

# Marketing Lecture 2: Product Differentiation Lecture Notes

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## 1 Competition and Product Differentiation

### 1.1 Key Concepts and Points

#### 1.1.1 Definition of Product Differentiation

Product differentiation, in a textbook sense, has two aspects.

1. **Product Differentiation as a State:** Refers to a situation where consumers possess a **strong preference** (commitment) for a product, to the extent that they feel **'this product has no substitute'**. (e.g., 'a differentiated market')
2. **Product Differentiation as an Action:** Refers to all activities (e.g., advertising, product development) that a company undertakes to create the aforementioned state (a strong preference).

(e.g., 'to differentiate a product')

Companies aim to intentionally create this 'state' through this 'action', securing **sustainable high profit margins**.

### 1.1.2 The Theory of Perfect Competition (The Absence of Differentiation)

To understand the significance of product differentiation, the contrasting economic model of '**perfect competition**' was introduced. While rare in reality, it serves as a theoretical benchmark. This market is established upon the following strict conditions:

- **Innumerable market participants** who act independently without influencing one another.
- **Perfect information**: All participants have complete knowledge of prices and sales conditions.
- **Product homogeneity**: Consumers perceive products offered by any firm as having **no differences whatsoever**.
- **Free entry and exit**: There are no costs associated with entering or leaving the market.

### 1.1.3 The Consequence of Perfect Competition: The Price Taker

In a perfectly competitive market as described above, firms have no incentive to engage in marketing activities.

- **Absence of pricing power**: Individual firms cannot influence the price at all. The price is determined solely by the balance of the market's **total supply** and **total demand**.
- **Price Taker**: Firms can only 'accept' the market-determined price, becoming **price takers**.
- **Profit minimization**: Since products are identical, consumers choose the cheapest option. As a result, firms can only earn the **bare minimum profit required for survival** in the market.

### 1.1.4 The Strategic Significance of Product Differentiation

Real-world markets (imperfectly competitive markets) are often oligopolies, where a few large companies hold significant market share. In such a market, the reason firms engage in product differentiation is clear. **Why do firms differentiate their products?** In short, it is '**to avoid becoming price takers**'.

1. **Providing non-price selection criteria**: When differentiation succeeds, consumers begin to select products based on **criteria other than price** (e.g., design, brand, functionality).
2. **Resilience to competitors' pricing strategies**: A customer base with a strong preference (loyalty) for the company's product **will not switch** (price elasticity decreases), even if competitors slightly lower (or raise) their prices.
3. **Gaining pricing power and high profit margins**: A firm can secure a customer base that will purchase at a higher price, convinced of that 'difference' (added value). This allows the firm to gain the power (**pricing power**) to set its own prices with **high profits** added on, rather than accepting a price forced by the market.

Acquiring this 'pricing power' is the primary goal of product differentiation.

## 1.2 Application and Case Analysis

### 1.2.1 Case Study: Bags with Logos (Differentiation by Brand)

In the lecture, bags 'with a logo' and bags 'without a logo' were presented, assuming identical quality and function.

- **Analysis:** Many consumers (if prices were the same) would prefer the bag with the logo. This 'logo' is a symbol of a specific brand (e.g., Louis Vuitton, Hermès).
- **Mechanism of differentiation:** Consumers find **added value** beyond functionality in that logo (brand), such as 'better design' or 'shows status'. This perception itself is the '**state**' of successful differentiation.
- **The firm's action:** Brand companies invest **large sums in advertising** or stage in-store experiences (e.g., distributing samples) to maintain and strengthen this state, intentionally building the consumer's '**strong preference**'.
- **Consequence:** The 'difference' of having a logo (brand) allows the company to escape the **price competition** that 'logo-free' bags (= homogeneous products) fall into, making it possible to secure high profit margins.

## 1.3 Deeper Context and Lessons

This section describes information supplementary to the main lecture, as well as an AI-driven expansion of the key points.

