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Managerial Marketing

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Part I: Marketing Management and Strategy

Part I of this text introduces the process of marketing management and the role of strategic planning in achieving the objectives of the organization. Marketing is a customer-focused philosophy of business that provides the basis for competition in most business-to-consumer and business-to-business markets. It comprises those business activities that facilitate buyer–seller exchanges, stressing customer satisfaction as the key to achieving organizational goals. The set of management processes aimed at anticipating and satisfying customer requirements, consistent with the profit goals of the company, is called marketing management. It shapes the interface between the organization and its environment. Marketing strategy provides the plan for focusing the organization's resources and deploying marketing tactics to capitalize on those opportunities that will yield the best possible outcomes for the firm. The remaining parts of this text explore the essential processes of marketing management in greater detail.

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Chapter 1: Strategic Planning and the Marketing Management Process

Chapter 2: Value Creation and Customer Satisfaction

Chapter 1

Strategic Planning and the Marketing Management Process

People working at a call center

istockphoto/Thinkstock

Learning Outcomes

By the end of this chapter, you should:

 Understand the fundamentals, concepts, and functions of marketing and marketing management.

 Know the four elements of the marketing mix and be able to provide examples of the common areas of decision making related to each.

 Recognize the purpose, goals, and basic design of a marketing plan.

 Understand how different levels of strategy work together to promote the objectives of the firm.

Ch. 1 Introduction

This chapter investigates the fundamentals of strategic planning and the marketing management process. We begin with the basics of marketing: What is it and why is it of value? You may already be familiar with some of the core concepts of marketing from previous coursework or your professional experience. Just to be sure, we review the essential functions and precepts of the discipline right at the start. We then move on to an examination of the process of marketing management and the development of strategy. This section highlights the strategy alternatives available to the organization and how the marketing mix can be deployed to achieve strategic objectives. We then examine how a marketing plan identifies the specific tactics for the implementation of strategy. The concluding sections of Chapter 1 examine how different levels of strategy interact to guide the organization.

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Throughout my career I have traveled extensively and experienced my fair share of layovers and delays at airports. I have found that reading and conversation are the two most reliable ways to pass the time while waiting for flights to arrive, weather to clear, and bottlenecks to resolve themselves. On one such occasion in Toronto, I was chatting with a flight attendant about our respective career choices and ambitions. Once I had explained that I taught marketing at a university and did some work as a marketing consultant as well, she seemed disappointed. "Marketing? Really?" she asked incredulously. "I mean, you sound like a very smart man. . . . isn't that kind of a waste?" I was stunned and a little embarrassed . . . and never did find a suitable response before the conversation migrated to other topics. If given a second chance, I would offer a good defense for my choices. I would explain that there's more to marketing than she probably realized. I would do my best to explain away the bad rap that the field has gotten over the years. I would try to impress upon her the economic value and social benefits that we all derive from a vast array of diverse marketing activities. But I still think about that conversation every so often. It helps me to keep things in perspective.

1.1 The Importance and Scope of Marketing

Marketing has been defined in many different ways over the years, and simply defining the term has been a contentious and controversial topic in both academic and business domains for nearly a century. It is a business discipline that can be defined according to its activities, functions, processes, roles, values, scope, economic utility, and social significance based on the priorities of its advocates and critics. This text focuses exclusively on the processes of effective marketing and marketing management from a business decision maker's perspective. In this regard, the practice of marketing can be defined as "the management process responsible for identifying, anticipating, and satisfying customer requirements profitably" (Chartered Institute of Marketing, 2011). More specifically, marketing management can be understood as "a set of processes for creating, communicating, and delivering value to customers and for managing customer relationships in ways that benefit the organization and its stakeholders" (American Marketing Association, 2011).

Both definitions stress that understanding buyers' wants and needs is at the very heart of marketing's role in the creation of customer value. Increasingly competitive global markets and rapidly shifting consumer needs have increased the complexity of markets and amplified the importance of the marketing function. Consequently, marketing and market research have emerged as essential core competencies for most types of organizations. The responsive character of the marketing function to both rapid changes and gradual shifts in both micro- and macro-environment conditions have made effective marketing an essential tool for both nonprofit and for-profit organizations. In short, marketing management provides the ability to succeed by effectively meeting the needs of target customers in a dynamic environment.

Marketing is essential to the effective promotion and successful operation of most business organizations. The scope and pervasiveness of this essential function is evident from both the aggregate economic impact of marketing and the range of jobs in the field. "Sales employees in manufacturing, service, and other industries; retail employees; and workers in transportation, communications, and other related groups represent between one-fourth and one-third of the civilian labor force. About 50 cents of every retail dollar goes to cover marketing costs" (World Academy Online, 2011). Marketing provides a very broad range of employment opportunities throughout business and industry, as described in Table 1.1.

Table 1.1: The 26 marketing occupations

Product Management Advertising Retailing Sales Marketing Research Non-Profit

Product Manager, consumer goods. Develops new products that can cost millions of dollars, with advice and consent of management. A job with great responsibility. Account executive. Maintains contact with clients while coordinating the creative work among artists and copywriters. In full-service ad agencies, account executives are considered partners with the client in promoting the product and aiding in marketing strategy. Buyer. Selects products a store sells; surveys consumer trends and evaluates the past performance of products and suppliers. Direct. Compensation is based mostly on commission. Project manager, supplier. Coordinates and oversees the conducting of market studies for a client. Marketing manager. Develops and directs mail campaigns, fundraising, and public relations for nonprofit organizations.

Administrative manager. Oversees the organization within a company that transports products to consumers and handles customer service. Media buyer analyst. Deals with media sales representatives in selecting advertising media; analyzes the value of media being purchased. Store manager. Oversees the staff and services at a store. Sales to channel. Sells to another step in the distribution channel (between the manufacturer and the store or customer). Compensation is salary plus bonus. Account executive, supplier. Serves as liaison between client and market research firm; similar to an advertising agency account executive.

Operations manager. Supervises warehousing and other physical distribution functions; often directly involved in moving goods on the warehouse floor. Copywriter. Works with the art director in conceptualizing advertisements; writes the text of print or radio ads or the storyboards of television ads. Industrial/semi-technical. Sells supplies and services to businesses. Compensation is salary plus bonus. Project director, in-house. Acts as project manager for the market studies conducted by the firm.

Traffic and transportation manager. Evaluates the costs and benefits of different types of transportation. Art director Handles the visual component of advertisements. Complex/professional. Sells complicated or custom-designed products to businesses. Requires an understanding of the technology of a product. Compensation is salary plus bonus. Marketing research specialist, advertising agency. Performs or contracts for market studies for agency clients.

Inventory control manager. Forecasts demand for stockpiled goods; coordinates production with plant managers; keeps track of current levels of shipments to keep customers supplied. Sales promotion manager. Designs promotions for consumer products; works at an ad agency or a sales promotion agency.

Administrative analyst planner. Performs cost analyses of physical distribution systems. Public relations manager. Develops written or filmed messages for the public; handles contacts with the press.

Customer service manager. Maintains good relations with customers by coordinating sales staffs, marketing management, and physical distribution management. Specialty advertising manager. Develops advertising for the sales staff and customers or distributors.

Physical distribution consultant. Expert in the transportation and distribution of goods.

Adapted from Rosenthal and Powell, 1984

Marketing as Philosophy: The Marketing Concept

The concept of marketing as a business discipline has evolved significantly over time. The field of marketing was once regarded simply as a branch of economics, and the emphasis was on the efficient production and distribution of goods. In the early decades of the twentieth century, the marketing emphasis became twofold: developing improved ways to sell what you produce, and improving product quality.

1950 Duz Laundry Detergent Advertisement

In this advertisement, Duz's marketing concept is to differentiate its detergent from its competitors by stating that the consumer can have the whitest whites "without red hands" caused by harsh cleaning chemicals.

Bettmann/Corbis/AP Images

A different perspective on the role of marketing began to emerge in the years following World War II. The growth of discretionary income in the postwar era altered the relative balance of power between buyers and sellers. In contrast to the patterns established during the Great Depression and the scarcity of the war years, buyers now had the means to be selective about their purchases. Product branding became increasingly important as a means of differentiating products from each other in terms of price, functional attributes, benefits, and quality. To compete effectively, sellers needed to develop a sharper understanding of what different types of customers wanted from the products the sellers offered. This realization provided the impetus behind changes in how marketing was done and led to the formal recognition of the marketing concept. The marketing concept is a customer-oriented philosophy of business management that stresses that the objectives of the organization can best be met through the analysis and satisfaction of customers' wants and needs. This philosophy maintains that sustainable competitive advantage rests in focusing all of the organization's efforts on identifying and satisfying the needs of the customer better than the organization's competitors.

In contrast to the production and selling emphasis of earlier eras, the market orientation established by the marketing concept places higher priority on understanding customers' needs before designing and producing a good or service. It explicitly recognizes that, to be successful, all of the functions and resources of the organization need to be integrated and aligned with the goal of customer satisfaction. And it explicitly identifies customer satisfaction as the key to long-term success and profitability.

In a fundamental sense, the discipline of marketing remains focused on the interaction between supply and demand, just as it did in its infancy. However, the contrasts between the contemporary customer orientation of marketing and traditional economics are quite substantial. Economic analyses of markets typically assume that all people are the same in their preferences for a given product and that all products in a category are identical. In contrast, the foundation of contemporary marketing practice is the understanding that segments of buyers differ from other groups with respect to their wants and needs. Similarly, the value of contemporary marketing is based on the ability of firms to differentiate their unique product brands from others in the market. In a sense, it is the unrealistic nature of these classical economic assumptions about people and products that makes the discipline of marketing necessary.

Avoiding Marketing Myopia

Over time, some marketing organizations lose sight of the importance of maintaining a customer-centered focus. In 1960, Theodore Levitt coined the term "marketing myopia" to describe short-sighted marketing strategy. The term refers to the potentially disastrous tendency of managers to focus on the products they sell rather than the customers they serve. As a result, they can lose sight of consumers' wants and needs as these preferences shift over time.

The histories of many industries provide vivid illustrations of opportunities that have been missed when management's view of buyers' wants has been shortsighted and product-oriented. The owners and managers of the vast railroad empire that dominated transportation at the start of the twentieth century were focused on the efficient operation of trains rather than customers' needs for safe and affordable transportation. Consequently, they didn't recognize the opportunity to diversify into other forms of passenger and freight transport such as airplane, bus, car, and truck transportation.

Many successful motion picture companies from the "golden years" of Hollywood simply failed to recognize that their product was about entertainment rather than making movies. Many missed out on the opportunity to become television networks, for example (though 20th Century Fox is a notable exception). Similarly, many radio networks simply failed when confronted with the challenge of television. However, the National Broadcasting Corporation (NBC), Columbia Broadcasting System (CBS), and the American Broadcasting Company (ABC) successfully made the transition.

Staying focused on customers' needs is essential in all types of organizations. Marketing managers need to ask themselves regularly: What business are we really in? Hospitals that focus on promoting wellness behave differently than those focused on treating illness. A firm that realizes its business is about personal expression will respond to more opportunities than one that sees itself as a greeting card company.

Marketing Fundamentals

Marketing can be used to achieve a wide range of objectives. It determines what prospective buyers want, and it also establishes the game plan for meeting customer demand. Although different types of organizations do the work of marketing in different ways, the essential concepts of the process are the same for all. This section explains those basic concepts and illustrates them using shampoo as an example product.

