a percentage of sales; high salesforce expenditures as a percentage of sales. | Low advertising, sales-promotion and salesforce expenditures as a percentage of sales. |
| Common marketing strategies | Mass-market penetration; niche penetration; skimming and early withdrawal. | Flanker strategy; market expansion; leapfrog strategy; encirclement. | Fortress-defence; confrontation; flanker strategy; increased penetration; extended use; market expansion; profitable survivor strategy; maintenance strategy; niche strategy. | Fortress-defence; confrontation; profitable survivor strategy; maintenance strategy; niche strategy; harvesting strategy. |

Exhibit 18.2 summarises how these variables relate to the successful implementation of different business strategies. Analyser strategies are not included because they incorporate some elements of both prospector and defender strategies. The administrative arrangements appropriate for implementing an analyser strategy

typically fall somewhere between those best suited for the other two types. To simplify the following discussion we focus only on the polar types – prospector, differentiated defender, and low-cost defender strategies.

**Exhibit 18.2 Administrative factors related to the successful implementation of business strategies**

| | Types of business strategy | | |
|---|---|---|---|
| **Administrative factor** | **Prospector** | **Differentiated defender** | **Low-cost defender** |
| SBU autonomy | Relatively high level. | Moderate level. | Relatively low level. |
| Shared programmes and synergy | Relatively little synergy – few shared programmes. | Little synergy in areas central to differentiation – shared programmes elsewhere. | High level of synergy and shared programmes. |
| Evaluation and reward systems | High incentives based on sales and share growth. | High incentives based on profits or ROI. | Incentives based on profits or ROI. |

## 18.1.1 Business-Unit Autonomy

Prospector business units are likely to perform better on the critical dimensions of new product success and increases in volume and market share when organisational decision making is relatively decentralised and the SBU's managers have substantial autonomy to make their own decisions. There are several reasons for this. First, decentralised decision making allows the managers closest to the market to make more major decisions on their own. Greater autonomy also enables the SBU's managers to be more flexible and adaptable. It frees them from the restrictions of standard procedures imposed from above, allows them to make decisions with fewer consultations and participants, and disperses power. All of these help produce quicker and more innovative responses to environmental opportunities.

One caveat must be attached to the above generalisation, however. High levels of autonomy and independence can lead to coordination problems across business units. This can have a negative effect on market performance in situations where a firm's business units are narrowly defined and focused on a single product category or technology but the firm's customers want to buy integrated systems incorporating products or services from different units. This was the problem encountered by HP as the growing popularity of the Internet caused its customers to attach greater importance to system integration. One possible solution to this coordination problem is to redefine SBUs with a focus on customer or application segments rather than on narrowly defined product categories, as we discussed in Module 2. An alternative approach is to reduce the SBUs' autonomy somewhat by installing an additional level of managers – such as HP did with the appointment of divisional

CEOs – responsible for coordinating the efforts of related business units. The risk inherent in this approach is that the essential flexibility and creativity of the individual business units may be compromised.

On the other hand, low-cost defender SBUs perform better on ROI and cash flow by giving their managers relatively little autonomy. For a low-cost strategy to succeed, managers must relentlessly pursue cost economies and productivity improvements. Such efficiencies are more likely to be attained when decision making and control are relatively centralised.

The relationship between autonomy and the ROI performance of differentiated defenders is more difficult to predict. On the one hand, such businesses defend existing positions in established markets and their primary objective is ROI rather than volume growth. Thus, the increased efficiency and tighter control associated with relatively low autonomy should lead to better performance. On the other hand, such businesses can maintain profitability only if they continue to differentiate themselves by offering superior products and services. As customers' wants change and new competitive threats emerge, the greater flexibility and market focus associated with greater autonomy may allow these businesses to more successfully maintain their differentiated positions and higher levels of ROI over time. These arguments suggest that the relationship between autonomy and performance for differentiated defenders (and probably for differentiated analysers as well) may be mediated by the level of stability in their environments and by the proportion of offensive or proactive marketing strategies they employ. Units operating in relatively unstable environments and pursuing more proactive marketing programmes (such as extended use or market expansion strategies) are likely to perform better when they have relatively greater autonomy.

### 18.1.2 Shared Programmes and Facilities

Firms face a trade-off when designing strategic business units. An SBU should be large enough to afford critical resources and to operate on an efficient scale, but it should not be so large that its market scope is too broad or that it is inflexible and therefore cannot respond to its unique market opportunities. Some firms attempt to avoid this trade-off between efficiency and adaptability by designing relatively small, narrowly focused business units, but then having two or more units share functional programmes or facilities, such as common manufacturing plants, R&D programmes, or a single salesforce.

Sharing resources poses a particular problem for prospector business units.[3] Suppose, for instance, a business wants to introduce a new product but shares a manufacturing plant and salesforce with other SBUs. The business would have to negotiate a production schedule for the new product, and it may not be able to produce adequate quantities as quickly as needed if other units sharing the plant are trying to maintain sufficient volumes of their own products. It also may be difficult to train salespeople on the new product or to motivate them to reduce the time spent on established products to push the new item. When Frito-Lay introduced Grandma's Soft Cookies, for instance, it relied on its 10 000 salty-snack route salespeople to attain supermarket shelf space for the new line. But because those salespeople were paid a commission based on their total sales revenue, they were reluctant to take time away from their profitable salty-snack lines to sell the new cookies. The resulting lack of strong sales support contributed to Grandma's failure to capture a sustainable share of the packaged cookie market.

One exception to this generalisation, though, may be sharing sales and distribution programmes across consumer package goods SBUs. In such cases, a prospector's new product may have an easier time obtaining retailer support and shelf space if it is represented by salespeople who also sell established brands to the same retail outlets. Similarly, sharing, or at least coordinating, sales, distribution, and customer service functions may be a good idea for business units that produce complementary goods or services that customers want to purchase as integrated systems rather than stand-alone offerings. In general, however, functional independence usually facilitates good performance for prospector businesses.

On the other hand, the increased efficiencies gained through sharing functional programmes and facilities often boost the ROI performance of low-cost defender SBUs. Also, the inflexibility inherent in sharing is usually not a major problem for such businesses because their markets and technologies tend to be mature and relatively stable. Thus, Heinz, the cost leader in a number of food categories, uses a single salesforce to represent a wide variety of products from different business units when calling on supermarkets.

The impact of shared programmes on the performance of differentiated defenders is more difficult to predict because they often must modify their products and marketing programmes in response to changing market conditions to maintain their competitive advantage over time. Thus, greater functional independence in areas directly related to the SBU's differential advantage – such as R&D, sales, and marketing – tends to be positively associated with the long-run ROI performance of such businesses. But greater sharing of facilities and programmes in less-crucial functional areas, such as manufacturing or distribution, also may help improve their efficiency and short-run ROI levels.

### 18.1.3 Evaluation and Reward Systems

Increasingly, US firms are adopting some form of pay-for-performance compensation scheme. Some do it for individuals who meet specific goals (e.g., bonuses for salespeople who exceed their quotas), others on the basis of the performance of the SBU or the company as a whole (e.g., stock options). In either case, SBU managers are often motivated to achieve their objectives by bonuses or other financial incentives tied to one or more dimensions of their unit's performance. The question is, Which dimensions of performance should be rewarded?

For defender businesses in relatively mature markets, particularly those competing as low-cost defenders, operating efficiency and profitability tend to be the most important objectives, for reasons discussed in Module 3. Consequently, tying a relatively large portion of managers' incentive compensation to short-term profits seems sensible. This can be done either through bonuses based on last year's profit performance or economic value added (EVA) or through options keyed to increases in the firm's stock price.

In prospector businesses, on the other hand, basing too large a portion of managers' rewards on current profitability may cause problems. Such rewards may motivate managers to avoid innovative but risky actions or investments that may not pay off for some years into the future.[4] Even successful new product introductions can dramatically increase costs and drain profits early in the product's life cycle. By the time the new product starts contributing to the unit's profits, the manager who deserves the credit may have been transferred to a different business. Therefore, evaluation and reward systems that place relatively more emphasis on sales volume or market share objectives, or on the percentage of volume generated by new products, may be more appropriate for businesses pursuing prospector strategies.

## 18.2 Designing Appropriate Organisational Structures and Processes for Implementing Different Strategies

Different strategies emphasise varying ways to gain a competitive advantage. Thus, a given functional area may be key to the success of one type of strategy but less critical for others. For instance, competence in new product R&D is critical for the success of a prospector business but less so for a low-cost defender.

Successful implementation of a given strategy is more likely when the business has the **functional competencies** demanded by its strategy and supports them with substantial **resources** relative to competitors; is organised suitably for its technical, market, and competitive environment; and has developed appropriate **mechanisms** for coordinating efforts and resolving conflicts across functional departments. Exhibit 18.3 summarises the relationships between these organisational structure and process variables and the performance of different business strategies.

**Exhibit 18.3 Organisational and interfunctional factors related to the successful implementation of business strategies**

| | Business strategies | | |
|---|---|---|---|
| **Organisational factor** | **Prospector** | **Differentiated defender** | **Low-cost defender** |
| Functional competencies of the SBU | SBU will perform best on critical volume and share-growth dimensions when its functional strengths include marketing, sales, product R&D and engineering. | SBU will perform best on critical ROI dimension when its functional strengths include sales, financial management and control and those functions related to its differential advantage (e.g. marketing, product R&D). | SBU will perform best on critical ROI and cash-flow dimensions when its functional strengths include process engineering, production, distribution and financial management and control. |

| Organisational factor | Business strategies: Prospector | Differentiated defender | Low-cost defender |
|---|---|---|---|
| Resource allocation across functions | SBU will perform best on volume and share-growth dimensions when percentage of sales spent on marketing, sales and product R&D are high and when gross fixed assets per employee and percentage of capacity utilisation are low relative to competitors'. | SBU will perform best on the ROI dimension when percentage of sales spent on the salesforce, gross fixed assets per employee, percentage of capacity utilisation and percentage of sales devoted to other functions related to the SBU's differential advantage are high relative to competitors'. | SBU will perform best on ROI and cash flow dimensions when marketing, sales and product R&D expenses are low, but process R&D, fixed assets per employee and percentage of capacity utilisation are high relative to competitors'. |
| Decision-making influence and participation | SBU will perform best on volume and share-growth dimensions when managers from marketing, sales, product R&D and engineering have substantial influence on unit's business and marketing-strategy decisions. | SBU will perform best on ROI dimension when financial managers, controller and managers of functions related to unit's differential advantage have substantial influence on business and marketing- strategy decisions. | SBU will perform best on ROI and cash flow when controller, financial and production managers have substantial influence on business and marketing-strategy decisions. |
| SBU's organisational structure | SBU will perform best on volume and share-growth dimensions when structure has low levels of formalisation and centralisation, but high level of specialisation. | SBU will perform best on ROI dimension when structure has moderate levels of formalisation, centralisation and specialisation. | SBU will perform best on ROI and cash flow dimensions when structure has high levels of formalisation and centralisation, but low level of specialisation. |
| Functional co-ordination and conflict resolution | SBU will experience high levels of interfunctional conflict; SBU will perform best on volume and share-growth dimensions when participative resolution mechanisms are used (e.g. product teams). | SBU will experience moderate levels of interfunctional conflict; SBU will perform best on ROI dimension when resolution is participative for issues related to differential advantage, but hierarchical for others (e.g. product managers, product improvement teams, etc.). | SBU will experience low levels of interfunctional conflict; SBU will perform best on ROI and cash-flow dimensions when conflict-resolution mechanisms are hierarchical (e.g. functional organisation). |

*Source*: Adapted from Orville C. Walker, Jr., and Robert W. Ruekert, 'Marketing's Role in the Implementation of Business Strategies', *Journal of Marketing*, July 1987, p. 31.

### 18.2.1 Functional Competencies and Resource Allocation

Competence in marketing, sales, product R&D, and engineering is critical to the success of prospector businesses because those functions play pivotal roles in new product and market development and thus must be supported with budgets set at a larger percentage of sales than their competitors. Because marketing, sales, and R&D managers are closest to the changes occurring in a business's market, competitive, and technological environments, they should be given considerable authority in making strategic decisions. This argues that bottom-up strategic planning systems are particularly well-suited to prospector businesses operating in unstable environments. Success here is positively affected by the extent to which customer orientation is an integral part of the unit's corporate culture.

In low-cost defender businesses, on the other hand, the functional areas most directly related to operating efficiency, such as financial management and control, production, process R&D, and distribution or logistics, play the most crucial roles in enabling the SBU to attain good ROI performance. Because differentiated defenders need to attain high returns on their established products, functional areas related to efficiency are also critical for their success. Similarly, such units also seek to improve efficiency by investing in process R&D, making needed capital investments, and maintaining a high level of capacity utilisation. But because they also must maintain their differential advantage over time, functional departments related to the source of that advantage – the salesforce and product R&D for SBUs with a technical product advantage or sales, marketing, and distribution for SBUs with a customer service advantage – are also critical for the unit's continued success. As we have seen, for example, in an attempt to defend its leading share position, cement the loyalty of its growing customer base, and generate greater revenues from repeat purchases, Amazon.com has invested hundreds of millions of dollars to build its own distribution centres and improve the speed and reliability of its order fulfilment.

### 18.2.2 Additional Considerations for Service Organisations

Given that service organisations pursue the same kinds of business-level competitive strategies as goods producers, they must meet the same functional and resource requirements to implement those strategies effectively. However, service organisations – and manufacturers that provide high levels of customer service as part of their product offering – often need some additional functional competencies because of the unique problems involved in delivering quality service.

This is particularly true for services involving high customer contact. Because the sale, production, and delivery of such services occur almost simultaneously, close coordination between operations, sales, and marketing is crucial. Also, because many different employees may be involved in producing and delivering the service – as when thousands of different cooks prepare Big Macs at McDonald's outlets around the world – production planning and standardisation are needed to reduce variations in quality from one transaction to the next. Similarly, detailed policies and procedures for dealing with customers are necessary to reduce variability in customer treatment across employees. All of this suggests that personnel management –

particularly the activities of employee selection, training, motivation, and evaluation – is an important adjunct to the production and marketing efforts of high-contact service organisations.[5] A good example of how well-trained service personnel can help improve sales and customer retention in even the most mundane businesses is provided by Wawa convenience stores, as discussed in Exhibit 18.4.

**Exhibit 18.4 Good service personnel can turn customers into fans**

Wawa is a chain of convenience stores with 550 locations in five states on the East Coast of the United States. Convenience stores, where employee turnover is often high and transactions impersonal, might seem like the perfect venue for indifferent service. But many Wawa customers are enthusiastic fans. The 'I Love Wawa' group on MySpace.com has more than 5000 members, and one couple even had their wedding at the Wawa store where they first met.

Wawa has been successful at making loyal fans among its clientele by focusing on repeat customers – some of whom stop by every day – and trying to provide satisfying customer–employee interactions via careful hiring and training practices. While Wawa wages are about the same as those of its competitors, the firm does a better job of investing in the development of the people it hires: training them at its Wawa Corporate University, providing them with benefits that facilitate self-improvement – such as reimbursing tuition for college courses – and the like. Consequently, employee turnover rates are low and the firm receives hundreds of applicants for each job opening. If a lowly convenience store chain can turn customers into fans, perhaps many other service companies could benefit from increased investments in employee recruitment, training, and rewards.

Source: Rob Walker, 'Convenience Cult?' *New York Times Magazine,* July 30, 2006, p. 15.

Competence in human resource development is more crucial for service businesses pursuing prospector strategies – and perhaps also for defenders and analysers who differentiate their offerings on the basis of good service – than for those focused primarily on efficiency and low cost. In prospector service organisations, employees often play a critical role in identifying potential new service offerings and in introducing them to potential customers. Consequently, the effective implementation of such a strategy requires employees with superior communication and social skills and necessitates frequent employee retraining and performance feedback. For instance, banks pursuing a prospector strategy not only have more branches and engage in more market scanning, advertising, and new service development than those with other types of competitive strategies, but also devote more effort to screening potential employees and providing training and support after they are hired.[6]

## 18.2.3 Organisational Structures

Three structural variables – formalisation, centralisation, and specialisation – are important in shaping both an SBU's and its marketing department's performance within the context of a given competitive strategy. **Formalisation** is the degree to which formal rules and standard policies and procedures govern decisions and working relationships. **Centralisation** refers to the location of decision authority and control within an organisation's hierarchy. In highly centralised SBUs or marketing departments, only one or a few top managers hold most decision-making authority. In more decentralised units, middle- and lower-level managers have more autonomy and participate in a wider range of decisions. Finally, **specialisation** refers to the division of tasks and activities across positions within the organisational unit. A highly specialised marketing department, for instance, has a large number of specialists, such as market researchers, advertising managers, and sales promotion managers, who perform a narrowly defined set of activities often as consultants to product managers.

Highly structured business units and marketing departments are unlikely to be very innovative or quick to adapt to a changing environmental circumstance. Adaptiveness and innovativeness are enhanced when (1) decision-making authority is decentralised, (2) managerial discretion and informal coordination mechanisms replace rigid rules and policies, and (3) more specialists are present. Thus, prospector business units and their marketing departments are likely to perform better when they are decentralised, have little formalisation, and are highly specialised.

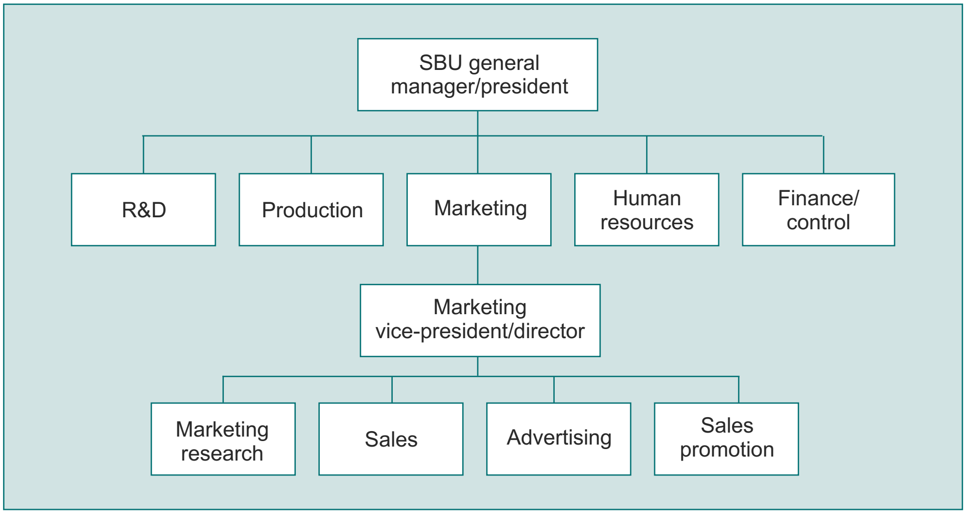
Differentiated defenders perform best when their organisation structures incorporate moderate levels of formalisation, centralisation, and specialisation. Those departments most directly related to the source of a differentiated defender's competitive advantage (sales, marketing, and R&D), however, should be less highly structured than those more crucial for the efficiency of the unit's operations (production and logistics).

Several common organisational designs incorporate differences in both the structural variables (formalisation, centralisation, and specialisation) and the mechanisms for resolving interfunctional conflicts. These include (1) functional, (2) product management, (3) market management, and (4) various types of matrix organisational designs.

### 18.2.3.1 Functional Organisations

The functional form of organisation is the simplest and most bureaucratic design. At the SBU level, managers of each functional department, such as production or marketing, report to the general manager. Within the marketing department, managers of specific marketing activity areas, such as sales, advertising, or marketing research, report to the marketing vice president or director, as shown in Exhibit 18.5. At each level the top manager coordinates the activities of all the functional areas reporting to him or her, often with heavy reliance on standard rules and operating procedures. This is the most centralised and formalised organisation form and relies primarily on hierarchical mechanisms for resolving conflicts across functional areas. Also, because top managers perform their coordination activities across all product-markets in the SBU, there is little specialisation by product or customer type.

**Exhibit 18.5 Functional organisation of an SBU and its marketing department**



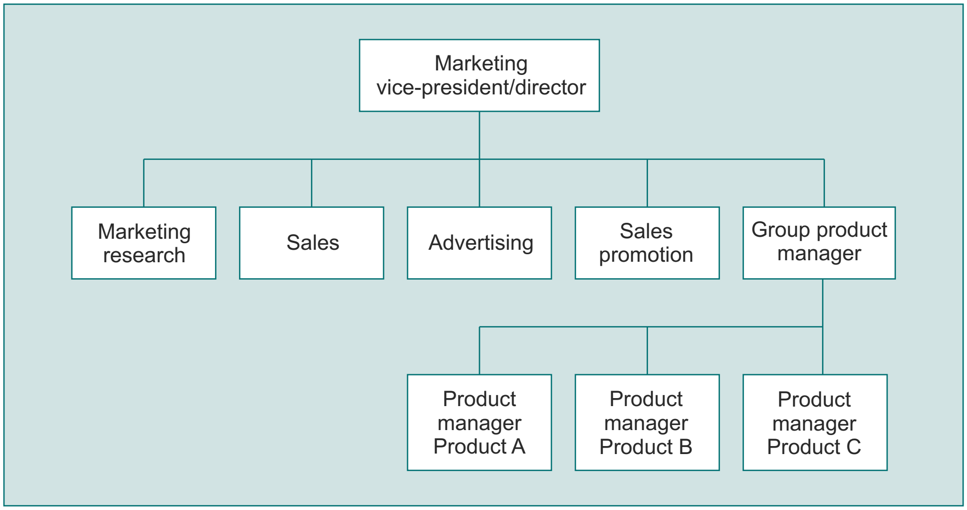

These characteristics make the functional form simple, efficient, and particularly suitable for companies operating in stable and slow-growth industries where the environments are predictable. Thus, the form is appropriate for low-cost defender SBUs attempting to maximise their efficiency and profitability in mature or declining industries. For example, Ingersol-Rand, a low-cost manufacturer of low-tech air compressors and air-driven tools such as jackhammers, uses a functional structure.

The simplicity of the functional organisation also makes it the most common organisational form among entrepreneurial start-ups, including many dot-com companies. Even though the functional form is very hierarchical, such firms can still be nimble and innovative provided that (1) the company remains small enough that the entrepreneur can personally supervise and coordinate the various functions, (2) the firm is focused on a single product or product line targeted at one customer segment, and (3) the entrepreneur's personal vision is an adequate source of innovation to differentiate the entire company. As the start-up grows, its product offerings expand, and its markets fragment; however, it is usually wise to adopt a more decentralised and specialised organisational form. Unfortunately, some entrepreneurs find it difficult to delegate decision-making authority to their subordinates.

### 18.2.3.2 Product Management Organisations

When a company or SBU has many product-market entries, the simple functional form of organisation is inadequate. A single manager finds it difficult to stay abreast of functional activities across a variety of different product-markets or to coordinate them efficiently. One common means of dealing with this problem is to adopt a product management organisation structure. As Exhibit 18.6 illustrates, this form adds an additional layer of managers to the marketing department, usually called product managers, brand managers, or marketing managers, each of whom has the responsibility to plan and manage the marketing programmes and to coordinate the activities of other functional departments for a specific product or product line.

**Exhibit 18.6 A marketing department with a product-management organisation**




A product management structure decentralises decision making while increasing the amount of product specialisation within the SBU. If the product managers also are given substantial autonomy to develop their own marketing plans and programmes, this structure also can decrease the formalisation within the business. Finally, although the product managers are responsible for obtaining cooperation from other functional areas both within and outside the marketing department, they have no formal authority over these areas. They must rely on persuasion and compromise – in other words, more participative methods – to overcome conflicts and objections when coordinating functional activities. These factors make the product management form of organisation less bureaucratic than the functional structure. It is more appropriate, then, for businesses pursuing differentiated defender and analyser strategies, particularly when they operate in industries with complex and relatively unstable market and competitive environments. Thus, many large consumer packaged-goods companies with multiple brands competing in diverse segments – such as Nestlé, Unilever, and Procter & Gamble – incorporate a product management structure.

When large firms target a number of brands at different market segments, a product management organisation typically includes one or more ‘group' or ‘category' marketing managers, on the level immediately above the product managers, who allocate resources across brands. Category management also provides an opportunity for the involvement of more experienced managers in brand management, particularly those concerned with coordinating pricing and other marketing efforts.[7]

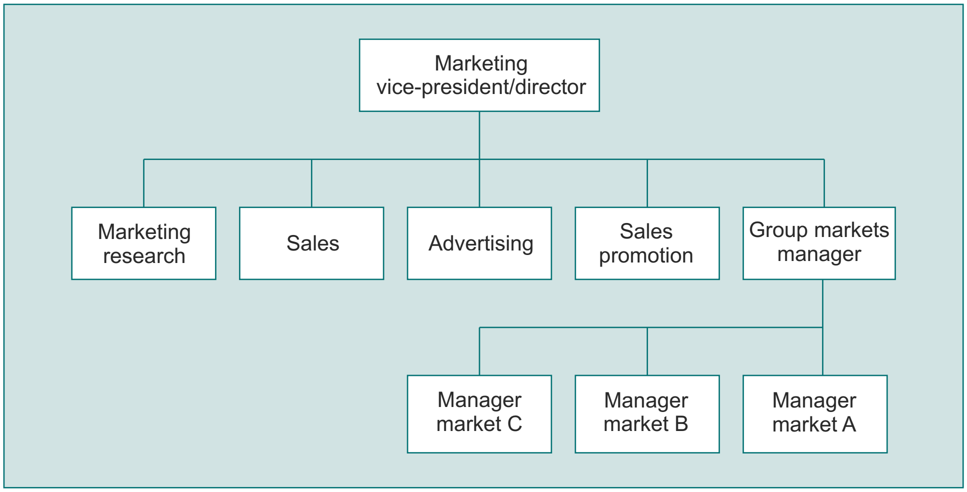
Product management organisations have a number of advantages, including the ability to identify and react more quickly to the threats and opportunities individual product-market entries face; improved coordination of functional activities within and across product-markets; and increased attention to smaller product-market entries that might be neglected in a functional organisation. Consequently, about 85 per cent of all consumer goods manufacturers use some form of product management organisation.

Despite its advantages, a product management organisation has shortcomings. The major one is the difficulty of obtaining the cooperation necessary to develop and implement effective programmes for a particular product given that a product manager has little direct authority. Also, the environment facing product managers is changing drastically. They increasingly must face the fact that customers can quickly compare products and prices – and even suggest their own price – over the Internet; that customers are becoming more price sensitive and less brand loyal; that competition is becoming more global; that rapidly changing technologies are providing new ways to improve production and distribution efficiency, but also shortening product life cycles; and that the power of large retailers and distributors has increased due in part to their ability to collect and control information about the marketplace. These environmental trends have led to an increase in the sales of private-label brands and more aggressive bargaining by distributors.[8] As a result of these trends and the inherent weakness of the product manager type of organisation, many companies have undertaken two major types of modifications – market management and matrix organisation – discussed next.

### 18.2.3.3 Market Management Organisations

In some industries an SBU may market a single product to a large number of markets where customers have very different requirements and preferences. Pepsi-Cola, for example, is sold through restaurants, fast-food outlets, and supermarkets. The syrup needed to make Pepsi is sold directly to institutions such as Kentucky Fried Chicken and Taco Bell. But marketing Pepsi to consumers for home consumption involves the use of franchised bottlers who process and package the product and distribute it to a variety of retail outlets. The intermediaries and marketing activities involved in selling to the two markets are so different that it makes sense to have a separate market manager in charge of each. Such a company or SBU might organise itself along the lines shown in Exhibit 18.7. Some SBUs have adopted a combination of product and regional market management organisation structures. A product manager has overall responsibility for planning and implementing a national marketing programme for the product, but several market mangers are also given some authority and an independent budget to work with salespeople and develop promotion programmes geared to a particular user segment or geographic market. This kind of decentralisation or regionalisation has become popular with consumer goods companies in their efforts to increase geographic segmentation and cope with the growing power of regional retail chains.

**Exhibit 18.7 A marketing department with a market-management organisation**




### 18.2.3.4 Matrix Organisations

A business facing an extremely complex and uncertain environment may find a matrix organisation appropriate. The matrix form is the least bureaucratic or centralised and the most specialised type of organisation. It brings together two or more different types of specialists within a participative coordination structure. One example is the product team, which consists of representatives from a number of functional areas assembled for each product or product line. As a group, the team must agree on a business plan for the product and ensure the necessary resources and cooperation from each functional area. This kind of participative decision making can be very inefficient; it requires a good deal of time and effort for the team to reach mutually acceptable decisions and gain approval from all the affected functional areas. But once reached, those decisions are more likely to reflect the expertise of a variety of functional specialists, to be innovative, and to be quickly and effectively implemented. Thus, the matrix form of organisation particularly suits prospector businesses and the management of new product development projects within analyser or differentiated defender businesses. Some examples are discussed in Exhibit 18.8.

**Exhibit 18.8 Using teams to get the job done**

Pillsbury, which has recently merged with General Mills, replaced its traditional marketing department with multiple discipline teams centred around a product group (pizza snacks). Each involved managers from marketing, sales and production. Lever Brothers has restructured in a similar fashion. It has reorganised its marketing and sales departments into a series of business groups and set up a separate customer development team responsible for retailer relations across all the various SBU brands.

*Source*: 'Death of the Brand Manager', *The Economist*, April 9, 1994, p. 67.

Another form of matrix structure involves the creation of an additional organisational unit or managerial position responsible for coordinating the actions of other units within the firm. For example, nearly every business school has an MBA programme director responsible for coordinating the courses offered by the functional departments in hopes of creating a tightly integrated and coherent curriculum. Similarly, Hewlett-Packard created an E-Services Solutions Group, a coordinating unit whose domain cuts across all the other SBUs and divisions in the company and who is charged with encouraging the other SBUs to work with each other and with outside partners to develop new Web-based goods and services.

### 18.2.4 Recent Trends in Organisational Design

As we have stressed throughout this book, the dynamics of the marketplace are forcing companies to respond more quickly to their opportunities and threats if they hope to survive and prosper. This has spurred a search for organisational structures that are flexible, responsive, able to learn, and market oriented.[9] While we are only just beginning to gain insights into organisational structures of the future, certain aspects seem reasonably clear. We briefly discuss the more important of these.

Organisations will increasingly emphasise the **managing of business processes** in contrast to functional areas.[10] Every business has about six basic or core processes, such as, for example, new product development and supply chain management. The former would be staffed by individuals from marketing, R&D, manufacturing, and finance. The latter would contain people with expertise in purchasing, manufacturing, order delivery, and billing.

Managing processes will make the organisation essentially horizontal – flat and lean versus a vertical or hierarchical model. Thus, executive positions will no longer be defined in terms of managing a group of functionally oriented people; instead, executives will be concerned with a process that strongly emphasises the importance of customer satisfaction.[11] Process management is quite different from the management of a function because, first, it uses external objectives, such as customer satisfaction versus simple revenues. Second, people with different skills are grouped to undertake a complete piece of work; their work is done simultaneously, not in sequence. Third, information flows directly to where it is used. Thus, if you have an upstream problem, you deal with people involved directly rather than via your boss.