The lecture noted that differentiation requires the premise that 'firms **can influence** the price, features, and service of their products'. This implicitly refutes the perfect competition model of economics (where firms are powerless and cannot influence price). This was an important remark, showing that marketing theory is based on the '**firm as an active agent**' perspective, where companies can proactively influence the market (customer perception) to build a **competitive advantage**.

Following today's topic (why differentiate), the lecturer previewed two themes for future lectures:

1. What 'aspects' of a product to use for differentiation (the concept of **positioning**)
2. Differentiation by **factors other than the product** (e.g., service, channels)

### 1.3.1 AI Supplement: Expanding on Key Points

The lecture's main theme was '**why**' firms differentiate (to escape price competition), but it lacked the perspective of '**how**' they differentiate. Product differentiation can be broadly classified into two types based on its nature.

1. **Vertical Differentiation** Differentiation where **objective superiority/inferiority** exists. Differentiation along an axis where all consumers prefer 'higher' (or 'better') (e.g., performance, speed, durability, fuel efficiency).

- **Examples:** CPU processing speed, digital camera pixel count, car fuel efficiency.
  - **Characteristics:** Achieving high quality/performance usually incurs high costs, leading to higher prices.
2. Horizontal Differentiation Differentiation where there is **no objective superiority/inferiority**, and choices vary based on individual consumer's **subjective taste**.
- **Examples:** Clothing design (simple vs. ornate), car color (red vs. blue), beer taste (crisp vs. rich).
  - **Characteristics:** The 'bag with a logo' from the lecture is an example where there is no functional (vertical) difference, but a strong preference is generated by brand image and design (horizontal).

Firms must strategically decide whether to pursue vertical (performance up), horizontal (meeting diverse tastes), or both types of differentiation.

## 1.4 Conclusion

In this lecture, we learned that **product differentiation** is an active strategic behavior by firms to escape the logic of '**perfect competition**', which forces them to settle for being **price takers**. The essence of product differentiation lies in providing customers with **non-price selection criteria**—such as function, design, or brand image—and building a **strong preference** that makes the product '**irreplaceable**'. This preference creates resilience to competitors' pricing strategies and grants the firm '**pricing power**'. The practical lesson from this lecture is that marketing is ultimately a battle to avoid falling into **price competition** in a '**homogeneous**' market, and instead to establish a '**unique value**' within the **perception** of the customer.

# 2 Product Attributes and Positioning

## 2.1 Introduction

In the previous lecture, we learned '**why**' firms engage in product differentiation from the perspective of escaping price competition (i.e., escaping the price-taker status). This report serves as a sequel, organizing the concrete methods and strategic thinking for '**how**' to execute product differentiation. In this lecture, we learn an approach that views a product as a '**bundle of attributes**', classifying those attributes as '**vertical**' and '**horizontal**'. Furthermore, we will analyze the concept of '**positioning**'—a core strategy using '**perceptual maps**' that visualize the market along these attribute axes—including its creation and strategic use.

## 2.2 Key Concepts and Points

### 2.2.1 Product = Bundle of Attributes

In marketing theory, a product is defined as a '**bundle of multiple attributes**'.

- **Attribute (Axis):** A feature of the product perceivable by consumers (e.g., TV size, picture quality, color, design).
- **Consumer evaluation process:** Consumers are thought to judge the **importance** of each attribute, **evaluate** how well the product satisfies each attribute, and then integrate these to form an overall evaluation of the product.

### 2.2.2 The Two Axes of Differentiation: Vertical and Horizontal Attributes

Product attributes (the axes of differentiation) are broadly categorized into two types based on their nature.

1. **Vertical Attributes** Attributes for which **clear superiority/inferiority** exists, and all consumers judge the '**same direction**' as 'good'. (e.g., mobile phone battery life = longer is better; packing tape durability = stronger is better).
2. **Horizontal Attributes** Attributes lacking objective superiority/inferiority, where **evaluations differ based on consumer preferences** (e.g., design (mature, flashy), color, umbrella (foldable vs. non-foldable)).