To begin with, a market is made up of all the individuals, groups, and organizations that want or need a product and have the resources required to purchase. Products may be goods, services, ideas, places, or people. Very few markets are homogeneous, or made up of people who are all the same. Groups of prospective buyers within most product markets differ from other groups based on their specific wants, needs, or purchasing ability. Market segments are clusters of prospective and current customers who are similar to each other in ways that lead them to respond to a firm's marketing mix similarly. The process of dividing the total market into distinct groups or submarkets based on similar wants, needs, behaviors, or other characteristics is called market segmentation.

Marketing: Satisfying Customer Needs

Typical marketing objectives include new products, increasing share the market, and identifying new markets. The marketing mix is integrated to meet the needs of the targeted market segments. Think of a particular product; how does the company appeals to their target market?

Consider a very simple product like shampoo. The potential market for this product would include anyone with hair. Yet consumers' expectations for what their shampoo should do covers a wide range of needs. Although cleaning hair is a feature that is common to all brands, one segment of the market will place the highest priority on fighting dandruff. Another will place greater importance on the aesthetics of fuller-looking, shinier hair. A third segment may stress the need for a brand that will make its hair more manageable. And, inevitably, there is always a segment whose primary priority when choosing between brands is price. It is important to recognize that these segments are not mutually exclusive with respect to the features they are seeking in a brand. Several segments, for example, may want a brand that fights dandruff and makes hair shiny. However, segments are defined by differences in the relative importance that each attaches to distinct product attributes.

Each of these segments can initially be defined according to what it wants from the brand it buys. An important next step in the process of market segmentation is examining the demographic, lifestyle, and behavioral characteristics of buyers who share similar needs and priorities. The fuller-looking, shinier hair segment might be composed primarily of women aged 16 through 35. Perhaps they are less likely to be married than the population at large and more socially active. Personal appearance in general, and fitness in particular, may be important lifestyle descriptors for this segment. The importance of developing these types of profiles is that it enables marketers to shape the promotional message to suit the prospective buyers' lifestyles, and profiles play an important role in identifying the best media alternatives to reach the target segment. One common misconception is that market segments are somehow preexisting divisions of the market just waiting for the marketing manager to uncover them. That is, some managers believe that market segments are simply waiting to be discovered in the way fossils are just below the surface, waiting for a paleontologist to uncover them. This is not the case. Market segments can be created by marketing managers based on any product or buyer characteristics that will be the most profitable. In fact, creating new market segments within old, established product markets is one way to create new opportunities for the firm.

Consider the market for baby shampoo. The category name suggests a very limited potential market. Over the years, however, marketers have identified new market segments for this product. Consumers who are concerned about the chemical "harshness" of regular shampoo brands represent an alternative to the traditional market. Customers with color-treated hair may find this type of shampoo a better option than "adult" brands. In short, any group of buyers who value gentleness as an essential product benefit of shampoo is a potential market segment.

Think About It

The migration of a brand's focus from the needs of one target market to the inclusion of others is usually confined to entering new, but similar, product-use segments—for example, from one group of buyers washing their hair to another with slightly different shampoo preferences. However, marketing history is replete with examples of big jumps across product categories. For instance, Arm & Hammer Baking Soda was originally limited to use as a baker's ingredient. It is now promoted for uses in household deodorizing products, toothpastes, laundry detergents, and cat litter. Sometimes these new uses are initially promoted by the manufacturer, but just as often they are pioneered by consumers. If you ever need to install window tinting film in your home or car, some manufacturers recommend preparing the glass surface by cleaning it with baby shampoo.

Can you think of other examples where products are being used for purposes different than those intended by the manufacturer?

Do you suppose it was initially the manufacturer's or a consumer's new idea?

A target market is the term used to describe a group of potential buyers that the firm seeks to satisfy with its marketing mix. It is the segment of the market to which the firm directs its product and marketing efforts. Separate marketing mixes are developed to suit each target market according to its preferences and needs. The target market for any given product may be a single market segment, multiple pooled segments, or a mass market characterized by a prototypical consumer.

Father and son shop at the wholesale store, Costco in Las Vegas, California

This father and son shop at a warehouse store to buy economy-size household items in bulk to save money. How do companies appeal to these customers?

Associated Press

The tools available to the marketing manager to influence the target market to purchase one brand over another are collectively referred to as the marketing mix. Often referred to as the "4 Ps," the marketing mix is the combination of four controllable factors that contribute to the organization's marketing program: product, price, place, and promotion. The way in which these variables are combined makes up the core marketing strategy of the organization. The marketing mix is the tool kit of marketers insofar as these four elements are under the discretionary control of the organization. They provide the means by which the organization can respond to and adapt to uncontrollable environmental factors such as economic, demographic, technological, natural, political, and cultural forces.

Let's return to the shampoo category. What can we say about the target market and marketing mix for the low-price segment of the market? In terms of demographics, you are likely to find that this segment is price sensitive because those in it are from the lower end of the household income spectrum. The demands of raising a large family may also be a factor in their desire to hold down expenses on common household items such as shampoo. The marketing mix required to sell to this segment would have several distinctive features. The product would have to be inexpensive to produce and package. This target market is not looking for anything "fancy," and a no-frills packaging presentation helps to communicate a good-value-for-money message. A competitively low price is essential, though this can be achieved in different ways such as coupon deals and economy-size packaging. The place element requires the manufacturer to secure distribution in those outlets where frugal shoppers go. These would include the big-box chain stores, price clubs, and discount and warehouse stores. The promotional message would necessarily emphasize value and low price.

Think About It

For virtually every product sold there is a low-price segment within the market. Suave brand shampoo has been very successful in the low-price segment of this market with promotional themes such as Suave does what theirs does . . . but for a lot less and Suave does what theirs does for less than half the price.

Think of some other advertising themes that are intended to persuade price-conscious consumers.,

Can there be more than one successful brand pursuing this strategy in any given market?

Can more than one brand successfully pursue this strategy in any given market?

Product differentiation is the term used to describe the process of distinguishing one product or brand from another. A product is said to be differentiated when it is perceived as distinct from competitors' products based on any tangible or intangible feature. Product differentiation also refers to the generic strategy that promotes the characteristics or unique benefits of its brand over competitors' brands in the same market.

Product positioning, or brand positioning, refers to the strategy and tactics involved in creating and shaping the brand's image in the mind of prospective buyers. These images are defined relative to how consumers perceive competing products. Consumer perceptions (not actual differences between products) are the critical issue. In general, the term "positioning" can be used in reference to the process by which marketers create an identity in the minds of consumers for either a product or brand.

The relative position of one brand to others is sometimes illustrated using a positioning map or perceptual chart, as shown in Figure 1.1.

Figure 1.1: Brand positioning map

A comparison of shampoo brands in how they add volume and how well they clean hair. The top two brands in the market are on the right side of the scale and are both high cleansing.

Two product benefits for shampoo are contrasted in this map: adding volume and cleansing hair. The size of the circles indicates the market share owned by the brand. Which dominates the market?

Successful product differentiation and positioning relative to the needs the target market can provide a firm with a differential advantage over competitors based on the unique attributes or benefits of its brand, which encourage consumer purchase. Differential advantages provide buyers with substantial reasons to prefer one brand over another. Both product differentiation and the effective positioning of the brand contribute to building differential advantages over competing products.

Basic Marketing Functions

Although our approach to the practice of marketing management emphasizes a process-oriented perspective, it is worthwhile to briefly note the six primary functions of marketing management:

 Environmental analysis

 Consumer analysis

 Product planning

 Price planning

 Place or physical distribution planning

 Promotion planning

Environmental and consumer analysis are essentially market research functions that provide the means to identify new opportunities, evaluate market potential, and select target markets. One approach to environmental analysis is called PEST analysis. This model focuses on the study of political, economic, social, and technological forces within the environment that might impact the organization's strategic plan. Consumer analysis provides an in-depth examination of the forces that shape demand. These include cultural, socioeconomic, and personal dimensions of the consumer environment. Environmental and consumer analysis are investigated in detail in Chapters 3 and 4.

Product, price, place, and promotion all have to do with the marketing mix, or the 4 Ps. When examined from a functional perspective, the 4 Ps of the marketing mix provide the strategy planning platform for the pursuit of market opportunities identified in the environmental and consumer analyses. Specific decision-related considerations for each of the marketing mix variables are addressed in the next section.

1.2 The Marketing Management Process

Marketing management is a process that is intended to facilitate transactions by bringing buyers and sellers together. Consistent with the marketing concept, the ultimate goal of the process is to create exchanges that satisfy both company and customer.

As illustrated in Figure 1.2, the process of marketing management from the seller's perspective can be characterized as a series of four stages of decision making: situation analysis, marketing strategy, marketing mix decisions, and implementation and control.

Figure 1.2: Marketing management process

The stages of Decision making are situation analysis, marketing strategy, marketing mix decisions and then implementation and control

How can you apply this process to a company, product, and target market you are aware of?

Each of these stages is described in greater detail in the sections that follow. Before proceeding, however, it is important to keep two features of the model in mind. The purpose of the model is to provide a measure of discipline to the process of marketing management to improve the quality of managers' decisions. Its value lies in making sure that the decision maker is deliberate, thorough, and systematic in the planning and execution of marketing strategy. An important consideration when evaluating the model is that it is not simply a linear recipe card for decision making. It is intended to provide an aid to assessing the goodness of fit between marketing problems and alternative solutions. As such, it is not a substitute for thinking. The model can only be as useful, flexible, and dynamic as the user makes it.

Stage I: Situation Analysis

In many instances, corporate, division, and business unit level goals and strategic priorities will shape and direct the process of marketing management from the outset. Given those constraints, the first step of the process is to undertake a thorough analysis of the current situation and environment confronting the organization. Situation analysis is at the heart of marketing's endeavor to identify new opportunities to satisfy unmet customer wants and needs. Opportunities typically stem either from finding new ways to serve the needs of existing customers or uncovering new markets for existing product or service lines. Many new opportunities incorporate elements of both new products and new markets. Product-related opportunities for a regional hospital, for example, might include the addition of alternative therapies (e.g., acupuncture) or creating satellite wellness or express-care centers in local shopping centers and malls. The addition of a new service line in sports medicine and rehabilitation care might be one way to reach a new segment of the market.

The goal in situation analysis is to provide an analysis of both macro- and micro-environmental factors that will impact marketing strategy. The process also serves to make the organization cognizant of its capabilities and resource limitations. For this reason, SWOT analysis (discussed in Chapter 3) is a starting point for performing situation analysis that is favored by many managers. SWOT is an analytical procedure that requires consideration of the firm's internal Strengths and Weaknesses relative to the Opportunities and Threats posed by the external environment.

A 2010 sign promoting flu shots in front of a CVS store in Maryland.

CVS and many other companies are meeting shoppers' needs conveniently and, ultimately, building more traffic for their stores.

Associated Press

Since the objective of situation analysis is to uncover viable market opportunities, it needs to be comprehensive in scope. One way to make sure that all relevant features of the environment are considered is by using the 4 Cs framework: company, customers, competitors, and climate/culture. In this model, company refers to the internal capabilities and resources of the firm, while the remaining three Cs represent elements of the external environment. (Applications of this model are discussed in Chapter 5.)