Next, the use of **self-managing teams** is increasing. Regardless of the form of worker self-management, all are based on the concept of *empowerment* – the theory that those doing the work should have the means to do what it takes to please the customer. In turn, this requires that performance objectives and evaluation of activities be linked to customer satisfaction. Successful teams can dramatically improve productivity; for example, Boeing used empowered teams to reduce the number of hang-ups by half when developing its 777 jet.[12] But many teams have failed because management was not serious about their empowerment, team members were poorly selected, or the team was launched in isolation with little training or support.[13]

In the future many companies will use teams as the basis for collaborative networks that link thousands of people together with the help of a variety of new technologies. Such networks enable businesses to form and dissolve relations quickly and to bring to bear on an opportunity or a threat the needed resources regardless of who owns them.[14] For example, XM Satellite Radio formed an alliance with Samsung Electronics to develop the first portable satellite radio combined with a digital music player. The two companies created a virtual product development team jointly headed by one manager from each company. Samsung engineers focused on industrial design and manufacturing, while XM dealt with the user interface, the antenna, and performance features – such as the ability to 'bookmark' a song playing on the radio and purchase it later online. Samsung and XM were able to introduce their cobranded Helix radio just nine months after forming their alliance.[15]

But not all such collaborative networks are successful, especially those involving **joint ventures**. Partnering is at best a difficult and demanding undertaking requiring considerable managerial skills as well as a great deal of trust.[16] A major difficulty, especially for those involving companies from different parts of the world, is that 'they cannot be controlled by formal systems, but require a dense web of interpersonal connections and internal infrastructures that enhance learning.'[17]

### 18.2.5 Organisational Adjustments as Firms Grow and Markets Change

Managers often think of the design of their organisation as stable and not subject to change. In rapidly growing entrepreneurial companies and in changing markets, however, such thinking can be dangerous. As the number of customers and the range of product lines grow, the best way to organise the marketing and sales functions should be subject to change.

An entrepreneurial start-up may begin with a simple functional structure, perhaps even simpler than that diagrammed in Exhibit 18.5. As it grows and its product offerings become broader and more complex, it may assign specialised product managers to coordinate the marketing efforts for the various products or product lines. Eventually, the firm might even split into several product divisions, each with its own sales and marketing departments. Or the firm's customers might fragment into a number of diverse segments with unique needs and requirements, favouring the adoption of a market management or matrix structure.

With each of these adjustments to a company's organisation structure, however, comes added complexity and potential disadvantages. For instance, what if the new structure results in multiple salespeople, representing the company's different product lines, competing with each other for a customer's business? Such competition may be contrary to the company's self-interest as well as confusing and inconvenient for the customer. More importantly, such a lack of coordination would make it difficult to sell comprehensive solutions that cut cross the firm's product or divisional boundaries.

How should managers decide when the time has come to restructure an organisation, and what new structure should replace the old one? There are five key drivers in such decisions: (1) customer needs, (2) informational requirements of the sales and marketing personnel charged with meeting those needs, (3) ability of a given structure to motivate and coordinate the kinds of activities that market conditions require, (4) available competencies and resources, and (5) costs.

When customers all tend to use a narrow range of goods or services to satisfy similar needs, a simple functional structure may be sufficient. When customer segments use goods or services in different ways, either a product-focused or market-focused structure is likely to work well. If individual customers buy a broad range of the firm's goods or services, however, having multiple salespeople calling on those customers, unless they are organised into teams, is probably a bad idea. When a company's offerings are relatively simple and easy to understand, a single salesforce may be able to handle the entire line. But when products are technically complex or open to customisation, each line may require its own specialised sales and marketing organisation. When the firm is not well established or needs to educate potential buyers about the advantages of an innovative offering, it may need heavy incentives to encourage salespeople to expend the effort necessary to win new business. Under such circumstances, team-oriented selling arrangements are likely to be ineffectual. Finally, the fact that more highly specialised structures also tend to increase personnel and administrative costs should not be overlooked.

Thus, growing firms or those serving rapidly changing markets are likely to need to rethink – and perhaps change – the structure of their sales and marketing organisations frequently. Such changes can be disruptive to both internal and customer relationships, but as HP discovered, failure to adjust in the face of changing market conditions can make it impossible for the firm to implement its marketing strategy.

## 18.2.6 Organisational Designs for Selling in Global Markets

An organisation's complexity increases, often quite dramatically, as it 'goes international' and especially so as overseas sales as a percentage of total sales increase. The issue is essentially one of deciding what organisational design is best for developing and implementing worldwide strategies while simultaneously maintaining flexibility with regard to individual markets.[18] In evaluating the several types of international organisational structures discussed in this section, keep in mind two things: 'first, that innovation is the key to success. An organisation which relies on one culture for its ideas and treats foreign subsidiaries as dumb production-colonies might as well hire subcontractors.'[19] Second, technology is making the world smaller.

### 18.2.6.1 Little or No Formal Organisation

Early on in a firm's international involvement, the structure typically ranges from the domestic organisation handling international transactions to a separate export department. The latter may be tied to the marketing department or may be a freestanding functional department.

### 18.2.6.2 An International Division

To avoid discriminating against international customers in comparison with domestic customers, an international division is often established to house all international activities, most of which relate to marketing. Manufacturing, engineering, finance, and R&D typically remain in their previous form to take advantage of scale effects. This type of organisation serves best with a limited number of products that lack cultural sensitivity – for example, basic commodity types such as chemicals, metals, and industrial machinery.

Many Japanese firms historically emphasised low-cost manufacturing coupled with quality assurance as the essence of their international competitive strategy. Both of these require strong centralised control and, thus, the use of an export-based organisational structure. In recent years though, Japanese firms have become more interested in global structures based on products or geographic areas.[20]

### 18.2.6.3 Global Structures

There are a variety of global types, of which the simplest replicates the firm's basic functional departments. A global company using the functional type of organisation would have vice presidents (worldwide) for such areas as manufacturing, marketing, and finance – all reporting to the president.

By far the most common global structure is one based on products, which translates into giving SBUs worldwide control over their product lines. The main advantages of this type of structure are the economies derived from centralising manufacturing activities and the ability to respond quickly to product-related problems originating in overseas markets. Marketing is usually localised at the country or regional level.

The *area structure* is another popular global organisational type and is especially appropriate when there is considerable variance across markets regarding product acceptance and marketing activities. Firms typically organise on a regional basis (North America, Latin America, Far East, Middle East, and Africa) using a central staff that coordinates worldwide planning and control activities. As we saw in Module 13, for example, Procter & Gamble has established a nearly autonomous operation in China with the authority to develop new products and line extensions suited to the Chinese market (such as Morning Lotus Blossom Crest), an extensive network of wholesale subdistributors who service small retailers, and a substantial budget for market development within the country.[21]

Some companies use a hybrid organisation that typically is some combination of the functional, product, or area types of structure. The global matrix is one such attempt. It has individual business managers reporting to both area and functional groups, or area managers reporting to business and functional groups, thereby enabling the company to balance the need for centralised efficiency and its responsiveness to local needs. But the dual reporting sets up conflicts and slows the management process to such an extent that many companies, including Dow and CitiCorp, have returned to more traditional organisational designs.[22]

### 18.2.6.4 Decision Making and Organisational Structure

Global organisation structures can be centralised or decentralised in terms of decision making. In the case of the latter, controls are relatively simple and relations between subsidiaries and headquarters mainly financial. The logic here is that local management is closest to the market and can respond quickly to change. But multinationals faced with strong global competition require more centralisation, which calls for headquarters to provide the overall strategy that subsidiaries (country units) implement within a range agreed upon with headquarters.[23]

## 18.3 Marketing Plans: The Foundation for Implementing Marketing Actions

As we pointed out in Module 1, preparation of a written plan is a key step in ensuring the effective execution of a strategic marketing programme because it spells out what actions are to be taken, when, and by whom. Written plans are particularly crucial in larger organisations because a marketing manager's proposals must usually be reviewed and approved by higher levels of management, and because the approved plan then provides the benchmark against which the manager's and the marketing programme's performances will be evaluated. Preparing formal, written marketing plans, however brief, is a useful exercise even in small firms because the discipline involved helps ensure that the proposed objectives, strategy, and marketing actions are based on rigorous analysis of the 4 Cs and sound reasoning. Marketing plans can vary a good deal in content and organisation, but they generally follow a format similar to the one outlined in Exhibit 1.6 and reproduced in Exhibit 18.9.[24] To illustrate the kinds of information that might be included in each section of the plan, the contents of a marketing plan for a disguised Pillsbury refrigerated dough product are summarised in Exhibit 18.10.

**Exhibit 18.9 Contents of an annual marketing plan**

| Section | | Content |
|---|---|---|
| I | Executive summary | Presents a short overview of the issues, objectives, strategy and actions incorporated in the plan and their expected outcomes for quick management review. |
| II | Current situation and trends | Summarises relevant background information on the market, competition and the macroenvironment, and trends therein, including size and growth rates for the overall market and key segments. |
| III | Performance review (for an existing product or service only) | Examine the past performance of the product and the elements of its marketing programme (e.g. distribution, promotion, etc.). |
| IV | Key issues | Identifies the main opportunities and threats to the product that the plan must deal with in the coming year and the relative strengths and weaknesses of the product and business unit that must be taken into account in facing those issues. |
| V | Objectives | Specifies the goals to be accomplished in terms of sales volume, market share and profit. |
| VI | Marketing strategy | Summarises the overall strategic approach that will be used to meet the plan's objectives. |

| Section | Content |
|---|---|
| VII Action plans | This is the most critical section of the annual plan for helping to ensure effective implementation and coordination of activities across functional departments. It specifies:<br>• The target market to be pursued.<br>• What specific actions are to be taken.<br>• Who is responsible for each action.<br>• When the action will be engaged in.<br>• How much will be budgeted for each action. |
| VIII Projected profit-and-loss statement | Presents the expected financial payoff from the plan. |
| IX Controls | Discusses how the plan's progress will be monitored; may present contingency plans to be used if performance falls below expectations or the situation changes. |
| X Contingency plans | Describes actions to be taken if specific threats or opportunities materialise during the planning period. |

Much of this course has focused on the planning process, the decisions that must be made when formulating a marketing strategy and its various components, the development of strategic marketing plans, and the analytical tools managers can use in reaching those decisions. Consequently, we will say little here about the processes or procedures involved in putting together a marketing plan. Instead, our purpose is to summarise how the topics we've covered can be integrated within a coherent marketing plan, and how the plan's content should be organised and presented to best ensure that the strategy will be effectively carried out.

**Exhibit 18.10 Summary of an annual marketing plan for a refrigerated bread dough product**

**I Analysis of the current situation**

**A The market situation**

- The total US market for dinner breadstuffs is enormous, amounting to about 10.5 billion servings per year.
- Speciality breads, such as whole grain breads, are growing in popularity, largely at the expense of traditional white breads.
- Pillsbury's share of the total dinner breadstuffs market, accounted for by several brands including Crescent rolls as well as refrigerated bread dough, is small, amounting to only about 2 per cent of the total dollar volume.
- Since its introduction several years ago, refrigerated bread dough (RBD) has been able to achieve only low levels of penetration (only about 15 per cent of all households have used the product) and use frequency (nearly two-thirds of the product's volume comes from light users who buy only one or two cans per year).
- RBD consumption is concentrated in the northern states and during the fall and winter months (about 75 per cent of volume is achieved from September to February).
- Marketing research results suggest consumers believe RBD is relatively expensive in terms of price/value compared to alternative forms of dinner breadstuffs.

B **The competitive situation**

- RBD's share of the total dinner breadstuffs category is likely to remain low because of the wide variety of competing choices available to consumers.
- The largest proportion of volume within the category is captured by ready-to-eat breads and rolls produced by supermarket chains and regional bakeries and distributed through retail grocery stores.
- RBD's major competition within the refrigerated dough category comes from other Pillsbury products, such as Crescent rolls and Soft Breadsticks.
- There are currently no other national competitors in the RBD category; but Merico, a small regional producer, was recently acquired by a major national food manufacturer. Evidence suggests Merico may be preparing to introduce a competing product line into national distribution at a price about 10 per cent lower than Pillsbury's.

C **The macroenvironmental situation**

- Changes in American eating habits may pose future problems for dinner breadstuffs in general and for RBD in particular:
  – More meals are being eaten away from home and this trend is likely to continue.
  – People are eating fewer starchy foods.
  – While the total volume of dinner breadstuffs did not fall during the early 1980s, neither did it keep pace with population growth.
- Increasing numbers of women working outside the home, and the resulting desire for convenience may reduce consumers' willingness to wait 30 minutes while RBD bakes, even though the dough is already prepared.
- Because RBD does not use yeast as a leavening agent, Food and Drug Administration regulations prohibit the company from referring to it as 'bread' in advertising or package copy, even though the finished product looks, smells and tastes like bread.

D **Past product performance**

- While sales volume in units increased only slightly during the past, dollar volume increased by 24 per cent due to a price increase taken early in the year.
- The improvement to gross margin was even greater than the price increase due to an improvement in manufacturing costs.
- The improvement in gross margin, however, was not sufficient to produce a positive net margin due to high advertising and sales promotion expenditures aimed at stimulating primary demand and increasing market penetration of RBD.
- Consequently, while RBD showed improvement over the last year, it was still unable to make a positive contribution to overhead and profit.

II **Key issues**

A **Threats**

- Lack of growth in the dinner breadstuffs category suggests the market is mature and may decline in the future.
- The large variety of alternatives available to consumers suggests it may be impossible for RBD to substantially increase its share of the total market.
- The potential entry of a new, lower-priced competitor poses a threat to RBD's existing share and may result in lower margins if RBD responds by reducing its price.

B **Opportunities**

- The largest percentage of RBD volume accounted for by light users suggests an opportunity of increasing volume among current users by stimulating frequency of use.
- Trends towards increased consumption of speciality breads suggests possible line extensions, such as whole wheat or other whole grain flavours.

C **Strengths**

- RBD has a strong distribution base, with shelf facings in nearly 90 per cent of available retail outlets.
- RBD sales have proved responsive to sales promotion efforts (e.g. money-off coupons), primarily by increasing purchases among existing users.
- The fact that most consumers who try RBD make repeat purchases indicates a high level of customer satisfaction.

D **Weaknesses**

- RBD sales have proved unresponsive to advertising. Attempts to stimulate primary demand have not been able to increase market penetration.
- Consumer concerns about RBD's price/value place limits on ability to take future price increases.

III **Objectives**

A

- Achieve a positive contribution to overhead and profit of $4 million in current year.
- Reach the target level of an average of 20 per cent return on investment over the next five years.

B **Marketing objectives**

- Maintain market share and net sales revenues at previous year's levels.
- Maintain current levels of retail distribution coverage.
- Reduce marketing expenditures sufficiently to achieve profit-contribution objective.
- Identify viable opportunities for future volume and profit expansion.

IV **Marketing strategy**

- Pursue a maintenance strategy aimed at holding or slightly increasing RBD volume and market share primarily by stimulating increased frequency of use among current users.
- Reduce advertising aimed at stimulation of primary demand/penetration and reduce manufacturing costs in order to achieve profit-contribution objective.
- Initiate development and test marketing of possible line extensions to identify opportunities for future volume expansion.

V **Marketing action plans**

- Improve the perceived price/value of RBD by maintaining current suggested retail price at least until the end of the peak selling season (February).
- Review the competitive situation and the brand's profit performance in March to assess the desirability of a price increase at that time.
- Work with production to identify and implement cost-savings opportunities that will reduce manufacturing costs by 5 per cent without compromising product quality.
- Maintain retail distribution coverage with two trade promotion discount offers totalling $855 000; one offered in October–November to support peak-season inventories and another offered in February–March to maintain inventories as volume slows.
- Reduce advertising to a maintenance level of 1100 gross ratings points during the peak sales period of September to March. Focus copy on maintaining awareness among current users.

- Encourage greater frequency of use among current users through three sales-promotion events, with a total budget of $748 000, that will stimulate immediate purchase:
  - One free-standing insert (FSI) coupon for 15 cents off next purchase to appear in newspaper on 19 September.
  - One tear-off refund offer (buy three, get one free) placed on retailers' shelves during November.
  - A $1 refund with proof of purchase offer placed in women's service books (i.e. women's magazines like *Good Housekeeping*) during March.

VI **Contingency plans**

- Maintain the above marketing strategy and action plans without change during the planning period even if Merico (see item I.B.) enters the market.
- If Merico enters, carefully monitor its pricing and promotion actions, sales results, consumer perceptions and so forth, and prepare recommendations for next year's plan.

The success of a marketing plan depends on effective communication with other parts of the organisation (such as production, engineering, and R&D) and a variety of marketing units, especially those concerned with sales, advertising, promotions, and marketing research. By using the experience of others (as consultants) in preparing the action programmes (for instance, in-store promotions), the planner not only benefits from the expertise of specialists, but also increases their buy-in to the overall marketing plan, thereby increasing the likelihood of its success.

The action programmes should reflect agreements made with other departments and marketing units as to their responsibilities over the planning period concerning the product. For example, if a special sale is to occur in a given month, the production department must commit to making sufficient product available and to the use of a special package; the promotion group agrees to develop and have available for use by the salesforce in-store displays; the salesforce must allocate the time necessary to do the in-store work; and so on. Thus, the annual plan serves as a means of allocating the firm's resources as well as a way of assigning responsibility for the plan's implementation.[25]

## 18.3.1 The Situational Analysis

While many marketing plans start with a brief executive summary of their contents, this is typically the first substantive section in which the marketing manager details his or her assessment of the current situation.[26] It is the 'homework' portion of the plan where the manager summarises his or her analysis of current and potential customers, the competitive environment and the company's relative strengths and weaknesses, trends in the broader macroenvironment that may impact the product, and past performance outcomes for existing products. This section also typically includes estimates of sales potential, forecasts, and other assumptions underlying the plan. Based on these analyses, the manager may then call attention to one or more key issues, major opportunities, or threats that should be dealt with during the planning period.

#### 18.3.1.1 Market Situation

Here data are presented on the target market. Total market size and growth trends should be discussed, along with any variations across geographic regions or other market segments. Marketing research information also might be presented concerning customer perceptions (say, awareness of the brand) and buying-behaviour trends (market penetration, repeat purchase rate, heavy versus light users). As Exhibit 18.10 indicates, for instance, information about the market situation presented in the plan for Pillsbury's refrigerated bread dough (RBD) not only includes data about the size of the total market for dinner breadstuffs and Pillsbury's market share, but also points out the low penetration and use frequency of RBD among potential users. Most of the kinds of customer analysis, market segmentation and targeting information discussed in Modules 6, 7, and 9 would be relevant here.

#### 18.3.1.2 Competitive Situation

This section identifies and describes the product's major competitors in terms of their size, market share, product quality, marketing strategies, and other relevant factors. It also should discuss the likelihood that other potential competitors will enter the market in the near future and the possible impact of such entry on the product's competitive position. Note, for instance, that while other Pillsbury brands are the primary competitors for RBD in the refrigerated dough category, the potential entry of a new low-cost competitor could dramatically change the competitive situation.

#### 18.3.1.3 Macroenvironmental Situation

This section describes broad environmental occurrences or trends that may have a bearing on the product's future. The issues mentioned here include any relevant economic, technological, political/legal, or social/cultural changes as outlined in Module 4. As Exhibit 18.10 indicates, for example, lifestyle trends leading to more meals being eaten away from home and increased desires for convenience pose a threat to future demand for Pillsbury's RBD.

#### 18.3.1.4 Past Product Performance

If the plan is for an existing product, this part of the situation analysis discusses the product's performance on such dimensions as sales volume, margins, marketing expenditures, and profit contribution for several recent years. This information is usually presented in the form of a table, such as the one for RBD shown in Exhibit 18.11. As the table indicates, even though RBD showed an improvement in gross margin due in part to reduced manufacturing costs, high advertising and sales expenditures prevented the product from making a positive contribution to overhead and profit.

The data contained in Exhibit 18.11 do not answer the question of whether the company's RBD prices and costs are competitive. Such information is critical since if a product's costs are not in line, then the product's market position is in jeopardy. This is especially true with commodity-type products, although even when products are differentiated it is essential that costs be maintained at competitive levels and any price premium charged provide a corresponding benefit to buyers. Some methods for measuring and monitoring costs and profitability are examined in the next module.[27]

**Exhibit 18.11 Historical and projected financial performance of refrigerated bread dough product**

| Variable | Last year | This year | Percentage change | Next year | Percentage change |
|---|---|---|---|---|---|
| Sales volume (cases) | 2 290m | 2 350m | +3% | 2 300m | (2%) |
| Net sales ($) | 17 078m | 21 165m | +24 | 21 182m | 0 |
| Gross margin ($) | 6 522m | 10 787m | +65 | 11 430m | +5 |
| Gross margin/net sales | 38% | 51% | – | 54% | – |
| Advertising and sales promotion ($) | 11 609m | 12 492m | +6 | 6 100m | (51) |
| Advertising and sales promotion/gross margin | 178% | 116% | – | 53% | – |
| Net margin ($) | (5 087m) | (1 705m) | – | 5 330m | – |
| Net margin/net sales | – | – | – | 25 | – |
| Product contribution ($) | (6 342m) | (3 740m) | – | 4 017m | – |

#### 18.3.1.5 Sales Forecast and Other Key Assumptions

Finally, the assessment of the current situation also typically includes estimates of sales potential, sales forecasts, and other evidence or assumptions underlying the plan. As we discussed in Module 8, such market measurements are particularly critical as the foundation for marketing plans for new goods or services where there is no past history to draw on. While the RBD plan does not explicitly report an estimate of total market potential, a sales forecast underlies the expected volume for next year, reported in the fourth column of Exhibit 18.11.

### 18.3.2 Key Issues

After analysing the current situation, the product manager must identify the most important issues facing the product in the coming year. These issues typically represent either threats to the future market or financial performance of the product or opportunities to improve those performances. This section also should highlight any special strengths of the product or weaknesses that must be overcome in responding to future threats and opportunities. Some of the key threats and opportunities faced by Pillsbury's RBD, together with the product's major strengths and weaknesses, are summarised in section II of Exhibit 18.10.

### 18.3.3 Objectives

Information about the current situation, the product's recent performance, and the key issues to be addressed now serve as the basis for setting specific objectives for the coming year. Two types of objectives need to be specified. **Financial objectives** provide goals for the overall performance of the brand and should reflect the objectives for the SBU as a whole and its competitive strategy. Those financial goals must then be converted into **marketing objectives** that specify the changes in customer behaviour and levels of performance of various marketing programme elements necessary to reach the product's financial objectives.

The major financial and marketing objectives for Pillsbury's RBD are summarised in section III of Exhibit 18.10. Sales volume and market share are not expected to increase, but the product is expected to make a $4 million contribution to overhead and profit through additional cost reductions.

## 18.3.4 Marketing Strategy

Because there may be a number of ways to achieve the objectives specified in the preceding section, the manager must now specify the overall marketing strategy to be pursued. It is likely to be one, or a combination of several, of the strategies discussed earlier in Module 15, Module 16 and Module 17. The chosen strategy should fit the market and competitive conditions faced by the product and its strategic objectives. It also should incorporate all of the necessary decisions concerning the 4 Ps.

The RBD product manager recommends that a **maintenance strategy** be pursued. The intense competitive situation, uncertainty over the possible entry of Merico, and the past inability of primary-demand advertising to increase market penetration all suggest that it would be difficult to expand RBD's market by simply doing more of the same. Consequently, the recommended strategy seeks to maintain or slightly increase RBD volume and share primarily by stimulating repeat purchases among current customers. Reductions in advertising expenditures and continued improvements in manufacturing costs will be relied on to help the brand achieve its profit contribution objective. In addition, it is recommended that development and test marketing of several line extensions (for example, whole wheat and a French-style loaf) be initiated in an attempt to identify viable opportunities for future volume expansion.

## 18.3.5 Action Plans

The action plan is the most crucial part of the annual marketing plan for ensuring proper execution. Here the specific actions necessary to implement the strategy for the product are listed, together with a clear statement of who is responsible for each action, when it will be done, and how much is to be spent on each activity. Of course, actions requiring the cooperation of other functional departments should be included, but only after the product manager has contacted the departments involved, worked out any potential conflicts, and received assurances of support.

Here is where specific timelines and milestones are set forth. A variety of planning and project management tools – such as Gantt charts, stage-gate development processes, and others – may be used to illustrate and orchestrate the action steps entailed in the plan. Some of the action programmes specified for RBD are outlined in section V of Exhibit 18.10.

### 18.3.6 Projected Profit-and-Loss Statement

The action plan includes a supporting budget that is essentially a projected profit-and-loss statement. On the revenue side, it forecasts next year's sales volume in units and dollars. On the expense side, it reflects manufacturing, distribution, and marketing costs associated with the planned actions. This budget is then presented to higher levels of management for review and possible modification. Once approved, the product's budget serves as a basis for the plans and resource allocation decisions of other functional departments within the SBU, such as manufacturing and purchasing, as well as other marketing units (e.g., marketing research). The projected financial results of RBD's annual plan are summarised in the second-to-last column of Exhibit 18.11.

### 18.3.7 Contingency Plans

Finally, the manager also might detail contingency plans to be implemented if specific threats or opportunities should occur during the planning period. The RBD product manager, for instance, recommended that no changes should be made in the product's overall marketing strategy nor in its pricing or promotion tactics in the event that Merico entered the national market. The rationale was that time should be taken to carefully analyse Merico's market impact and the magnitude of its competitive threat before crafting a response.

## Learning Summary

- While much of this book has covered the various analytical tools and frameworks necessary to develop effective marketing strategies, such strategies are worthless without good implementation. Therefore, marketing managers, and general managers concerned about marketplace issues, must attend to organisational design issues. A business's structure, policies, procedures, and resources must fit its chosen strategy or else implementation will fall short.
- For firms with multiple businesses or product lines, different administrative relationships between the business unit and corporate headquarters are appropriate for different competitive strategies. Prospector businesses perform better with high levels of autonomy, fewer shared resources, and more top-line focused reward systems than defender businesses.
- Within a given business – whether it's part of a larger organisation or a one-product entrepreneurial start-up – different functional competencies, levels of specialisation, extent of employee participation in decision making, and mechanisms for the resolution of internal conflicts are needed to effectively implement varying competitive strategies.
- Several organisational designs incorporate differences in both structural variables (formalisation, centralisation, and specialisation) and mechanisms for resolving interfunctional conflicts. These include functional, product management, market management, and various types of matrix organisational designs.
- Writing a formal marketing action plan is a key step toward ensuring the effective execution of a strategic marketing programme because it spells out

what actions need to be taken, when, and by whom. Written plans also provide the benchmarks by which the marketing strategy can be evaluated and controlled, as discussed in the next module.

# Review Questions

## Content Questions

18.1 What are the three aspects of the relationship between corporate headquarters and the business unit that determine the SBU's success in implementing a particular competitive strategy?

18.2 Successful implementation of a given strategy is more likely under what conditions?

18.3 What additional functional-area competencies are needed for success for service organisations – especially those involving high customer contact?

18.4 Organisational adaptiveness and innovativeness are enhanced under what conditions?

18.5 Under what conditions is a functional type of organisation best to use? And a product-management type?

18.6 Discuss briefly the recent organisational design developments.

18.7 What are the more common organisational designs for selling in global markets?

18.8 What are the major components of an annual marketing plan for a given product?

18.9 What subject areas should be discussed under the analysis of the current situation section of the annual marketing plan?

18.10 Describe what should be included in the discussion of a company's action plan for a given product.

## Multiple Choice Questions

18.11 Important issues regarding administrative relationships and strategy implementation include:

A. the degree of autonomy given to business unit managers.
B. the size of the product markets being pursued by a business unit.
C. the degree to which functional programmes or facilities are shared by different business units.
D. all of the above.
E. only A and C above.

18.12 All of the following are activities important to the production and marketing efforts of high-contact service organisations, EXCEPT:

A. employee selection.
B. defining job descriptions.
C. training.
D. motivation.
E. evaluation.

18.13 When a firm has little forward vertical integration and has high trade promotion expenses as a per cent of sales, it has adopted a(n) _____ business strategy.

A. analyser.
B. differentiated defender.
C. reactor.
D. prospector.
E. low-cost defender.

18.14 A company following a differentiated defender business strategy would have the following promotion policy: _____ expenditures for advertising; _____ expenditures for sales promotions and _____ expenditures for the salesforce.

A. low; low; low.
B. low; low; high.
C. moderate; moderate; variable.
D. high; high; high.
E. moderate; high; variable.

18.15 What organisational structure are entrepreneurial start-ups most likely to use?

A. Functional.
B. Product management.
C. Market management.
D. Matrix.
E. Unstructured.

18.16 Self-managing teams are based on the concept of:

A. little authority given from above.
B. individuals act on own then as a team.
C. empowerment.
D. personal management.
E. collaborative efforts.

18.17 The _____ a business units degree of autonomy the _____ respond to environmental opportunities.

A. lesser; quicker it can
B. lesser; more completely it can
C. greater; more completely it can
D. greater; quicker it can
E. greater; more likely it will

18.18 The only instance where shared resources has been shown to benefit a prospector business units is:

A. distribution channels.
B. pricing strategy.
C. product development.
D. production.
E. promotion.

18.19 In terms of shared programmes and facilities, an SBU should be large enough to operate on a(n) _____ scale, but not so large that its market scope is too broad so that it is _____ and cannot respond _____ to new market opportunities.

A. efficient; inflexible; quickly
B. inefficient; inflexible; quickly
C. efficient; flexible; quickly
D. inefficient; flexible; slowly
E. efficient; flexible; slowly

18.20 Evaluation and reward systems that place more emphasis on sales volume or market share objectives may be more appropriate for businesses pursuing:

A. analyser.
B. differentiated defender.
C. reactor.
D. prospector.
E. low-cost defender.

18.21 Successful implementation of a strategy is more likely when the business has the _____ demanded by its strategy and uses its _____ to support the strategy.

A. resources; divisions.
B. resources; competitive advantage.
C. functional competencies; expertise.
D. functional competencies; resources.
E. functional competencies; competitive advantage.

18.22 A company operating within a low-cost defender business strategy would be most likely to encourage _____ levels of synergy among manufacturing facilities and _____ levels of shared programmes among marketing and R&D departments.

A. low; moderate.
B. low; low.
C. high; high.
D. moderate; high.
E. high; low.

18.23 A(n) _____ SBU strategy will perform best on _____ dimension(s) when marketing and related expenses are low.

A. prospector; share growth.
B. differentiated defender; ROI.
C. prospector; ROI.
D. analyser; share growth.
E. low-cost defender; ROI.

18.24 A(n) _____ SBU strategy will perform best on _____ dimension(s) when finance types have substantial influence in the marketing decision-making process.

A. prospector; share growth.
B. differentiated defender; ROI.
C. prospector; ROI.
D. analyser; share growth.
E. low-cost defender; ROI.

18.25 A participative means to conflict resolution is best for _____ SBU strategies because the level of interfunctional conflict is likely to be _____.

A. prospector; moderate.
B. differentiated defender; low.
C. analyser; high.
D. prospector; high.
E. low-cost defender; low.