### 2.2.3 Vertical vs. Horizontal Differentiation

Firms differentiate by controlling these two types of attributes.

1. **Vertical Differentiation** Differentiation based on **vertical attributes**. Making a product's quality or performance **superior** to competitors.
  - **Means: Technological innovation** (product technology, production process) is essential, requiring **long-term and large-scale resource investment**.
  - **Characteristics:** If successful, it can build a strong, sustainable competitive advantage, but it is a high-risk, high-return strategy.
2. **Horizontal Differentiation** Differentiation based on **horizontal attributes**. Providing a product that matches a specific **customer's taste domain**.
  - **Means:** Rather than massive technological investment, **accurate grasp** of customer needs and **ideas** (i.e., **marketing sense**) become crucial. (e.g., finding the optimal 'scent strength' for an air freshener).
  - **Characteristics:** Can be executed at a relatively low cost, but has the weakness of being **easily imitated** (copied) by competitors.

### 2.2.4 Perceptual Maps and Positioning

The primary tool for executing and managing differentiation strategy is the '**perceptual map**'.

- **Perceptual Map:** A diagram that sets multiple **attributes** used by consumers to evaluate products as axes, and **plots** each product (own company, competitor) on that space based on consumers' **average evaluation scores**.

- **Positioning:** The act of grasping and visualizing '**what position**' one's own product occupies on the perceptual map relative to competing products, or the activities themselves to acquire an intended position.
- **Interpretation:** Products **located close** to each other on the map are perceived by consumers as '**substitutable**' (similar).

## 2.3 Application and Case Analysis

### 2.3.1 Case Study: The Notebook PC Trade-off

The laptop was raised as an example where conflicting vertical attributes result in horizontal differentiation (a matter of taste).

- **Attributes:** 'Screen size' (bigger is better) and 'weight' (lighter is better) are both **vertical attributes**.
- **Trade-off:** However, due to technological constraints, products with 'large screens' tend to be 'heavy'.
- **Analysis:** Consumers are forced to choose based on a **matter of taste** (horizontal), i.e., which vertical attribute they **prioritize** (e.g., 'lightness' for frequent carriers, 'screen size' for home users). Thus, a **trade-off** between vertical attributes can become a source of horizontal differentiation.

### 2.3.2 Case Study: The Beer Market Perceptual Map

A perceptual map of the beer market was shown as an example (e.g., Asahi Super Dry, Suntory Malts, Sapporo Yebisu).

- **Axes:** For example, setting **horizontal attributes** as axes, such as 'crispness' and 'richness' (koku).
- **Analysis:** Super Dry (crisp, refreshing) and Yebisu (rich, full-bodied) are positioned **far apart** on the map.
- **Implication:** This visually demonstrates that these two products are not perceived as '**substitutable**' by consumers, and have succeeded in **horizontal differentiation** by targeting different **customer preferences** (segments).

### 2.3.3 Strategic Uses of Perceptual Maps

Perceptual maps are used for the following three strategic activities through positioning.

1. **Reorganizing the product lineup:** If a company's own products are located very close together on the map, they are likely causing **cannibalization** (competition between one's own products). The map helps identify the need to review the lineup (consolidation/discontinuation).
2. **Repositioning:** When the current positioning becomes inappropriate due to changes in the market environment (e.g., new competitors, shifts in consumer taste), it becomes necessary to

intentionally change the positioning (**repositioning**).

- **Means:** **Model changes** (design changes), **advertising** (changing appeal points), **changing sales channels** (e.g., selling a low-price item exclusively in department stores).
3. **New product development (Discovering market opportunities):** (Cited as 'most important' in the lecture) Discovering **empty spaces** ('**blank spots**') on the map where no competing products exist. If a customer's '**ideal point**' exists in that area, it is a **market opportunity** with unmet needs, and a potential target for a new product launch.

## 2.4 Deeper Context and Lessons

This section describes information supplementary to the main lecture, as well as an AI-driven expansion of the key points.