Regardless of the analytical devices and techniques deployed, the final product of the situation analysis is an accurate map of both the internal and external environmental circumstances confronting the organization. This process may identify potential problems in the firm's current marketing plan that require remedial action. However, the primary objective is to identify market opportunities by demonstrating gaps between consumer preferences and the current array of competitive brands. Once the most attractive of these opportunities are evaluated, a marketing strategy for applying the organization's resources to satisfy the potential market demand is created.

Let's consider again the challenges confronting a regional hospital. The high cost of delivering quality health care and many patients' limited ability to pay reflect both internal and external environmental challenges. This growing gap or tension necessarily poses a threat to maintaining high levels of patient satisfaction. Marketing opportunities exist to help narrow this gap. The concept of creating wellness centers at shopping centers and malls is one possible response to the challenge. These express health care centers could provide basic care for common ailments, routine inoculations, and short customer waiting times and extended hours to make the centers more convenient. If staffed only by a registered nurse, the per-patient cost of treatment for common ailments and minor injuries in this setting would be far less than clinic or hospital visits.

Stage II: Marketing Strategy

After the situation analysis has identified the best opportunities for the firm, a multilayered strategic plan is required to effectively and efficiently capitalize on them. The most general level of strategy that needs to be addressed at this stage in the marketing management process is the identification of the generic strategy that is best suited to pursuing the opportunity. The three basic types of generic marketing strategy are product differentiation, cost leadership, and market focus (Porter, 1980).

Product differentiation strategy requires distinguishing your product from competitors' in a way that makes prospective buyers prefer your brand. The basis of differentiation can be tangible or intangible attributes of the product—including the brand image itself. For this reason, product differentiation strategy is often most closely identified with the marketing function.

Cost leadership strategy allows a firm with lower overall costs of production and marketing to attract price-sensitive customers by selling at relatively lower prices than competitors. Lower costs can be derived from economies of scale and experience curve efficiencies in manufacturing and other operational areas of the organization. Competitively lower direct and indirect operating costs may also be rooted in outsourcing, tighter production cost control processes, more-efficient distribution networks, and higher rates of capacity utilization.

Market focus strategy is not a separate or distinctly different strategy from the other two, but instead describes the scope over which the firm will implement either cost leadership or differentiation strategies. Organizations may opt to compete in broadly defined mass markets or focus on narrower segments of the market. In a narrow, focused approach to strategy, competitive advantage is gained by serving the unique needs of a market segment or niche better than larger competitors can because of their size.

The generic strategy options for a regional health care provider can be defined in the same way as they would be for any other type of organization. Hospitals can pursue a differentiation strategy based on several dimensions of care. For example, some may opt to emphasize the latest in high technology, while others stress personal care. The contrast of high tech versus high touch is typical in fields such as cardiology, obstetrics, and senior care.

Cost leadership in health care can be achieved through more efficient operations and superior cost management techniques. Some advantages are uniquely tied to economies, giving bigger organizations an advantage. However, smaller health care systems have access to cost-savings opportunities that diminish as the size of the organization increases. Focus strategy options, as noted, simply describe the scope over which the firm will implement either cost leadership or differentiation strategies. In a health care setting, this typically applies to decisions made for individual service lines versus the organization as a whole.

The best generic strategy is chosen based on how the unique strengths of the organization relate to the opportunity identified by the situation analysis. All organizations thrive in environments that allow them to leverage their strengths relative to their competitors. The strengths of a firm are typically rooted in either superior brand differentiation or cost advantages over other producers. Further, these advantages can be applied in either broadly defined markets or narrow market niches. The resulting generic strategy options are illustrated in Figure 1.3.

Figure 1.3: Porter's generic strategies

A figure showing Porter's Generic Strategies which show that strengths of a product is either because of brand differentiation or cost advantages. These advantages can either have a broad or narrow market scope.

Strategic alternatives stem from either brand differentiation or cost-related advantages. These advantages can be broad or narrow in scope—why do you think that is?

The chosen generic strategy, as the name suggests, provides a broadly defined strategic orientation for pursuing the identified market opportunity. Beyond this initial determination of an overall strategy, three other closely related strategy decisions need to be made before an operational marketing plan can be developed. These more specific strategic options relate to market segmentation, product differentiation, and brand positioning.

Strategic planning is as much an art as a science, and there is no one "best way" to organize the effort. Table 1.2 provides one simple model that you may find helpful.

Table 1.2: A matrix model of marketing management

 The Marketing Mix

 PRODUCT PRICE PLACE PROMOTION

Generic Market Strategy

Market Segmentation

Product Differentiation

Brand Positioning

Once decisions regarding the four strategy categories in the left-hand column have been made, their goodness of fit with the four elements of the marketing mix can be assessed by examining each intersection in the 16-cell matrix. For example, is our pricing strategy (column 2) consistent with our generic market strategy, market segmentation strategy, product differentiation strategy, and brand positioning strategy? In practice, managers may find it useful to fill in each cell of the matrix to demonstrate how each element of the marketing mix contributes to the strategic objectives established in the left-hand column. This exercise can refine the process of strategic planning and avoid costly mismatches down the road.

Marketing strategy provides the overall "battle plan" for capitalizing on the opportunities initially identified through the situation analysis. The next step in the process of marketing management is to develop the plans for the implementation of the marketing mix.

Stage III: Marketing Mix Decisions

The marketing mix represents the basic tool kit of marketing since it provides the means for executing strategy. In keeping with the marketing concept, the objective is to make decisions and develop plans that relate the 4 Ps to the target market to provide greater perceived value than competitors can offer. Each of the four elements of the marketing mix will be addressed in detail in subsequent chapters. The outline that follows provides a brief summary of typical decisions that marketing managers need to make within each of the four categories.

The product variable includes both tangible and intangible dimensions of physical products and services. Common areas of product-related decision making include:

 New product development,

 Test marketing,

 Branding and brand management,

 Product design and styling,

 Packaging,

 Product safety,

 Quality control,

 Post-purchase product service and support,

 Ancillary services and accessories,

 Product mix and product line management, and

 Product life cycle management.

The pricing variable includes both economic and psychological characteristics. Common areas of price-related considerations and decision making include:

 Evaluation of price elasticity of demand,

 Meeting legal and ethical pricing constraints,

 Introductory price setting (price skimming versus penetration pricing),

 Price discrimination

 Cost-based pricing versus demand-based pricing versus competition-based pricing,

 Economic value estimation,

 Pricing through channels of distribution,

 Geographic pricing,

 Discounting policies,

 Price–quality correlation,

 Prestige pricing,

 Price lining,

 Leader pricing,

 Seasonal pricing,

 Bundling,

 Profitability and margin analysis,

 Break-even analysis, and

 Sales and profit projections.

The place variable relates primarily to distribution and focuses on getting the product to the customer. Common areas of place-related considerations and decision making include:

 Evaluating alternative distribution plans and networks,

 Selecting distribution channels,

 Establishing and maintaining channel relationships,

 Negotiating and administering channel contracts,

 Resolving channel conflict and maintaining channel control,

 Managing distribution coverage/intensity (intensive versus selective versus exclusive),

 Evaluating and implementing push versus pull strategies,

 Inventory management and control,

 Order processing, and

 Warehousing.

A sign in front of the clothing store, CharoletteRusse that is promoting their Facebook page.

Retailers are increasingly looking to social media to strengthen relationships with customers. In this image, Charlotte Russe displays a Facebook promotion to gain more customer support and store traffic.

NajlahFeanny/Corbis

The promotion variable encompasses a wide range of functions related to the firm's overall communications program. Common areas of promotion-related decision making include:

 Setting and evaluating communications goals,

 Assessing alternative communication channels,

 Establishing promotion budgets,

 Measuring promotional effectiveness,

 Advertising,

 Message and media planning,

 Social media promotions,

 Personal selling and sales management,

 Recruiting and training salespeople,

 Sales territory management and sales force allocation,

 Publicity and public relations,

 Consumer- and middleman-directed sales promotions.

Think About It

Select a consumer product of personal interest—one that you have purchased within the past six months. It can be anything, just as long you are familiar with the product and generally understand how it is marketed. Using the matrix model of marketing management in Table 1.2, fill in the cells of the matrix as completely and thoroughly as you can for the brand that you purchased. Be sure that your entries correspond to your perspective as a customer for this brand. In short, you are the target market. You may wish to create one or more positioning maps to help illustrate how you perceive the competitive playing field. Once you're done, examine the intersection of each cell.

How do the elements of the marketing mix align with the four strategy categories in the left-hand column?

Does every one of the 4 Ps contribute to each of the strategic objectives established in the left-hand column? Do you see room for improvement?

How would this assessment be different for other types of customers?

Stage IV: Implementation and Control

The value of the three preceding stages in the process of marketing management depend wholly the organization's ability to effectively implement the developed strategy. Stages I through III have identified the opportunity within the marketplace, isolated the best strategic option for exploiting the opportunity, and created the marketing mix that will faithfully execute the strategy. The final stage of the process is to implement the marketing mix decisions that have been made and monitor the results.

The final stage in the marketing management process is to assess whether the goals and objectives established through the four-step process and corresponding marketing plan are being achieved. This evaluation and control process relies on specific, measureable, short-term goals or benchmarks established for the new marketing initiative. The comparison of performance to objectives provides critically important performance feedback and enables decision makers to make adjustments to the marketing program as needed. Although poor performance may implicate the effectiveness of the marketing mix for a given program, it should also cause marketing managers to reexamine their assumptions about the nature of the market opportunity they are pursuing. No plan can meet expectations if the estimates of market potential for a new opportunity are unrealistically inflated. Specific techniques for evaluating market demand and forecasting sales are developed in Chapter 5.

The detailed plan for implementation is called a marketing plan. The American Marketing Association defines a marketing plan as "a document composed of an analysis of the current marketing situation, opportunities and threats analysis, marketing objectives, marketing strategy, action programs, and projected or pro-forma income (and other financial) statements. This plan may be the only statement of the strategic direction of a business, but it is more likely to apply only to a specific brand or product. In the latter situation, the marketing plan is an implementation device that is integrated within an overall strategic business plan" (American Marketing Association, 2011).

The specific format for a marketing plan can vary substantially from one instance to the next, depending on the nature of the firm, the market, and the opportunity in question. In each instance, however, the intent of the written plan is to provide a detailed, systematic blueprint for implementing the decisions reached in the marketing management process. The outline for a typical marketing plan is provided in the next section.

It is also worth noting that most competitive market environments are in a constant state of flux to a greater or lesser degree. The impact of macro- and micro-environmental forces on market demand requires careful monitoring. Marketing managers must be able to adapt the marketing mix for any given product to respond to these changes. Consequently, the process of marketing management itself requires continual monitoring and modifications to the marketing mix in response to shifts in the character of the target opportunity. As with most things in marketing, the focus must remain on the customer and the pursuit of ways to meet buyers' needs more effectively and consistently than one's competitors.

1.3 The Marketing Plan

Teenagers playing Playstation 3 in row at a Sony Building.

A marketing plan identifies the company's strengths and weaknesses and the potential threats of the marketing environment. This ensures that specific products like PlayStation 3 reach the right target audience and market.

Associated Press

The marketing plan is the set of operational blueprints that translates the initial strategic choices identified by the marketing management process into actions. It establishes the firm's initial marketing strategy and identifies the activities required to carry out the overall plan. Marketing plans specify target markets and provide an overview of the decision-oriented steps and objectives for each element of the marketing mix. Additional information usually includes market research plans, consumer and environmental analyses, and sales forecasts.