18.26 A company like Clorox, which seeks to maximise fixed assets per employee and percentage of capacity utilisation relative to its competitors, is more than likely following a(n) _____ business strategy.

A. analyser.
B. low-cost defender.
C. prospector.
D. reactor.
E. differentiated defender.

18.27 A company following a 'prospector' business strategy would typically allocate a _____ percentage of its resources to_____.

A. low; product R&D.
B. high; reducing overhead.
C. high; process engineering R&D.
D. high; marketing.
E. low; improving capacity utilisation.

18.28 Formalisation reflects a manager's _____ in responding to environmental threats and is generally higher in SBUs pursuing a(n) _____ strategy.

A. skill; low-cost defender.
B. skill; differentiated defender.
C. flexibility; low-cost defender.
D. flexibility; prospector.
E. flexibility; analyser.

18.29 Centralisation reflects a manager's _____ in responding to market opportunities and is generally lower in SBUs pursuing a(n) _____ strategy.

A. skill; low-cost defender.
B. skill; differentiated defender.
C. motivation; analyser.
D. motivation; prospector.
E. authority; prospector.

18.30 Specialisation reflects the level of task _____ across managers and is generally lower in SBUs pursuing a(n) _____ strategy.

A. sharing; low-cost defender.
B. sharing; differentiated defender.
C. complexity; low-cost defender.
D. complexity; prospector.
E. complexity; analyser.

18.31 In terms of an SBU's organisational structure, the SBU using a prospector strategy will perform best in terms of sales-volume growth and market-share gains when its structure has _____ levels of centralisation and _____ levels of specialisation.

A. low; high.
B. low; low.
C. high; low.
D. high; high.
E. moderate; low.

18.32 _____ levels of centralisation together with _____ levels of formalisation together with _____ levels of specialisation are most likely to promote operational efficiency within an SBU.

A. High; high; low.
B. High; low; low.
C. High; high; high.
D. Low; high; low.
E. Low; low; high.

18.33 A key structural variable in determining organisational structure is _____, which can be defined as the division of tasks and activities across positions within the organisational unit.

A. specialisation.
B. formalisation.
C. centralisation.
D. bureaucratisation.
E. authorisation.

18.34 The simplest as well as the most bureaucratic organisational design is the _____ design.

A. product-management.
B. functional.
C. market-management.
D. matrix.
E. customer-management.

18.35 About what percentage of consumer goods manufacturers use some form of product management organisation structure?

A. 40 per cent.
B. 55 per cent.
C. 70 per cent.
D. 85 per cent.
E. 95 per cent.

18.36 What type of organisation structure is PepsiCo using when it assigns one manager to institutional sales for its soft-drink syrup (KFC, Pizza Hut, Taco Bell) and another manager to sales to consumers of its soft drinks?

A. Product.
B. Functional.
C. Matrix.
D. Market-management.
E. Transactional.

18.37 The matrix form of organisation structure is the _____ bureaucratic, _____ centralised and _____ specialised type of organisation structure.

A. least; most; most.
B. least; least; most.
C. least; most; least.
D. most; most; least.
E. most; least; most.

18.38 The written marketing plan is extremely important to the execution of a given strategy because it:

A. provides valuable information on competitors' recent actions.
B. makes the marketing manager think through her markets' needs.
C. spells out what actions are to be taken, when and by whom.
D. calls attention to what has and has not worked in the past.
E. provides a 'road map' of a product's recent history.

18.39 The type of statement one might expect to find in the 'Key issues' section of the marketing plan is:

A. alter the focus from the stimulation of primary demand to the stimulation of secondary demand.
B. change the advertising message to highlight competitive features.
C. the relative share increased more than did sales value.
D. research indicates that the sales volume can be increased 10 per cent via an emerging segment.
E. maintain current sales at last year's unit volume.

18.40 Hewlett Packard's policy of allowing divisions to compete with each other would be captured under which section of a divisions marketing plan?

A. Analysis of current situation
B. Objectives.
C. Marketing strategy.
D. Marketing action plans.
E. None of the above.

18.41 The type of statement one might expect to find in the 'Marketing action plans' section of the marketing plan is:

A. alter the focus from the stimulation of primary demand to the stimulation of secondary demand.
B. change the advertising message to highlight competitive features.
C. the relative share increased more than did sales value.
D. research indicates that the sales volume can be increased 10 per cent via an emerging segment.
E. maintain current sales at last year's unit volume.

18.42 The type of statement one might expect to find in the 'Objectives' section of the marketing plan is:

A. alter the focus from the stimulation of primary demand to the stimulation of secondary demand.
B. change the advertising message to highlight competitive features.
C. the relative share increased more than did sales value.
D. research indicates that the sales volume can be increased 10 per cent via an emerging segment.
E. maintain current sales at last year's unit volume.

## Application Questions and Cases

18.43 Suppose you have been offered the job of developing and managing a new medical products unit for a major electronics manufacturer. The purpose of the new SBU will be to adapt technology from other parts of the company for medical applications (diagnostic equipment such as CAT scanners, surgical lasers, etc.) and to identify and build markets for the new products the unit develops. The new unit's performance over the next few years will be judged primarily on its success at developing a variety of new products and its rate of growth in sales volume and market share. Before accepting the job, what assurances would you seek from the company's CEO concerning the administrative relationships to be established between the new SBU and corporate headquarters? Why?

18.44 Now that you have accepted the job described in Question 18.44, you have been given a \$50 million operating budget for the first year. Your first task is to staff the new unit and to allocate your budget across its various functional departments. While you obviously want to hire good people for every position, which departments require the most competent and experienced personnel and which departments should receive relatively large shares of the available budget? Why?

18.45 As general manager, what type of organisational design would you select for the new SBU described in Question 18.45? Justify your choice in terms of its ability to help the SBU implement its strategy and accomplish its primary objectives. What potential advantages – if any – might be associated with your chosen organisation structure?

18.46 As the general manager of 3M's industrial tape division you are responsible for a business where the basic technology and the majority of product-markets are relatively mature, but where new applications and product improvements are still possible. Consequently, you are pursuing a differentiated defender strategy. If you had the authority to design the structure for your SBU, what type of organisational design would you select? How would you characterise your choice in terms of the structural variables of centralisation, formalisation and specialisation? Why do you think this design most appropriate for your SBU?

18.47 Given your answer to Question 18.47, how would potential conflicts between functional departments within the industrial tape SBU be resolved? Who would be responsible for coordinating the activities of the various functional departments for each of the SBU's product-market entries?

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# Module 19

# Measuring and Delivering Marketing Performance

## Contents



## Metrics Pay for Walmart[1]

Walmart, the discount general merchandise retailer, generated sales of $405 billion and operating income of over $24 billion in fiscal 2009–10. Founded less than 50 years ago, it is America's largest, most-profitable, and, in some circles but not others, one of its most-admired companies. Over the past two decades it has ranked as one of the best companies in its return on stockholders' equity.

As of September 2010 the company operated over 8500 stores of which more than 3000 were in countries outside the United States (in the Americas, Europe, and Asia). In the United States, Walmart operates stores in several different formats apart from its original stores – some are supercentres (a combination supermarket and general merchandise store) and some are Sam's Clubs (a members-only warehouse store, selling high volumes, but at very low individual profit margins), and some a smaller format, Neighborhood Markets, with a focus on groceries, in carefully chosen urban locations. Walmart stores serve more than 200 million customers per week, and the company employs more than 2.1 million people. A major reason for Walmart's success is its ability to control costs. In 2009–10 it was able to hold its operating, selling, and general administrative costs to 19.7 per cent of sales. This was substantially below that of its closest competitors in the US, Kmart and Target, and explains, in part, the company's excellent profitability record.

In the 1960s when he had only 10 stores, Sam Walton realised he couldn't expand successfully unless he could capture the information needed to control his operations. He became, according to one competitor, the best utiliser of control information in the industry. By the late 1970s Walmart was using a storewide computer-driven information system that linked stores, distribution centres, and suppliers. Kmart started using a similar system only in the early 1990s. In the late 1980s Sam Walton tapped David Glass to take over as CEO. Now the company's chairman, Glass, more than anyone, successfully engineered the development of Walmart's advanced distribution and merchandise-tracking system, which were needed to handle the enormous sales increases as the company's stores spread throughout the United States. 'Walmart's incomparable systems are a secret of its success – the unadvertised contributor to the stock's 46.8 per cent average annual return during the decade before Sam's death.'

Today, the company can convert information into action almost immediately. To do so required a massive investment (over $700 million) in computer and satellite systems, which collectively generate the largest civilian database of its kind in the world. In addition to automated replenishment, the system provides up-to-the-minute sales of any item by region, district, and store. By looking at the computer screens in the satellite room, a manager can see system-wide data of the day's sales as they happen, the number of stolen bank cards retrieved that day, whether the seven-second credit card approval system is working properly, and the number of customer transactions completed that day.

### *Changing Metrics for a Changing Strategy*

The combination of its nearly fanatical focus on keeping costs low and the availability of sophisticated and timely management information, which has enabled Walmart management at all levels to respond quickly to new opportunities as well as to performance problems, has served Walmart well. But in recent years, Walmart's cost-leader strategy, at least in the United States, appears to have lost its punch. Same-store sales in the United States fell 0.8 per cent in 2009–10, the company's worst performance ever in its home market.

As the purchasing power of Walmart's mostly low-income core US customers has been squeezed by a combination of low hourly wages and rising energy costs, Walmart has sought to trade up in an effort to attract more selective middle-income shoppers. For these customers, quality, style, and store ambience are as important as – maybe more important than – price. 'Price is not enough any more,' says investment analyst Todd Slater of Lazard Capital Markets.

And adding more stylish, more fashionable apparel means Walmart's systems and metrics need updating, no easy task. 'The issue with apparel is long lead times,' lamented John Fleming, Walmart's chief merchandising officer whom the company hired away from its more upscale competitor, Target. Visiting a Walmart supercentre in spring 2007, Fleming noted that, for about half of the 12 brightly-hued colours of stylish $14 stretch T-shirts, numerous sizes were not only out of stock, but would remain in short supply until the second half of 2007.

'There are a lot of issues here, but what they add up to is the end of the age of Walmart,' says Richard Hastings, an analyst at Bernard Sands, the retail rating agency. The strategic and operational challenges entailed in trading up – while taking care not to lose the traditional Walmart customer – combined with a variety of societal challenges, including employee lawsuits and community resistance to new stores, make the task of maintaining Walmart's growth and its legendary record of profitability a daunting one.

But new CEO Michael T. Duke, who took the leadership reins in 2009 after 15 years with the company, remains bullish about Walmart's future. 'We live at a time and in a world that I believe truly calls out for Walmart and the work that our two million associates do every day. We strongly believe that Walmart is the best positioned global retailer and that we can continue to build on our momentum.'

### Learning Objectives

This module addresses several critical questions that provide the link between a company's efforts to plan and implement marketing strategies and the actual results that those strategies produce. How can we design **strategic control systems** to make sure the strategies we are pursuing remain in sync with the changing market and competitive environment in which we operate? How can we design systems of **marketing metrics** to ensure that the marketing results for which we plan are the results we deliver? In other words, if the ship gets off course during the journey, either strategically or in terms of execution of the marketing strategy, how can we make sure that we know quickly of the deviation so that mid-course corrections can be made in a timely manner? In today's rapidly changing markets, even the best-laid plans are likely to require changes as their implementation unfolds.

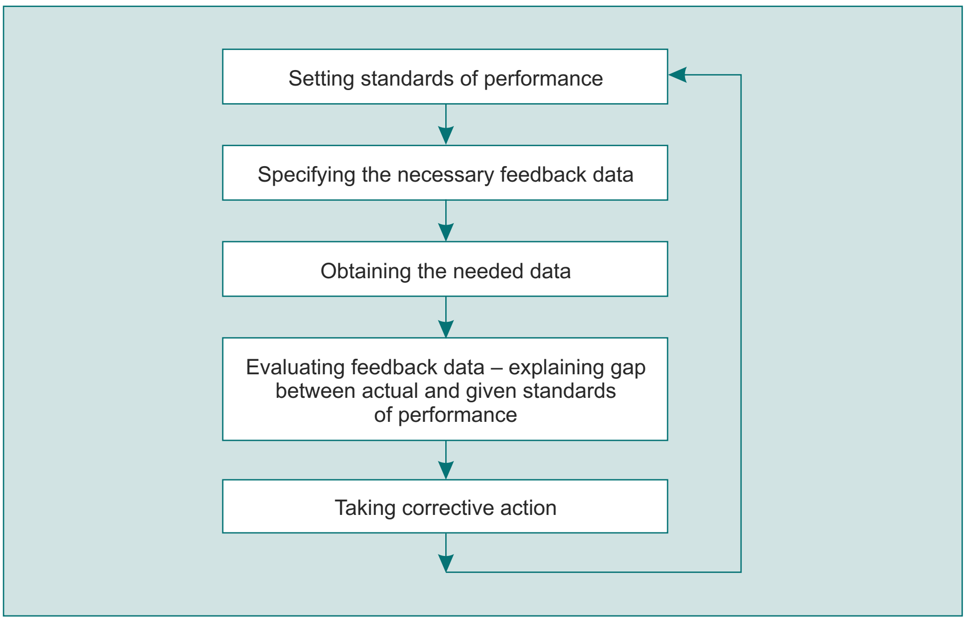
The module begins by developing a five-step process for evaluating and controlling marketing performance on a continuous basis. The process is then applied to the issue of **strategic control**: How can we monitor and evaluate our overall marketing strategy to ensure that it remains viable in the face of changing market and competitive realities? Next, the process is applied the process to tracking the performance of a particular product-market entry and to the marketing actions taken to implement its marketing plan, or **marketing performance measurement**. Are we meeting sales targets, in the aggregate and for various products and market segments? Is each element of the marketing mix doing its job: Which items in the product line are selling best, are the ads producing enough sales leads, is the salesforce generating enough new accounts, and so on? Finally, the module considers how **marketing audits** can be used periodically to link the control process – for both strategic control and for measuring current marketing performance – with marketing planning.

## 19.1 Designing Marketing Metrics Step by Step

As the Walmart example and a recent empirical study demonstrate, a well-functioning control and reappraisal system is critical to the success of a business.[2] To be successful, it should be well integrated with the other steps in the marketing management process: setting objectives, formulating strategies, and implementing a plan of action. The performance measurement system monitors the extent to which the firm is achieving its objectives. When it is not, the firm determines whether the reason lies in the environment, the strategies employed, the action plans, the way the plans were being implemented, or some combination thereof. Thus, the control and reappraisal step is diagnostic, serving to start the marketing management process anew.

Control processes differ at each organisation level. Thus, in a large diversified company, corporate management is concerned with how well its various SBUs are performing relative to the opportunities and threats each faces and the resources given them. Control here would be strategic. At the SBU level, or in smaller companies, concern is primarily with the unit's own strategy, especially as it pertains to its individual product-market entries. We will concentrate mainly on this latter organisational level since it constitutes the bulk of any performance measurement system.

**Exhibit 19.1 The control process**




Regardless of the organisational level involved, the performance measurement is essentially the same. It consists of five steps: setting performance standards, specifying feedback, obtaining data, evaluating it, and taking corrective action (*see* Exhibit 19.1). Although the staff organisation is typically responsible for generating the performance data, the line organisation administers the process. Certainly, this is the case with Walmart, as seen in the involvement of regional vice presidents, district managers, store managers, and department heads in obtaining and processing performance data as well as taking corrective action. More importantly, line managers need to be closely involved with the development of the performance measurement system, so that they can be assured of getting the performance data they need, on a timely basis, and in a format they can easily use to support their long-term and day-to-day decision making.

### 19.1.1 Setting Standards of Performance

These standards derive largely from the objectives and strategies set forth at the SBU and individual product-market entry level. They generate a series of performance expectations for profitability (return on equity or return on assets managed), market share, and sales. At the product-market level, standards of performance also include sales and market-share determinants such as per cent effective distribution, relative shelf-facings, awareness, consumers' attitude change toward a given product attribute, customer satisfaction, and the extent of price parity.

Similarly, for every line item in a marketing budget – product development costs, advertising and promotional expenses, costs for salespeople, and so on – specific and measurable standards of performance must be set so that each of these elements of marketing performance can be evaluated. We address the development of these standards later in this module. Without a reasonable set of performance standards, managers cannot know what results are being obtained, the extent to which they are satisfactory, or why they are or are not satisfactory. Performance-based measures are often tied to the compensation of those individuals responsible for attaining the specified goals. Unfortunately, such a system can cause actions to be taken that in the short term may help attain the desired goals but in the longer term may be detrimental to the firm (*see* Exhibit 19.2).

**Exhibit 19.2 Are drug makers addicted to showing profits?**

In 2002, Bristol-Meyers Squibb faced the problem of two of its blockbuster products, the breast-cancer treatment drug Taxol and the anti-anxiety medication BuSpar coming off patent and losing market-share to generics in the US marketplace. When the drugs that the company had depended on replacing these were delayed, the company resorted to 'stuffing the channel', i.e., forcing its distributors to stock up on 56 weeks' worth of stock for these drugs. Such overselling into the channel is commonplace in this industry and normally goes unnoticed. However, when news of an SEC inquiry reached the marketplace, several top executives were forced to resign, and the stock price dropped by 37%. Schering-Plough ran into a similar issue when its anti-allergy drug Claritin came off patent.

Other industry giants like Merck and Johnson & Johnson reported that they monitor inventory levels. Johnson & Johnson said that it had put in place programmes to reduce the volatility of inventories and that it was working closely with its largest distributors to forecast demand and restocking plans.

*Source*: Amy Tsao, 'Drugmakers Struggle with An Addiction', *BusinessWeek Online*, April 22, 2002.

Recent years have witnessed a shift from using primarily financially based performance measures to treating them as simply part of a broader array of marketing metrics.[3] The now widely used balanced scorecard is one such approach.[3] While the use of nonfinancial measures is not new, giving them equal or greater status is. Thus, more and more companies are turning to metrics they feel better reflect how their managers think about what decision areas drive the firm's success, such as customer satisfaction, product quality, market share, and new product development.

To be of any value, performance standards must be measurable; further, they must be tied to specific time periods, particularly when they concern a management compensation system. The SMART acronym (specific, measurable, attainable, relevant, and timebound), to which we have referred when discussing the setting of objectives in earlier modules, is a useful framework for setting performance standards. Typically, performance measurement systems at the product-market level operate on a monthly, quarterly, and annual basis, with the monthly and quarterly data cumulated to present a current picture and to facilitate comparisons with prior years. In recent years, the trend has been for such systems to operate over shorter periods (weekly and even daily) and for performance data to be more readily available. Walmart's inventory control system, for example, provides instantaneous up-to-date data. Strategic control tends to operate over longer periods.

Of particular importance is whether the business unit as a whole and its individual product-market entries have met achievement measures at predefined points in time. For example, in a three-year strategic plan, a given SBU might have 12-month goals such as annual sales of $100 million, profits of $20 million, and a return on assets managed of 14.5 per cent. At the product-market entry level, metrics might include such measures as product sales by market segments, marginal contributions, and operating margins. At the marketing functional area level, examples of measures for a consumer good are level of awareness, trial, repeat purchases (brand loyalty) among members of the target audience, reduction in marketing costs as a per cent of sales, and per cent of stores stocking (weighted by sales).

In recent years, major multinational companies such as DuPont, Roche, IBM, and others have used another performance measure – benchmarking. What this means is that the firm's performance in a given area is compared against the performance of other companies. Thus, Walmart regularly compares itself with its competitors on merchandise assortments, service quality, and out of stocks. The comparison does not always have to be with companies in the same industry. For example, Xerox benchmarked its order filling/shipping performance against LL Bean (a mail order retailer catering to outdoor enthusiasts), which has a well-deserved reputation for fulfilling orders both quickly and accurately.[4] Small companies also use benchmarking to find out how they can better serve their customers and thereby increase sales. One small company found out that while customers in general were very happy with their financial advisory services, they felt that they did not get enough of the partners' time. A trucking company found out that their accounts receivables were much longer than the industry norm, simply because the truckers were not submitting their information soon enough after delivery.[5]

#### 19.1.1.1 Profitability Analysis

Regardless of the organisational level, performance measurement involves some form of profitability analysis, whether of profitability per se or of return on marketing investment, a perspective that some CFOs find appealing. For a discussion of one observer's view of using ROI as a means of holding marketing accountable for its effectiveness, *see* Exhibit 19.3. In brief, **profitability analysis** requires that analysts determine the costs associated with specific marketing activities to find out the profitability of such units as different market segments, products, customer accounts, and distribution channels (intermediaries). Walmart does this at the department and individual store levels as well as for individual lines of goods within a department. More and more managers are attempting to obtain profitability measures for individual products by market segments.

### Exhibit 19.3 Does ROI add up?

These days, there's lots of interest in measuring ROI as a means of holding marketing accountable for its performance. A good idea, right? Not so fast, argues Tim Ambler, author of *Marketing and the Bottom Line*. Ambler agrees that accountability is essential. But 'this focus on ROI is misguided for five reasons,' he says. 'First, very few can calculate ROI with any accuracy. Second, ROI ignores the longer term. Third, it is inconsistent with corporate financial goals. Fourth, marketers do not really mean "ROI" anyway. Fifth, zealous application of ROI will bankrupt the business.'

Like the old tale about improving a donkey's ROI by cutting its food rations and increasing its loads until what results is a dead donkey, Ambler argues that much of the talk about ROI for marketing is fashion rather than substance. Nonetheless, he argues, it does constitute a step 'toward increasing accountability and the understanding of marketing by top management.'

Sources: Tim Ambler, 'Why ROI Doesn't Add Up,' *Financial Times, FT Creative Business*, October 14, 2003, p. 15; and Tim Ambler, *Marketing and the Bottom Line: The Marketing Metrics to Pump Up Cash Flow,* 2nd ed. (Upper Saddle River, NJ: Prentice Hall, 2003).

Profitability is probably the single most important measure of performance, but it has limitations. These are that (1) many objectives can best be measured in nonfinancial terms (maintaining market share); (2) profit is a short-term measure and can be manipulated by taking actions that may prove dysfunctional in the longer term (reducing R&D expenses); and (3) profits can be affected by factors over which management has no control (the weather). For one view of how obsession with profit targets leads to customer abuse, *see* Exhibit 19.4.

### Exhibit 19.4 Good profits or bad profits?

Some retail banks have found a new and lucrative source of earnings – nuisance fees, as customers call them. Charges for bouncing a cheque are a whopping $25 or $30 at many banks. As if that were not bad enough, some banks process the largest cheque first each day, potentially hitting customers with bad cheque fees for the greater number of small cheques that follow and may bounce. Is this any way to earn long-term customer loyalty? But it's not just banks that engage in customer-abusive behaviour such as this. Cell phone operators offer such a confusing array of rate plans that it's nearly impossible for customers to know which plan is best for their pattern of calls. Putting customers on the plan that's best for them would cut profits by as much as 40 per cent, according to one operator.

A new book by Fred Reichheld, *The Ultimate Question: Driving Good Profits and True Growth,* argues that accounting systems and incentive plans often fail to distinguish between profits that result from customer-abusive policies and those that arise from activities that enhance customer loyalty. Thus, as we'll see later in this chapter, in some companies measures of customer satisfaction are taking their place alongside measures of profitability. Reichheld and his colleague James Allen argue that there's an undeclared war on customers raging in many companies, a war that companies cannot afford and cannot win. Thinking differently about performance metrics may offer an olive branch to end the fighting.

*Sources:* Fred Reichheld and James Allen, 'How Companies Can End the Cycle of Customer Abuse,' *Financial Times,* March 23, 2006, p. 43; and Fred Reichheld, *The Ultimate Question: Driving Good Profits and True Growth* (Cambridge, MA: Harvard Business School Press, 2006).

Analysts can use direct or full costing in determining the profitability of a product or market segment. In **full costing**, analysts assign both direct, or variable, and indirect costs to the unit of analysis. **Indirect costs** involve certain fixed joint costs that cannot be linked directly to a single unit of analysis. For example, the costs of occupancy, general management, and the management of the salesforce are all indirect costs for a multiproduct company. Those who use full costing argue that only by allocating all costs to a product or a market can they obtain an accurate picture of its value.

**Direct costing** involves the use of **contribution accounting**. Those favouring the **direct costing** approach argue there is really no accurate way to assign indirect costs.

Further, because indirect costs are mostly fixed, a product or market may make a contribution to profits even if it shows a loss. Thus, even though the company must eventually absorb its overhead costs, the contribution method clearly indicates what is gained by adding or dropping a product or a customer. Exhibit 19.5 shows an example of full and direct costing. The difference in the results obtained is substantial – $370 000 using full costing versus $650 000 with the contribution method.

Contribution analysis is helpful in determining the yield derived from the application of additional resources (for instance, to certain sales territories). Using the data in Exhibit 19.6 we can answer the question, 'How much additional profit would result from a marginal increase in sales of $300 000 – assuming the gross margin remains at 29.62 per cent and the only cost is $35 000 more in sales commissions and expenses?' As Exhibit 19.6 shows, the answer is a profit increase before taxes of $53 000.

Companies are increasingly turning from traditional accounting methods, which identify costs according to various expense categories, to activity-based costing (ABC), which bases costs on the different tasks involved in performing a given activity. ABC advocates have used it to improve product costing, thereby improving pricing parameters, providing better service, trimming waste, and evaluating quality initiatives.[6]

### 19.1.1.2 Customer Satisfaction

So far, we have been discussing performance measures in essentially financial terms. But financial terms are insufficient since they fail to recognise the importance of customer satisfaction, which is an important driving force of the firm's future market share and profitability. As products and services become more alike in an already highly competitive marketplace, the ability to satisfy the customer across a variety of activities (of which the product is only one) will become an even greater success determinant. Thus, measures relating to customer preferences and satisfaction are essential as an early warning of impending problems and opportunities.

Developing a meaningful measure of customer satisfaction requires the merging of two kinds of measures. One approach involves understanding and measuring the criteria used by customers to evaluate the quality of the firm's relationship with them. Knowing the product/service attributes that constitute the customer's choice criteria as well as the relative importance of each should facilitate this task. Once these attributes are identified, they serve as the basis for developing expectation measures. Then, measures are taken of how well the firm is meeting the customer's expectations on an individual attribute as well as an overall basis. For example, if the choice criteria of a cruise line's target market included such attributes as food, exercise facilities, and entertainment, then a performance measure would be developed for each. By weighting these by the relative importance of each, an overall performance measure can be obtained. These two measures collectively serve as the basis for evaluating the company's performance on customer satisfaction.

Another approach favoured by some companies is far simpler. General Electric, Enterprise Car Rental, and others ask customers one simple question: How likely is it that you would recommend us to a friend or a colleague? Such a simple approach has some significant benefits. It gets high response rates – as much as 70 per cent in some cases – and can be conducted often enough and inexpensively enough to give timely and granular information by product, by car rental branch, or whatever. GE adds the percentages of customers who are happiest (scores of 9 or 10 out of 10) and subtracts the percentage who are clearly unhappy (those scoring 6 or lower). The net score provides a clear and compelling – and actionable – indicator of customer satisfaction. At Enterprise, employees working at branches scoring below the company mean are ineligible for promotion. Not surprisingly, employees seeking to boost their branches' scores have developed many customer-friendly innovations at Enterprise.[7]

Face-to-face approaches to assessing customer satisfaction are also used, adding depth to the more cursory quantitative approaches. In recent years, more top-level executives are visiting their major accounts (whether they be end-use customers or intermediaries) to learn firsthand how to better serve them. Such visits frequently result in joint projects designed to reduce the costs incurred by both parties in the sale of a given set of products. One of the high fliers in the Internet boom, Commerce One, rose to fame because of its partnership with General Motors to set up an online electronic marketplace.[8] The detailed customer understanding that Commerce One obtained through executive visits played an important role in its efforts.

Finally, some companies are using the growing availability of customer relationship management (CRM) data to measure the lifetime value of customers. Doing so enables them to more effectively allocate marketing resources.[9]

**Exhibit 19.5** **Finding product or market profitability with full costing and marginal contributions methods ($000)**

| | Full costing | Marginal contribution |
|---|---|---|
| **Net sales** | 5 400 | 5 400 |
| Less: Cost of goods sold – includes direct costs (labour, material and production overhead)* | 3 800 | 3 800 |
| Gross margin | 1 600 | 1 600 |
| **Expenses** | | |
| Salesforce – includes direct costs(commissions) plus indirect costs (sales expenses, sales management overhead)† | 510 | 450 |
| Advertising – includes direct costs (media, production) plus indirect costs (management overhead) | 215 | 185 |
| Physical logistics – includes direct costs (transportation) plus indirect costs (order processing, warehousing costs) | 225 | 190 |
| Occupancy – includes direct costs (telephone) plus indirect cost (heat/air, insurance, taxes, building maintenance) | 100 | 25 |
| Management overhead – includes direct costs (product/brand manager and staff) plus indirect costs (salaries, expenses, occupancy costs of SBU's general management group) | 180 | 100 |
| Total | 1 230 | 950 |
| Profit before taxes | 370 | |
| Contribution to fixed costs and profits | | 650 |

* Production facilities dedicated to a single product.

† Multiproduct salesforce.

**Exhibit 19.6** **Effect of $300000 increase in sales resulting from increased sales commissions and expenses of $35000 (same data as in Exhibit 19.5)**

| | |
|---|---|
| **Net sales** | 5 700 |
| Less: direct costs (29.62%) | 4 012 |
| | 1 688 |
| **Expenses** | |
| Sales commissions and expenses | 485 |
| Advertising | 185 |
| Physical logistics | 190 |
| Occupancy | 25 |
| Management | 100 |
| | 985 |
| Contribution to overhead and profits | 703 |
| Increase in profit (before tax) = $703 − $650 = | $53 |

## 19.1.2 Specifying and Obtaining Feedback Data

Once a company has established its performance standards, its next step is to develop a system that provides usable and timely feedback data on actual performance. In most cases someone must gather and process considerable data to obtain the performance measures, especially at the product-market level. Analysts obtain feedback data from a variety of sources, including company accounting records and syndicated marketing information services such as Nielsen. The sales invoice or other transaction records, such as those produced by retailers' point-of-sale systems, are the basic internal source of data because they provide a detailed record of each transaction. Invoices are the basis for measuring profitability, sales, and various budget items. They also provide data for the analysis of the geographic distribution of sales and customer accounts by type and size. Exhibit 19.7 gives an example of how Tesco, the British supermarket chain, used customer purchasing data to strengthen its low-price image.