An advanced tactic in horizontal positioning was introduced. Beyond simply discovering variance in existing customer '**ideal points**' (needs), it is possible for firms to **actively guide** (manipulate) those ideal points. For example, by repeatedly appealing in advertisements that 'fresh is good this summer', a company can create a '**boom**' and **concentrate** consumer ideal points toward the 'fresh' direction (their own product's position). This is a strategy of leading the market, not following it.

Vertical differentiation (e.g., Sharp's LCDs, Apple's innovation) requires enormous **resources (time and money)** for **technological innovation**, making it a competition among large corporations with deep pockets. The greatest danger of this strategy is having the technological advantage, achieved through heavy investment, immediately **imitated** (copied) by competitors. Therefore, for this strategy to succeed, two conditions are important: 'few rival firms' and 'consumers strongly prefer the attribute being invested in'.

### 2.4.1 AI Supplement: Expanding on Key Points

The lecture primarily explained '**discovering market opportunities**' by looking for '**blank spots**'. This is '**differentiated positioning**', aiming for a unique spot unmatched by competitors. However, in MBA-level strategy, other positioning strategies also exist.

1. '**Me Too**' Strategy (Homogeneous/Imitative Positioning) A strategy that **intentionally positions** a product **close to** the market leader or a successful brand, **without differentiating**. This is adopted when it's determined that the leader's success factors (e.g., quality, function) represent the market's '**ideal point**'. It seeks to have itself recognized as an **alternative** to the leader, often using **lower prices** as a weapon to gain market share (e.g., private brands vs. national brands).
2. Competitive Repositioning (Repositioning the Competitor) This is a strategy that goes beyond 'repositioning' one's own product. It uses **advertising** and other means to **move a competitor's product** to an **undesirable position** in the consumer's mind (i.e., 'repositioning' them). For example, Apple's 'Get a Mac' ad campaign not only positioned itself (Mac) as 'stylish and creative' but also aimed to **negatively reposition** the competitor

(PC/Windows) as 'old-fashioned and trouble-prone'.

Thus, a perceptual map is not just for finding 'blank spots' but is also a tool for analyzing the maneuvering against competitors over the 'optimal position'.

## 2.5 Conclusion

In this lecture, we learned the concrete execution process of product differentiation. The first step is to break down the product as a '**bundle of attributes**' and determine if they are **vertical** (performance) or **horizontal** (taste). **Vertical differentiation** is a high-risk, high-return battle of '**technological innovation**', while **horizontal differentiation** is a battle of niche-finding through '**marketing sense**'. The strategic map for this battle is the '**perceptual map**', and the act of establishing one's position on it is '**positioning**'. The practical lesson from this lecture is that marketing strategy is a logical and visual process of how to discover and occupy the '**blank spots**' on this battle-field (the '**perceptual map**' = the consumer's mind) where competitors are absent or less attractive, while avoiding **cannibalization**.

## 3 Product Differentiation Strategy

### 3.1 Introduction

In the previous lecture, we learned about positioning strategy using a product's '**vertical attributes**' and '**horizontal attributes**' as the basic logic of product differentiation. However, in modern marketing competition, differentiation is not conducted solely based on the product's own functions or specs (attributes). The purpose of this report is to analyze and organize the diversity of broader '**differentiation strategies**', namely differentiation by '**other elements surrounding the product**' as indicated in the lecture, such as service, advertising, channels, and even intangible **organizational capabilities**.

### 3.2 Key Concepts and Points

This lecture expanded the perspective on differentiation from product attributes (narrow sense) to overall corporate activities (broad sense).

#### 3.2.1 Differentiation Factors Other Than the Product

Companies strategically control not only the product's own attributes (**product differentiation**) but also the diverse elements surrounding the product to build a customer's **non-substitutable preference** (a situation where they don't look elsewhere). This is called '**differentiation strategy**' in the broad sense. The following four factors were raised as primary examples:

1. **Consumer evaluations (Reputation/Word-of-mouth)** The 'reputation' formed by consumers itself becomes a differentiation factor. Companies provide high satisfaction to encourage positive **word-of-mouth** or utilize an acquired reputation (e.g., '@cosme No. 1') in **promotions**.