There are many formats, outlines, and styles for writing marketing plans, which reflects the need to tailor the plan to suit the product, market, and specific audience it is intended to reach. The following annotated outline is intended to provide a flexible guide to writing a marketing plan, while allowing the marketing manager to adapt the model to suit the unique demands of most business situations.

Marketing Plan Outline

The marketing plan outline consists of 11 sections. It begins with an executive summary that provides a preview of the main points of the plan. Section II describes the current situation confronting the firm and includes an assessment of the competitive environment. This is a pivotal section insofar as it forces marketing managers to develop a comprehensive understanding of the markets in which they are competing. The section that follows presents the results of any market research that has a direct bearing on the viability of the plan.

Sections III through V describe all of the strategic decisions and goals related to the pursuit of this market opportunity, with particular emphasis on market segmentation and product positioning. Sections VI through IX provide a breakdown of how the marketing mix will be used to accomplish those strategic goals.

The final two sections of the marketing plan include forecasts of the financial results anticipated from the execution of the plan and a summary of the long-range plans for this product.

SECTION I: Executive Summary

The executive summary should provide an overview of the entire plan, including a description of the product, the differential advantage, the required investment, and anticipated sales and profits.

SECTION II: Situation Analysis and Assessment of the Competitive Environment

This section of the marketing plan needs to:

 Provide a review of past performance for existing programs covered by the plan.

 Discuss any issues within the macro-environment that are pertinent to demand for your product, markets, and the proposed marketing plan. Do you intend to profit from any changes taking place in the marketplace? Macro-environmental dimensions may include: demographic shifts, legal/political factors, changing lifestyles, social changes, economic trends, technological changes, or shifts in cultural/religious values.

 Describe your competitors, their products, and strategies. What are their advantages in the market? What channels do they use? Identify their strengths and weaknesses. Prepare a SWOT chart illustrating strengths, weaknesses, opportunities, and threats relevant to the plan.

SECTION III: Researching Market Opportunities and Market Potential

This section of the marketing plan will present any information that indicates the viability of this product. This could include either primary or secondary data that describe the size or potential of this market.

Fully describe your market research plans. What types of research would you conduct prior to introducing this product? Be explicit when explaining the purpose or intent of this research plan. Describe your research methodology as completely as possible.

SECTION IV: Market Segmentation, Product Differentiation, and Positioning

Present your segmentation analysis by identifying the market segments, segment name, and descriptive characteristics. Include a chart presenting this information and the purchase determinant attributes, features, or benefits for each of the following:

 Target Market Selection/Strategy. This should be based on the preceding analysis, specifying target market(s) by name and buyer characteristics. Describe your target market segment(s) in detail by using demographics, psychographics, geography, lifestyle, or whatever segmentation variables are appropriate. Explain why this is your target market. Describe the size and other relevant group characteristics.

 Product Differentiation. This should be a description of the essential difference between your product and its closest competitors. Indicate any potential for attracting other groups of consumers in the future: Why is it a superior alternative for some buyers . . . specifically your target market? What is the motivation of buyers and users of competing products? What would be their motivation for buying your product?

 Product Positioning. Here you should prepare complete positioning maps or comparable charts for your product and competing products on relevant dimensions.

SECTION V: Statement of Marketing Strategy and Goals

Based on the analysis presented in Sections I through IV, specify your overall marketing strategy for the product. In this section you need to state your goals for the product in terms of sales volume, market share, return on investment, or other measures, and the time needed to achieve each of them. Sections VI through IX will describe your implementation of this strategy—how you will deploy the marketing mix to carry out your strategy.

SECTION VI: Product Planning

This part of the marketing plan should discuss your firm's product planning issues. What is your brand management strategy? Describe your rationale for this choice. Discuss product packaging and the purposes your packaging serves. Include a discussion of relevant product features that were not described previously.

SECTION VII: Pricing

Here, discuss the nature of your pricing strategy and tactics for this product relative to competing brands and substitute products. Organize this section to stress any factors or strategies that are important to the success of your marketing plan. Be certain to address the issue of "skimming" versus penetration pricing.

SECTION VIII: Place, Physical Distribution, or Location Strategy

In this section, you should specify the details of your distribution strategy, compare your system of product delivery to those used by competitors, and describe where your service will be offered or how the service will be delivered to the buyer. How important is the choice of location? Discuss the relevance of push versus pull strategies with respect to your goals.

SECTION IX: Promotion

State the goals of your promotional strategy and identify your promotional campaign theme clearly and concisely. Remember to explain how the choice of goals and themes will accomplish the objectives stated in Section V. You should also discuss how the elements of the promotions mix are interrelated in your promotional efforts. Where do your priorities lie?

SECTION X: Projections of Sales, Costs, and Profits

You will need to determine project or product launch startup costs and a monthly operations budget. Calculate the break even point for alternative price levels and provide sales and cash flow projections for same.

SECTION XI: Summary and Conclusion

In addition to a summary overview of the plan, you should also provide a description of your long-range plans and expectations for this product. This section also offers an opportunity to highlight the strengths of your marketing plan and acknowledge its weaknesses.

1.4 Hierarchy of Corporate, Business, and Marketing Strategies

The process of marketing management takes place within the much broader context of the organization's limited resources and objectives. The hierarchy of most large organizations requires that the strategic direction for the whole body is established at the highest levels. Consequently, marketing decisions at lower levels of the hierarchy must be informed and shaped by an understanding of the organization's larger priorities and goals.

The term strategy has many meanings, depending on the context in which it is used. In its simplest form, however, a strategy is a long-term plan of action designed to achieve specific objectives. In business, common strategic goals are often expressed in terms of growth and profitability. Strategy is distinct from tactics, which are the short-term means required to execute the strategy and achieve the stated goals.

In this section, we turn our attention to big picture issues by tracing the path of strategic planning from its origins in the company mission statement and through the development of a corporate-level strategy until we reach the level of the individual business units. It is at the business unit level of decision making that marketing managers take charge of strategic planning.

Corporate Mission Statement

Advertisement for MAC's Viva Glam collection.

Companies are increasingly responding to customers' social concerns as well as their product needs to strengthen the image of the brand.

WireImage/Getty Images

Most large organizations develop multiple levels or layers of strategy over time. Corporate-level strategy establishes the operational domain or boundaries of the organization. The corporate mission statement defines the purpose and scope of the organization. In doing so, it typically sets forth the company's values and establishes the predominant areas of business focus and practice. A formal corporate mission statement may also include other features such as the historical roots of the firm, the prevailing management philosophy, relevant environmental concerns, and a statement of what the company perceives as its distinctive competencies.

Peter Drucker, a twentieth-century business author, believes that the mission of a corporation can be defined by the answer to five basic questions (Drucker, 2008):

 What is our mission?

 Who is our customer?

 What does the customer value?

 What are our results?

 What is our plan?

Corporate mission statements define the character of the company for people inside and outside the company. The most significant role of the mission statement for company managers is in shaping the development of corporate-level and business-level strategy.

Corporate Strategy

Strategies at all levels of an organization share certain features. They define the objectives that the business will pursue within a given environment, and they guide the allocation of organizational resources and effort. At a basic level of analysis, corporate-level strategy is primarily concerned with establishing the corporate domain by answering the core question, "What businesses should we be in?" Business-level strategy is designed to answer the question, "In which product markets should we compete within these businesses?" Marketing strategy is a statement of how a brand or product line will achieve its objectives within the broader context of business-level objectives.

Corporate-level strategy defines the business areas in which the organization will compete and provides a statement of the core rationale required to integrate the subordinate goals of the operational subunits and functional departments. This is necessary to be certain that every strategic business unit (SBU) within the company is pulling in the same direction.

Strategic Business Units

Strategic business units are often the unit of analysis for planning corporate strategy, and they can be defined in many ways. SBU typically refers to any major product or service line within a company that is small enough to be flexible in its response to external market forces and big enough to exercise direct control over the internal decision factors affecting its performance. From a marketing manager's perspective, this includes direct control over the elements of the marketing mix. Most SBUs have a significant degree of managerial autonomy and have their own objectives and business strategies independent of the organization as a whole. The strategy statement for a strategic business unit defines the markets in which the business will compete and describes how it intends to achieve and promote a competitive advantage in that market. From the perspective of planning corporate strategy, SBUs represent the individual elements within the company's portfolio of business ventures.

Allocating Corporate Resources

Large corporations typically have many SBUs under their organizational umbrella. Having an array or portfolio of product lines and brands under the control of one entity affords the company several potential advantages. Managers can shift the investment of corporate resources to those SBUs that hold the promise of greater growth and profitability while reducing their commitment to less attractive options. These resources may include the assignment of key managerial talent, research and development funding, and marketing support. Marketing support includes the company's investment in product development, advertising, promotions, the development of distribution channels, and the commitment of increased support from the sales staff.

In the early 1970s the Boston Consulting Group (BCG) introduced a conceptual planning model for managing a portfolio comprised of multiple SBUs. The BCG Growth-Share Matrix is an aid to decision making that displays each of the firm's strategic business units on a two-by-two graph defined by forecasted market growth rate and current relative market share. Each SBU is assigned to one of four categories on the resulting matrix as a function of its market share relative to immediate competitors and growth rates for the industry.

The BCG matrix illustrated in Figure 1.4 provides a framework for evaluating the allocation of corporate resources among different business units. Recommendations for the allocation of resources to strategic business units are made according to where the units are situated within the BCG Growth-Share Matrix.

Figure 1.4: BCG Growth-Share Matrix

The BCG Growth-Share Matrix that shows that having a high relative market share and high market growth rate are labeled as being a star. A high relative market share with a low market growth rate has a question mark image. A high relative market share with a low market growth rate has a cash cow image. A low relative market share and market growth rate has a dog image.

The BCG Growth-Share Matrix helps managers assign corporate resources to opportunities with the greatest potential by evaluating each SBU's relative market share and the corresponding rate of market growth.

Cash cow is a business unit that has a large market share in a mature, slow-growing industry. These units typically generate large profits and require relatively little investment to maintain their market share in slow growth industries. Cash generated from cash cows can be reinvested into other, growth-oriented SBUs.

Stars are defined by their relatively high market shares in high-growth markets. They tend to generate substantial profits but also consume substantial resources to finance their continued growth in rapidly growing, competitive markets. Just "keeping up" in these dynamic markets may require a substantial commitment from the firm. If successful, a star will become a cash cow in the long run, as its industry matures.

A question mark (sometimes called a "problem child") is a business unit that holds a relatively small market share in a high growth market. These units do not generate substantial profits at this time, but they require resources to grow their market share. Whether they will succeed and develop into stars is usually uncertain, but they still require high levels of investment to maintain or build their market share. The decision to invest in these opportunities or divest them is among the most challenging ones facing marketing managers.

Dogs provide the organization with little profitability or opportunity for sales growth. These are SBUs with relatively small market shares, surviving in a low-growth or mature industry. A dog may not require substantial cash to maintain its market position, but it ties up capital that could be better invested in other product lines.

A basket of fruit shaped as flowers

Companies succeed by looking for new ways to serve their customers' essential needs. A fruit "floral" basket is an example of this innovative response to customer desires.

Design pics/SuperStock

The BCG portfolio analysis can be applied to organizations of kinds and sizes. Consider the challenges facing a small retail florist shop. Perhaps its cash cows are made-to-order floral arrangements and fresh-cut flowers sold to walk-in traffic. The market is defined by the store's location. These represent the core SBUs that generate most of the stores profits.