Tesco's ClubCard data has informed numerous strategic decisions, including the company's move into smaller store formats, the launch of its Internet shopping business, the development of its up-market Finest food assortment, and others. 'ClubCard has brought about a step-change in the size of the company,' says Tim Mason, who heads Tesco's nascent business in the United States. In Mason's view, ClubCard has been the driver of Tesco's recent success. Retail analyst Mike Tattersall of Cazenove agrees. 'Contrary to popular belief, Tesco's most significant competitive advantage in the UK is not its scale,' he says. 'We believe that ClubCard, which conveys an array of material benefits across virtually every discipline in its business, is Tesco's most potent weapon in the ongoing battle for market share.'[10]

**Exhibit 19.7 It's not about the bananas**

Tesco, the largest and most profitable supermarket chain in the United Kingdom, has pioneered the use of loyalty card information to better manage its pricing, product assortment, and store location decisions, along with a host of other crucial management issues. Tesco wanted to beat Asda's image for having the lowest prices. The question was how. The obvious first step was to cut the price of bananas, since nearly everyone buys bananas. But Tesco's new targeted marketing director, Laura Wade-Gery, wouldn't buy it. Instead, she used Tesco's loyalty card data to carefully examine the segment of Tesco customers that was its most price-sensitive, as revealed by their shopping habits recorded on their Tesco ClubCard accounts.

Cutting the price of a bunch of bananas is emphatically not the place to start, she found, because you are giving a discount to everyone, including lots of people who are not really looking for low prices. The solution? Tesco Value Brand Margarine, along with a carefully targeted group of similar products bought largely by price-conscious shoppers. By cutting prices on these items, Tesco was able to buy a low-price image with the customers to whom such an image mattered most, for a lower net cost overall. Its ability to use customer data insightfully has been a powerful source of competitive advantage. According to Edwina Dunn, whose company Dunnhumby works with Tesco on its ClubCard programme, 'They obviously have to get the basics of grocery retailing right, and we are only part of the equation. But if you asked them how it would affect them, they'd say it is fundamental to their business.'

*Sources:* Clive Humby, Terry Hunt, with Tim Phillips, *Scoring Points: How Tesco Is Winning Customer Loyalty* (London: Kogan Page, 2003), pp. 145–147; 'Marketing Clubbing Together,' *Retail Week,* November 8, 2002.

Another source, and typically the most expensive and time-consuming, involves undertaking one or more marketing research projects to obtain needed information. In-house research projects are apt to take longer and be more expensive than using an outside syndicated service. But there may be no alternative, as, for example, in determining awareness and attitude changes and obtaining data on customer service.

## 19.1.3 Evaluating Feedback Data

Management evaluates feedback data to find out whether there is any deviation from the plan, and if so why. Walmart does this in a variety of ways, including sending its regional vice presidents into the field on a regular basis to learn what's going on and why.

Typically, managers use a variety of information to determine what the company's performance *should* have been under the actual market conditions that existed when the plan was executed. In some cases this information can be obtained in measured form; examples include a shift in personal disposable income (available from government sources), a change in the demand for a given product type (obtained when measuring market share), the impact of a new brand on market share (reported by a commercial source), or a change in price by a major competitor. Often, however, the explanation rests on inferences drawn from generalised data, as would be the case in attributing poor sales performance to an improvement in a competitor's salesforce.

At the line-item level, whether for revenue or expenses, results are compared with the standards set in step one of the control process. A merchandise manager or buyer at an apparel retailer such as Gap, for example, would track sales results of each style or merchandise category in terms of its selling rate (how many weeks' supply is on hand overall and in which stores?) and its gross margin performance. For a district sales team of an industrial goods manufacturer, salespeople might be measured on the number of sales calls they make per week, the number of new accounts they generate, their sales volume in revenue and units, their travel expenses, and a variety of other metrics. A stylist in a beauty salon might be measured in terms of the number of haircuts or sales revenue she produces per day or per hour.

## 19.1.4 Taking Corrective Action

The last step in the control process concerns prescribing the needed action to correct the situation. At Walmart, this is partly accomplished at its various congresses held every Friday and Saturday when managers decide what actions to take to solve selected problems. Success here depends on how well managers carry out the evaluation step. When linkages between inputs and outputs are clear, managers can presume a causal relationship and specify appropriate action. For example, assume that inputs consisted of an advertising schedule that specified the frequency of a given TV message. The objective was to change attitudes about a given product attribute (the output). If the attitude change did not occur, remedial action would start with an evaluation of the firm's advertising effort, particularly the advertising message and how frequently it ran.

But in most cases it is difficult to identify the cause of the problem. Almost always, an interactive effect exists among the input variables as well as the environment. There is also the problem of delayed responses and carry-over effects. For example, advertisers can rarely separate the effects of the message, media, frequency of exposure, and competitive responses in an attempt to determine advertising effects. Even if the company could determine the cause of a problem, it faces the difficulty of prescribing the appropriate action to take. The result of these difficulties is that marketers continue to struggle with quantifying the value of marketing efforts and with creating a culture of accountability for marketing performance.[11]

## 19.2 Design Decisions for Strategic Monitoring Systems

While it's difficult to argue that managers can actually 'control' anything they are asked to manage, strategic control is concerned with monitoring and evaluating a firm's SBU-level strategies (*see* Exhibit 19.8 for the kinds of questions this type of control system is designed to answer). Such a system is difficult to implement because there is usually a substantial amount of time between strategy formulation and when a strategy takes hold and results are evident. Since both the external and internal environments are constantly evolving, strategic control must provide some way of changing the firm's thrust if new information about the environment and/or the firm's performance so dictates. Inevitably, much of this intermediate assessment is based on information about the marketplace and the results obtained from the firm's marketing plan.

**Exhibit 19.8 Examples of questions a strategic control system should be able to answer**

1. What changes in the environment have negatively affected the current strategy (e.g. interest rates, government controls or price changes in substitute products)?
2. What changes have major competitors made in their objectives and strategies?
3. What changes have occurred in the industry in such attributes as capacity, entry barriers or substitute products?
4. What new opportunities or threats have derived from changes in the environment, competitors' strategies or the nature of the industry?
5. What changes have occurred in the industry's key success factors?
6. To what extent is the firm's current strategy consistent with the preceding changes?

### 19.2.1 Identifying Key Variables

To implement strategic control, a company must identify the key variables to monitor, which are usually the major assumptions made in formulating the strategy. The key variables to monitor are of two types:

- those concerned with external forces, and
- those concerned with the effects of certain actions taken by the firm to implement the strategy.

Examples of the former include changes in the external environment such as changes in long-term demand, the advent of new technology, a change in governmental legislation, and actions by a competitor. Examples of the latter types (actions by the firm) include the firm's advertising efforts to change attitudes and in-store merchandising activities designed to improve product availability.

The frameworks and analytical tools for market and competitive analysis that we discussed in Module 3 are useful in determining what variables to monitor in a strategic control system. Deciding exactly which variables to monitor is a company-specific decision; in general, it should focus on those variables most likely to affect the company's future position within its industry group.

### 19.2.2 Tracking and Monitoring

The next step is to specify what information or measures are needed on each of the key variables to determine whether the implementation of the strategic plan is on schedule – and if not, why not. The firm can use the control plan as an early-warning system as well as a diagnostic tool. If, for example, the firm has made certain assumptions about the rate at which market demand will increase, it should monitor industry sales regularly. If it has made assumptions about advertising and its effect on attitudes, it would be likely to use measures of awareness, trial, and repeat buying. In any event, the firm must closely examine the relevancy, accuracy, and cost of obtaining the needed measures.

The advent of email, intranets, and other digital tools for disseminating information has made it easier for sometimes far-flung managers to monitor strategic developments. Critical strategic control information can now be monitored on a real-time basis anywhere in the world.

### 19.2.3 Strategy Reassessment

This can take place at periodic intervals – for example, quarterly or annually – when the firm evaluates its performance to date along with major changes in the external environment. A strategic control system can also alert management of a significant change in either or both its external/internal environments. This involves setting triggers to signal the need to reassess the viability of the firm's strategy. It requires a specification of both the level at which an alert will be called and the combination of events that must occur before the firm reacts. For example, total industry sales of 10 per cent less than expected for a single month would not be likely to trigger a response, whereas a 25 per cent drop would. Or a firm might decide that triggering will occur only after three successive months in which a difference of 10 per cent occurred in each.

In today's fast-changing world, strategy reassessment may happen much more quickly, as competitive and technological developments cause firms to quickly change their entire strategies and business models. Amazon, which started out an online bookseller in the United States, has today grown to become a veritable online shopping mall, with a huge assortment of merchandise categories and a local presence in several countries across the globe.

## 19.3 Design Decisions for Marketing Performance Measurement

Designing control systems to measure marketing performance at the product-market and line-item levels involves answering four essential questions:

- Who needs what information?
- When and how often is the information needed?
- In what media and in what format(s) or levels of aggregation should the information be provided?
- What contingencies should be planned for?

In essence, designing a marketing performance measurement system is like designing the dashboard of a car. Such a system needs to include the most critical metrics to assess whether the car or the business is progressing toward its objectives. Thus, for a car, the dashboard includes a speed gauge and odometer to measure progress toward the destination, a fuel gauge, warning lights for engine and braking system malfunction, and so on, but it typically does not indicate how much windshield wiper fluid remains, how much weight the car is carrying, or other relatively nonessential indicators. The same holds true for a business: The 'drivers' who are managing the business need to know certain essential information while the 'car' – or strategy – is running, while other less crucial indicators can be omitted or provided only when requested. Designing such an information 'dashboard' for the top management team is a good place to start, as it provides a clear signal about the kinds of data to which the rest of the organisation should attend. We now address the four key questions, or **design parameters,** of marketing performance measurement systems.[12]

### 19.3.1 Who Needs What Information?

Marketing performance measurement systems are designed to ensure that the company achieves the sales, profits, and other objectives set forth in its marketing and strategic plans. In the aggregate, these plans reflect the outcomes of the company's or the SBU's planning efforts, which have specified how resources are to be allocated across markets, products, and marketing-mix activities. These plans, as we noted in Module 18, include line-item budgets and typically specify the actions expected of each organisational unit – whether inside or outside the marketing function or department – and deemed necessary to attain the company's financial and competitive positioning objectives. The first and foremost objective for marketing is the level of sales the company or the product-market entry achieves.

Who needs sales information? Top management needs it. Functional managers in other parts of the organisation – manufacturing, procurement, finance, and so on – need it. Marketing managers responsible for the various marketing-mix activities, from product design to pricing to channel management to selling and other promotional activities, need it.

#### 19.3.1.1 Sales Analysis

A sales analysis involves breaking down aggregate sales data into such categories as products, end-user customers, channel intermediaries, sales territories, and order size. The objective of an analysis is to find areas of strength and weakness; for example, products producing the greatest and least volume, customers accounting for the bulk of the revenues, and salespersons and territories performing the best and the worst.

Sales analysis recognises that aggregate sales and cost data often mask the real situation. Sales analysis not only helps to evaluate and control marketing efforts, but also helps management to better formulate objectives and strategies and administer such nonmarketing activities as production planning, inventory management, and facilities planning.

An important decision in designing the firm's sales analysis system concerns which units of analysis to use. Most companies assemble data in one or more of the following groupings:

- Geographical areas – regions, counties, and sales territories.
- Product, package size, and grade.
- Customer – by type and size.
- Channel intermediary – such as type and/or size of retailer.
- Method of sale – mail, phone, channel, Internet, or direct.
- Size of order – less than $10, $10–25, and so on.

These breakdowns are not mutually exclusive. Most firms perform sales analyses hierarchically; for example, by county within a sales territory within a sales region. Further, they usually combine product and account breakdowns with a geographical one: say, the purchase of product X by large accounts located in sales territory Y, which is part of region A. Only by conducting sales analysis on a hierarchical basis using a combination of breakdowns can analysts be confident that they have made every reasonable attempt to locate the opportunities and problems facing their firms.

##### Sales Analysis by Territory

The first step in a sales territory analysis is to decide which geographical control unit to use. In the US, the county is the typical choice since it can be combined into larger units such as sales territories and it is also a geographical area for which many data items are available, such as population, employment, income, and retail sales. Analysts can compare actual sales (derived from company invoices) by county against a standard such as a sales quota that takes into account such factors as market potential and last year's sales adjusted for inflation. They can then single out territories that fall below standard for special attention. Is competition unusually strong? Has less selling effort been expended here? Is the salesforce weak? Studies dealing with such questions as these help a company improve its weak products and exploit its stronger ones. Category and brand development indices, such as those described in Module 6, are often used in assessing sales performance by territory.

Exhibit 19.9 illustrates a sales territory analysis. It shows that only one territory out of seven shown exceeded its 2010 quota, or standard of performance, and by just $18 112. The other six territories accounted for a total of $394 685 under quota. Territory 3 alone accounted for 55 per cent of the total shortfall. The sales and the size of the quota in this territory suggest the need for further breakdowns, especially by accounts and products. Such breakdowns may reveal that the firm needs to allocate more selling resources to this territory. The company needs to improve its sales primarily in territories 3 and 5. If it can reach its potential in these two territories, overall sales would increase by $301 911, assuming that the quotas set are valid.

Without a standard against which to compare results, the conclusions would be much different. Thus, if only company sales were considered (column 1), White would be the best salesperson and Finch the worst. By using sales quotas as a performance standard, White was not the best but the worst salesperson, with a 77 per cent rating.

**Exhibit 19.9** **Sales analysis based on selected sales territories**

| Sales territory | Salesperson | (1) Company sales 2010 ($) | (2) Sales quota 2010 ($) | (3) Overage, Underage ($) | (4) Percentage of potential performance |
|---|---|---|---|---|---|
| 1 | Barlow | 552 630 | 585 206 | −32 576 | 94 |
| 2 | Burrows | 470 912 | 452 800 | +18 112 | 104 |
| 3 | White | 763 215 | 981 441 | −218 226 | 77 |
| 4 | Finch | 287 184 | 297 000 | −9 816 | 96 |
| 5 | Brown | 380 747 | 464 432 | −83 685 | 82 |
| 6 | Roberts | 494 120 | 531 311 | −37 191 | 93 |
| 7 | Macini | 316 592 | 329 783 | −13 191 | 96 |

## Sales Analysis by Product

Over time, a company's product line tends to become overcrowded and less profitable unless management takes strong and continuous action to eliminate no-longer-profitable items. By eliminating weak products and concentrating on strong ones, a company can increase its profits substantially. Before deciding which products to abandon, management must study such variables as market-share trends, contribution margins, scale effects, and the extent to which a product is complementary with other items in the line.[13]

A product sales analysis is particularly helpful when combined with account size and sales territory data. Using such an analysis, managers often can pinpoint substantial opportunities and develop specific tactics to take advantage of them. For example, one firm's analysis revealed that sales of one of its highest-margin products were down in all the Asian sales territories. Further investigation showed that a regional producer was aggressively promoting a recently modified product with reduced prices. An analysis of the competing product revealed questionable reliability under certain operating conditions. The salesforce used this information to turn around the sales problem.

### Sales Analysis by Order Size

Sales analysis by order size may identify which size orders are not profitable. For example, if some customers frequently place small orders that require salesforce attention and need to be processed, order picked, and shipped, a problem of some importance exists.

Analysis by order size locates products, sales territories, and customer types and sizes where small orders prevail. Such an analysis may lead to setting a minimum order size, charging extra for small orders, training sales reps to develop larger orders, and dropping some accounts or serving them differently. An example of such an analysis involved a nationwide needlework product distributor, which found that 28 per cent of all its orders were $10 and under. A study revealed that the average cost of servicing such orders was $12.82. The analysis also showed that the company did not break even until the order size reached $20. Based on these findings, the company installed a $35 minimum order, charged a special handling fee of $7.50 on all orders below $35, and alerted its field sales reps and telephone salespeople to the problem. As a result, the company increased its profits substantially.

### Sales Analysis by Customer

Analysts use procedures similar to those described earlier to analyse sales by customers. Such analyses typically show that a relatively small percentage of customers accounts for a large percentage of sales. For example, the needlework products distributor cited above found that 13 per cent of its accounts represented 67 per cent of its total sales. Frequently, a study of sales calls shows that the salesforce spends a disproportionate amount of its time with the small accounts as compared with the larger ones. Shifting some of this effort to the larger accounts may well increase sales.

Tesco, using its ClubCard data, now categorises its customers into various buckets, or market segments, based on the premise that 'You are what you eat.' It then tailors quarterly coupon mailings based on the customer behaviour. The 'Loyal Low Spenders' get different coupons than the 'High Spending Superstore Families,' for example. And within these still broad segments, the quarterly offers are further tailored. Tesco mails more than 400 000 variations each quarter.[14]

The key to sales analysis by customer is to find useful decompositions of the sales data that are meaningful in a behavioural way. Three useful variables in doing so are recency (How recently did the customer last buy?), frequency (How often?), and monetary value (How much did the customer spend?). These variables can lead to the development of metrics that can aid the marketer in defining market segments and in understanding the dynamics that underlie changes in sales.[15]

### 19.3.1.2 Line-Item Margin and Expense Analysis

Sales data are not the only marketing performance information needed, of course. Gross and net margins must be tracked, and the effectiveness and efficiency of all line-item marketing expenses must be measured. The designers of marketing performance measurement systems must develop appropriate metrics to track the critical performance indicators for margins and expenses so that timely mid-course corrections can be made. Thus, the weeks-on-hand metric that tells a Gap sweater buyer how quickly each style is selling tells him or her whether to buy more of a particular style if it is selling well, or mark it down if it is not moving. Making such decisions on a timely basis can have a profound effect on gross margins. A not-so-pretty sweater may be more saleable at 25 per cent off before Christmas than at 60 per cent off after December 26. The same idea holds for swimsuits in summer, as shown in Exhibit 19.10.

**Exhibit 19.10 Web-based pricing metrics fatten swimsuit margins**

Steven Schwartz, senior vice president of planning at Casual Male, the 410-store US clothing chain, knew that swimsuit prices had to fall after the Fourth of July holiday in the United States. But was the optimal timing the same in the lake country in Minnesota as at the beaches of Florida or New Jersey or California? Guesswork wasn't good enough, so Schwartz and his team loaded boatloads of the prior year's swimsuit sales data into a Web-based pricing system to get some answers. Northeasterners stopped dead in their tracks in July, they found. Midwesterners kept buying into August. And Sun Belt shoppers never stopped at all.

By making smarter pricing decisions, Casual Male improved its swimsuit gross margins by 25 per cent over the previous year. Dillard's, the department store chain, saw 5 per cent to 6 per cent increases in gross margin across 17 departments using similar tools. Best of all, sales rose, too. Swimsuits may be getting skimpier, but their margins are moving the other way!

*Source*: Faith Keenan 'The Price Is Really Right,' *BusinessWeek,* March 31, 2003, pp. 62ls.

Because budgets project revenues and expenses for a given time period, they are a vital part of the firm's planning and control activities. They provide the basis for a continuous evaluation and comparison of what was planned with what actually happened. In this sense, budgeted revenues and profits serve as objectives against which to measure performance in sales, profits, and actual costs.

Budget analysis requires that managers continuously monitor marketing–expense ratios to make certain the company does not overspend in its effort to reach its objectives. Managers also evaluate the magnitude and pattern of deviations from the target ratios. Managers of the various marketing units have their own control measures. For example, advertising managers track advertising costs per 1000 target audience, buyers per media vehicle, print ad readership, size and composition of TV audiences, and attitude change. Sales managers typically track number of calls per salesperson, costs per call, sales per call, and new accounts. The major marketing expenses are those associated with marketing research, brand management, sales salaries, sales expenses, media advertising, consumer promotions, trade promotions, and publicity.

Before taking corrective action on any of these expenses that are out of line, managers may need to disaggregate the data to help isolate the problem. For example, if total commissions as a per cent of sales are out of line, analysts need to study them by each sales territory and product to determine exactly where the problem lies.

## 19.3.2 When and How Often Is the Information Needed?

Timeliness is a key criterion for the development of a marketing performance measurement system. As we have seen, Walmart's systems provide sales information at the store and item level on an up-to-the-minute basis. More commonly, though, managers attend to performance information – whether for sales, margins, or expenses – on a periodic basis, since they don't have time or the need to assess the performance of every item at every minute of every day. Buyers and merchandise managers in retailing firms typically assess item and category sales performance on a weekly basis. In fashion categories, such as women's apparel, where timeliness is especially important, having sales information a couple of days, or even hours, ahead of competitors can make the difference between obtaining more of a hot-selling item or being left in a faster-moving competitor's dust. For global retailers like Mango, fast data is a crucial driver of the company's fast-fashion strategy (*see* Exhibit 19.11).

**Exhibit 19.11 Mango breaks the fashion rules**

Fashion retailers know that having the right goods in the right stores at the right time is the name of the fashion game. But doing so isn't easy, what with fickle consumers and their changing tastes in everything from hemlines to colours to silhouettes. David Egea, merchandising director at Mango, the Barcelona-based fast-fashion chain with more than 700 young women's boutiques in 72 countries, says, 'To react and have what people want, we have to break some rules.'

Breaking the rules, in Mango's case, means that designs for new items can move from sketchpad to stores in as little as four weeks. By sourcing its styles close to home – instead of making big commitments to Asian suppliers with longer lead times – Mango can drop what's not selling and move quickly into what's hot, as it did in February 2004, when its collection of leather-trimmed black styles inspired by the movie *Matrix* weren't selling. Out went the black, and in came softer, more feminine styles.

Mango's fast-fashion system demands flexibility and speed, as well as up-to-the-minute sales data from the stores, all of which have paid big dividends for the young company, just 20 years old. With fast data and fast fashion, 'We know how to improvise,' says Egan. The closely held company's 2003 sales of £782 million suggest that they do, indeed.

*Source:* Erin White, '"Speeding Up" Fast Fashion,' *The Wall Street Journal Europe,* May 28–30, 2009, p. 45.

Store payroll expense, another key performance criterion for retailers that impacts both customer service and profitability, is typically measured on a weekly basis, though store managers may be encouraged to send employees home if business is unexpectedly slow on a given day or call in extra help when more is needed. The performance of industrial salespeople – in terms of number of sales calls, sales volume, expense control, and other indicators – is typically done on a monthly basis, though some firms may do so more or less frequently as they see fit. Strategic control indicators, such as changes in market share, macro trends, and so on, are likely to be measured and reported less frequently because these kinds of longer-term issues may not be readily apparent or may give false alarms at more frequent intervals.

### 19.3.3 In What Media and in What Format(s) or Levels of Aggregation Should the Information Be Provided?

Advances in information technology have made possible the measurement and reporting of marketing performance information with previously unheard-of ease of access and timeliness, without even printing the data! As we have seen, Walmart's sales information is available on computer screens on an up-to-the-minute basis. In other companies, salespeople around the world now log on to company intranets to see the latest order status of a customer before they walk in the door on a sales call. But *having* good and timely information and *reporting* it in such a manner that it is easy and quick to use are different things. Imagine a Mango buyer having to manually add up the performance of various styles to determine how the category or a particular vendor is performing. Reports should provide such aggregation, of course, but someone must decide what sort of aggregation is most useful for each information user.

Even the format or medium in which performance information is presented can make a big difference to the manager using the data. Weekly weeks-on-hand sales reports that retail buyers and merchandise managers depend on are most usefully reported in order of how fast the styles are selling, rather than alphabetically or some other way. The styles at the top of the report (those with little stock on hand, as measured by their weeks-on-hand sales rate) are candidates for reorders. Styles at the bottom of the report (the ugly sweater in mid-November with 25 weeks of inventory on hand) are candidates for markdowns. The ones in between may need little attention. Once a season ends, a different report, aggregating styles by vendor, perhaps, might be useful to determine which suppliers have performed well and which have performed poorly across the assortment of styles they provide. Thoughtful attention to the format in which marketing performance information is reported, to the levels at which it is aggregated, for different kinds of decision purposes, and for different users, can provide a company with a significant competitive advantage. As we noted earlier in this module, it took Kmart many years to come close to Walmart's system of tracking and reporting store and item sales performance.

### 19.3.4 Does Your System of Marketing Metrics Measure Up?

A key issue in developing a set of marketing metrics as part of an overall performance measurement system is getting the metrics aligned with the strategy. Just as professional athletes measure their performance in order to raise the bar, so too must marketing managers quantify and measure what they accomplish against what was planned. Doing so is particularly difficult if there's no explicit strategy or no culture of measurement that goes beyond summary financial performance.

As we've seen in this module, marketing metrics involve far more than simple analysis of the variances reported by the company's accounting system. So where should one start? A good first step is to identify the elements in a dashboard that the top management team can use to track marketing performance from period to period. Doing so will help gain top management involvement in marketing issues, and it will identify some of the data to which the rest of the organisation should attend. Exhibit 19.12 lists 10 questions for assessing any firm's system of marketing metrics and for identifying some of the elements that its dashboard might report. For many companies, these questions provide a useful wake-up call.

**Exhibit 19.12 Do your marketing metrics measure up?**

**Ten questions for your company's top executive team:**

1. Does the exec regularly and formally assess marketing performance?

*(a) Yearly (b) Six-monthly (c) Quarterly (d) More often (e) Rarely (f) Never*

2. What does it understand by 'customer value'?

*(a) Don't know. We are not clear about this (b) Value of the customer to the business (as in 'customer lifetime value') (c) Value of what the company provides from the customer's point of view (d) Sometimes one, sometimes the other*

3. How much time does the exec give to marketing issues?

—%

4. Does the business/marketing plan show the non-financial corporate goals and link them to market goals?

*(a) No/no plan (b) Corporate no, market yes (c) Yes to both*

5. Does the plan show the comparison of your marketing performance with competitors or the market as a whole?

*(a) No/no plan (b) Yes, clearly (c) In between*

6. What is your main marketing asset called?

*(a) Brand equity (b) Reputation (c) Other term (d) We have no term*

7. Does the exec's performance review involve a quantified review of the main marketing asset and how it has changed?

*(a) Yes to both (b) Yes but only financially (brand valuation) (c) Not really*

8. Has the exec quantified what 'success' would look like 5 or 10 years from now?

*(a) No (b) Yes (c) Don't know*

9. Does your strategy have quantified milestones to indicate progress toward that success?

*(a) No (b) Yes (c) What strategy?*

10. Are the marketing performance indicators seen by the exec aligned with these milestones?

*(a) No (b) Yes, external (customers and competitors) (c) Yes, internal (employees and innovativeness) (d) Yes, both*

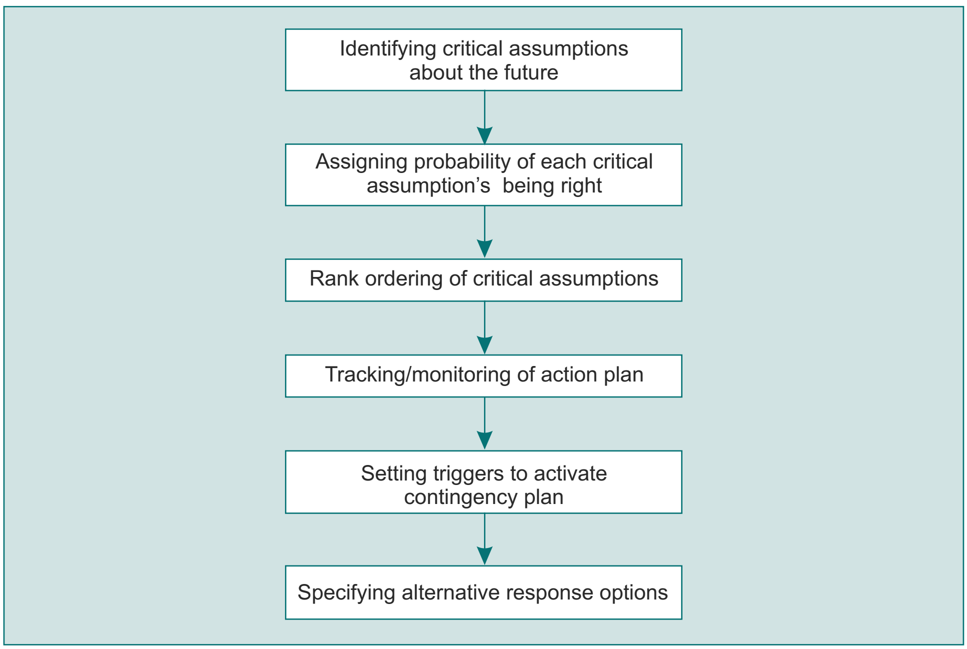
*Source:* Tim Ambler, *Marketing and the Bottom Line. The Marketing Metrics to Pump Up Cash Flow,* 2nd ed. (Copyright © 2003. Pearson Education Limited.)

### 19.3.5 What Contingencies Should Be Planned for?

Because all strategies and the action plans designed to implement them are based on assumptions about the future, they are subject to considerable risk. Too often, assumptions are regarded as facts; and little attention is paid to what action or actions can be taken if any or all of the assumptions turn out to be wrong.

Managers, therefore, often follow a contingency planning process that includes the elements shown in Exhibit 19.13: identifying critical assumptions; assigning probabilities of being right about the assumptions; ranking the importance of the assumption; tracking and monitoring the action plan; setting the 'triggers' that will activate the contingency plan; and specifying alternative response options. We briefly discuss these steps next.

**Exhibit 19.13 The contingency planning process**




#### 19.3.5.1 Identifying Critical Assumptions

Because there are simply too many assumptions to track them all, contingency plans must cover only the more important ones. Assumptions about events beyond the control of the individual firm but that strongly affect the entry's strategic objectives are particularly important. For example, assumptions about the rate of market growth coupled with the entry's market share will strongly affect the entry's profitability objectives. The effect of a wrong assumption here can be either good or bad, and the contingency plan must be prepared to handle both. If the market grows at a rate faster than expected, then the question of how to respond needs to be considered. Too often contingency plans focus only on the downside.

Another type of uncontrollable event that can strongly affect sales and profits is competitive actions. This is particularly true with a new entry (when a competitor responds with its own new product), although it can apply with more mature products (competitor's advertising is increased). Assumptions about industry price levels must be examined in depth because any price deterioration can quickly erode margins and profits.

Assumptions about the effects of certain actions taken by the firm to attain its strategic objectives also need to be considered in depth. Examples include the firm's advertising objectives, which are based on assumptions about an improvement or maintenance of consumer attitudes toward the product's characteristics compared with competing brands, or the monies allocated to merchandising to improve the product's availability. Further, once the targeted levels of the various primary objectives are reached, there are assumptions about what will happen to sales and share.

#### 19.3.5.2 Assigning Probabilities

This step consists of assigning to the critical assumptions probabilities of being right. These probabilities must be considered in terms of the consequences of being wrong. Thus, assumptions that have a low probability of being wrong but could affect the firm strongly need to be considered in depth (for car makers, for instance, petrol shortages or a sharp increase in oil prices).

#### 19.3.5.3 Rank Ordering the Critical Assumptions

If assumptions are categorised on the basis of their importance, the extent to which they are controllable, and the confidence management has in them, then the basis for rank ordering the assumptions and drafting the contingency plan has been set forth. Ordinarily, such a process will have screened out those assumptions that need not be included – those with a low impact on objectives and those about which there is a high confidence they will not occur. Assumptions that relate to uncontrollable events should, however, be monitored if they strongly affect the entry's strategic objectives since the firm can react to them. For example, if the assumption about the rate of market growth is wrong, then the firm can either slow or increase its investments in capacity.