2. **Service** **Service** provided after (or accompanying) the product purchase. This is crucial in categories where the **quality, quantity, and speed of service** significantly impact the purchase decision, such as PCs (technical support) or air conditioners (speed of installation). The level of service (e.g., speed) often becomes a factor for **vertical differentiation** (faster is better).
3. **Advertising** **Advertising** not only conveys product information but also has the power to **transform** the 'importance of attributes' that consumers use when evaluating products. This can create new markets (differentiated positions).
4. **Channel (Sales Channel)** The **sales channel** (place and method) for delivering the product to the customer also serves as a powerful weapon for differentiation.

### 3.2.2 Differentiation by Output vs. Process (Organizational Capability)

Differentiation can be considered at two levels: the '**output**' visible to the customer, and the invisible '**process (organizational capability)**' that creates it. As market **commoditization** (homogenization) progresses and differentiation by output becomes difficult, differentiation in process (organizational capability) is becoming more important.

1. **Differentiation in Output (Product)** Differences at the product level, directly visible to the consumer.
  - **Differentiation in specific functions:** Superiority in **vertical attributes** (e.g., CPU speed, storage capacity).
  - **Changing the functional axis:** Adding a **new function** (e.g., video editing capabilities on a PC).
  - **Creating a new category:** **New product development** in a field where no market existed (e.g., Apple's iPad).
2. **Differentiation in Process (Organizational Capability)** The 'invisible' strengths within the company for continuously creating the above outputs.
  - **Technological strength:** **Overwhelming technological power** that competitors cannot imitate, and the organizational structure to produce it.
  - **Decision-making process:** **Speed of decision-making.** The organizational capability or factory coordination ability to launch innovative products '**first to market**'.
  - **Concept creation ability:** An organizational culture and talent pool that can decipher needs consumers are not yet aware of and **propose** new concepts (**horizontal attributes**) to the market.

## 3.3 Application and Case Analysis

### 3.3.1 Case Study: @cosme (Differentiation by Reputation)

The cosmetics review site '@cosme' is a typical example of using consumer **reputation** (word-of-mouth) for differentiation.

- **Analysis:** A vast amount of detailed user reviews (**word-of-mouth**) is accumulated, which itself holds strong influence over consumer purchasing behavior.

- **Corporate use:** Companies (manufacturers) use the objective '**reputation**' of being '**No. 1 on @cosme**' on **POP** (point-of-purchase displays) to appeal their product's superiority (differentiation) to consumers. This is an example of companies strategically using reputation as a promotional tool.

### 3.3.2 Case Study: Laundry Detergent for Indoor Drying ('Attribute Transformation' by Advertising)

The emergence of '**laundry detergent for indoor drying**' is a case where advertising changed the consumer's **axis of evaluation** (the attributes they prioritize).

- **Analysis:** Traditionally, the evaluation axes (attributes) for detergent were centered on '**cleaning power**' and '**whiteness**' (vertical attributes).
- **Transformation by advertising:** Grasping social changes (consumer insights) like the increase in dual-income households, companies emphasized a **new attribute** in advertising: '**doesn't smell even when dried indoors**'.
- **Result:** This created a new axis (suitability for indoor drying) on the consumer's mental **perceptual map**. The company successfully created and differentiated within this new market (position). A similar example given was BB cream for men (proposing the new attribute of a 'clean look').

### 3.3.3 Case Study: Channel Strategy in Retail (Differentiation at the Point of Purchase)

For consumer goods (e.g., snacks, drinks), the **sales channel** is an extremely important differentiation factor.