Online sales and local delivery have been growing in popularity. This shop got into this aspect of the market earlier than most. It enjoys relatively high market share on a citywide basis and continued sales growth. Though quite profitable on a per-order basis, the costs of maintaining the website, making deliveries, and promoting the service have been limiting the overall profitability and growth of this SBU. It will require investment in newer technology and dedicated delivery staff to remain competitive in this market. This could be considered a star.

Recently this florist has been experimenting with line extensions of edible products such as fruit baskets and chocolate bouquets. This is currently a very high-growth market in this area, but franchised competitors are capturing most of the sales volume. To build market share, this question mark would require significant investments in new prepping/packaging facilities, the acquisition of more inventory, and a big commitment to advertising and promotion. If the franchised operations are already too well entrenched in prospective buyers' minds, all of this investment could be lost.

Small toys, stuffed animals, and novelties related to specific holidays are also sold at the retail shop. The margins are quite poor, since the florist needs to compete on price with the big-box retailer across the street. These lines require far more inventory and retail space than they are worth. However, many of the store's oldest and most loyal customers have been faithfully buying these items for years. In fact, the tradition began with many of the current customers' parents at a time when there were no big-box retailers in the city. The owner may feel the need to keep this dog to retain the loyalty and goodwill of some of his best customers.

The underlying conceptual model is straightforward and intuitively appealing, but, as with all of the decision making aids presented in this text, it is not intended to be a substitute for thinking. Each SBU requires consideration and subsequent analysis on its own merits. Often other considerations take precedence over near-term growth. Sometimes, for example, a firm will retain an "old dog" long after its financial value to the company has ended. Old flagship brands have value in terms of the company's image, its relationship to core customer groups, and its significance to the firm's own employees.

Although the BCG matrix can be of great value in the process of strategic planning, it is necessary to understand the basic assumptions required by the model. First, it assumes that increasing market share will result in a corresponding growth in profitability. However, the costs of building market share often grow proportionately faster than the corresponding improvements in profits. In short, "buying" more market share can cost more than it is worth.

A second potential weakness in the application of this model is that it can only provide a snapshot of the current situation. There is a built-in assumption that growing markets will continue to grow and not decline. If this assumption is violated by the reality of dynamic market shifts, the firm may reassign resources to units that represent a declining opportunity. Conversely, the model may underestimate the potential value that remains in declining markets and prompt a shift of resources away from profitable opportunities.

Expansion and Diversification

The BCG Growth-Share Matrix model focuses on how to allocate corporate resources within an existing portfolio of business units to improve the organization's performance in the dimensions of growth and profitability. Two other paths to the pursuit of these goals rely on the expansion of the current business portfolio and diversification into new areas of business. Decisions about expanding or diversifying the corporation's portfolio of SBUs are complex and typically have substantial consequences for the organization, but the identification and development of new opportunities is essential to the growth and long-term success of the firm. As we will see in subsequent sections of the text, marketing managers rely on several different approaches to finding and evaluating growth opportunities. In Chapter 3 we will examine a range of applications and market research methodologies for uncovering potential new ventures. This includes the Ansoff Matrix model and SWOT analysis. Chapter 5 will explore the techniques that marketing managers use to evaluate market demand for new products and forecast sales.

Strategic Decisions for Marketing Managers

When it comes to making strategic decisions, marketing managers necessarily take their lead from strategies set at the corporate and divisional levels of their organization. The larger strategic context for the identification of marketing objectives, new market opportunities, and subsequent development of marketing plans is provided by the organization's corporate strategic plan. In many instances, the specific corporate culture will also establish a prevailing theme in terms of generic competitive strategies. For example, some companies find that their core competencies in manufacturing or distribution favor the pursuit of a cost leadership strategy in most product-markets. In fact, such firms are likely to evaluate prospective market opportunities based on the ability to exercise this competitive advantage.

A marketing strategy is a statement of how a brand or product line will coordinate the marketing mix to achieve its objectives. The strategy for a given product or service is always specific to its target market. Marketing objectives identify growth and profitability goals for the firm in quantitative terms (e.g., sales, profit, and market share) as well as establish benchmarks for qualitative goals (e.g., market leadership and corporate image). To be effective in shaping decision making, these objectives must be specific, measurable, and stated specifically for the time period for which they are in effect. These objectives can then be converted into detailed goals that shape the integration and coordination of the marketing mix. Marketing strategy also provides direction regarding issues such as the segmentation of the market, identification of the target market, positioning, and the allocation of budgets.

Ch. 1 Conclusion

The strategic application of the principles of marketing management provides many firms with an essential competitive advantage in crowded markets. The value of the marketing function increases as the competition for customers and market share intensifies. Effective managers are those who can leverage the resources of the firm to serve the needs of their target market more efficiently and effectively than their competitors.

At the core of marketing strategy is the marketing concept: the philosophy that emphasizes customer satisfaction as the means to sustained competitive advantage and profitability. Consequently, companies need to be keenly aware of the need to understand value: the basis on which consumers make purchasing decisions. Our focus in the next chapter will be on the marketing manager's role in creating value for the buyer as the primary path to producing customer satisfaction.

Ch. 1 Learning Resources

Key Ideas

Critical Thinking Questions

 Marketing can't possibly be the only effective business strategy. What alternative strategy paradigms or philosophies are there? Can these alternatives be used effectively in isolation? Can they be used in conjunction with marketing strategy?

 Why is so much emphasis in marketing placed on brands? How did companies compete with each other before there were brands?

 What does a brand name mean to a consumer? Consider some of your favorite brands. Are you brand loyal? Why?

 The marketing concept requires balancing the interests of consumers against those of the company. What happens if things get out of balance and you become too focused on just customer satisfaction or just profitability?

 Marketing myopia happens all the time in business. Consider what different types of businesses would look like if they just focused on the quality of the products they sell and ignored the preferences of customers.

 Product differentiation and brand positioning are very important concepts. Can you explain how these two concepts differ from each other? Use two or three specific examples to illustrate the contrast.

 Why are new market opportunities and growth considered essential to the survival of both small and large companies? Why can't an organization remain content to stay where it is?

 Explain how Porter's generic strategy options could be applied to a symphony orchestra, a carpet manufacturer, and a CPA firm. Does this model of three alternative strategies seem to work better in one of these contexts than the other? Why?

 The text noted that strategic business units are typically the unit of analysis for planning corporate strategy. Why does this make more sense than planning at the divisional level for large corporations?

Key Terms

Click on each key term to see the definition.

BCG Growth-Share Matrix

A decision making aid that displays strategic business units on a two-by-two graph defined by forecasted market growth rate and relative market share.

cash cow

An SBU with a large market share in a mature, slow-growing industry.

corporate mission statement

A formal, written statement that defines the purpose and scope of the organization.

cost leadership strategy

Leveraging lower overall costs of production to enable the firm to attract price-sensitive customers by selling at prices that are relatively lower than competitors' prices.

differential advantage

The unique product attributes or benefits that provide buyers with significant and substantial reasons to prefer one brand over another.

dogs

SBUs with little profitability or little opportunity for sales growth.

generic strategy

A general level of strategy applied to the pursuit of market opportunities. The three basic types of generic marketing strategy are product differentiation, cost leadership, and market focus.

market

All the individuals, groups, and organizations that want or need a product and have the resources required to purchase.

market focus strategy

A strategy option defined by the scope over which the firm will implement either cost leadership or differentiation strategies.

market segmentation

The process of dividing the total market into distinct groups or submarkets based on similar wants, needs, behaviors, or other characteristics.

market segments

Clusters of prospective and current customers who are similar to each other in ways that lead them to respond to a firm's marketing mix similarly.

marketing concept

A customer-oriented philosophy of business management which stresses that the objectives of the organization can best be met through the analysis and satisfaction of customers' wants and needs.

marketing management

A set of processes for creating, communicating, and delivering value to customers and for managing customer relationships in ways that benefit the organization and its stakeholders.

marketing mix

Tools available to the marketing manager to influence the target market to purchase one brand over another. Often referred to as the 4 Ps.

marketing objectives

Growth and profitability goals for the firm expressed in quantitative and qualitative terms.

marketing plan

A document composed of an analysis of the current marketing situation, marketing objectives, marketing strategy, marketing mix plans, and financial projections.

marketing strategy

A statement of how a brand or product line will coordinate the marketing mix to achieve its objectives.

place

One of four variables in the marketing mix; relates primarily to distribution and location decisions.

pricing

One of four variables in the marketing mix; relates to both economic and psychological dimensions of price setting.

product

One of four variables in the marketing mix; relates to both tangible and intangible dimensions of physical products and services.

product differentiation

The process of distinguishing one product or brand from another.

product differentiation strategy

Distinguishing your product from competitors' products in a way that makes prospective buyers prefer your brand. The basis of differentiation can be tangible or intangible attributes of the product.

product positioning

The strategy and tactics involved in creating and shaping the brand's image in the mind of prospective buyers. Product positioning is also referred to as brand positioning.

promotion

One of four variables in the marketing mix; relates to the firm's overall communications program.

question mark (problem child)

An SBU that holds a relatively small market share in a high-growth market.

relative market share

The ratio of one SBU's market share to the market share of its largest competitor.

stars

SBUs that exhibit relatively high market share in high-growth markets.

strategic business unit (SBU)

Any product or service line within a company that is small enough to be flexible in its response to external market forces and big enough to exercise direct control over the internal decision factors affecting its performance.

strategy

A long-term plan of action designed to achieve specific objectives.

tactics

The short-term means required to execute strategy and achieve specific objectives.

target market

A group of potential buyers that the firm seeks to satisfy with its marketing mix. It is the segment of the market at which the firm directs its product and marketing efforts.

Web Resources

This website provides free access to hundreds of contemporary articles on all phases of marketing and marketing management. This expansive range of thought-provoking readings should be of interest to both students and marketing professionals. This can be a valuable to reference as you read each successive chapter of this text.

www.chapmanrg.com/IMR/

This is the home of the U.S. Small Business Administration on the Web. The site provides a wide array of resources for small businesses, small-business owners, and prospective business owners. It includes information on company formation, marketing a business, legal tools, and expert advice from professionals. It has a great deal of practical information on developing business plans.

www.sba.gov

This site provides information specific to the preparation and presentation of marketing plans. Features include a marketing plan outline, conducting market research, identifying your best potential customers, and understanding your competition.

www.mplans.com

This is the homepage for Sales & Marketing Management, one of the leading publications in the sales and marketing field. The website provides free access to articles and expert opinion on all phases of the marketing management process.

www.salesandmarketing.com

This link provides direct access to the Occupational Outlook Handbook at the U.S. Bureau of Labor Statistics. This source profiles several hundred occupations describing the nature of the work involved, typical pay ranges, and employment projections for the coming decade.

<http://bls.gov/ooh/>

Chapter 2

Value Creation and Customer Satisfaction

A graph that shows that there is a positive correlation with growth and increased marketing and sales.

istockphoto/Thinkstock

Learning Outcomes

 By the end of this chapter, you should:

 Understand the foundations of customers’ perceptions of product quality and value and their relationship to customer satisfaction.

 Appreciate how total quality management and continuous quality improvement processes can be applied to enhance customer satisfaction.