#### 19.3.5.4 Tracking and Monitoring

The next step is to specify what information (or measures) are needed to determine whether the implementation of the action plan is on schedule – and if not, why not. The contingency plan is, therefore, an early warning system as well as a diagnostic tool. If, for example, the firm has made certain assumptions about the rate of market demand increase, then it would monitor industry sales on a regular basis. If assumptions were made about advertising and its effect on attitudes, then measures of awareness, trial, and repeat buying would be likely to be used. Relevancy, accuracy, and cost of obtaining the needed measures must be examined in depth. Some of the information needed in the contingency plan might have been specified in the control plan, in which case it is already available.

#### 19.3.5.5 Activating the Contingency Plan

This involves setting the ‘triggers’ to activate the contingency plan. It requires a specification of both the level at which an alert will be called and the combination of events that must occur before the firm reacts. If, for example, total industry sales were 10 per cent less than expected for a single month, this would not be likely to trigger a response, whereas a 25 per cent drop would. Or a firm may decide the triggering would occur only after three successive months in which a difference of 10 per cent occurred. Triggers must be defined precisely and responsibility assigned for putting the contingency plan into operation.

#### 19.3.5.6 Specifying Response Options

Actually, the term *contingency plan* is somewhat misleading. It implies that the firm can know in advance exactly how it will respond if one or more of its assumptions go awry. This implication is unrealistic because there are a great many ways for critical assumptions to turn out wrong. To compound the problem, the firm’s preplanned specific responses can be difficult to implement, depending on the situation and how it develops. This can lead to a set of responses that build in intensity. Thus, most firms develop a set of optional responses that are not detailed to any great extent in an effort to provide flexibility and ensure further study of the forces that caused the alert.

### 19.3.6 Global Marketing Control

Maintaining control over global marketing activities is more difficult than with domestic marketing, primarily because of the number of countries involved, each presenting a unique set of opportunities and threats. This makes it difficult to monitor simultaneously a variety of environments and to prescribe corrective action on an individual-country basis where appropriate. Differences in language and customs, accentuated by distance, further compound the control problem.

Nonetheless global companies typically use essentially the same control system format for both their domestic and foreign operations, though report frequency and extent of detail can vary by the subsidiary’s size and environmental uncertainties. The great advantage of using a single system is that it facilitates comparisons between operating units and communications between home office and local managers. If Mango didn't have uniform systems across its 700-plus stores in 72 countries, it simply would not have been able to grow as it has. On the surface, the use of electronic data interchange should simplify performance evaluation across countries. While this is true in terms of budget control, it leaves much to be desired in terms of understanding the reasons for any deviations.

## 19.4 A Tool for Periodic Assessment of Marketing Performance: The Marketing Audit

While marketing performance measurement systems are essential for tracking day-to-day, week-to-week, and month-to-month performance to see that planned results are actually delivered, it is sometimes useful to step back and take a longer view of the marketing performance of an SBU or of the entire company. Marketing audits are growing in popularity, especially for firms with a variety of SBUs that differ in their market orientation. They are both a control and planning activity that involves a comprehensive review of the firm's or SBU's total marketing efforts cutting across all products and business units. Thus, they are broader in scope and cover longer time horizons than sales and profitability analyses.

Our concern here is at the individual SBU level or, for smaller or single-business firms, the entire company. Such an audit covers both the SBU's objectives and strategy and its plan of action for each product-market entry. It provides an assessment of each SBU's current overall competitive position as well as that of its individual product-market entries. It requires an analysis of each of the marketing-mix elements and how well they are being implemented in support of each entry. The audit must take into account the environmental changes that can affect the SBU's strategy and product-market action programmes.

### 19.4.1 Types of Audits

Audits are normally conducted for such areas as the SBU's marketing environment, objectives and strategy, planning and control systems, organisation, productivity, and individual marketing activities such as sales and advertising. These areas are shown in Exhibit 19.14 together with examples of the kinds of data needed.

**Exhibit 19.14 Some major areas covered in a marketing audit and questions concerning each for a consumer goods company**

| Audit area | Examples of questions to be answered |
|---|---|
| Marketing environment | What opportunities and/or threats derive from the firm's present and future environment; that is, what technological, political and social trends are significant? How will these trends affect the firm's target markets, competitors, suppliers, and channel intermediaries? Which opportunities/threats emerge from within the firm? |
| Objectives and strategy | How logical are the company's objectives, given the more significant opportunities/threats and its relative resources? How valid is the firm's strategy, given the anticipated environment, including the actions of competitors? |

| Audit area | Examples of questions to be answered |
|---|---|
| Planning and control system | Does the firm have adequate and timely information about consumers' satisfaction with its products? With the actions of competitors? With the services of intermediaries? Is the new product development process effective and efficient? |
| Organisation | Does the organisation structure fit the evolving needs of the marketplace? Can it handle the planning needed at the individual product/brand level? |
| Marketing productivity | How profitable are each of the firm's products/ brands? How effective and efficient are each of its major marketing activities? |
| Marketing functions | How well does the product line meet the line's objectives? How well do the products/brands meet the needs of the target markets? Does pricing reflect cross-elasticities, experience effects and relative costs? Is the product readily available? What is the level of retail stockouts? What percentage of large stores carries the firm's in-store displays? Is the salesforce large enough? Is the firm spending enough on advertising? |

- The **marketing environment audit** requires an analysis of the firm's present and future environment with respect to its macro-components, as discussed in Modules 3 and 4. The intent is to identify the more significant trends to see how they affect the firm's customers, competitors, channel intermediaries, and suppliers.
- The **objectives and strategy audit** calls for an assessment of how appropriate these internal factors are, given current major environmental trends and any changes in the firm's resources.
- The unit's **planning and control system audit** evaluates the adequacy of the systems that develop the firm's product-market entry action plans and the control and reappraisal process. The audit also evaluates the firm's new product development procedures.
- The **organisation audit** deals with the firm's overall structure (can it meet the changing needs of the marketplace?); how the marketing department is organised (can it accommodate the planning requirements of the firm's assortment of brands?); and the extent of synergy between the various marketing units (are there good relations between sales and merchandising?).
- The **marketing productivity audit** evaluates the profitability of the company's individual products, markets (including sales territories), and key accounts. It also studies the cost-effectiveness of the various marketing activities.
- The **marketing functions audit** examines, in depth, how adequately the firm handles each of the marketing-mix elements. Questions relating to the product concern the attainability of the present product-line objective, the extent to which individual products fit the needs of the target markets, and whether the product line should be expanded or contracted. Price questions have to do with price elasticity; experience effects, relative costs, and the actions of major competitors; and consumers' perceptions of the relationship between a product's

price and its value. Distribution questions centre on coverage, functions performed, and cost-effectiveness. Questions about advertising focus on advertising objectives and strategies, media schedules, and the procedures used to develop advertising objectives and strategies, media schedules, and advertising messages. The audit of the salesforce covers its objectives, role, size, coverage, organisation, and duties plus the quality of its selection, training, motivation, compensation, and control activities. In some companies marketing audits cover additional areas including the two that follow.

- The company's **ethical audit** evaluates the extent to which the company engages in ethical and socially responsible marketing. Clearly this audit goes well beyond monitoring to make sure the firm is well within the law in its market behaviour. If the company has a written code of ethics, then the main purpose of this audit is to make certain that it is disseminated, understood, and practised.
- The **product manager audit**, especially in consumer goods companies, seeks to determine whether product managers are channelling their efforts in the best ways possible. They are queried on what they're doing versus what they ought to be doing. They also are asked to rate the extent to which various support units were helpful.

## 19.5 Measuring and Delivering Marketing Performance

As we've seen in this final module, the challenges entailed in measuring expenditures in marketing programmes in relation to marketing performance in such a manner as to produce information that is timely, relevant, easy-to use, cost-effective, useful to managers, and credible across the organisation are daunting. But tackling these challenges head-on can make the difference when it comes to the sort of superior returns on investment that companies like Walmart deliver year after year. While marketing audits and various kinds of decision support systems do not guarantee strong performance, they help responsible, committed managers make decisions on the basis of current and valid information instead of hunches or uninformed guesses. It is for this reason that companies are paying increased attention to the development of information dashboards that provide people at all levels – from board members to top execs to line managers who deal with customers every day – the information they need to make timely, well-informed decisions about marketing, operational, and a host of other crucial decisions (*see* Exhibit 19.15).

**Exhibit 19.15 Dashboards: The CEO's Killer App?**

Jerry Driggs, COO of Little Earth Productions, a marketer of funky, eco-fashion clothing and accessories such as handbags made out of recycled licence plates, used to run his business by the seat of his pants. It showed. Without a good system to keep track of the amount of raw materials his Chinese suppliers needed, it used to take Little Earth six weeks to make and ship a handbag. And too much cash was tied up in trim pieces and closures that weren't really needed. To solve his problems, Driggs spent four months installing a dashboard from NetSuite, a fast-growing software company that specialises in this arena. Now he gets critical information displayed in easy-to-read graphics whenever and wherever he needs it.

Little Earth and many much larger companies including Verizon, Home Depot, and Microsoft swear by their dashboards, which some observers now regard as the CEO's killer app, making details that used to be buried deep inside the business available at a moment's notice. 'The dashboard puts me and more and more of our executives in real-time touch with the business,' says CEO Ivan Seidenberg of Verizon. While some critics worry that executives will spend too much time glued to their PCs and that the instant availability of data can add to the pressures that line managers already face, Driggs is a convert. As he puts it, 'All of those things that used to drive us crazy are literally at our fingertips. Once you see it is so intuitive, you wonder how we ran the business before.'

*Source:* Spencer E. Ante, 'Giving the Boss the Big Picture,' *BusinessWeek European Edition,* February 13, 2006, pp. 48–51.

As the saying goes, what gets measured gets done. Measuring marketing performance and doing so effectively is the all-important icing on the marketing manager's cake. Measure well – and in a timely and easy-to-use fashion – and performance is likely to follow.

## Learning Summary

- Most managers and entrepreneurs are evaluated primarily on the results they deliver. Effective design of control systems, whether for strategic control or for marketing performance measurement, helps ensure the delivery of planned results. A step-by-step process for doing so is provided in this module.
- Control systems that deliver the right information – in a timely manner and in media, formats, and levels of aggregation that users need and can easily use – can be important elements for establishing competitive advantage. Four key questions that designers of such systems should address are discussed in this module.
- From time to time, it is useful to step back from day-to-day results and take a longer view of marketing performance for a company or an SBU. A marketing audit, as outlined in this module, is a useful tool for conducting such an assessment.

# Review Questions

## Content Questions

19.1 What are the major steps in the control process?

19.2 Why are more and more firms using non-financial control measures in addition to the traditional financial-based measures? What are some of the more commonly used non-financial measures?

19.3 Describe the use of benchmarking as a performance type of measure.

19.4 What are the advantages of using the contribution method to determine a product's profitability?

19.5 What does strategic control hope to accomplish?

19.6 What are the various types of marketing audit?

19.7 What are the major steps in the contingency planning process?

## Multiple Choice Questions

19.8 Which of the following is a measure of a non-financial objective?

A. ROI.
B. Unit sales.
C. Monetary value of sales.
D. Maintenance of market share.
E. Return on sales.

19.9 The president of RJ Enterprises wants to develop a control system to monitor the marketing operation of the company. What should be the first step?

A. Specify the type of information needed to make decisions.
B. Develop corporate marketing objectives.
C. Set performance standards to evaluate the marketing plan.
D. Obtain feedback data.
E. Evaluate control information.

19.10 When Walmart wants an estimate of what a new retail programme is costing, but excludes items like the time its managers spent in developing and administering the programme, they are conducting a(n):

A. contribution margin analysis.
B. full cost analysis.
C. merchandise allowance analysis.
D. indirect cost analysis.
E. cost/benefit analysis.

19.11 When Xerox wants to know how much they earned from a new product and they include all variable and administrative costs related to the product they are conducting a(n):

A. contribution margin analysis.
B. full cost analysis.
C. merchandise allowance analysis.
D. indirect cost analysis.
E. direct cost analysis.

19.12 The costs associated with an agent salesforce represent which type of cost?

A. Full cost.
B. Indirect cost.
C. Direct cost.
D. Contribution cost.
E. Motivational cost.

19.13 The basic argument of _____ is that there is really no accurate way to assign indirect costs.

A. contribution accounting.
B. contribution costing.
C. profitability analysis.
D. direct accounting analysis.
E. full cost analysis.

19.14 A manager with the M Company is concerned with assessing how much additional business can be derived by applying additional resources to each of the company's best customers. What type of analysis should the manager conduct?

A. Direct cost.
B. Customer assessment.
C. Contribution margin.
D. Profitability.
E. Cost benefit.

19.15 If a firm wishes to determine the cost on the different tasks involved in performing a given activity it may get the most accurate answer by using:

A. activity based costing.
B. benchmarking.
C. a direct cost analysis.
D. a full cost analysis.
E. an indirect cost analysis.

19.16 Assessing customer satisfaction is very important because it:

A. is a solid measure of financial performance.
B. may reveal why a firm has a given share of market.
C. tells the marketing manager how satisfied his customers are.
D. provides the marketing manager with a benchmark.
E. is a type of non-financial analysis.

19.17 The attributes which customers use to evaluate the quality of a company's relationship with them are known as those customers':

A. operating measures.
B. choice criteria.
C. contribution criteria.
D. direct criteria.
E. indirect criteria.

19.18 Measures of how well McDonald's has met the customers' expectation on the speed of service are known as:

A. contribution measures.
B. performance measures.
C. indirect measures.
D. P&L measures.
E. gross margin measures.

19.19 The last step in the control process is:

A. the evaluation of feedback data.
B. setting corporate objectives for next year.
C. obtaining control information.
D. setting performance standards for next year.
E. taking corrective action.

19.20 Outcome feedback is regularly obtained through all of the following methods EXCEPT:

A. corporate espionage.
B. company records.
C. syndicated services like IRI.
D. marketing research.
E. executive interviews with customers.

19.21 Before _____ can occur marketing managers must know _____ the outcome deviated from plan.

A. strategic planning; if.
B. strategic planning; the amount by which.
C. corrective action; why.
D. future planning; if.
E. future planning; the amount by which.

19.22 The basic objective of _____ is to develop a continuous monitoring system that provides data designed to help answer key questions about the opportunities and threats to each SBU.

A. management control.
B. marketing evaluation systems.
C. contingency plans.
D. performance review systems.
E. strategic control.

19.23 A strategic control system should be able to answer all of the following questions EXCEPT:

A. What new threats have emerged from environment changes?
B. What environmental changes have negatively affected the current strategy?
C. What changes in strategy have our competitors made?
D. What performance criteria should be set for our new product?
E. What capacity changes have occurred in our industry?

19.24 Strategy reassessment usually occurs:

A. quarterly.
B. annually.
C. during performance evaluation.
D. during major changes in the external environment.
E. all of the above.

19.25 The first step in the strategic control process is to identify key variables to monitor, some of which will be _____ to the firm and some that are related to the actions taken by the firm to _____ its strategy.

A. internal; plan.
B. internal; assess.
C. external; plan.
D. external; assess.
E. external; implement.

19.26 Which of the following is a possible way of performing a sales analysis?

A. By sales territory.
B. By channel intermediaries.
C. By order size.
D. By customer type.
E. All of the above.

19.27 Breaking a company's sales down by county is an example of a sales analysis by:

A. size of order.
B. channel intermediaries.
C. product.
D. territory.
E. customer type.

19.28 When a sales analysis is performed by territory, the typical choice of the unit of analysis is:

A. the city.
B. the county.
C. the state.
D. the five regions of the USA.
E. the block.

19.29 One consequence of _____ sales analysis is that unprofitable accounts may be dropped.

A. product.
B. territorial.
C. order size.
D. geographic.
E. brand.

19.30 All of the following are factors that can contribute to the need for unique control systems for a firm's domestic and international subsidiaries EXCEPT:

A. differences in size.
B. differences in strategy standardisation.
C. differences in customer type.
D. differences in environments.
E. none of the above.

19.31 The major reason global marketing activities are more difficult to control than domestic marketing activities is that:

A. cultural differences create different problems.
B. language problems make translation difficult.
C. top management frequently finds it difficult to identify with global markets.
D. standardised control mechanisms are inappropriate in foreign markets.
E. the company is operating in so many different environments, with each presenting a unique situation.

19.32 A firm's new-product-development process would most likely be evaluated in the _____ area audit.

A. organisation.
B. marketing-productivity.
C. marketing-functions.
D. marketing-environment.
E. planning and control system.

19.33 An audit can be performed for which of the following areas?

A. Productivity.
B. Planning and control systems.
C. Objectives and strategy.
D. Marketing environment.
E. All of the above.

19.34 If Ford were to investigate questionable sales practices of one of its dealers it might be engaging in a(n)

A. ethical audit.
B. objectives and strategy audit.
C. organisation audit.
D. productivity audit.
E. product manager audit.

19.35 In contingency planning, rank ordering the critical assumptions should be based on:

A. their importance.
B. the extent to which they are controllable.
C. the confidence management has in them.
D. all of the above.
E. only A and B above.

19.36 The first step in the contingency planning process is to identify critical assumptions and the next step is:

A. assigning probabilities.
B. rank ordering the critical assumptions.
C. tracking the critical assumptions.
D. specifying response actions.
E. none of the above.

## Application Questions and Cases

19.37 The control system at Walmart is an important reason for their success. Specifically, how has this system helped them become the largest retailer in the world? Walmart's recent placement of stores in Canada, Mexico, South America and Asia must have posed control problems for higher-level management. Discuss these problems and, in doing so, include your suggestions for ways of solving them.

19.38 Discuss the relative advantages and limitations of the *full costing versus the contribution margin* approaches for determining the profitability of a specific item within a firm's product line. Which approach do you think is most commonly used by large, multi-SBU corporations? Why?

19.39 Use the data presented in Exhibit 19.5 in the text. As new marketing manager, you believe the product's net sales could be increased by $250 000 by taking the following actions: (a) increase advertising by $45 000; (b) add one more salesperson at a total cost of $60 000; and (c) improve delivery time to customers by spending an additional $25 000 on order processing and warehousing for the product. If the product's cost of goods sold does not change, what would be the effect of these actions on the product's contribution margin? What would be the original effect on pretax profits?

19.40 An alternative to the actions described in Question 19.39 would be to increase the advertising promotion budget by $70 000 without making any changes in the salesforce or the logistics system. It is estimated that such an increase in advertising would generate an additional $130 000 in net sales. Which alternative should be adopted?

19.41 You are a marketing manager in an SBU of a large consumer food manufacturer. The SBU's general manager has asked you to conduct a *marketing audit* of the SBU as a basis for evaluating its strategic and operations strengths and weaknesses. What issues or areas of concern should be covered by your audit? After completing your marketing audit, you are asked to develop a contingency plan for the SBU's major product line. Outline the plan you would recommend.

19.42 For each set of issues to be included in the audit you designed in your answer to Question 19.41, specify the kinds of information you would need to collect and the major sources you might use to obtain that information.

19.43 When they saw the result of the *sales territory analysis* presented in Exhibit 19.9 in the text, the firm's top managers concluded that Barlow in territory 1 was not devoting sufficient effort to her job, since her performance was more than $32 000 below quota. They have asked you – the firm's sales manager – to have a talk with Barlow and suggest a way to improve her performance. Do you agree that Barlow's performance is probably the result of too little effort on her part? Why or why not?

19.44 What other causes might be responsible for Barlow's failure to make quota? What additional information or analyses would you seek in order to determine what should be done to improve Barlow's future performance?

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# Appendix 1

# Practice Final Examinations

## Contents

# Practice Final Examination 1

*Note*: The answers provided are guidelines only. Though they contain the major points sought, the student's response should provide further insight into many of the points. Simply repeating the major bullet points does not necessarily demonstrate the required level of understanding of the subject.

## Case Study – Question 1

Across Europe and the USA, during the next 10–12 years, more than half the population will become 50 or older. Many of these over-50s will have high levels of disposable income. Yet many companies still avoid the 'grey' market, due to its negative associations with frailty. Indeed, much mass-media advertising features mid-30s people, with few positive images of older people.

A major entrepreneur wishes to launch a specialist publication for this market of over-50s in Europe and the USA. There is concern that over-50s do not think of themselves as being old, and therefore the selection of design, contents and even terminology will be crucial for the success of the publication.

1 *You are asked to design a targeting and positioning strategy for the new publication and to outline what kind of information will be required to implement the strategy.*

(30 marks)

## Case Study – Question 2

Despite wholly optimistic predictions about the worldwide tourist industry, travel agents are under threat. The role of the travel agent is to sell the services of a 'tour operator'. There are three levels to the travel agent business. The first level contains the big 'chains' that dominate the market, such as Thomson Holidays, American Express or Thomas Cook. The second level is made up of independent travel agents who offer a wide range of travel services. The third level includes the specialist travel agents who concentrate on discount travel, travel to one country and so on.

One of the threats to the travel agents' business is the increasing vertical integration between tour operators and travel agents, which pressurises commission on the various travel services sold. For example, in the US, most airlines pay no commission at all and travel agents simply add a service fee to the net price. In addition, the tendency for tourists to want to plan and customise their own holiday means that the traditional 'package holiday' is less attractive and that would-be tourists will increasingly by-pass travel agents.

1 *How would you advise a chain of travel agents to defend itself against trends such as those listed in the case?* (30 marks)

## Essay – Question 3

1 *Discuss the contention that it is often too time-consuming and costly to identify the benefits sought by purchasers and that marketers can more usefully focus on product characteristics. Illustrate your answer with reference to* ***two*** *of the following products:*

- *carbonated soft drinks*
- *personal computers*
- *alarm clocks*
- *camcorders*

(40 marks)

# Practice Final Examination 2

## Case Study – Question 1

Go-Green is a small company established in Australia five years ago to promote and sell ecologically sensitive holidays in the Antipodes. Until now its operation has targeted Australian tourists, but the target segment of tourists remains relatively small at 5 per cent of the overall tourist market of 6m. Go-Green is one of around 50 Australian companies providing tailor-made holidays for the eco-sensitive tourist and is estimated to have a market share of 8 per cent. The average price of a 7-day eco-holiday is around $A2400. Go-Green seeks to expand its operation to attract tourists from outside Australia to its eco-destinations and has initially specified Europe and the USA as the major markets of interest.

1 *How can Go-Green assess the attractiveness of the various segments within the region it has initially identified? How would you advise Go-Green's management to select its new target markets?* (30 marks)

## Case Study – Question 2

The European speciality vegetable market is expected to grow from $US20 billion turnover in 2010 to $US24 billion by the year 2015. Brazil is the fifth-largest exporter of speciality vegetables to the European Union (EU), providing over 9000 tonnes of fine beans, baby corn, mange-tout and snow peas per annum.

However, the Brazilian producers are facing increasing competition from producers in other countries, including Kenya, Tanzania, Israel and Argentina. Furthermore, while fine beans are the most typical Brazilian vegetable, other countries are also supplying them in increasing volumes, forcing down prices.

1 *Outline a marketing strategy for a speciality vegetable producer in Brazil to ensure long-term success in the European market.* (30 marks)

## Essay – Question 3

1 *Discuss the main strategic pricing objectives a company may specify and give examples of the types of markets where each type of objective is most appropriate. What are the implications for relative price levels of pursuing each of the types of objective?* (40 marks)

# Examination Answers

## Practice Final Examination 1

### Case Study – Question 1

1 This question requires candidates to demonstrate knowledge of:

- Personal influences on consumer decision-making processes (Module 6)
- Market segmentation and targeting (Module 9)
- Positioning decisions (Module 10)
- Research design (Module 8)

The answer should point out the steps in the positioning process with regard to the information required of the 'grey' market at each stage. The steps in the process are detailed in Section 10.5 in the text. The information requirements of each stage should be discussed in detail, together with the observation that *qualitative data* is imperative in this particular instance.

| Stage | Information examples |
|---|---|
| 1. Identify competitive products | Reading/leisure pursuits. |
| 2. Determinant attributes | Antecedent factors influencing magazine readership, liking, disliking, etc. |
| 3. Customer perception | This can only be done *vis-à-vis* other products as the new one is a new format. |
| 4. Intensity of current products | Cannot be done for non-existent product – but information on intensity and distinctiveness of a new product's position is crucial. |
| 5. Good answers will point out use of analytical techniques for determining gaps, but will also show that measurement based on poor groundwork is dangerous. | |
| 6. Market positioning | Again difficult to define precise information for product which does not exist. Information regarding the 'ideal' point can be gleaned. Good answers will identify the need for segment definition. |
| 7. Define positioning segmentation | Information required now is what benefits are thought to appeal to what segments. Good answers will integrate discussion of market positioning maps. |
| 8. Select positioning strategy | Detailed coverage of this is not implied by the question. |

## Case Study – Question 2

1 This question requires candidates to demonstrate knowledge of:

- The conditions for exchange (Module 1)
- Industry dynamics (Module 5)
- Distribution decisions (Module 13)
- Market targeting (Module 9)
- Promotion (Module 6 and Module 14)

Central to this answer must be a discussion of the 'distributive function' of travel agents (Module 13) and the nature of the benefits they do or do not provide (Module 1).

Candidates should clearly identify what service the travel agent provides, and to whom, before going on to suggest how a position might be maintained via market targeting and positioning decisions.

## Essay – Question 3

1 This question requires candidates to demonstrate knowledge of several underlying areas of marketing, the specifics of which, together with an indication of where they are dealt with in the text, are shown below:

- The role of benefits in facilitating exchange (Module 1)
- Consumer markets and buying behaviour (Module 6)
- Market segmentation (Module 9)
- Research design (Module 8)
- Product and services decisions (Module 11)

A basic pass answer will first mention:

- how exchange creates value and how product benefits will determine customer value;
- that benefits may be derived by a variety of different technological/product configurations;
- that the above give rise to both direct and indirect competition, which expands the necessary field of enquiry if identifying benefits.

The superior answer will use a choice of examples to amplify these points, e.g. the value of a camcorder is defined as the amount of money with which the buyer is prepared to part for a variety of benefits: capturing cherished moments; the clarity of the picture/sound; the status enhancement from owning a camcorder; the ease of storage/parking and so on. These benefits may be gained from a camcorder, but also from cameras or professional video recording services. Accordingly, the identification of 'benefits' should not simply be a list of the temporal characteristics of current camcorders.

Interwoven into this basic proposition should be:

(a) the determinants of consumer buying behaviour;
(b) the existence of different groups of customers seeking different benefits.

Discussion of these influences on the determination of 'benefits sought' must lead on to further discussion of the difficulties they present for research design. Specifically, it is easier to attempt to 'measure' importances and preferences among current product characteristics than it is to unearth the motivations behind the purchases in any of the four examples given in the question. Yet it is imperative to do the latter, since ways of delivering benefits are likely to change. In the case of the camcorder, digital recording may deliver superior benefits for which certain segments' buying behaviour might be appropriate.

Finally, some mention of the actual product decisions predicated upon the analysis of benefits and characteristics should be made.

Answers omitting consideration of the examples given in the question should not pass.

## Practice Final Examination 2

### Case Study – Question 1

1 This question relates largely to Module 9 on market segmentation and market targeting.

The introduction to the answer should demonstrate understanding of the relative position of Go-Green: a small, new company in a small and competitive area of the tourism market in Australasia. Its market share, however, is good in view of the numbers of competitors, so in its sector, it is in a relatively strong position. On the other hand, it has no experience of the consumers in the markets it may seek to attract. The answer should also demonstrate an understanding of the difference between segmentation, targeting and positioning. Segmentation is the process by which a market is divided up into distinct customer subsets with similar needs and characteristics which lead them to respond in similar ways to a company's marketing. Target marketing is the result of evaluating segments in terms of the relative attractiveness, benefits sought by each segment and the resources available to attract a particular segment. Positioning involves the design of a product or service which creates competitive advantage in the target segment.

**Maximum 8 marks**

The importance of market segmentation in the context of this case study should be described. Population growth, having slowed in developed economies such as Australia, Europe and the USA, means that markets are maturing and there is a need to focus on increasing market share as a way of increasing business. Social and economic factors such as higher disposable income and greater familiarity with the basic product have produced customers with more discriminating tastes and requirements. As recently as thirty years ago, foreign holidays were novel to most Europeans and Americans alike; now they are more common and people are looking for a specific type of foreign holiday to suit their chosen lifestyle. In addition, the ability to cater for specific tastes has been greatly increased through increasing availability of transport, tour operators and primary suppliers to the tourist industry such as hotels, campsites, self-catering accommodation and so on. Finally, media through which specific holiday types might be promoted have been growing in number: special interest magazines and travel books, sections in newspapers, television programmes as well as the Internet.

**Maximum 8 marks**

A chosen process of segmentation, targeting and positioning should then be described. The precise details of the mix of choices is less important than a contextual discussion for segmentation and targeting which should include:

*Segmentation*

- The chosen descriptors of the intended US and European markets: demographic descriptors include age, sex, family life cycle, income, occupation, education level, geography and race; behavioural descriptors include: life style, social class, propensity to go on foreign/activity/alternative holidays, innovativeness, source of purchase influence and choice criteria.
- A description of how to apply these descriptors to the chosen market: how many distinct segments can be found, which are attractive opportunities for Go-Green in view of their size and relative strength and which segments are not being currently satisfied? The criteria of measurability, accessibility, differing responses and size of segments should be mentioned.

**Maximum 4 marks**

*Targeting*

- The identified segments should be analysed in terms of potential. This might be done by applying the market attractiveness/business position matrix but would certainly include the following steps:
  1. Choose criteria to measure attractiveness. This includes market factors (such as size, growth rate, potential for differentiation, satisfaction with current offering), economic and technological factors (such as industry capacity, barriers to entry/exit, access to the holiday supply chain from the two new regions); competitive factors (such as industry structure, competitive groupings, competitive position and strengths) and environmental factors such as regulation and degree of social acceptance.
  2. Assign a numerical weight to each factor to indicate its importance.
  3. Rate each segment on the criteria of attractiveness.
  4. Project the future position of each segment based on competitive position factors such as market share, company image; economic and technological factors such as relative cost position of Go-Green and Go-Green's capabilities in all the major business functions.
  5. Project the future position of the segments, although acknowledging that forecasting the future is less easy than diagnosing the present.
  6. Evaluate the implications for choosing a target market and allocating resources.
- The niche markets should then be identified.

**Maximum 10 marks**

## Case Study – Question 2

1 This question requires candidates to demonstrate knowledge of the strategic role of marketing. Candidates should discuss the role of strategy in aligning corporate strengths with the environment and state that within this context, marketing's strategic responsibility is its influence on the choice of which products and in which markets a company operates. These are also known as decisions of scope. Marketing also has an important input into the identification of sustainable competitive advantage, particularly if this is through product differentiation. Within the speciality vegetable markets of Europe, the marketing strategies used have largely concentrated on consistent quality and availability of produce, which has required the careful management by retailers of the supply chain in general and primary producers in particular.

**Maximum 10 marks**

Industry dynamics and the product life cycle are clearly relevant to the speciality vegetable supply chain and the characteristics of the PLC should be demonstrated: introduction, growth, shakeout, maturity and decline. Although the markets for speciality vegetables have been growing, there is likely to be a simultaneous growth in suppliers and a slowing of growth in demand with the appearance of the characteristics of maturity. Thus the current marketing strategies of Brazilian growers should be: hold share, concentrate on features quality and continuity of supply, differentiate on packaging and 'features' (e.g. pre-packed and washed vegetables). As the industry moves towards late maturity, growers will need to pay particular attention to increasing price competition (or adding more value for the same price) from lesser developed countries.