- **Reality of the purchase scene:** Even if a consumer enters a store with a strong brand preference (wanting A), they can easily **change their mind** if a competitor (B) is offering a discount or a '**freebie**' at the point of purchase.
- **Differentiation by channel (2 types):**
  1. **In-store superiority:** Increasing the probability of being chosen at the final moment (**purchase scene**) by securing **POPs** (point-of-purchase displays) or the most prominent **sales space** (shelf).
  2. **Specialization of sales location:** Selling **exclusively** in stores with an image of 'only selling high-quality goods', like 'Seijo Ishii', thereby enhancing the product's own **quality image** (value).

## 3.4 Deeper Context and Lessons

The 'best-selling chocolate ranking (1-10)' presented in the lecture shared a common feature: '**available anywhere nationwide**' (= **ease of access**). This indicates the ultimate form of '**Differentiation by Channel**'. Whether they are popular because they are available everywhere, or available everywhere because they are popular, is a 'chicken and egg' question. However, it shows that the sales situation of being '**readily available**' when a consumer wants to buy (= strong distribution

power) itself serves as a powerful entry barrier against other companies and a differentiation factor.

Related to consumer 'reputation', the lecturer introduced a researcher's findings: people tend to '**work harder to spread**' '**negative word-of-mouth**' than '**positive word-of-mouth**'. Translating positive word-of-mouth into action requires '**considerably high satisfaction**'. This suggests that for companies, the pursuit of customer satisfaction is not just a slogan, but a matter of survival to prevent negative reputation and to (surpass a high bar to) acquire positive reputation.

A sharp point was made that even seemingly positive 'reputations' like 'long-loved' or 'liked by young people' can be converted into negative meanings like 'old-fashioned' or 'not for older people', depending on the recipient. In this way, reputation and evaluation easily become a '**P2 horizontal axis**' where evaluations are split by the recipient's subjectivity, not objective superiority.

#### 3.4.1 AI Supplement: Expanding on Key Points

The lecture introduced various 'differentiation strategies', from product attributes to organizational capabilities. However, it lacked mention of how these are positioned within overall corporate strategy, especially the relationship with '**price**'. This point is supplemented by the '**Three Generic Strategies**' proposed by the authority on management strategy, **Michael E. Porter**. Porter posited that there are only three basic strategic positions (effectively two dimensions) for a firm to build a sustainable competitive advantage against its rivals.

1. **Cost Leadership Strategy**: A strategy aiming to provide products/services at a **lower cost** than competitors. This allows the firm to either secure high profitability at the same price, or initiate **low prices** (= price competition) to capture market share. This strategy requires economies of scale and efficient operations (a form of differentiation in '**process (organizational capability)**').
2. **Differentiation Strategy**: The strategy discussed intensively in this lecture. It aims to provide unique value to customers through **something other than price** (e.g., product, service, brand image), and in return, realize a **premium price** (a marked-up high price).
3. **Focus Strategy**: A strategy of **focusing** one of the above two strategies (Cost Leadership or Differentiation) on a specific **niche market** (e.g., a particular customer segment, region, or product line).

The various differentiation methods learned in the lecture (service, channel, organizational capability) can all be positioned as concrete tactics for executing what Porter calls the '**Differentiation Strategy**' and justifying a **premium price**.

### 3.5 Conclusion

In this lecture, we learned that product differentiation is not merely a competition of product attributes (specs), but an '**all-out war**' for the company, involving **all elements surrounding the product** (service, advertising, channels, reputation) and the **invisible organizational capabilities** (technology, decision-making speed, concept creation) that produce them. In today's market, which

is prone to **commoditization**, differentiation in output (the product) is quickly imitated (**followed**). Therefore, the source of sustainable competitive advantage lies in the differentiation of the '**process (organizational capability)**' itself. The practical lesson from this lecture is that marketers must re-examine every element they can control to build a customer's **non-substitutable preference**—from the consumer's mind (**perceptual map**) to the company's '**sales floor**', '**service system**', and even the '**organization's decision-making process**'—and view all of them as '**weapons of differentiation**'.