 Compare and contrast the product supply system with the value delivery system.

 Know the elements of the value chain and the general principles of applying value chain analysis.

 Understand how customer relationship management and customer profitability analysis can be used to build customer loyalty.

 Recognize the role of customer lifetime value in shaping the development of marketing strategy and plans.

Ch. 2 Introduction

This chapter examines how the marketing management process creates value for customers and explores the interrelationship between different conceptions of value and customer satisfaction. We begin by developing an understanding of value that is focused on the buyer, not the product being sold. It is a customer-driven measure that is derived from perceptions of product quality and price. Essential to understanding this perspective is the importance of maintaining a marketing orientation with the organization. We then move on to develop our conception of how customer satisfaction is rooted in buyers’ prior expectations of product value. The principles of total quality management, continuous quality improvement, and value chain analysis are introduced as potentially important drivers in creating and delivering consistently high levels of customer satisfaction. The concluding sections of Chapter 2 examine how the tools of customer relationship management and customer profitability analysis can be applied to maximize the financial value of customer loyalty.

\* \* \*

We typically associate outstanding customer service with small, local retail businesses . . . places where we recognize faces and often know the names of service providers. Heroic plumbers coming out at 2 a.m. to stop the basement from flooding. A dentist coming in to his office on a Sunday to attend to an abscessed incisor. The auto mechanic who loaned an out-of-town family his car so that they could continue on their vacation while he rebuilt the failing transmission on their 1997 Dodge Caravan.

Stories of great customer satisfaction experiences are less often told about large, seemingly impersonal or distant businesses such as Internet service providers, wireless carriers, and airlines. When you do hear these stories, however, they are often about individual employees who have gone out of their way to help a customer, often in ways indirectly related to their company’s core business. Consider the case of a lost toy—a raggedy, but much loved, stuffed hedgehog. "Hiram" was accidently left behind by a Texas family on vacation at a 4,000-room hotel complex in Las Vegas. More specifically, left ensnared in a tangle of bed sheets by 4½-year-old Tinya.

When Tinya’s mom called the hotel after returning to Houston, they assured her they would try to find Hiram . . . and they did. Though now thoroughly clean, Hiram had not survived the rigors of institutional laundering unscathed. However, when he arrived home via FedEx three days later, only the mom noticed or cared about the careful repairs that someone had made.

We don’t know how many people were involved in the search, rescue, and repair of Hiram.

We don’t know, but we’re pretty sure that Tinya was delighted by the reunion with her favorite hedgehog. And we definitely know that her mom was a satisfied customer, even though her vacation was over and she had to return to work. Incidentally, we also know . . . though the hotel didn’t . . . that mom owns one of the largest independent conference and convention planning firms in Texas.

2.1 Marketing Orientation and Customer Value

As noted in the previous chapter, the marketing concept is a customer-oriented business philosophy that stresses customer satisfaction as the key to achieving organizational goals. The translation of the marketing concept from philosophy to actual business practices requires the establishment of a marketing orientation within the firm. Creating and maintaining a marketing orientation requires sustained focus on the elements of that external environment that make the greatest impact on the company’s ability to satisfy its customers. First and foremost are the customers themselves. Successful firms understand their customers’ preferences and are able to effectively adapt to market shifts. In fact, a thorough understanding of the target market will enable the business to anticipate some changes in buyer preference.

The second dimension of the external environment that needs to be studied and monitored is the competition. The marketing mix offered by competitors seldom remains static. They are also in the process of refining and reshaping their marketing efforts, exploring new opportunities, and trying to find better ways to satisfy their prospective buyers. They are in business to satisfy some of the same target markets that your firm is pursuing, and they are not likely to be any less earnest in their efforts. As obvious as this may seem, far too many marketing managers develop elaborate plans without any consideration for how their competitors’ strategies are evolving and how they will respond to your price change, new advertising campaign, or shift in distribution strategy. In the same way that marketing managers sometimes become myopic by focusing on the product rather than the customer, they can also develop blinders—failing to pay attention to shifts in marketplace dynamics and competitive behavior.

In addition to being focused on the customer and the competitors, the development of a competitively successful marketing orientation also requires organizational discipline. It requires that all of the functions and resources of the organization be aligned and integrated with the primary corporate objective of customer satisfaction. This is not always readily accepted within organizations. The perception that the objectives of other functional areas within the firm should be subordinated to marketing is frequently met with resistance. For example, production managers may feel that they have been hired to improve the efficiency of the production processes first and foremost. Improvements in the quality of the product, if any, will have to be a consequence of those goals. However, better-built products that don’t reflect the preferences of the target market simply won’t sell, no matter how well they have been designed.

Creating a Marketing Orientation

Advertisement from the Fair Trade Just Coffee Cooperative.

This advertisement from the "Fair Trade" Just Coffee Cooperative illustrates that consumers are concerned with the social implications of their purchases as well as the product-specific attributes.

Just Coffee Cooperative

Consider the example of a Dave Ingraham, a young entrepreneur who has just graduated from an MBA program and wants to open a small café in the northeastern college town where he lives. He is attracted to the college market because he believes he understands the prospective customers and senses an unmet market opportunity near campus. Starting from a marketing orientation rather than a product focus, he will need to analyze those characteristics of the environment that will impact his ability to satisfy this target market. Before thinking about interior designs, promotional schemes and location decisions, Dave needs to be sure that he understands the preferences, behavioral tendencies, and key trends in this competitive market.

One emerging trend in this age segment of the market is the resurgence of interest in making coffee at home. Specifically, there has been very significant growth in the popularity and sales of single-serve pod brewing systems. These single-pod brewers offer college students an easy-to-use, cost-effective alternative to running out to the local coffee shop. This may work against Dave’s initial marketing plan and require changes to the basis on which the café environment appeals to college students.

Another trend in the market that warrants Dave’s attention is college students’ growing concern over safe environmental and ethical practices. Though evident in many markets, every coffee-related business needs to be particularly sensitive to these issues due to the growth of the "fair-trade" movement in coffee-producing countries.

What types of changes would you make to the typical café to overcome or even capitalize on these two specific trends in coffee consumption and sales?

A working marketing orientation requires more than simply tracking trends in the product markets where you compete. For example, Dave read an article in a business magazine that said sales of premium-priced, high-quality coffee by fast-food chains has experienced very high rates of growth in recent years. Should this be considered good news? Not necessarily. National trends are not indicative of local conditions. College students may be substantially more price-sensitive than the average coffee buyer. Fast-food chains are prospective competitors with business models that are vastly different from what Dave has initially planned to do.

All efforts to understand the competitive environment need to be viewed within the specific context of your target market. In this instance, the age, income levels, family status, and other demographic characteristics of the target market make these consumers atypical coffee buyers in some ways. For a retail business, the unique qualities of the local market also limit the value of making comparisons to national trends. The number, location, and business model of competitors within the market boundaries of this proposed café define the competitive landscape. National patterns of competition may be meaningless. Fostering a working, useful marketing orientation always requires a narrow focus on those factors within the specific environment that directly impact the firm’s ability to satisfy its customers.

Local consumer trends often fail to keep pace with changes at the regional or national level. In fact, local cultures can sometimes push consumption patterns in the opposite direction of that observed at the national level. Can you think of any examples of this phenomenon in your town or city?

Building Customer Value and Satisfaction

Value is a term that can carry very different connotations depending on the circumstances. In marketing, it is important to recognize that it is not synonymous with product quality. The better-built product may be of very high quality, but it provides little value to consumers if they derive no satisfaction from its ownership or use. Value is, first and foremost, always specific to the buyer—not the seller and not the product.

This point can be reinforced by looking at the difference between a product- and a market-oriented view of value creation. A product orientation will emphasize excellence in engineering and manufacturing to produce a product that is superior to the available alternatives on the market based on the designer’s understanding of how product quality should be assessed. Incremental "improvements" to the product are subject to financial analysis with relatively little regard for buyers’ preferences. The underlying mentality is that we are competing in an economic market where people are pretty much all the same and products are undifferentiated commodities. Although there may be product markets where one or both of these assumptions are valid, they are quite rare. The role of marketing in this scheme is simply to sell whatever the company produces. Marketing managers are tasked with finding the best market for the product that has been produced and making the sale.

The market-oriented model to creating value begins with the focus on the target customer. The prospective buyers’ wants and needs provide the initial blueprint for the design of the product. Ultimately, it will be the buyers’ perceptions of product quality that determine value and their experience with the product that determines customer satisfaction. Marketing is involved in the overall process far earlier than in the alternative product-driven model. Through the market research function, marketing managers are tasked with identifying the target market and determining what these customers want from the products they buy. Similarly, the job of understanding how consumers perceive the array of competitive brands in this category also resides in the marketing department.

Based on this analysis of the two alternatives, it is apparent that value is not simply product quality, though it has something to do with quality. It is also evident that its meaning resides with the buyer more than the seller—that is, the true value of a product is based on the buyer’s subjective evaluation, not the seller’s estimation. From a marketer’s perspective, value is understood as a measure of the bundle of benefits a buyer gets from the product relative to the perceived costs of acquiring the product. Insofar as product quality can be defined by the purchaser’s perception of the sum of the benefits he or she receives from the product, value can be expressed as a conceptual equation of the form:

Value = {Sum of Benefits / Perceived Cost to Acquire}

Or alternatively as:

Value = {Product Quality / Price}

customers at Best Buy looking at lap tops for sale

Consumers try to maximize the value of their purchase by identifying the best quality at the lowest price relative to their product-specific needs.

Associated Press

In each formulation, value is subjectively defined as a function of the buyer’s estimation of the bundle of benefits received from the product relative to the price paid to acquire them. Consider, for example, how consumers assign value when shopping for a laptop computer. Different benefits are conveyed by specific attributes of the product. These include processor performance characteristics, viewing screen size and resolution, memory (RAM), graphics, hard drive capacity, modem speed, battery life, warranty, and other features. A buyer’s evaluation of the sum total of benefits he or she will derive from this bundle of attributes, relative to the cost to purchase, is the perceived value of the product. Consequently, marketing managers can enhance the outcome of the value equation either by decreasing the price or increasing the aggregate quality of the product offering.

Like value, customer satisfaction is based on a subjective appraisal on the part of the consumer. It is an experience-based assessment of whether a product or service meets or surpasses his or her expectations. By definition, a customer is satisfied only when the benefits derived from a purchase meet or exceed his or her prior expectations of product value. How customers perceive the value of a brand depends on their appraisal of the whole bundle of benefits derived from purchasing and using the product.

Think About It

"Value is, first and foremost, always specific to the buyer—not the seller and not the product." Although this statement can be verified by closely examining any product market, it is more readily evident in some markets than others. Consider the markets for antique toy trains, imported brands of beer, and streak-free varieties of glass cleaner.

Which provides the best evidence to support the proposition that value is specific to the buyer?

In general, what types of product markets most clearly illustrate the truth of this proposition? Why?

Perceived Value as the Expected Bundle of Benefits

Since both value and satisfaction are rooted in subjective perceptions, they can be significantly influenced by a number of non-product factors. Ultimately, however, the importance of each of these factors rests on the buyer’s expectations. Positive indications of customer satisfaction and perceived product value are signs that the purchase has met or exceeded prepurchase expectations.