**Maximum 10 marks**

Extending this PLC theme, answers should demonstrate familiarity with the strategies for mature markets. Strategic issues in mature markets are: replacement purchases, customer retention and increased competition as demand slows down. Both analyser and defender strategies might be appropriate for growers with a leading, or at least a profitable share of one of the segments in a mature market. Both are concerned with maintaining a strong share position in established product-markets. Analysers and defenders may use either low-cost or differentiation strategies; low-cost options require a no-frills product, innovative low cost design, cheaper raw materials, innovative production processes, low-cost distribution and reductions in overheads. Differentiated programmes require a focus on product and service quality. The good answers will give examples of how these strategies might be used by the Brazilian growers of speciality vegetables.

**Maximum 10 marks**

## Essay – Question 3

1 This question demands that students identify five major objectives of pricing in marketing: maximise sales growth and market penetration; maintain quality or service differentiation; maximise current profit; survival of the firm and, finally, social objectives. It should be noted that these objectives are part of integrated

marketing wherein the business strategy, target market and positioning strategy for the product are all clearly defined.

**Maximum 10 marks**

The types of markets where each is most appropriate are as follows:

*Maximise sales growth and market penetration*

This strategy is most appropriate where the product-market is relatively young (as in the case of Go-Green (Case Study 1 above); other examples include customer loyalty programmes, digital audio tapes, alternative energy). Customers are generally sensitive to price – particularly in relation to their current product/services. Firms deploying this strategy must have a relatively low-cost position (so that they can compete when more players arrive to take advantage of an expanding market). A relatively low price is set, aimed at winning new customers and expanding the product-market as well as capturing as large a market share as possible.

**Maximum 6 marks**

*Maintain quality or service differentiation*

This strategy is most appropriate in the growth or early maturity stages of the product life cycle, as in the case of the speciality growers in Case Study 2 above. Other examples include mobile telecommunications, laptop PCs and colour photocopiers. The price may be set higher than competitive offerings, but this must reflect customer perception of high quality, relative price insensitivity from those customers and the firms' determination to keep the product at the forefront of the customer's mind with promotion. The high relative price is intended to cover high production costs due to differentiation, distribution and advertising costs. Also it is higher than that of competitors due to the need to maintain differentiation and to reinforce the high-quality image.

**Maximum 6 marks**

*Maximise current profit*

This strategy is subdivided into two: skimming and harvesting pricing. Skimming is appropriate in the early introductory or late maturity stages of a product-market life cycle. It involves setting very high prices which are accepted by the market either because the firm is offering highly differentiated benefits to customers (typically supplied by the latest advances in technology in a given field) or because there are no alternatives available on the market. As the market matures a firm can reduce the price to attract new segments or withdraw from the product-market to pursue new skimming policies elsewhere.

**Maximum 5 marks**

Harvesting is appropriate to the decline stage of a product-market life cycle, and involves cutting costs from the product and setting a relatively high price to maintain margins and maximise profits. These product-markets are suffering long-term decline, mostly due to substitution from new technologies. Examples include dot matrix printers and analogue heating/air-conditioner controls. The relatively high price may increase switching behaviour by customers, but this is accepted as part of the product's funding of other, longer-term ventures of the firm. (Cash-cow funding is a term that may be used.)

**Maximum 5 marks**

*Survival of the firm*

This is appropriate – indeed necessary – where a firm's product has a weak competitive position but where 'faults' are correctable and the firm needs to buy time to make the necessary changes. The product-market life cycle is usually still in the growth or early maturity stage. This objective requires reduced prices, even below total cost, as long as the revenues make a contribution to variable costs and a contribution to overheads.

**Maximum 5 marks**

*Social objectives*

Here the firm is usually nonprofit making, costs are subsidised, as with museums, hospitals and school education. Prices are set low, again below total costs in some segments of the market in order to stimulate or subsidise demand for reasons identified by policy makers. An example of this is where performing arts companies offer discounts to students in order to build future loyalty.

**Maximum 3 marks**

# Appendix 2

# Answers to Review Questions

## Contents



## Module 1

### Review Questions

### Content Questions

1.1 *See* Section 1.2.

1.2 *See* Section 1.2.1.

1.3 *See* Section 1.2.3.

1.4 *See* Section 1.2.6.

1.5 *See* Section 1.2.6.

1.6 *See* Exhibit 1.7.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 1.7 | C | 1.8 | B | 1.9 | E | 1.10 | B | 1.11 | E |
| 1.12 | C | 1.13 | A | 1.14 | A | 1.15 | D | 1.16 | D |
| 1.17 | D | 1.18 | A | 1.19 | C | 1.20 | E | 1.21 | C |
| 1.22 | A | 1.23 | E | 1.24 | B | 1.25 | E | 1.26 | A |
| 1.27 | C | 1.28 | B | 1.29 | B | 1.30 | E | 1.31 | D |
| 1.32 | C | | | | | | | | |

## Application Questions and Cases

1.33 This was an exchange – money for recognition and a feeling of having done a good deed for some worthwhile cause. Charitable organisations typically build up the need for your support by explaining what it will accomplish, providing recognition and status, and using volunteers to encourage others to support the charity.

For an exchange to occur, the following must happen: (1) there must be at least two parties involved; (2) both parties must offer something of value; (3) both parties must be aware of the existence of the other, and be capable of communication and delivery; (4) both parties must be free to accept or reject the other's offer; and (5) both parties must be willing and able to negotiate terms of exchange that they find acceptable (i.e., both must believe that the exchange creates benefits or values).

1.34 A customer's *needs* refer to the gap between a person's actual and desired state, in terms of some physical or psychological condition. Needs are not created by marketers or other social forces; they flow from the basic biological and psychological makeup of human beings.

A customer's *wants* refer to a person's desires or preferences for specific ways of satisfying a basic need; that is, the particular products, brands, or services sought to fulfil an unsatisfied want. Thus, different people may have very different wants to satisfy the same need (e.g., some people may want an electric blanket while others may want a down comforter to satisfy the need for warmth).

Needs or benefits that might be met by the following products include:

| **Product** | **Need/Benefit** |
|---|---|
| Toujours Moi perfume | Physical need: to smell good.<br>Psychological need: self-esteem.<br>Benefits: physical attractiveness, status, feel good about self. |
| BMW car | Physical need: transportation for self and others.<br>Psychological need: self-esteem.<br>Benefits: transport status, self-esteem, power. |

| Product | Need/Benefit |
|---|---|
| Physical examination | Physical need: reduce fear/anxiety.<br>Psychological need: security.<br>Benefits: health maintenance, psychological security. |
| Mainframe | Psychological need: security, esteem, self-fulfilment.<br>Benefits (for the organisation): computational ability (i.e. data processing); service.<br>Benefits (for individual buyer): security in making correct purchasing decision, job enhancement. |

# Module 2

## Review Questions

## Content Questions

2.1 *See* Section 2.1.1.
2.2 *See* Section 2.2.1.
2.3 *See* Section 2.2.2.
2.4 *See* Exhibit 2.6.
2.5 *See* Section 2.3.1.
2.6 *See* Section 2.3.1.2.
2.7 *See* Section 2.3.1.4.
2.8 *See* Section 2.3.2.
2.9 *See* Section 2.3.4.
2.10 *See* Section 2.3.5.1.
2.11 *See* Section 2.3.5.1.
2.12 *See* Section 2.3.5.1.
2.13 *See* Section 2.3.5.2.
2.14 *See* Section 2.3.5.2.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 2.15 | E | 2.16 | A | 2.17 | B | 2.18 | E | 2.19 | E |
| 2.20 | E | 2.21 | C | 2.22 | A | 2.23 | A | 2.24 | D |
| 2.25 | E | 2.26 | D | 2.27 | C | 2.28 | C | 2.29 | A |
| 2.30 | A | 2.31 | B | 2.32 | B | 2.33 | D | 2.34 | C |
| 2.35 | C | 2.36 | D | 2.37 | D | 2.38 | D | 2.39 | D |
| 2.40 | A | 2.41 | E | 2.42 | B | 2.43 | B | 2.44 | E |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 2.45 | C | 2.46 | A | 2.47 | C | 2.48 | B | 2.49 | A |
| 2.50 | A | 2.51 | D | | | | | | |

## Application Questions and Cases

2.52 This is obviously a difficult question to answer – one which poses a dilemma for the company. While most countries have laws which forbid bribery, there is considerable difference in the way anti-bribery laws are enforced across countries. One problem is the way bribery is defined since it can range from the payment of a few dollars to a minor government official or business manager to facilitate the processing of papers or the unloading of a truck, to the payment of thousands – even millions – of dollars to obtain a lucrative contract.

In the case at hand, the company policy forbidding 'gifts, loans, favours, or other services' needs further definition. In the US it is legal to entertain business clients (sporting events), give relatively inexpensive gifts, and pay for meals (including tips). Surely, such forms of 'bribery' are acceptable in other countries provided moderation is practised. But bribery in the form of payments for preferential treatment in securing a contract of substance should, of course, be prohibited. Still, the answer to the question of bribery is not a straightforward one. Given the variety of ethical standards existing in different countries as well as the varying morality level, the dilemma of ethics versus practicality will not be resolved any time in the near future.

2.53 Kelly might expand its revenues via each of the following expansion strategies:

(a) Market penetration in present markets – increasing market share by taking share from competitors, increasing product usage among present customers (increasing home inventories).
(b) Market development by expanding into new markets with the same product line – entering proximate metropolitan areas, selling essentially the same product under private label (store brand), selling concentrate to bottlers in other areas.
(c) Product development via becoming the franchisee for an existing soft drink brand (Dr. Pepper, 7UP, Canada Dry Ginger Ale), mixer (Sweppes), or bottled water; adding new beverage products under own name; improve the taste of present products and/or reduce calories; and add new package types and size(s).
(d) Diversification in the form of forward integration (vending machines), backward integration (flavour company), purchase of a competitor, and investment in real estate.

2.54

(a) Packaged food company's acquisition of a fast-food company which features hamburgers and French fries.
(b) A large retailer's purchase of an interest in a company producing small appliances.
(c) A tobacco company's acquisition of a beer company.
(d) An oil company's acquisition of an insurance company.

The packaged food company's acquisition could be considered forward integration in that the company produces ingredients used by the fast-food company. Benefits would involve cost reductions.

The second case illustrates backward integration. Benefits would derive from scale economies and control over quality.

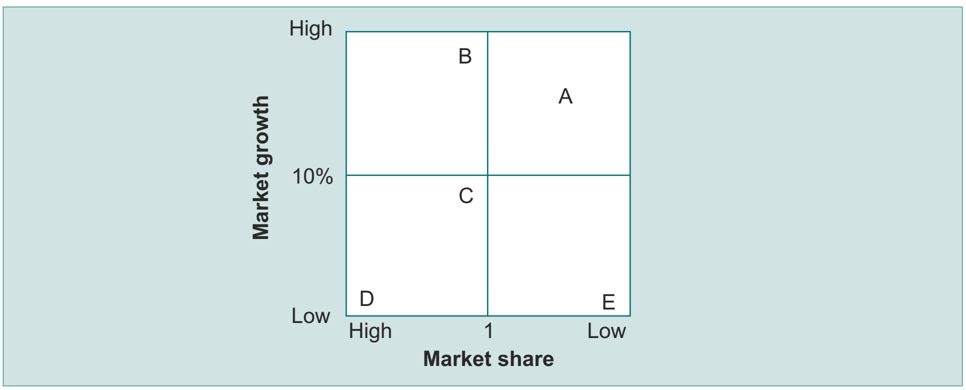
The third case illustrates a related (concentric) diversification. Thus, its marketing skills – primarily in the areas of promotion and development of new products – should benefit the acquisition as well as its economic resources.

The last case illustrates unrelated (conglomerate) diversification with few, if any, synergies or benefits deriving from such an acquisition. At the corporate level such diversification is sometimes instituted to level revenue flows and investment risks.

2.55

| SBU | Sales ($m) | Sales of top three competitors ($m) | | | Market growth rate (%) |
|---|---|---|---|---|---|
| A | 1.0 | 1.4 | 1.4 | 1.0 | 15 |
| B | 3.2 | 3.2 | 3.2 | 2.0 | 20 |
| C | 3.8 | 3.8 | 3.0 | 2.5 | 7.0 |
| D | 6.5 | 6.5 | 1.6 | 1.4 | 4 |
| E | 0.7 | 3.0 | 2.5 | 2.0 | 4 |

An approximation of the BCG growth-share matrix in this situation is shown below. Note that relative market share is determined by dividing company SBU market share by average of top three competitors.




The implication is that funds from the 'cash cows' D and C might be used to fund the 'question mark' business A, and the borderline 'question mark'/'star' business B. Because the remaining business (E) is a 'dog,' it might be considered for divestment or harvesting.

However, this analysis should be supplemented with additional analyses, including perhaps another portfolio and other analyses specific to the situations inherent in each business.

2.56 Limitations of the BCG growth share matrix include:

(a) The inadequacy of growth as a measure of overall industry attractiveness.
(b) The inadequacy of relative share as a measure of overall competitive strength.
(c) The level of aggregation may include too many products and markets.

(d) The sensitivity of the growth share matrix to variations in how 'growth' and 'share' are defined.
(e) The lack of guidance about how appropriate investment strategies might be implemented.

Managers might avoid some of those problems by making definitions more explicit and by utilising the BCG growth share matrix as only one part of the corporate planning process.

With regard to definitions, it would be useful for managers to require more explicit statements about the product-market relationship (and competitors) and their use in deriving relative share.

With regard to instruments used in the planning process, the growth share matrix might be used as one among other planning tools (which might also include the use of another portfolio type and other situation-specific analyses). If multiple methods are used, the implications of the growth share matrix can be reconciled with those of other methods. Also the model should be used on a trend basis; for example, at two-year intervals. It should also be used to show the portfolios of major competitors.

2.57 General Mills is likely to have a strong market orientation. This orientation would be characterised by: (1) the emphasis placed on high-quality, new products; (2) using consumer research in new-product development; (3) adapting its marketing mix to specific market segments; (4) cross-functional involvement in marketing.

A small entrepreneurial start-up in a fast-growing high-tech industry is likely to have a production orientation. This orientation would result from threats posed by production problems.

2.58 The firm is likely to move from a production to a sales and, perhaps, finally to a market orientation. The first movement results from competitors attracted into the market by growing volume and profits. This is likely to increase competition for product innovation and production process efficiency. At some point, as production capacity is added to the industry and demand increases decline, excess capacity will probably result. The existence of excess capacity will probably focus company attention on moving available stocks (i.e. a sales orientation). If the firm survives the shakeout phase of industry growth, it is likely to move towards a market orientation.

2.59

| Strategy level | Critical issues |
|---|---|
| Corporate | What business(es) is the company in?<br>What business(es) should the company be in?<br>What portion of total resources should the company devote to each business to achieve its overall goals and objectives? |
| Business | What distinctive competencies can give the business unit a competitive advantage?<br>Which of these competencies best matches the needs and wants of the customers in the business target segment(s)? |

| Strategy level | Critical issues |
|---|---|
| Marketing | What target market(s) exist for each product and product line? How can the marketing mix elements best be tailored to the needs and wants of potential customers in each target market? |

2.60 At the corporate level, the marketing manager can be: (1) a key participant (along with the SBU general manager) in determining the SBU's objectives and scope (both in terms of products and markets); (2) a strong contributor to environmental, competitive, and situation assessments; (3) a key participant in defining objectives and goals; and (4) a major contributor to development of strategies.

Useful planning information includes that about the environment, focusing on customers, and economic, political, and regulatory trends; competition, both actual and potential; and specific information about industry and market attractiveness, including profitability and segment growth rates.

At the business level, the marketing manager should have a primary role in discussions pertaining to product-market development, product quality, and product line, and may have an additional role (depending on specific circumstances) in technology, human resources, business development, and manufacturing facilities.

## Module 3

### Review Questions

### Content Questions

3.1 *See* Section 3.2.1.

3.2 *See* Exhibit 3.1.

3.3 *See* Exhibit 3.4.

3.4 *See* Exhibit 3.5.

3.5 *See* Section 3.5.

3.6 *See* Section 3.2.3.

3.7 *See* Section 3.1.1.

3.8 *See* Section 3.1.2.

### Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 3.9 | C | 3.10 | D | 3.11 | A | 3.12 | B | 3.13 | D |
| 3.14 | E | 3.15 | B | 3.16 | A | 3.17 | B | 3.18 | E |
| 3.19 | E | 3.20 | A | 3.21 | B | 3.22 | C | 3.23 | D |
| 3.24 | C | 3.25 | C | 3.26 | C | 3.27 | D | 3.28 | B |
| 3.29 | B | 3.30 | C | 3.31 | C | 3.32 | A | 3.33 | D |
| 3.34 | C | 3.35 | E | 3.36 | A | 3.37 | C | 3.38 | E |

3.39 E 3.40 B 3.41 E

## Application Questions and Cases

3.42

(a) Scope.
(b) Objectives.
(c) Deployment of resources.
(d) Sources of synergy.

| Dimension | Prospector | Low-cost defender |
|---|---|---|
| Scope | Broad | Narrow |
| Objectives | Adaptability | Efficiency |
| Focus of resource deployment | Marketing, R&D | Production process engineering |
| Sources of synergy | Marketing skills | Production skills |

3.43 Obtaining 30 per cent of sales from products introduced within the last four years is a particularly challenging goal for a business in a mature and stable industry, but it can be appropriate. By imposing such a goal, top management may seek to compel the business's managers to develop product modifications in anticipation of competitor moves. While such innovations are unlikely to be radical in a mature/stable industry, they may be substantive from the standpoint of users (indeed, they may be suggested by users).

While pressing the management of a business in a mature industry to develop new products presents a challenge, it is the challenge used by companies like Gillette, which is also in a stable/mature industry. Yet Gillette utilises revenues from existing products in the mature shaving-products industry to fund new-product development and marketing. Thus, products like Trac II funded development of Atra.

The disadvantages or dangers in this technique are that: (1) innovations will be developed that were unnecessary, due to lack of competition; (2) innovations may prove to be unsuccessful; and (3) innovations may cannibalise existing products.

3.44 One realistic (and potentially profitable) argument would be to augment the new product goal with a new-uses goal, given the maturity of the industry. This is comparable to the situation that confronted the marketing management of Arm & Hammer baking soda, which faced a stable industry (which it dominated) with a mature product-market. Rather than develop new products, management developed new uses (such as use in refrigerators to absorb odours) for the existing product. The strategy was highly successful and did not require substantial new-product development costs.

3.45 This is an analyser strategy. The strengths of this strategy are that: (1) by operating from a core product-market base, the organisation is able to realise production efficiencies; and (2) by monitoring the success of new products in the external environment, the organisation is able to adapt to market change. A fundamental weakness of this strategy is evident when a dramatic change occurs that affects the core business. Thus, GM's large-car core market was dramatically affected by a radical increase in petrol prices. Because of the time required to retool a car manufacturing plant, GM was not able to shift the core business from large to small cars. Several Japanese firms, which had already been producing quality small cars in an environment with high petrol prices were ready to capitalise on the market opportunity.

3.46 Saturn was expected to pursue a prospector business strategy. This strategy should have helped Saturn avoid preconceptions about the market (i.e. that a large-car approach is needed). The strategic emphasis and sometimes the creation of a new division is necessary because strategic preconceptions can become institutionalised. In the other divisions, the commitment to large cars was reinforced by the executives in power who had made initial decisions in that direction, who had committed resources to those decisions and who held power based on the production of large-car divisions. This problem is not unique to one company, and a change in strategy (and the creation of a new division) is sometimes a useful approach to the problem.

3.47 For a marketing manager, this move will probably be seen as positive. The differentiated defender will emphasise production efficiencies; the prospector will emphasise marketing skills. Thus, you are likely to be involved in making more (and more important) decisions about advertising, sales and other marketing-related issues in the new prospector job.

3.48 Compared to the other business strategy types, prospector firms such as this one are likely to spend more on trade promotion and advertising in general. This trade promotion can occur as advertising and sales ('to the trade'), and may also include trade discounts or outright 'renting' of shelf space, a practice that is increasing.

3.49 As a low-cost defender, this firm will seek to minimise the cost of each of the marketing functions, including product development, distribution, and promotion. There will probably be a more limited product line, and little if any product R&D to augment that line. Promotion will be minimised, both to the trade and to the public. The marketing manager's primary emphasis, aside from cost cutting, will probably be a strong orientation toward watching – and matching – competitive price moves.

## Module 4

### Review Questions

### Content Questions

4.1 *See* Section 4.2.6.

4.2 *See* Section 4.2.6.

4.3 *See* Section 4.2.4.

4.4 *See* Section 4.2.5.

4.5 *See* Section 4.2.1.

4.6 *See* Section 4.3.3.1.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 4.7 | B | 4.8 | C | 4.9 | B | 4.10 | D | 4.11 | D |
| 4.12 | A | 4.13 | E | 4.14 | E | 4.15 | C | 4.16 | B |
| 4.17 | B | 4.18 | B | 4.19 | D | 4.20 | E | 4.21 | B |
| 4.22 | C | 4.23 | C | 4.24 | A | 4.25 | C | 4.26 | D |

## Application Questions and Cases

4.27 Water contamination creates a variety of business opportunities, examples of which are the sale of bottled water to households and businesses for drinking, water purification systems to businesses using water as a raw material and water purification systems to municipalities. The above uses would require a variety of containers, chemicals and machinery.

4.28 Deregulation typically makes an industry more competitive, with an increase in the number of firms. At the outset, emphasis is placed on improved pricing practices, cost reductions, product/service differentiation including new-product development and increased emphasis on customer satisfaction. A few years later, strategies centre on pricing, strategic alliances and the development of market power. All of the marketing-mix elements are affected by deregulation – product, place (distribution), price and promotion (advertising, personal selling promotion and publicity).

4.29

| Demographic change | Potential marketing-mix impact |
|---|---|
| Movement towards middle age | Products developed for weight-conscious, health-conscious families and individuals. |
| Increasing household income | Emphasise quality products and services. |
| Geographically concentrated population growth | Concentrate advertising in growth areas.<br>Intensify distribution in growth areas. |
| Increasing minority population | Develop ethnic products.<br>Target advertising for these products to minority groups.<br>Distribute ethnically oriented products to favoured shopping areas. |

4.30

| Environmental management process | Activities |
|---|---|
| Environmental scanning | Monitor changes in technology, ecology, regulation, economy, etc. |

| Environmental management process | Activities |
|---|---|
| Key issue identification and timing | Isolate key issues and probability of impacting profitability or market share by a certain date. |
| Impact evaluation | Assess the impact of each issue in terms of its level (high/low). |
| Formulation of response strategy | Work with senior management to formulate strategies to deal with each issue. |

4.31 There are two options here. One is to 'harvest' the paediatric service by minimising investment to maximise return on this unit. The other is to utilise the paediatric service to build longer-term relationships with families. This 'relationship' strategy is similar to the approach taken by Toys 'R' Us, which is said to offer infant supplies (e.g. nappies) at near cost to encourage mothers with young children to shop there and to form a favourable opinion of the store (including its pricing). The hospital could utilise the paediatric unit to position itself with families in the household-formation stage, and could probably utilise the traffic that a paediatric ward draws on the part of middle-aged and elderly relatives to position itself for those in other stages of the family life cycle.

It is also important to note in this case that the hospital administrator's decision must include the overall mission of the organisation.

4.32 Assuming the new plastic take-out food container is safe to use (e.g., does not contaminate package contents, does not 'leak', minimises 'spilling', and protects against excessive moisture and heat for a reasonable time), the area of concern is the extent to which it can be safely and efficiently disposed of. To determine this, the company would need to know the system used in the developed countries it serves in order to collect, transport, and dispose of such containers. It would probably make a difference, for example, if disposal was by landfill versus incineration. If the former, does the package comprise sufficient biodegradable materials so that complete disposal could be effected in a desirable amount of time.

4.33 The changing family structure provides numerous new product opportunities for consumer companies. It's impossible to devise an all-inclusive list, but some samples are services to save time for households with two or more working families (shopping, dog care, and house maintenance); early childhood development centers which provide a high level of education and care starting early in the morning to late in the evening-and even over weekends; homes specially constructed and equipped with labour-saving devices that minimise maintenance; a range of prepared foods ranging from the 'basic' to the 'fancy' with different levels of 'fat'; and compacted literature which provides both entertainment and education with a lower time investment.

# Module 5

## Review Questions

## Content Questions

5.1 *See* Section 5.2.1.
5.2 *See* Section 5.1.2.
5.3 *See* Section 5.5.
5.4 *See* Section 5.5.2.
5.5 *See* Section 5.5.3.
5.6 *See* Section 5.5.3.
5.7 *See* Section 5.4.1.
5.8 *See* Section 5.4.2.
5.9 *See* Section 5.4.3.
5.10 *See* Section 5.2.2.

## Multiple Choice Questions

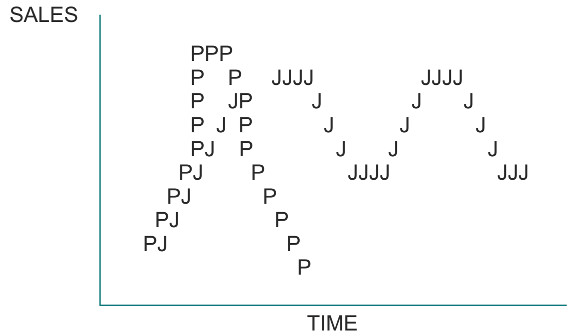
| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 5.11 | B | 5.12 | B | 5.13 | C | 5.14 | D | 5.15 | B |
| 5.16 | C | 5.17 | E | 5.18 | A | 5.19 | C | 5.20 | D |
| 5.21 | B | 5.22 | B | 5.23 | E | 5.24 | C | 5.25 | C |
| 5.26 | C | 5.27 | A | 5.28 | B | 5.29 | A | 5.30 | E |
| 5.31 | D | 5.32 | D | 5.33 | A | 5.34 | B | 5.35 | A |
| 5.36 | B | 5.37 | D | 5.38 | D | 5.39 | D | | |

## Application Questions and Cases

5.40 Product types for ready-to-eat cereals could be defined in terms of raisin bran, cornflakes, sugared cereal, etc. Automobiles could be defined in terms of types such as luxury cars, economy cars, vans, and off-road vehicles. Television sets might be defined by screen size and quality of picture. Men's dress shirts could be defined by collar and cuff type, such as button-down and French cuffs, fabric type, such as cotton versus silk, sleeve length, and perhaps colour.

5.41 The product life-cycle model provides a conceptual framework which signals the occurrence of opportunities and threats in the marketplace and the investment requirements for success. It also indicates how the firm's strategy and marketing programmes must change as the product moves through the various life-cycle stages. The major weakness of the concept lies in its normative approach to prescribing strategies based on assumptions about the characteristics of each stage. More specifically, it fails to take into account the major forces driving the life cycle – the evolution of consumer preferences, technology, and competition.

5.42 The life cycles of the two products – pet rocks (P) and jeans (J) – might look like this:




The two curves differ in that *the fad* rises and falls sharply, is less spread out from side to side (i.e. comes and goes in less time) and ends as a product within a brief time period. *The fashion* rises and falls less sharply (i.e. comes and goes over longer periods of time) and maintains some existence throughout the time period.

Among the marketing implications are those relating to profitability, product management and the portfolio mix. Because of its volatility, the fad will only be profitable if it is produced with little or no committed capital. The pet rock was profitable for this reason, but companies producing faddish clothing, toys or games can become vulnerable to commitment of capital to a product whose demand may drop precipitously. Such products must be managed for maximum initial return; thus, a skimming price might be advisable. People purchasing fads are generally price inelastic in the short run. If fads were predictable (i.e. replicable), and if they could be generated to utilise common skills, the marketing manager might assemble a portfolio of fads over time. The more likely portfolio is of fashions, balancing the cycles of one fashion item against another.

5.43 I would attempt to do several things. First, I would try to find ways to differentiate my product in terms of such features as (for voice dialling) size, range, and sound fidelity. I would also increase my line of 'alternative' products and rate structures so as to cater to larger audiences. I would both advertise and promote aggressively (special sign-up deals). And I would do all I could to reduce costs without negatively impacting the quality of my service or product.

5.44 As discussed in answer 5.42, jeans are a fashion. Essentially, they are a high-involvement, highly differentiated product class. As such, the product is prone to a sort of 'social variety seeking'. They continue to grow in sales over time, and then because they have been socially visible for a prolonged period, decline in popularity (i.e. 'go out of fashion' ).

5.45 Aseptic packages are in the introductory stage of their life cycle, where there are few segments and a small number of competitors. The essential marketing objective is primary demand stimulation (building up a market for the product) rather than secondary demand stimulation (building up a market for the brand). The company should seek quality improvement, keep its product line narrow, price to penetrate the market, use its own salesforce and seek publicity in trade journals. As the market grows, the company should seek to build market share, continue to make quality improvements, widen its product line, reduce its price and build a strong sales service organisation.

5.46 Among the factors that affect the rate of adoption are risk, simplicity, availability for trial and ease with which the core concept can be communicated. The rubbish compactor replaces the garbage can, and yet is higher in (financial) risk, is somewhat more complex to operate and typically is not displayed in a situation where trial is convenient. The core concept (the convenience and time savings of reducing the frequency of rubbish-to-garbage-can trips) is somewhat difficult to communicate.

Because it replaces one product with another, substantially different, product, it is likely to gain slow acceptance. The most important communications mode is likely to be word of mouth, as people see rubbish compactors in use in daily life in the homes of opinion leaders. Yet this effect is likely to be subdued by the fact that this is not a visible, prestigious item. Thus, the product life cycle is likely to be slow growth, stable maturity, slow decline.

5.47 Several things lie ahead for the worldwide automobile industry, including fewer full-line producers, longer product lines, more and more production transferred to developing countries, more world models resulting in fewer basic platforms, and continued efforts to make cars safer, more economical to drive, and more in harmony with the environment. In addition, continued efforts to reduce costs, but still provide a production system which will lend itself to mass customisation.

# Module 6

## Review Questions

## Content Questions

6.1 *See* Exhibit 6.2.

6.2 *See* Exhibit 6.3.

6.3 *See* Exhibit 6.6.

6.4 *See* Exhibit 6.7.

6.5 *See* Section 6.2.2.1.

6.6 *See* Section 6.2.2.2.

6.7 *See* Section 6.2.3.