At this point it is essential to recall that consumers are responding to the bundle of benefits that products provide—not simply to the tangible characteristics of goods being sold. Consider snowboards. Do buyers really value owning composite metal bindings attached to highly polished vertical strips of wood that have been laminated together? Or do they value the fun and excitement that can be derived from the product’s use? No one wants lumbar spinal surgery or term life insurance or 5 mm drill bits. But many consumers want relief from chronic back pain, peace of mind that their children will be cared for in the event of their death, or a 5 mm hole somewhere.

When evaluating goods and services, consumers consider those features that are of greatest importance and assign the greatest significance or weight to them. A product as simple as toothpaste may be perceived very differently by different groups or segments of the market. Each market segment may recognize that the potential benefits from using toothpaste include fighting cavities, whitening teeth, and freshening breath. However, young, unmarried consumers may place a higher weight on the aesthetic benefits, while the parent of five children may assign greater importance to fighting cavities. Both groups may value all three of these benefits, but not in the same way. These differences form the basis for creating benefit segments within product categories. Understanding which product benefits your target market values most is an essential first step to differentiating your brand from competitors’ brands in ways that will provide differential competitive advantages. Superior quality and performance on key product benefits defines one class of factors that directly impact customer satisfaction. These factors are sometimes called value drivers because they enhance the value of a product or service in the eyes of the consumer. These can be tangible characteristics, readily discernable from our five senses, such as color, size, weight, and taste. However, they can also be rooted in very subjective impressions related to brand image, product performance, or other intangible characteristics that are separate and distinct from the physical properties of the product. Abstract qualities such as luxury, reliability, beauty, style, and strength cannot be directly observed but are often pivotal in buyers’ decision making.

Product Pricing as a Value Driver

A second class of factors that directly impact customer satisfaction can be deduced easily from the two conceptual equations introduced previously. Price is a fundamental element to buyers’ assessment of value and central to the determination of their satisfaction with the products they purchase. There is a wide range of price-related value drivers to be considered when developing marketing plans. The three general categories of pricing considerations that directly impact buyers’ perceptions of value are reference prices, psychological pricing, and performance value.

Making comparisons across alternatives is a basic and essential skill. Shoppers often compare one brand’s price to a reference price that they maintain in their minds for that product category. This is the approximate price or price level that people expect to pay for a given product. This price level provides an important internal basis for shaping expectations of value. Marketing managers can adapt pricing strategy to suit their target market’s prevailing reference price for their product. However, the marketing mix can also be used to influence buyers’ perceptions of an appropriate or acceptable price.

Psychological pricing practices are centered on understanding the ways in which products create innate or intrinsic satisfaction for the buyer. Strategies that stress the mental and emotional value of the bundle of benefits realized from buying a product are commonly used throughout all sectors of the economy—not simply retail consumer markets. Many of these techniques and applications are specifically aimed at shaping prospective buyers’ reference prices. Sellers often attempt to alter buyers’ frames of reference by promoting discounts from manufacturers’ suggested retail prices. In this instance, the manufacturer’s suggested retail price (MSRP) serves as an anchor-point for consumers’ perceptions of brand quality, and the discounted price elevates their subsequent perception of overall value.

A shopper looks at Ford vehicles in at a dealership in Carlsbad, California.

A customer’s sense of satisfaction from the purchase will depend on his or her pre-sale expectations and post-sale perceptions of product value.

Corbis News/Corbis

Alternatively, marketers may establish pricing strategies that are exclusive to specific distributors or channels of distribution, thereby establishing different reference prices in parallel markets. Or the seller may try to improve consumers’ perceptions of value with promotional messages encouraging them to compare their own brand only to more expensive, premium-priced alternatives. The way in which prices are communicated and the order in which they are encountered are among the many other ways that sellers can shape buyers’ perceptions of value.

Consider the way in which new cars are typically sold. The MSRP is often displayed in an invoice format on the car’s window. This "sticker price" may be the first price information shoppers encounter. It provides a reference price for the sake of comparison. Subsequent conversations and negotiations with a salesperson typically start from this sticker price and move downward. However, a good salesperson will work to keep the MSRP in the buyer’s mind because it is intended to anchor his or her perceptions of product quality. Consequently, a car with a $24,950 list price becomes a better value as the cost is negotiated downward, but the perception of the vehicle’s quality remains tied to the higher price. An essential psychological element of this process is the price–quality correlation.

The price–quality correlation is at the heart of a long list of psychological pricing techniques that work independent of the category’s reference price. These include introductory price dealing, bundling, price lining, and prestige pricing. In the absence of reliable information to the contrary, consumers tend to believe that higher-priced products provide a higher level of quality. Since value is a function of product quality and price (Value = {Product Quality / Price}), the implications of a positive price-quality correlation for customer satisfaction are substantial. The detailed investigation of this and other pricing topics is provided in chapter 10.

In contrast to psychological value, performance value refers to the functional ability of the product to deliver tangible benefits to the buyer. From the buyer’s perspective, it is an assessment of how well a product does what the product has promised to do. Within the context of industrial product sales, this is sometimes referred to as the monetary value of the product because it represents either cost savings or revenue improvements resulting from the purchase. In both consumer and industrial markets, the performance of a product can have multiple dimensions. If a customer is purchasing software to track inventory at his retail shop, the product probably has relatively little prestige or psychological value associated with its use. However, dimensions such as accuracy, flexibility, ease-of-use, reliability, capability, and speed are likely to be important considerations.

The impact of performance value pricing on customer satisfaction is readily evident in most transactions between buyers and sellers. When buyers are inclined to be more rational than emotional in their evaluation of alternative brands, it is the performance value of the alternatives that determines brand choice. In this case, the buyer’s perception of a brand’s performance relative to a competitor’s brand is typically a primary determinant of perceived product quality and therefore value for money. Strong, consistent, and reliable product performance over time is an essential ingredient in building customer satisfaction and brand loyalty in most markets.

Think About It

The price of a product is intended to communicate much more information than simply the cost of making a purchase.

Thinking back on some of the larger purchases you have made, how might the seller’s pricing strategy have impacted your perception of the product and its value?

What elements of pricing strategy can make something seem like a good deal?

2.2 Total Quality Management and Total Customer Satisfaction

Total customer satisfaction (TCS) is an integral part of a broader set of management practices called total quality management (TQM). The essence of TQM is that quality is every employee’s responsibility. Every level of operations and all processes should be designed to ensure that uncompromising quality is the norm at every stage from product inception through the final sale. By definition, every job within the firm provides added value to the processes and products of the organization.

Within the TQM paradigm, managers have several types of responsibilities. As supervisors of other employees, management is tasked with ensuring that everyone’s work is making a positive contribution to the quality of the final product. Managers at all levels are responsible for aligning company resources and processes to maintain and enhance product quality. And managers also have unique responsibility for the pursuit of continuous quality improvement.

Continuous quality improvement (CQI) requires that managers within the organization remain vigilant, constantly searching for new ways to improve operations and processes. One way to systematically seek opportunities for quality improvements is through benchmarking. Benchmarking is the process of evaluating your organization’s processes and performance against the best standards within your own or other industries. CQI metrics or standards of measurement are usually related to a combination of product/service quality, time, and costs. The objective of benchmarking is to improve your firm’s operations by modeling your own practices after the best exemplars throughout the world.

TCS is a strategic, integrated management philosophy based on the concept of achieving ever higher levels of customer satisfaction. It is, essentially, a special case of the larger set of principles defined by TQM. It is also wholly consistent with the tenets of the marketing concept insofar as the objective is to satisfy the consumer better than the competition. Obviously, total customer satisfaction (or 100 percent) would provide a substantial competitive advantage.

These are the eight principles of TCS for marketing managers:

 Be customer focused.

 Involve and empower all employees.

 Focus on process-oriented thinking.

 View processes within an integrated system.

 Think strategically and systematically.

 Pursue CQI.

 Make decisions based on evidence.

 Maintain communication throughout all levels of the organization.

As with all applications of TQM, TCS programs in large organizations rely on a team approach to achieving goals. Many teams are formed temporarily to solve specific problems or complete customer satisfaction improvement projects. Other teams are a permanent part of the organizational structure. Many of these are cross-functional groups, working to align the TCS efforts of the firm by integrating, coordinating, and improving processes of the whole organization. Cross-functional teams are preferred as a means of improving decision making, participation, and communication across levels of the corporation.

The ultimate aim of the TCS philosophy is to foster environments, operations, and management processes that will maximize customer satisfaction. The essential feature of the TCS model is the reliable delivery of the highest possible product value to the customer within the constraints established by costs and pricing. To sustain the highest possible levels of customer satisfaction and enhance the firm’s differential advantage in the marketplace, the pursuit of CQI opportunities is imperative.

There are several alternative models for identifying new ways to improve existing customer satisfaction levels. Although each utilizes slightly different metrics of customer satisfaction and data analysis procedures, the CQI steps used to improve customer satisfaction within specific processes generally conform to the following sequence:

 Develop a thorough understanding of the contributions of the specific process to TCS. Identify potential opportunities for process improvements.

 Evaluate the alternatives by tracing the potential value added from process improvements for each. Select the option based on the greatest potential for addressing an area of company performance that is not currently meeting customers’ expectations.

 Analyze the selected alternative. Investigate the underlying causes of suboptimal performance for this process. Clearly define and delineate the root causes of the underlying problem.

 Brainstorm and engage in preliminary research to generate alternatives to improve the target process.

 Conduct a more thorough investigation of the feasibility of this option before selecting it as the best alternative.

 Evaluate the level of projected improvement in the TCS model relative to the incremental costs and revenue implications of implementation.

 If viable, develop a detailed plan of implementation and seek formal approval.

 Initiate the process improvement. Measure actual performance metrics against customer satisfaction expectations and cost projections.

Processes such as these are designed to improve customer satisfaction by enhancing the value of the goods and services provided. The section that follows examines alternative perspectives on the process of conveying value from sellers to buyers.

Putting It All Together

Cashier handing bag of groceries to customers in line

Blend Images/SuperStock

TCS has applications in contexts ranging from the largest and most complex manufacturing organizations to the smallest and simplest service providers. Consider a business as ordinary as your local supermarket. The highly competitive nature of the retail grocery trade in large urban markets makes it difficult to clearly differentiate one store from another in terms of pricing, product selection, or even atmosphere. However, the shopper’s experience in the checkout line is often quite different from one retailer to the next, and this difference can contribute either positively or negatively to brand differentiation. How might the principles of TCS and CQI be applied to this process?

Start by examining the contributions of this specific process to TCS and identify opportunities for process improvements. The checkout line is often both the first and last point of contact with customers. If shoppers confront long, noisy lines when first entering the store, it will adversely impact their psychological disposition toward shopping for the balance of their visit. Specific improvements in the process aimed at reducing average line length and wait times would improve the shopper’s initial impression of the store and definitely enhance customer satisfaction at the end of the process.

The next steps require generating alternative improvements to the process and conducting an evaluation of the alternatives on costs, revenues, and customer satisfaction levels. There are many different types of supermarket shoppers, different order sizes, and different service requirements. One of the challenges facing management is to identify cost-effective opportunities to improve service for different segments of the market. As a manager, you might consider several alternatives to changing the checkout process, including the addition of more cashiers, baggers, and checkout lines for large-order customers; providing curbside carryout service for seniors; or installing automated self-checkout lines for convenience- and time-sensitive shoppers. Keep in mind that not all customers are equally profitable for the store and not all shoppers derive their satisfaction from the same elements of the process. For example, some thrive on personal, social interaction, while others view the experience simply as completing a necessary function and want to get out of the store as quickly as possible.