6.8 *See* Section 6.3.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 6.9 | B | 6.10 | E | 6.11 | D | 6.12 | A | 6.13 | D |
| 6.14 | D | 6.15 | B | 6.16 | A | 6.17 | D | 6.18 | B |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 6.19 | B | 6.20 | C | 6.21 | C | 6.22 | C | 6.23 | A |
| 6.24 | C | 6.25 | D | 6.26 | A | 6.27 | A | 6.28 | D |
| 6.29 | C | 6.30 | E | 6.31 | D | 6.32 | E | 6.33 | D |
| 6.34 | A | 6.35 | D | 6.36 | C | 6.37 | E | 6.38 | B |
| 6.39 | D | 6.40 | E | 6.41 | A | | | | |

## Application Questions and Cases

6.42 Because taking a cruise represents a high involvement purchase, consumers search out information pertaining to the product. They seldom consider all brands; rather they focus on a limited number with which they have some familiarity. Thus, for a brand to be even considered it has to be included in the consumer's evoked set. Next, each brand is evaluated on a limited number of attributes. They are also judged on the relative importance of these attributes (one of which is price). And finally, consumers sum their ratings of each brand across attributes taking into account their relative importance. These are compared against the consumer's choice criteria. A cruise line, to be successful, must develop a product which best fits the choice criteria of its target market(s). Promotion must take into account the consumers' choice criteria and their current rating of various alternatives using these criteria. This can be done using advertising or personal selling in a variety of ways. The firm should be careful not to promote too many features or attributes at the same time to avoid confusing the consumer.

6.43

| Type of product | Extent of involvement | Effect on marketing decisions |
|---|---|---|
| Frozen vegetables | Low (inertia) | Price parity, maximum distribution and limited brand advertising coupled with seasonal coupon deals. |
| Banking services | High (complex) | Value-added pricing, limited distribution and emphasis on personal selling. |
| Tennis racquet | High (complex, possibly involves brand loyalty) | High price, limited distribution and emphasis on personal selling and demonstrations. |
| Toothpaste | High (brand loyalty) | Price parity, maximum distribution and national brand advertising. |
| Colour television sets | High (complex) | Price based on brand image, full distribution among large stores and local 'price' cooperative advertising. |
| Lawn service | High (complex) | Tailored price, local distribution and emphasis on personal selling. |

6.44 For discussion of this issue, consider a new colour printer.

(a) Problem identification
Problem identification is initiated when the consumer perceives a difference between his ideal and actual state. In the case of the introduction of a new colour printer, the actual state (i.e. old printer) probably did not change. However, the performance promised by the new printer raises the ideal state – creating a gap that represents a problem.

(b) Information search
Because this is a relatively high-involvement purchase, information may be sought from several sources, including personal, public and commercial sources.

(c) Evaluation of alternatives
After all this, an evoked set of branded colour printers may be in your mind. These will, in turn, be evaluated by a set of evaluative criteria formed from your different information sources. These criteria, in terms of their importance to you and your rating of each brand of colour printer on each criterion, will form your attitude towards each brand.

(d) Purchase
You purchase the colour printer, based on the evaluation described above. Terms of payment may be discussed at this time, if not previously.

(e) Postpurchase evaluation
Although the purchase is made, you probably considered several printers to be of approximately equal quality, so you now wonder whether you made the correct purchase. However, ten days after you bring your new colour printer home: (1) the seller contacts you to see if everything is working properly; or (2) the manufacturer sends you a special booklet on the printer you purchased and your cognitive dissonance is reduced.

6.45 The kinds and sources of information for the purchase of a new colour printer would be:

**Kinds of information:** Different types of colour printers, features available in each type, recent technology developments and potential impact on types of printers and their features, leading national and private label (if any) brands by type of printer desired and features of each, reputation of brand and company involved, price of each model of brands of interest, warranties and local stores selling line of printers.

**Sources of information:** Consumers' union, credible specialised magazines and newspapers catering to business community and computer users in general, owners and/or users of colour printers, retail store personnel and company literature available at local outlets and websites.

**Marketing programme implications:** Competitive price but based in good part on features offered; distribution in large retail computer stores which sell to households and local businesses; use of own salesforce to sell to large businesses and to not-for-profit organisations such as government, hospitals and educational institutions; and extensive advertising in specialised magazines, newspapers focusing on business (*Wall Street Journal*), special brochures for use by retail sales persons, articulate website and special price deal promotions.

6.46 Among the options are to:

(a) Draw on a basic social value relating to the consumer's self-identity (e.g. the 'Pepsi is the choice of the new generation' advertisements).
(b) Introduce important new features (e.g. Diet Pepsi, caffeine-free Pepsi).
(c) Tie to a personally involving situation (e.g. caffeine-free Pepsi for an evening beverage when you do not want to lose sleep).
(d) Link to some involving issue (e.g. a percentage of the price of every Pepsi purchased to go to an international famine fund).

6.47 Recall that the comparisons in Exhibit 6.9 were as follows:

| | | Brand ratings | | |
|---|---|---|---|---|
| **Service attribute** | **Weight** | **A** | **B** | **C** |
| Demographics – other passengers | 10 | 8 | 8 | 8 |
| Entertainment | 10 | 8 | 10 | 9 |
| Ports of call | 8 | 8 | 9 | 9 |
| Low fares | 7 | 9 | 8 | 8 |
| Size/steadiness of ship | 6 | 9 | 8 | 8 |

The overall scores are 341 for (A), 356 (B) and 346 (C). The implications for A would depend on the cost of changing the entertainment attribute against the rating points gained. However, assuming equal costs of improvements across attributes, Cruise Line A would do well to focus on increasing its entertainment feature to the maximum rating level of 10. This would increase its rating to 361 – just slightly ahead of B, but considerably in front of C. If the ports-of-call attribute can be increased to 9, then the overall rating goes up to 369 – widening the gap with B considerably.

# Module 7

## Review Questions

### Content Questions

7.1 *See* Section 7.1.1.

7.2 *See* Section 7.1.3.1.

7.3 *See* Section 7.2.2.

7.4 *See* Section 7.3.

### Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 7.5 | D | 7.6 | D | 7.7 | B | 7.8 | C | 7.9 | C |
| 7.10 | C | 7.11 | D | 7.12 | A | 7.13 | C | 7.14 | B |
| 7.15 | C | 7.16 | C | 7.17 | A | 7.18 | C | 7.19 | D |
| 7.20 | A | 7.21 | E | 7.22 | C | 7.23 | B | 7.24 | C |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 7.25 | A | 7.26 | E | 7.27 | B | 7.28 | E | 7.29 | E |
| 7.30 | B | 7.31 | B | 7.32 | C | | | | |

## Application Questions and Cases

7.33 This can be an effective use of the salesperson's time in that the secretary or office manager often functions as a gatekeeper who controls the flow of information to other people in the purchasing process. The organisation decision maker cannot choose the salesperson's products unless she/he is aware of them and a secretary or office manager often controls access to the decision maker. Also, since secretaries are usually the primary users of such equipment, they may have some influence on the firm's evaluation criteria and in the final purchase decision.

7.34

A. R&D managers.
B. Product design engineers.
C. Production managers.
D. Purchasing managers.

| Group | Influence role | Most influential stage in purchasing |
|---|---|---|
| R&D managers | Influencers | Information search.<br>Alternative evaluation. |
| Product design engineers | Influencers | Information search.<br>Alternative evaluation. |
| Production managers | Deciders, users | Problem recognition.<br>Purchase decision. |
| Purchasing managers | Buyers, gatekeepers | Alternative evaluation. |

7.35

| Stage | Marketing actions |
|---|---|
| Problem recognition | Routine sales calls on production manager and purchasing manager to be considered in decision set. |
| Information search | Sales calls on R&D manager, product design manager. |
| Alternative evaluation | Sales calls on product decision engineer and purchasing manager. |
| Purchase decision | |

| Stage | Marketing actions |
|---|---|
| Postpurchase evaluation | If selected: ensure that delivery and product quality are superior.<br>If not selected: seek debriefing from GM buying group, to shape subsequent bids. |

7.36 The unstable environment would probably lead to:

(a) More decentralised decision making, accompanied by relatively greater use of technical expertise and specialisation of purchasing managers.
(b) Fewer formal purchasing procedures.
(c) More professional purchasing personnel.

The marketing implications of this include a corresponding need for product-related expertise in the supplying firm. This may involve assembling a technical team associated with each product (or product group) to meet with corresponding purchasing personnel. Periodic briefings of purchasing personnel from the buying firm about advances or modifications of product may be useful to maintain the firm-to-firm relationship.

7.37 Sellers must ensure a steady, reliable supply of materials and parts since the system's objective is to eliminate inventories at the customer's manufacturing site, which requires the delivery of 100 per cent quality (zero defects) products. This relieves the customer of any incoming inspection. Buyers have to work closely with suppliers to develop and continuously update the just-in-time system with regard to the product, changes in the manufacturing processes which include the product and information pertaining to the volume and pattern of usage. Both parties must strive to develop a close relationship based on trust.

7.38 The challenges in marketing industrial robots (accessory equipment) are:

(a) Identification and prioritising of potential customers.
(b) Demonstrating the benefits of using industrial robots including tailoring their operation to the needs of a particular company. Servicing such equipment to minimise downtime.

The most critical parts of the marketing plan are the product and its servicing (including the availability of spare parts), pricing (both product and software) and personal selling (including the installation and servicing).

7.39 Pricing would certainly be different since leasing would have to take into account the cost-of-capital, default by the customer, unplanned obsolescence resulting from new product development by the company, and the cost of service over the lifetime of the lease.

# Module 8

## Review Questions

## Content Questions

8.1 *See* Section 8.2.
8.2 *See* Section 8.2.
8.3 *See* Section 8.2.1.
8.4 *See* Section 8.2.2–Section 8.2.5.
8.5 *See* Section 8.3.2.
8.6 *See* Section 8.5.2.
8.7 *See* Section 8.6.
8.8 *See* Section 8.6.2.1.
8.9 *See* Section 8.5.
8.10 *See* Section 8.6.3.3.
8.11 *See* Section 8.5.3.
8.12 *See* Exhibit 8.7.
8.13 *See* Section 8.6.4.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 8.14 | B | 8.15 | B | 8.16 | C | 8.17 | D | 8.18 | A |
| 8.19 | B | 8.20 | B | 8.21 | B | 8.22 | A | 8.23 | E |
| 8.24 | C | 8.25 | E | 8.26 | B | 8.27 | A | 8.28 | E |
| 8.29 | D | 8.30 | D | 8.31 | D | 8.32 | A | 8.33 | B |
| 8.34 | A | 8.35 | B | 8.36 | C | 8.37 | A | 8.38 | E |
| 8.39 | E | 8.40 | B | 8.41 | C | 8.42 | A | 8.43 | E |
| 8.44 | C | 8.45 | D | 8.46 | E | | | | |

## Application Questions and Cases

8.47 The objective of a retention programme for a car rental company should be to offer a direct incentive to customers for heavy usage which will encourage repeat business. Probably the most successful type of programme would be similar to the airlines' frequent flyer programmes – indeed, one can use them by transferring car rental revenues into mileage awards with a given airline. In a similar fashion, the car rental firm could set up its own programme and award points which could be transferred into monetary credits to be used to rent the company's cars. The company could also identify its heavy users by geographical location or season of the year, and then use direct mail to offer discount or trade-up coupons which are good for use during a restricted time period on certain types of company cars. The value of the discounted coupon would depend on the extent of usage.

8.48 The programme could be tested by selecting a sample of company users for the prior year and making them a special offer via a discount coupon good for a limited time period. To validate the coupon, the recipients would have to join the company's frequent mileage club, whereby they could receive credit for the points earned by using the car rental company's cars. The effectiveness of the intended programme would be determined largely by the difference between the usage generated by members of the sample for the previous 12 months and the following 12 months. Also, a tabulation should be make of new customers (those who had not patronised the company during the prior 12 months).

8.49 This problem lends itself to a telephone survey, because this method is quick and low cost. Further, unlike personal interviews in the mall, the method can be based on a probability sample – so the results can be examined for statistical reliability. The primary limitation (compared to other methods) is that visual materials cannot be readily displayed in a telephone survey (this could only be done with technology in place by mailing out visual materials and calling in conjunction with them). Also, some interpersonal feedback that depends on body language is lost in this approach. Another problem is that refusal rates are high and increasing due to an overload on consumers from a variety of companies.

8.50 The problems which will be encountered in doing such research across a variety of countries include the difficulties associated with sample design (inadequate population data), questionnaire design, hiring/training/control over interviewers, data-collection methods (phone versus personal interviewing) and actual data collecting (asking questions and recording answers). It will be difficult to compare the results across countries given the variation in the sample designs, the response rates of different groups, the calibre of the interviewers and the meaning of key words in the questionnaire.

8.51 The salesforce estimate may have an upward or downward bias. A downward bias is particularly likely if the sales forecast is tied to quota goals. Further, salespeople are unlikely to know about other marketing efforts (such as planned advertising campaigns) that would affect future sales. However, salesforce estimates are particularly useful for short-term forecasts during especially volatile market.

## Module 9

### Review Questions

### Content Questions

9.1 *See* Section 9.1.

9.2 *See* Section 9.1.

9.3 *See* Section 9.1.1.

9.4 *See* Section 9.1.2.

9.5 *See* Section 9.2.

9.6 *See* Section 9.2.

9.7 *See* Section 9.2.1.

9.8 *See* Section 9.2.2.1.

9.9 *See* Section 9.3.

9.10 *See* Section 9.4.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 9.11 | E | 9.12 | C | 9.13 | B | 9.14 | D | 9.15 | D |
| 9.16 | E | 9.17 | E | 9.18 | E | 9.19 | B | 9.20 | B |
| 9.21 | B | 9.22 | C | 9.23 | A | 9.24 | E | 9.25 | B |
| 9.26 | E | 9.27 | D | 9.28 | C | 9.29 | D | 9.30 | A |
| 9.31 | C | 9.32 | C | 9.33 | B | 9.34 | B | 9.35 | B |
| 9.36 | E | 9.37 | D | 9.38 | A | 9.39 | B | | |

## Application Questions and Cases

9.40 Environmental changes that have increased interest in market segmentation include: (1) slowing of population growth and maturing of product-markets (which increase competition among firms within the industry and markets); (2) social and economic forces that have increased the demand for product variety; and (3) segmenting of services by institutions serving consumers (in effect, derived segmentation).

9.41 Market segmentation is the process by which the market is divided into distinct subsets of people with similar needs and characteristics which lead them to respond in similar ways to a particular product offering. Target marketing requires that the relative attractiveness of each segment be evaluated from which a decision would be made as to which segment(s) to target. And, finally, product positioning would be undertaken to design the specific product offerings and develop the strategic marketing programmes that collectively create an enduring competitive advantage. If the segmentation is seriously flawed, then the whole 'system' is jeopardised not only in terms of inept products and programmes, but in the allocation of funds between segments and elements in the marketing programme.

9.42 Microsegmentation which sets the stage for direct marketing can be accomplished by using huge geodemographic databases which possess demographic and behavioural data down to the household level including addresses. For consumer goods manufacturers that sell via mail order, their customer lists can be enhanced and enlarged by buying lists which contain individuals/households similar in characteristics to their own heavy buyers. Industrial companies that sell direct can build their own data banks based on sales data coupled with call reports from their salespersons or agents. These lists can be augmented by data on lost customers, enquiries from trade shows and requests from catalogues.

9.43 The primary disadvantage of oversegmentation is reduced profitability. Changing the product, promotion, pricing and distribution arrangements is expensive. The change in revenue (at the margin) must equal or exceed the costs incurred by segmenting. Other disadvantages of oversegmentation (increased administrative burden, dilution of brand image, cannibalisation of existing brand sales) can be expressed as costs.

A firm that believes the market has been broken into too many small segments can attempt to consolidate the market through demand function modification. That is, it can try to bring together the consumers who have drifted into small dispersed segments, by showing how its benefits are superior. For example, Ted Levitt suggests that marketing research inclines managers to be 'mindlessly accommodating', making small-segment marketing-mix changes that consumers say they want. Instead, he suggests that they can be led to want more generally appealing features – like economy and durability – associated with market aggregation (instead of segmentation).

9.44

(a) Lawnmowers.
(b) Frozen dinners or entrées.
(c) Breakfast cereals.
(d) Financial services.

| Product | Segment descriptors |
|---|---|
| Lawnmower | Family life cycle (home size may vary).<br>Age, sex (requirements for self-propelled, starting features).<br>Income (receptivity to expense). |
| Frozen dinner/entrée | Psychographics (weight consciousness).<br>Income (price elasticity). |
| Breakfast cereals | Age. |
| Financial services | Family life cycle (affects investment needs). |

9.45

(a) Photocopiers.
(b) Floor sweepers.
(c) Truck leasing.

| Product | Segment descriptors |
|---|---|
| Photocopiers | Purchasing structure (sell to HQ or unit?). Company size (photocopy needs may vary). Hierarchical position (perhaps mid- to low-). |
| Floor sweepers | Company size (needs may vary). |
| Truck leasing | Purchasing structure (lease to HQ or unit?).<br>Company size (needs may vary).<br>Hierarchical position (perhaps mid- to high-). |

9.46

| | Information needed |
|---|---|
| *Industrial market* | |
| Providing ability to do primary work (e.g. professional photographer) | Professional journals read. Variety of equipment utilised. Usage situations. |
| Providing ability to do secondary work (e.g. estate agent) | Usage situations. |
| *Consumer markets* | |
| Providing personal/family mementos | Skill levels. Price elasticity. |
| Providing social interaction (as with instant films) | Price elasticity. |
| Providing hobby, recreation | Price elasticity. Usage situations. |

9.47 Growth-market strategy, as the name implies, concentrates on identifying fast-growth segments of the market. A niche strategy serves one or more segments, which, while perhaps not the largest, offer the firm a substantial enough number of customers to be successful. In a niche strategy there is no requirement on the growth of a particular niche.

A growth market targeting strategy often is best suited to smaller firms who wish to avoid direct confrontation with larger firms. This strategy requires strong R&D and marketing capabilities to identify and develop products. It also requires the necessary financial resources to finance rapid growth.

9.48 The major drawback is that the factors involved as well as their ratings are subjective in nature and yet give the impression of being precise. A further weakness is that the factors used may not be independent of each and hence are improperly weighted in the scoring.

Ways of minimising the subjectivity cited above are (1) to generate as much objective data about each of the market attractiveness sectors as well as the competitive position factors and (2) to bring the managers involved together after they have completed their ratings to discuss/debate their differences.

# Module 10

## Review Questions

## Content Questions

10.1 *See* Section 10.1.

10.2 *See* Section 10.1.2.

10.3 *See* Section 10.2.1.

10.4 *See* Exhibit 10.4.

10.5 *See* Section 10.5.2.

10.6 *See* Section 10.5.4.4.

10.7 *See* Section 10.5.4.5.

10.8 *See* Section 10.5.7.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 10.9 | E | 10.10 | A | 10.11 | A | 10.12 | C | 10.13 | A |
| 10.14 | E | 10.15 | D | 10.16 | C | 10.17 | A | 10.18 | D |
| 10.19 | A | 10.20 | E | 10.21 | B | 10.22 | A | 10.23 | C |
| 10.24 | E | 10.25 | D | 10.26 | A | 10.27 | C | 10.28 | E |
| 10.29 | E | 10.30 | B | 10.31 | D | 10.32 | A | 10.33 | B |
| 10.34 | E | 10.35 | D | 10.36 | C | 10.37 | A | 10.38 | C |

## Application Questions and Cases

10.39 The major difference between physical and perceptual product positioning is that the former is based on some set of objective physical characteristics. Such positioning can provide useful information, particularly in the early stages of designing a new product. This is especially so with industrial goods. It also helps marketing in interfacing with R&D. But a comparison of alternative offerings based only on the physical dimensions of alternative offerings does not provide a complete picture of relative positions since positioning ultimately takes place in the consumers' minds – i.e. it depends on how the product/brand is perceived. The evaluation of many products is subjective since it is determined by factors other than physical properties. Undertaking a perceptual product positioning is therefore critical.

10.40 Since many consumer goods brands are similar in their physical characteristics, it is important to undertake a perceptual product positioning study to determine if consumers perceive them as being similar or being different because of different histories, names, and consumer attitudes. It is also important to note how competing brands differ, not only from each other but against the consumer's ideal brand. For industrial groups a perceptual positioning study will reveal how various customer groups perceive a given product on the basis of both its physical and nonphysical characteristics. In some cases the latter can be extremely important (e.g., service dimensions).

10.41 Perhaps most important, the positioning intensity of a brand depends on how strongly customers associate it with one or more determinant attributes when deciding which to buy. In addition, another factor is how strongly customers associate the brand with the product category. Establish an intense position by focusing on one or two key determinant attributes, as P&G did with Crest when it focused on decay prevention and received the endorsement of the American Dental Association. A better option for a firm holding a small market share, however, may be to concentrate on an attribute not strongly associated with the dominant brand, and to position itself as a feasible substitute for bigger brands under certain situations, or for targeting a peripheral segment of the market.

10.42 Consumers typically use a relatively small number of attributes to evaluate products and brands. Consumers first consider only those attributes they are aware of, but the importance attached to those often varies. Even an important attribute may not be a strong influence on a consumer's preference if the alternative brands are perceived as being about equal on that dimension. A determinant attribute is one which plays a major role in helping consumers differentiate among the alternatives and determine which brand they prefer. Possible determinant attributes for the following are:

(a) A cruise line – number of ports visited.
(b) A laptop computer – memory capacity.
(c) French wine – availability in large bottles.
(d) A sportswear – loose fitting.
(e) A hospital – cleanliness.
(f) A liberal arts college – business courses.
(g) A tractor – operator comfort.

10.43 To measure customer preferences requires that respondents rate their ideal product or brand within a product category and use this as the basis for rating existing products. The results will show how the various brands are positioned versus the ideal. These ideal points can be clustered for a given market segment to determine its preferences. By comparing how (and why) the competing brands differ from one another based on their distances from one another and the cluster of ideal points, a firm can decide whether a new product concept is viable or what needs to be done to reposition an existing brand which will result in greater revenues.

10.44 Nordstrom already has an enviable position in terms of value and fashion ability. It could improve this position slightly by moving closer to segment 4.

10.45 Nabisco may wish to pre-empt a strong move by the competition by introducing a second, similar brand positioned to appeal to the same market segment.

*Advantages* – it is better in the long run for a firm to compete with itself than to lose customers to other firms.

*Disadvantages* – this move cannibalises the market of the established brand and results in higher investments and lower economies of scale.

# Module 11

## Review Questions

## Content Questions

11.1 *See* Section 11.1.

11.2 *See* Exhibit 11.3.

11.3 *See* Section 11.1.2 and Exhibit 11.4.

11.4 *See* Section 11.1.3

11.5 *See* Section 11.1.3.1.

11.6 *See* Section 11.2.

11.7 *See* Exhibit 11.5.

11.8 *See* Section 11.3.2.

11.9 *See* Section 11.3.3.

11.10 *See* Section 11.3.4.

11.11 *See* Section 11.3.4.3.

11.12 *See* Section 11.3.4.4.

11.13 *See* Section 11.3.4.7.

11.14 *See* Section 11.3.4.7.

11.15 *See* Section 11.3.4.8.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 11.16 | E | 11.17 | B | 11.18 | B | 11.19 | A | 11.20 | C |
| 11.21 | D | 11.22 | E | 11.23 | E | 11.24 | C | 11.25 | A |
| 11.26 | D | 11.27 | E | 11.28 | A | 11.29 | E | 11.30 | B |
| 11.31 | C | 11.32 | E | 11.33 | E | 11.34 | A | 11.35 | A |
| 11.36 | E | 11.37 | E | 11.38 | E | 11.39 | D | 11.40 | A |
| 11.41 | B | 11.42 | C | 11.43 | C | 11.44 | D | 11.45 | D |

## Application Questions and Cases

11.46

(a) Cars.
(b) Motor cycles.
(c) Raincoats.
(d) Contribution to a local charity.
(e) Reading a serious book.

| Product | Possible want-satisfying benefits |
|---|---|
| Cars | Transportation.<br>Prestige.<br>Self-expression (i.e. 'this car expresses the kind of person I am' ). |
| Motor cycles | Transportation (inexpensive).<br>Belonging to a group (self-satisfaction). |
| Raincoats | Protection from rain.<br>Prestige (e.g. designer raincoat).<br>Self-expression. |
| Contribution to a local charity | Self-satisfaction in doing good.<br>Community betterment.<br>Prestige (e.g. boast about contribution). |
| Reading a serious book | Enlightenment.<br>Entertainment.<br>Prestige. |

11.47

| Shopping good | Speciality good |
|---|---|
| Receptive to personal selling | Receptive to personal selling. |
| Receptive to persuasive advertising | Receptive only to informational advertising (e.g. brand available at this location). |
| May evaluate multiple brands | Consider few or one brand only. |
| May be price sensitive | Less likely to be price sensitive. |
| May expect to visit multiple locations | Will probably visit fewer locations. |

11.48 The differences between marketing the new toothpaste as a convenience good and marketing it as a speciality good are:

(a) The line, in terms of the size of the container, would be longer – in part to gain greater shelf space.
(b) The package would be designed more as a promotional item, whereas, as a speciality good, the emphasis would be on developing a 'medical' image.
(c) The price would be competitive with other brands whereas, as a speciality good, the price would be considerably above that of 'popular' brands.
(d) Emphasis would be placed on mass outlet stores to gain widespread distribution, as against a speciality good's limited distribution, for which the selected stores would provide in-store displays, personal selling and local advertising.
(e) Mass advertising coupled with coupons and perhaps free samples, as against local cooperative advertising and perhaps some advertising in a limited number

of magazines. Efforts would be made to influence dentists to recommend the brand. Free samples would be given to dentists to pass on to their patients. (These promotions to dentists would be undertaken whether it was to be marketed as a convenience or a speciality good.)

11.49

(a) Price policy.
(b) Distribution.
(c) Promotion.

| | |
|---|---|
| **Price** | Customers relatively insensitive to price; thus, firm will price higher than for similar shopping goods. |
| **Distribution** | Customers expect exclusivity; thus, firm will place product in relatively few stores, and only stores of high perceived status and quality. |
| **Promotion** | Advertisements should enhance perceived status and quality of brand, and identify location of stores carrying line. |

11.50 The key is that this segment does not emphasise the product feature requirements of the major segments of the car market (which presumably seek features like economy, durability and so on). Rather, this ‘peripheral’ segment emphasises sportiness, expressiveness and perhaps ‘performance’. Thus, rather than seek product-line breadth (i.e. a variety of cars emphasising different features), the company should seek product-line depth (i.e. a variation on the themes of sportiness, expressiveness and performance).

11.51 A store brand (or private label) is one developed by either a wholesaler or a retailer who is responsible for their naming, pricing, promotion and quality control. Such brands have increased in importance in recent years mainly because national brands have regularly increased their prices along with the massive use of coupons, thereby training consumers to shop for price. They also undertook a large number of line extensions and, in general, focused less and less on brand quality. Such powerful discounters as Walmart and Target have moved aggressively with their own brands to take advantage of the price vulnerability of many national brands. The latter have responded by reducing the price gap between their brands and private brands and by promoting value pricing which features fewer coupons (and price promotions in general) and stressing the higher quality (including the greater number of features) of their products.

11.52 Whether Walmart – or any large discounter – should adopt a family branding strategy is a moot question. Much depends on the extent to which the company engages in private branding. If the items are related, then the company’s use of a family brand is more apt to be successful. If the family brand covers products that vary in quality, consumers can become confused about what quality to expect in the other products using the same name. Also, extending a brand name to an inadequate product is likely to hurt the quality reputation of the entire line.

11.53 The advantages of this strategy are that it: (1) separates the upmarket Honda product from the low-priced Honda products; (2) increases the number of Honda dealerships to which consumers are exposed; (3) allows Honda to establish separate structures for dealer pricing and other activities; and (4) permits trading up within the Honda family of cars.

The disadvantages of this strategy are that it: (1) encourages horizontal conflict within the dealer channels (regular Honda versus Acura Honda dealer disputes); (2) separates the Acura from the favourable general Honda image (e.g. dependability, reliability); (3) compels separate advertising and other promotional programmes.

11.54 There were probably two motives: experience and margin. Many firms (including particularly internationally oriented Japanese firms like Honda) attempt to gain as much production volume as possible. Volume is sought as an explicit goal because it increases the experience base, which drives down unit production costs in a predictable fashion. Also, Honda may have substantially saturated its low-price model market, and thus sought additional markets to increase its car volume. And the high-price model market carries a higher profit margin.

11.55

| **Unique characteristics** | **Marketing implications** |
|---|---|
| Ethical constraints | Establish peer review/self-regulation. |
| Buyer uncertainty | Educate consumers on need for services, important attribute, how to buy particular service. |
| Need to be seen as having experience | Acquire and promote expertise. |
| Limited differentiability | Emphasise expertise, special procedures and experience. |
| Need to convert service 'doers' into 'sellers' | Educate and train service providers in importance and techniques of marketing. |

11.56 The World Wide Web can be helpful in a variety of ways including announcing and detailing all new products, price changes, recalls, special promotions, new uses of existing products, maintenance suggestions, repairs and a place to display its catalogue containing detailed specifications on all products and services.

# Module 12

## Review Questions

## Content Questions

12.1 *See* Module 12 Learning Objectives.

12.2 *See* Module 12 Learning Objectives.

12.3 *See* Exhibit 12.1.

12.4 *See* Section 12.1.1.1.

12.5 *See* Section 12.1.1.3.

12.6 *See* Section 12.1.1.3.

12.7 *See* Section 12.1.2.1.

12.8 *See* Section 12.1.2.2.

12.9 *See* Section 12.1.2.2.

12.10 *See* Section 12.1.2.2.

12.11 *See* Section 12.1.2.3.

12.12 *See* Section 12.1.4.

12.13 *See* Section 12.2.1.

12.14 *See* Section 12.2.2.

12.15 *See* Section 12.2.3.

12.16 *See* Section 12.3.1.

12.17 *See* Exhibit 12.8.

12.18 *See* Section 12.3.3.

12.19 *See* Section 12.3.4.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 12.20 | C | 12.21 | B | 12.22 | D | 12.23 | C | 12.24 | E |
| 12.25 | C | 12.26 | A | 12.27 | B | 12.28 | C | 12.29 | D |
| 12.30 | A | 12.31 | A | 12.32 | B | 12.33 | B | 12.34 | B |
| 12.35 | E | 12.36 | E | 12.37 | D | 12.38 | B | 12.39 | E |
| 12.40 | A | 12.41 | E | 12.42 | C | 12.43 | C | 12.44 | B |
| 12.45 | C | 12.46 | A | 12.47 | D | | | | |

## Application Questions and Cases

12.48 A value-based pricing strategy emphasises the value of a brand to the consumer. It hopes to capture the consumer's perceived value of the product. To adopt such a strategy, a manufacturer of consumer household products would have to consider how and on what basis its products differed from competing products and use the perception of these differences to set a price relative to the prices being charged by competing products. To exploit these perceived differences as translated into stable, relative price differences (as against the use of frequent promotional deals involving price), the manufacturer would need to abandon its promotional pricing. This would not only stabilise prices over time, but save money, thereby permitting a reduction in price. To ease the pain of accepting value pricing by retailers, a firm should reduce the retailer's costs of selling the product (e.g. better control over inventories).

12.49

(a) Maximise sales growth through penetration pricing – the market is in the introductory or growth stage and the firm is an early entrant to the market. There are few barriers to entry, so other competitors are likely to enter quickly.

(b) Maximise current profit through skimming pricing – the market is in the introductory or growth stage and the firm is the first entrant. There are high barriers to entry, as the firm plans to withdraw after competitors enter.

(c) Maximise current profit through harvesting – the market is in the late maturity or decline stage and the firm is not a dominant player in the market.

12.50 A firm wanting to maintain a high-quality image and keep production quantities down may wish to adopt a high price in order to: (1) limit demand among customers; (2) reinforce the quality image of the product; and (3) attract other competitors to help build primary demand. Consequently, the company may want competitors to come in at the other end of the market to satisfy consumer demand for lower-priced products while the company continues to sell its products at the high end. Also, if the pioneer has limited marketing resources, it may want competitors to help build primary demand for the new product.

12.51 *Price elasticity* – A small price increase leads to a relatively large drop in quantity demanded.

*Price inelasticity* – A small price increase leads to a relatively small decline in quantity demanded.

When the price is elastic the firm may wish to lower the price, while the firm may want to consider raising the price when the price is inelastic.

12.52 There are three major groups of factors that affect a consumer's sensitivity to price – the buyer's perceptions and preferences, the buyer's awareness of and attitude towards alternatives and the buyer's ability to pay. There are many ways in which firms can attempt to estimate demand curves for their products. These include laboratory or test-market experiments. Another way to estimate the price/quantity relationship is via a regression analysis of historical sales using consumer panel data, in-store experiments where a product's price is systematically varied or multiple test markets.

12.53

$$\text{Unit cost} = \$100 + \frac{\$5000000}{100000} = \$150$$

$$\text{Target return price} = \$150 + \frac{0.20 \times 4000000}{100000} = \$158$$

12.54 The suggested retail price is $329.15.

The retailer should pay the wholesaler $197.50. The wholesaler should pay the manufacturer $158.00.

12.55

$$\text{Break-even volume} = \frac{\$3000000}{\$150} = 20000\text{units}$$

If the price was reduced by $50 the break-even volume would increase by 10 000 units to 30 000 units.

12.56

(a) *Uniform delivered pricing* – The pricing policy uses a standard freight charge equal to the average freight costs across all customers. The disadvantage is that it raises freight costs to customers near the manufacturing facility while lowering them for customers in the western states.

(b) *Zone pricing* – The policy divides the country into zones and charges the same price within each zone. The disadvantage is that customers in the west would still pay higher freight costs than customers in the east; however, within a particular area the freight charges would be comparable.

12.57 Manufacturer A must: (1) be one of the most efficient producers in the industry; (2) be perceived to have good marketing expertise which will help move the product even with a price increase; or (3) have a history of making price increases stick. It is more than likely that the industry is oligopolistic with little product differentiation and a few large competitors (e.g. steel).

12.58 A key factor to consider is the cross-elasticity between models (cannibalisation) which is the percentage change in sales of one product induced by a 1 per cent change in the price of another. This would enable Ford to examine how price increases in one model would affect demand for the other models in its line. In addition, the company must consider the costs and demand for replacement parts and how much of each car model should be composed of parts from other models (e.g. bumpers).

12.59 For a new product the company could use the Internet to auction it off. To do so would require a description of the product, its uses, the benefits it provides, the amount involved, and competitive/substitute products and their prices. Bidders would receive some kind of incentive to enter a bid. The range of bid prices coupled with their frequency could be used as an estimate of the perceived value of the new product.

For an established product consumers could be asked to estimate the per cent increase or decrease in sales resulting from each increment 'up' and 'down.' The assumption here is that in responding the consumer is actually revealing his/her demand schedule. Again, there would have to be a 'reward' for responding. The difficulty would be that the company would not know whether those answering were representative of the firm's customers.

## Module 13

### Review Questions

### Content Questions

13.1 *See* Section 13.1.

13.2 *See* Exhibit 13.3.

13.3 *See* Section 13.3.

13.4 *See* Section 13.3.3.

13.5 *See* Section 13.3.4.

13.6 *See* Section 13.4.1.

13.7 *See* Section 13.4.2.

13.8 *See* Section 13.2.

13.9 *See* Section 13.5.1.1.

13.10 *See* Section 13.8.1.

13.11 *See* Section 13.8.2.

13.12 *See* Section 13.8.3.

13.13 *See* Section 13.8.4.

13.14 *See* Section 13.6.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 13.15 | C | 13.16 | D | 13.17 | C | 13.18 | B | 13.19 | D |
| 13.20 | B | 13.21 | E | 13.22 | C | 13.23 | D | 13.24 | D |
| 13.25 | C | 13.26 | C | 13.27 | D | 13.28 | E | 13.29 | D |
| 13.30 | E | 13.31 | B | 13.32 | E | 13.33 | B | 13.34 | C |
| 13.35 | E | 13.36 | C | 13.37 | A | 13.38 | E | | |

## Application Questions and Cases

13.39 Hallmark actually has few options for salvaging relations with its stores. It could try to develop another line or brand of cards with high margins – but they would not have the same acceptance, given the power of the Hallmark brand name. Another possibility would be to develop 'niche' cards under the Hallmark name – a limited line for certain holidays as well as for anniversaries, birthdays, etc. These could be high-quality cards sold at a competitive price with good margins. Further, they would not be sold to the large chains.

An early warning system would have discovered the actions of competitors in selling to discount chains and the decision by discount chains to sell items similar to cards, such as stationery as well as boxes of seasonal cards (e.g. Christmas cards). But even if Hallmark executives had received an early alert, there was no way the tide could be reversed. But with advance notice, the company would have had more time to develop its strategy as well as its action plans. Further, the company could have started an orderly downsizing.

13.40 The key issue is selling effort. There is a trade-off between control, which the company would have with its own salesforce, and costs, which would be higher with a salesforce. Salespeople are not necessarily more productive than wholesalers and are almost guaranteed to generate higher costs, so the company needs to study the benefits of additional control over the channel as against higher costs.

Information which would be helpful in making a decision include: (1) costs; (2) estimated sales under new plan; (3) profit margins under current and proposed plans; (4) estimated overhead for new plan; and (5) commission proposal for new plan as well as current structure.

13.41 A firm is most likely to consider the use of multiple distribution channels when it is trying to reach several markets simultaneously and each market has unique characteristics which require different levels of performance from channel members.

IBM has its own direct salesforce and also sells via retailers.

13.42 Probably the best approach would be for the manufacturer to use an agent in the USA who is familiar with the industry. In this channel there would be the following parties: manufacturer–agent–wholesaler–retailer–consumer.

The agent would be familiar with the industry and would know how most efficiently to get the product into the ultimate consumers' hands.

13.43 In the case of Calvin Klein jeans this is an appropriate channel design, since the jeans are considered shopping goods that customers buy infrequently and compare on price and product features. It is also appropriate since certain retailers such as mass-merchandisers (Kmart) do not fit the image set by Klein for their jeans.

13.44 Just-in-time has to do with inventory control. It programmes the delivery of a component by a supplier to a customer at literally the moment when the last component in stock has been used. The objective of a just-in-time system is zero inventory which would imply not only a unique physical logistics system, but products with zero quality defects. In order to be able to make such a system work, a wholesaler must be able to work closely with a client, develop and constantly update a decision-support system and stock error-free products.

13.45 Information and the technology to supply it quickly are the primary reasons for the increased power of retailers. Expert power is supplied by the ability of retailers to have access to up-to-the-minute information on sales of products.

13.46 A cooperative chain gives the individual retailer greater power in dealing with suppliers, economies of scale in advertising, lower prices and special promotional materials.

The benefits are: (1) ability to compete with national chains more effectively; (2) better, more profitable relationship with suppliers.

The growth of a cooperative chain would shift power towards the retail end of the channel.

13.47 A push strategy would be most appropriate in the situation described.

Specifically, the company should: (1) offer higher margins on some of its products than its competitors; (2) provide sales training programmes to the sales staff of each of the wholesalers; (3) develop a cooperative advertising programme with the wholesaler to subsidise its advertising programme; (4) provide in-store display racks or demonstrations; and (5) enhance product return and replacement policies to make the product more attractive.

13.48 If the cereal manufacturer is the market leader and its other products hold strong market shares, the manufacturer has a better opportunity to make a pull strategy work successfully. Specifically, the manufacturer should: (1) have substantial resources to devote to the product's marketing programme; (2) be perceived to have a great deal of marketing expertise; and (3) have an extensive track record of past new-product successes.

13.49 Disagreements among channel members centre on incompatible goals (margins, services and costs), unclear rights and responsibilities, poor communications, inconsistent handling by manufacturers of problems (complaints) and misperceptions. Firms can help minimise channel conflict by recognising and resolving potential conflicts early, involving channel members in policy decisions, increasing interaction among all levels of personnel, focusing/emphasising common goals and using mediation and arbitration.

13.50 In many parts of Africa, the manufacturer would find no channels suitable for the sale and servicing of a line of small electrical appliances – or, at best, inadequate ones. If the latter, the manufacturer could try to augment the channel's effort – e.g. by providing inventory items on a consignment basis, providing credit at the retail level and helping retailers to open new accounts with company salespersons. If no channels are available, the manufacturer can either set up its own channel or locate a wholesaler who is willing to work with the manufacturer in selling and servicing retail accounts.

13.51 A small chain of supermarkets should consider incorporating the following subjects in its ethical manifesto:

(a) Control over the level of slotting allowances so as not to inhibit the stocking of new products as well as the providing of adequate shelf facings.
(b) Consider locating one or more stores in or near poor neighbourhoods.
(c) Not advertising specially priced merchandise which does not have an adequate retail inventory.
(d) Not using the 'to meet competition' argument with a seller to obtain a special concession when such is not the case.
(e) Not discriminating against customers residing in poor neighbourhoods in times of product shortages.

# Module 14

## Review Questions

## Content Questions

14.1 *See* Section 14.1.

14.2 *See* Section 14.2.

14.3 *See* Section 14.3.1.

14.4 *See* Exhibit 14.9.

14.5 *See* Section 14.3.1.4.

14.6 *See* Section 14.3.1.4.

14.7 *See* Section 14.3.3.

14.8 *See* Section 14.3.3.

14.9 *See* Section 14.1.

## Multiple Choice Questions

| | | | | |
|---|---|---|---|---|
| 14.10 E | 14.11 C | 14.12 E | 14.13 E | 14.14 E |
| 14.15 C | 14.16 D | 14.17 B | 14.18 D | 14.19 D |
| 14.20 B | 14.21 E | 14.22 D | 14.23 C | 14.24 D |
| 14.25 A | 14.26 A | 14.27 C | 14.28 B | 14.29 A |
| 14.30 B | 14.31 C | 14.32 C | 14.33 C | 14.34 B |
| 14.35 D | 14.36 E | 14.37 A | 14.38 D | 14.39 B |
| 14.40 E | | | | |

## Application Questions and Cases

14.41 Three factors lead to the different promotion strategies. First, the markets for the types of computers marketed by IBM are much larger than the market for supercomputers; consequently, IBM can justify spending large amounts of money on advertising to reach these markets. Second, the markets which IBM targets are quite competitive and while IBM dominates many of them, it must still advertise to maintain its position in those markets. Cray, on the other hand, has so dominated the supercomputer market, especially in the USA, that there is little need to advertise. Finally, while all computers are complex and require some personal selling, supercomputers are among the most complex and intricate machines in existence. As a result, advertising can do little to enhance the marketing process, while personal selling is essential so that customers can explain their needs in detail and salespeople can, in turn, respond to their questions.

14.42 *Individual consumers* focus on advertising media which reach consumers such as print media (local newspapers, national news magazines such as *Time*). Develop incentive (frequent flyer) promotions. Target certain segments in order to increase the load factor. Also develop package vacations.

*Corporate travellers* focus on media designed to reach decision makers in the travel department; for example, trade publications within the travel industry. Also, if the company maintains a salesforce, it should have them call on large corporations to explain in detail what exactly each airline is offering and at what price.

14.43 The information needed to develop a copy platform for the new hurricane policy and the sources of the needed information are described below:

| Copy platform contents | Information sources |
|---|---|
| Problems advertising must address | (a) Advertising of competitive products.<br>(b) Past advertising of client company.<br>(c) Discussion between agency and client personnel. |
| Advertising objectives | (a) Objectives for previous client's hurricane advertising as well as other types of policies.<br>(b) If advertising is to use response copy/materials, their objectives can be set in terms of response rates based on past experience. |
| Target audience | (a) Client marketing research in terms of quantification of demographics involved. If business units and/or agents involved, then profiles of the different types. |
| Key benefits | (a) Agency/client interactions.<br>(b) Possibly focus groups discussing key benefits desired and how client's policy compares to what is wanted, as compared with competing policies. |
| Creative statement | (a) Agency personnel – copy writers, account executives and marketing research personnel.<br>(b) Possible use of focus groups to react to campaign themes and appeals. |
| Supportive information | (a) Agency research department.<br>(b) Client research department. |

14.44 The following media are recommended for the following kinds of products:

| Kinds of product | Recommended media |
|---|---|
| Premium ice cream | In-store displays, television |
| Sophisticated/expensive consumer electronics | Magazines |
| Major home appliances | Newspaper |
| Laundry detergents | Television |

14.45

(a) How will the money be spent – how will it be divided among various advertising media?
(b) Over what time frame are the additional funds to be spent?
(c) What is the time frame for the projected sales increase – how long will it take to achieve the $2 million sales increase?
(d) What percentage increase in total sales does this $2 million represent and what is the percentage increase in the advertising budget if the $500 000 is appropriated?
(e) What is the amount of the marginal contribution generated by this expenditure?
(f) Could a better return be achieved by spending the $500 000 on other promotional tools, such as hiring more salespeople?

14.46 *Advantages*: (1) simple to calculate; (2) risk adverse – since spending is tied to sales it keeps the company from getting too far out of line with the rest of the industry.

*Disadvantages*: (1) provides little direction in setting promotional budgets; (2) does not work well with new brands or in situations where sales volume is unstable or declining.

# Module 15

## Review Questions

### Content Questions

15.1 *See* Exhibit 15.1.

15.2 *See* Section 15.2.1.

15.3 *See* Section 15.2.3.

15.4 *See* Section 15.2.4.

15.5 *See* Exhibit 15.4.

15.6 *See* Exhibit 15.5.

15.7 *See* Exhibit 15.5.

### Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 15.8 | B | 15.9 | A | 15.10 | C | 15.11 | D | 15.12 | E |
| 15.13 | B | 15.14 | D | 15.15 | C | 15.16 | E | 15.17 | B |
| 15.18 | D | 15.19 | C | 15.20 | C | | | | |

### Application Questions and Cases

15.21 The text now identifies seven possible advantages to the pioneer. The new one is possible network externalities or positive network effects. However, Minnetonka's products are unlikely to benefit from such effects.

15.22 Research indicates that 'pioneers' succeed through a combination of large-scale entry, broad product line, high product quality and heavy promotional expenditures. This suggests Minnetonka should concentrate on introducing high-quality products.

15.23 This difference in profits results from the fact that cost cutting has a largely short-term affect whereas revenue growth – particularly that derived from innovative new products – has a much longer-term impact. This is especially true if the company's initial product generates a product line of considerable consequence and the company develops and holds the largest market share.

15.24 A pioneering firm has the best chance for long-term success in market-share leadership and profitability when the new product-market is insulated from the entry of competitors and/or the firm has sufficient size, resources and competencies to take full advantage of its pioneering position and preserve it in the face of later competitive entries. Followers are most likely to succeed when there are few legal, technological or financial barriers to inhibit entry and when it has sufficient resources or competencies to overwhelm the pioneer's early advantage.

15.25 Skimming with early withdrawal is most successful when there is limited potential demand, customers are likely to adopt early and pay a premium and when there is substantial potential competition.

3M is most likely to engage in skimming and spinning off when the product technology cannot be effectively protected, when the resources to produce the product are commonly available and when production is relatively simple.

# Module 16

## Review Questions

## Content Questions

16.1 *See* Section 16.2.2.

16.2 *See* Section 16.3.2.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 16.3 | A | 16.4 | A | 16.5 | A | 16.6 | E | 16.7 | A |
| 16.8 | A | 16.9 | E | 16.10 | C | 16.11 | D | 16.12 | D |
| 16.13 | B | 16.14 | A | 16.15 | A | 16.16 | A | 16.17 | E |
| 16.18 | B | 16.19 | A | 16.20 | B | 16.21 | C | 16.22 | E |

## Application Questions and Cases

16.23 Stouffer should focus on retaining current customers by: (1) maintaining and improving satisfaction and loyalty; (2) encouraging and simplifying repeat purchases; and (3) reducing the attractiveness of switching. It should also stimulate selective demand among late adopters by: (1) head-to-head positioning against competitive offerings or potential offerings; and (2) differentiated positioning against competitive offerings or potential offerings.

16.24

| Marketing element | Specific actions |
|---|---|
| Product | Increase quality control.<br>Continue product modification.<br>Expand production capacity. |
| Price | Meet prices as needed; selective sales promotion. |

| Marketing element | Specific actions |
|---|---|
| Place | Improve inventory control.<br>Continue building distribution channels. |
| Promotion | Focus advertisements on selective demand.<br>Increase salesforce servicing of current accounts. |

16.25

| Strategy | Marketing actions |
|---|---|
| Fortress | Increase satisfaction, loyalty, and repeat purchase by current customers; appeal to late adopters.<br>Continue quality control.<br>Continue product modification/improvement.<br>Use ads to stimulate selective demand. |
| Flanker | Develop a second entry (in this case, perhaps a budget topping). |

16.26 Initially the Japanese auto makers pursued a flank attack, providing automobiles for a segment of the US market seeking fuel-efficient, inexpensive, reasonably reliable transportation. Important marketing variables were product (reliability, as measured by such indicators as frequency of repairs) and price (relatively low).

16.27 Major US car makers probably should have pursued a flanker maintenance strategy, designing and producing cars for the segment(s) of the market seeking fuel-efficient, inexpensive, reasonably reliable transportation.

There are probably several reasons this approach was not pursued. First, car plant construction, or retooling of existing plants, is expensive and requires a long lead time. US car makers may have avoided the expense until too late, and then the lead time prevented share maintenance. Second, the larger, more expensive models produced by US firms had higher margins, and US car makers were probably reluctant to divert attention from that market (or perhaps to admit it was declining). Third, Japanese production systems are a unique combination of culture and cultivation achieved over a long period. Not all US car makers demonstrated an ability to make cars of such quality.

# Module 17

## Review Questions

## Content Questions

17.1 *See* Section 17.2.

17.2 *See* Section 17.2.1.

17.3 *See* Section 17.2.2.1.

17.4 *See* Section 17.2.2.2.

17.5 *See* Section 17.2.3.1.

17.6 *See* Section 17.2.4.

17.7 *See* Section 17.3.1.

17.8 *See* Section 17.3.2.

17.9 *See* Section 17.3.2.4.

17.10 *See* Section 17.4.1.

17.11 *See* Section 17.4.3.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 17.12 | B | 17.13 | A | 17.14 | D | 17.15 | E | 17.16 | D |
| 17.17 | D | 17.18 | D | 17.19 | C | 17.20 | A | 17.21 | D |
| 17.22 | B | 17.23 | D | 17.24 | B | 17.25 | C | 17.26 | A |
| 17.27 | E | 17.28 | D | 17.29 | D | 17.30 | A | 17.31 | A |
| 17.32 | E | 17.33 | C | 17.34 | C | 17.35 | E | 17.36 | A |
| 17.37 | B | 17.38 | A | 17.39 | A | 17.40 | C | 17.41 | D |

## Application Questions and Cases

17.42 The service dimensions and marketing actions needed to develop a high quality image for the airline are:

| Dimensions | Marketing actions |
|---|---|
| Tangibles | Clean facilities including interior and exterior of plane – and professional appearance of all flight personnel. |
| Reliability | On-time performance. |
| Responsiveness | Agent/flight attendant/training in reacting to customers' needs, queries, etc. |
| Competence | Pilot/flight attendant/agent training in operating procedures. |
| Empathy | Flight attendant/agent training in customer contact protocols. |
| Courtesy | Flight attendant/agent training in customer contact protocols. |
| Communications | Flight attendant/agent training in customer contact protocols. |

17.43 A measure of customer loyalty (repeat patronage) could be obtained by surveying a sample of the airline's passengers (while *en route*) asking for information concerning the last five or so flights – month, cities involved (from/to), day of week, time of day and airline. This would provide an overall measure of loyalty as well as loyalty by geographical area and demographics and loyalty to other carriers.

A measure of customer satisfaction is derived from an expectancy measure based on the weight (relative importance) given to all airlines, coupled with customers' rating of the image of the airlines, as mentioned in the loyalty answer above. These questions would be included in the survey of customer loyalty. Thus, the satisfactions measured/obtained can be tied directly into the loyalty data.

17.44 The company may have achieved this position by: (1) producing a no-frills copier; (2) designing its product in an innovative, low-cost way; (3) obtaining less-expensive sources of component parts; (4) developing an innovative, lower-cost production process; (5) developing low-cost distribution channels; and (6) reducing overhead.

17.45 McDonald's employed a market-expansion strategy to strengthen its domestic position by introducing new product lines and line extensions to its established clientele. These new menu items probably also attracted some new customers. Further, since the new products used essentially the same production and distribution facilities, there was considerable synergy with the other products. Also, by being first in its industry to do so, the company was able to appropriate the benefits which derive from being a pioneer. It also expanded overseas – to countries that included Russia and China. It did so largely via the use of franchisees, which reduced the cost of doing so. Again, the company was a pioneer in this expansion move.

17.46 McDonald's followed a home market, developed markets and developing markets expansion strategy route. Note that it first exploited its home market and then proximate North American markets before moving to Europe, even though Mexico would not – at that time – be considered an industrialised nation. Even so, the synergy of expanding into Canada and Mexico was substantial – especially Canada. European consumers are more similar to American consumers than are those in the developing countries. And it would be easier to establish and manage franchisees in Europe. Even so, McDonald's longer-term future growth may well lie in the developing countries where disposable incomes and discretionary expenditures are expected to grow substantially over the years.

17.47 Kunz was pursuing a 'profitable survivor' strategy. It held a leading share in a market certain to decline (but at a steady rate), with few strong competitors.

It was probably able to acquire remaining firms at a favourable rate, streamline their product lines and improve production and distribution efficiency. There may have been purchasing economies as the firm increased its scale. Further, while advertising was probably necessary, marketing expenses were probably minimal (a reorder situation). With little price competition, and by reducing costs, margins could be maintained or increased.

17.48 Harvesting makes sense when the market is expected to decline at a steady rate, there are few strong competitors, low exit barriers and the firm has a leading share position. When the decline is expected to be relatively rapid, divestment makes sense.

Marketing actions consistent with harvesting include: (1) eliminating R&D expenditures; (2) reducing marketing expenditures; (3) seeking ways to reduce production costs; and (4) raising prices as needed to maintain margins.

# Module 18

## Review Questions

## Content Questions

18.1 *See* Section 18.1.
18.2 *See* Section 18.2.
18.3 *See* Section 18.2.2.
18.4 *See* Section 18.2.3.
18.5 *See* Section 18.2.3.1.
18.6 *See* Section 18.2.4.
18.7 *See* Section 18.2.6.
18.8 *See* Exhibit 18.9.
18.9 *See* Section 18.3.1.
18.10 *See* Section 18.3.5.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 18.11 | E | 18.12 | B | 18.13 | D | 18.14 | B | 18.15 | A |
| 18.16 | C | 18.17 | D | 18.18 | A | 18.19 | A | 18.20 | D |
| 18.21 | D | 18.22 | C | 18.23 | E | 18.24 | E | 18.25 | D |
| 18.26 | B | 18.27 | D | 18.28 | C | 18.29 | E | 18.30 | A |
| 18.31 | A | 18.32 | A | 18.33 | A | 18.34 | B | 18.35 | D |
| 18.36 | D | 18.37 | B | 18.38 | C | 18.39 | D | 18.40 | A |
| 18.41 | B | 18.42 | E | | | | | | |

## Application Questions and Cases

18.43 Two key issues would need to be addressed, given the delineation of evaluation already identified. One involves the autonomy which the new unit will have relative to other units in the organisation. The manager should be promised a relatively high level of autonomy in order to make the decisions necessary to develop new products. The second issue is the amount of shared programmes and synergy which will exist between the new unit and other SBUs in the company. The manager should insist on there being relatively little required synergy between units in order to have the ability to develop the SBU's marketing and R&D programmes.

18.44 The place to start would be with the R&D department. This must be good in order to generate product ideas using the technology within the other organisational SBUs. This would require the hiring of good medical technicians and perhaps a few doctors to help in the R&D process. In addition, the manager should hire some experienced salespeople to test the market for ideas.

18.45 Recent developments in types of organisational structures have generated a renewed interest in matrix organisations similar to the one used by Hewlett-Packard. This is the least bureaucratic or centralised and the most specialised type of organisation. Matrix organisations are making increased use of product teams which are given substantial empowerment to develop, for example, and make operational a business plan for a given product or product line.

Companies are struggling to develop an entrepreneurial culture centred on customers. Other important changes include managing business processes rather than functional areas and developing collaborative networks that include joint ventures.

18.46 Given the complexity of the products and the apparent scope of the SBU's product offerings, a product management structure would probably be most appropriate. The reason for this is that it would allow managers to concentrate their efforts on developing a broad range of products at the same time as each manager is responsible for his/her own product development and marketing approaches. A possible alternative would be a matrix or team structure for product development, switching to product managers as those products become established.

The structure should include moderate levels of formalisation, centralisation and specialisation. According to the text, the most appropriate organisational design would be one involving both product managers (to stay abreast of product improvements), and/or market managers (to keep up with new market opportunities) or possibly both in a matrix structure.

18.47 A participative approach would be the best way to handle potential conflicts. A general manager would be given the responsibility of co-ordinating all the functional activities one level above each of the product groups.

# Module 19

## Review Questions

## Content Questions

19.1 *See* Exhibit 19.1.

19.2 *See* Section 19.1.1.

19.3 *See* Section 19.1.1.

19.4 *See* Section 19.1.1.1.

19.5 *See* Section 19.2.

19.6 *See* Section 19.4.1.

19.7 *See* Exhibit 19.13.

## Multiple Choice Questions

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 19.8 | D | 19.9 | C | 19.10 | A | 19.11 | B | 19.12 | C |
| 19.13 | A | 19.14 | C | 19.15 | A | 19.16 | B | 19.17 | B |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 19.18 | B | 19.19 | E | 19.20 | A | 19.21 | C | 19.22 | E |
| 19.23 | D | 19.24 | E | 19.25 | E | 19.26 | E | 19.27 | D |
| 19.28 | B | 19.29 | C | 19.30 | E | 19.31 | E | 19.32 | E |
| 19.33 | E | 19.34 | A | 19.35 | D | 19.36 | A | | |

## Application Questions and Cases

19.37 Walmart's control system has been a major reason why the company is the low-cost leader in its industry. By being able to convert information into action almost immediately, it can control and automatically replenish its inventories; track sales by stockkeeping unit, product groupings, departments, stores, district and regions; determine whether the seven-second credit card approval system is working properly, distribute messages to the entire system with but a few minutes' notice, determine whether Walmart continues to be the lowest-priced discounter; and take advantage of new merchandise opportunities. By merging state-of-the-art computer communications technology with hands-on management, Walmart has developed a distribution system which is the envy of the industry.

In Canada the company has enough stores to make it economically feasible to set up a control system similar to that of the USA – one which could be accessed by Walmart's headquarters personnel. Much the same could be said for Mexico. There are fewer stores in South America and Asia and the distances are greater; hence, more control has to be delegated to local country managers. Obviously, the control system used will not be as sophisticated as the one used in the USA.

19.38 *Full costing* – Analysts assign both direct or variable and indirect costs to the unit of analysis. Direct costs are directly associated with the unit of analysis (production costs, direct marketing costs). Indirect costs involve certain fixed joint costs that cannot be linked directly to a single unit of analysis (general management, costs of occupying a facility).

*Contribution margin* – This approach argues that there is really no accurate way to assign indirect costs. In addition, because indirect costs are mostly fixed costs, a product or market may make a contribution to profits even if it shows a loss. Thus, even though overhead must eventually be absorbed, the contribution method clearly indicates what is gained by adding or dropping a product or customer.

Large, multi-SBU corporations would most probably use a contribution margin approach, since it enables the firm to better assess the way a product adds or subtracts from overall profitability.

19.39

| | |
|---|---|
| **Net sales** | $5650 |
| Less: direct costs | $3800 |
| | $1850 |
| **Expenses** | |
| Salesforce | $ 510 |
| Advertising | $ 230 |

| | |
|---|---|
| Physical logistics | $ 215 |
| Occupancy | $ 25 |
| Management overhead | $ 100 |
| | $1080 |

Contribution to overhead and profits = $770

Increase in profit (before tax) = $770 – $650 = $120

19.40

| | |
|---|---|
| **Net sales** | $5530 |
| Less: direct costs | $3800 |
| | $1730 |
| **Expenses** | |
| Salesforce | $ 450 |
| Advertising | $ 255 |
| Physical logistics | $ 190 |
| Occupancy | $ 25 |
| Management overhead | $ 100 |
| | $1020 |

Contribution to overhead and profits = $710

Increase in profit (before tax) = $710 – $650 = $60

The better alternative is the one proposed in Question 19.39, which produces an increase in profit of $120.

19.41

1. Marketing environment.
2. Objectives and strategy.
3. Planning and control system.
4. Organisation.
5. Marketing productivity.
6. Marketing functions.

19.42

1. *Marketing environment* – What opportunities and/or threats derive from the firm's present and future environment: that is, what technological, political and social trends are significant? Sources – news magazines, government publications.
2. *Objectives and strategy* – How logical are the company's objectives, given the more significant opportunities/threats and its relative resources? How valid is the firm's strategy, given the anticipated environment? Sources – internal company strategic documents.
3. *Planning and control system* – Does the firm have adequate and timely information about consumers' satisfaction with the products? With the actions of competitors? Sources – internal marketing information system.
4. *Organisation* – Does the organisation structure fit the evolving needs of the marketplace?

5. *Marketing productivity* – How profitable are each of the firm's products/ brands? How effective are each of the firm's marketing activities? Sources – internal company cost and marketing documents (invoices).
6. *Marketing functions* – How well does the product line meet the unit's objectives? How well do the other marketing-mix elements fit corporate objectives? Sources – internal company documents.

19.43 It is difficult without further information to say for certain what is the cause of Barlow not reaching her quota. On her behalf, she is fairly close to reaching her quota (94 per cent). This might suggest that perhaps a little more effort would put her over the top. However, there might be other factors (more training, personal reasons, etc.) at play. It is also possible that her quota was set too high in view of competitive conditions or other uncontrollable factors.

19.44

1. *Customer analysis* – An analysis of Barlow's customers to determine if she is doing a good job of qualifying her customers.
2. *Product analysis* – What is the mix of products she is selling? Perhaps she needs to sell a different mix of product combinations.
3. *Order size* – How big is an average order? Perhaps she needs to work on putting together larger orders.
4. Analysis of competitive actions in Barlow's territories.

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