So, evaluating each of the process alternatives on costs, revenues, and enhancements to customer satisfaction is not a simple task—not even for something as ordinary as the local supermarket.

In reality, the application of the TCS paradigm to this specific problem would be a complex undertaking. The initial step of understanding how the checkout process contributes to customer satisfaction levels for different segments of the target market is challenging. Translating this knowledge into discrete, segment-specific, process-driven alternatives focused on delivering measurable results at specific cost rates is also a formidable task. However, this type of analysis is absolutely essential in an industry noted for razor-thin profit margins. There will always be new opportunities for process improvements. The challenge for marketing managers is to find cost-effective and efficient process enhancements to improve customer satisfaction within the most profitable segments of the market.

2.3 The Value Delivery Process

As we established in the preceding chapter, marketing management is composed of processes for creating, communicating, and delivering value to customers. In this section, we’ll contrast the two competing views on how best to deliver value. The traditional view of the product supply system rests on a sequence that begins when the firm creates something of value and ends when it is sold to the customer. A more contemporary understanding of delivering value starts with the development of a value proposition and emphasizes the need to create value based on customers’ preferences before engaging the delivery processes.

Product Supply System

Traditional views on delivering value to customers have focused primarily on the creation and distribution of manufactured goods. Sometimes referred to as the product supply system, an implicit assumption of this model, as illustrated in Figure 2.1, is that the firm will find markets for what it produces.

Figure 2.1: The product supply system

A product supply system is composed of development, production and marketing of a product.

The product supply system is focused on the development, creation, and distribution of manufactured goods.

Lanning, 2000

This approach is, in effect, the embodiment of marketing myopia. It is the consequence of first focusing on the product and its manufacture rather than on the wants and needs of the customer. The strategy is to sell what you can make rather than making what you can sell. This is sometimes referred to as the ready-fire-aim firing squad mentality.

Value Delivery System

Businesses began to recognize the high costs of this fallacy in the 1980s as globalization and the accelerating growth of international trade introduced many new competitors to domestic product markets. With increasing brand alternatives available in many markets, buyers gravitated toward those options that best suited their preferences. To protect market share and systematically develop new concepts for existing markets, managers realized the need to begin the product development process by examining customer needs first.

Consistent with this new perspective, Michael J. Lanning first introduced the value delivery system model, as shown in Figure 2.2, in the late 1980s. In contrast to the way that previous views suffered from marketing myopia, this new alternative was the embodiment of the marketing concept. The emphasis on providing greater customer satisfaction as a competitive strategy was captured by the idea of superior value propositions.

A value proposition can best be understood as the promise that the seller is making to the buyer. It consists of the bundle of product benefits that the marketer promises the consumer will receive for the price paid. As a strategy planning tool, a formal statement of the value proposition will specify the reasons that a target customer should buy one brand over another, and it should explicitly identify how this brand delivers greater value for a given target market than others.

Figure 2.2: The value delivery system

A value delivery system diagram.

The value delivery system needs to choose, provide, and communicate its value proposition to customers.

Lanning, 2000

The three-stage value delivery system model provides the means to build customer satisfaction and brand loyalty by focusing first on understanding the needs of the target market. The actions involved at each stage of the model are:

Stage 1: Choose a value proposition by identifying the target market and determining how the brand will be positioned relative to competitors.

Stage 2: Provide this value proposition by creating the bundle of benefits (goods and services) that fulfills the promise you are making to prospective buyers. Pricing and distribution are usually significant parts of keeping this promise.

Step 3: Communicate this value proposition through targeted promotional activities, including advertising and personal selling. The concept of a unique selling proposition (USP) communicates the promise that if you buy this brand, you can expect these benefits. It is truly a unique proposition only if no other brand can validly make this claim.

The value delivery process modeled above can be very effective in creating satisfied, loyal customers. However, it is important to note that firms can lose sales and customer loyalty very rapidly if they fail to deliver on the promises of the value proposition. And, it is a matter of human nature that buyers will almost always remember disappointing experiences far longer and more vividly than positive ones.

Think About It

The product delivery system and value delivery system require very different views of what marketing management is intended to accomplish.

How would a book publisher’s final products differ under one process model rather than the other? In what ways might they be similar?

2.4 The Value Chain and Core Competencies

The same competitive forces that led Lanning to develop the value delivery system model in the 1980s spurred Michael Porter to introduce value chain analysis during that same period. As illustrated in Figure 2.3, a value chain is defined as a succession of activities and processes, usually defined for specific SBUs, that converts inputs into outputs of greater value. Porter’s value chain model identifies five primary strategic activities: inbound logistics, operations, outbound logistics, marketing and sales, and services. The purpose behind dissecting the workings of an SBU into a set of discrete activities in this way is to seek opportunities to improve product quality, buyer satisfaction, and, consequently, competitive advantages.

Concept of the Value Chain

From fashion design to distribution, the creation and the value of a product are constantly measured with the customers' needs and what the customers think it is fiscally worth. How would a company advertise a specific product for a particular target customer? What does the company have to know about their customer?

Figure 2.3: Value chain

A value chain diagram.

A value chain involves five primary functions that must be coordinated to create product value and to satisfy customers.

Five primary strategic activities provide the components in the value chain that directly impact customer satisfaction. Inbound logistics is the term used to describe all of the processes involved in bringing raw materials and unfinished goods into the company for conversion into final products. This includes receiving, warehousing, and inventory control processes. Raw materials include all forms of inputs into the firm’s operations, including human resources and various forms of intellectual property.

A manager recording the number of stocks in a warehouse.

Maintaining sufficient inventory is essential to meeting customers’ demands.

istockphoto/Thinkstock

Operations encompasses all of the activities within the SBU that transform and convert the inputs delivered by the inbound logistics systems into final products. These, in turn, are shipped out and distributed via the outbound logistics systems. Marketing’s role in outbound logistics is usually limited to elements of the place variable within the marketing mix, including warehousing and transportation.

Marketing and sales includes many of the elements related to the pricing and promotion components of the marketing mix, such as advertising, personal selling, and sales promotion. The fifth activity, services, are typically used to describe the ways in which the organization attends to customers’ needs after the initial product sale has been completed, such as repair services and customer support.

In addition to the five primary activities, Porter’s value chain model also specifies four essential support activities: procurement, technology development, human resource management, and firm infrastructure. The infrastructure refers to a range of supporting management activities that are typically housed in specialized departments. These include finance, accounting, legal services, and quality control.

To create product value and customer satisfaction, organizations must manage their value chain and value delivery system for each SBU in a customer-centered way. This is essential to attracting new buyers and retaining current customers as well. As we will see in section 2.6, the financial gains realized over the lifetime of an established, loyal customer far exceed the projected average lifetime value of a newly acquired customer.

As goods and/or services move through each stage of the chain, they increase in value. Of particular importance to understanding the significance of this sequence is that there are both summative and synergistic effects at work. The synergy is reflected in the fact the total value added across the whole span of activities and processes is greater than the sum of all activities and processes. Nonetheless, each individual activity in the chain must create value for the customer in excess of the associated costs of executing that activity.

Value Chain Analysis

To maximize customer satisfaction in accordance with the prescriptions of TQM and TCS, organizations need to be engaged in the process of CQI. The value chain provides a conceptual model to aid managers in organizing the search for new ways to improve operations and processes. This requires breaking down the system into its component parts to look for opportunities and examining the value chain as a whole, integrated system of value delivery.

The initial task in value chain analysis is to evaluate how each of the processes and activities differentially contributes added value to the customer’s experience with the product and the organization. In most cases, the five general activities identified by the model are broken down into the underlying component processes. When isolated as unique processes, they can be evaluated with respect to both effectiveness and cost. At this level of analysis, competitors’ performance and costs can be estimated to provide specific targets or benchmarks in accord with CQI principles.

The functional interrelationships between activities also make contributions to the value chain and, consequently, to customer satisfaction. To assess the value contributed by the effective coordination across activities, the same type of analysis can be extended to the investigation of linkages between activities. Simply maximizing the efficiency and performance of units in isolation seldom maximizes the performance of the whole. Improvements in the costs or performance of how the overall system is managed and coordinated can yield substantial differential advantages for the firm.

Core Competencies

Within a few years after the publication of Lanning’s work on value delivery systems and Porter’s development of value chain analysis, Prahalad and Hamel introduced the concept of core competencies (1990). A core competency can be described as "a narrowly defined field or task at which a company excels. A firm’s core competencies are difficult for its competitors to mimic, allowing the company to differentiate itself. Most core competencies will be applicable to a wide range of business activities, transcending product and market borders" (Investopedia Financial Dictionary, 2011). It represents the unique set of acquired skills and knowledge behind the firm’s product lines. It is, in simplest terms, what a given organization does best.

It is essential to note that although core competencies are not products, they lead to the development of successful products. They are processes and activities—ways of doing things—that provide the organization with differential advantages relative to its competitors. According to Prahalad and Hamel (1990), there are three qualifying tests for identifying a core competence:

 It should not be easy for competitors to imitate.

 It should have applications to many products and markets.

 It should make a significant, positive contribution to the consumer’s experience of the product’s benefits.

Core competencies are typically developed within those activities that are most essential to the organization’s success. Consequently, they are invariably related to those processes that directly enhance the value consumers receive from the products being sold. It is important to recognize that the specific skill sets that constitute core competencies within an organization are constantly evolving. They are forever in a state of flux, changing and adapting in response to changes in the market environment.

Think About It

Core competencies are those value-creating capabilities within your organization that promote growth and long-term profitability. They are the important things that you do better than your competitors. Identify the core competencies of the following companies: Hewlett-Packard, Coca-Cola, and Holiday Inn.

Think of other successful firms across a range of industries. Can you identify their core competencies?

The ultimate utility of TQM, TCS, value chain management, and the development of unique core competencies lies in satisfying the customers’ needs. The value chain needs to be understood and managed as a whole, integrated system of related activities. Only by optimizing the value chain and leveraging core competencies can an organization reliably provide sustainable competitive advantages in accord with the primary precept of the marketing concept: customer satisfaction as the key to achieving organizational goals. Consistently and reliably providing superior customer satisfaction is at the core of retaining current customers and winning new ones.

2.5 Attracting, Retaining, and Growing Customers

Our initial definition of marketing management identified two sets of activities. First, it referred to a set of processes that create, communicate, and provide value to customers. So far, this chapter has investigated those activities within the broader context of delivering superior customer satisfaction. The second half of the definition specifies that marketing management is the means by which the company manages customer relationships for the benefit of the organization and its stakeholders. The end objective of marketing management, therefore, is to attract, acquire, and retain customers for the ongoing financial benefit of the firm by providing greater value to buyers than competitors and creating satisfied customers.

Business organizations devote substantial resources to the process of attracting new customers because it is typically essential to the growth and survival of the organization. Companies that are primarily dependent on business-to-business (B2B) sales rely on fewer and larger customers than those in retail markets. B2B firms rely on generating, qualifying, and pursuing new leads from a relatively limited pool of potential buyers. Their primary emphasis is often on personal selling more than impersonal media promotions. Business-to-consumer (B2C) companies are usually in pursuit of larger numbers of prospective buyers, each of whom individually represents a smaller part of the customer base for the business. Consequently, mass media promotions are frequently a key element of the firm’s efforts to attract new buyers.

Customer Relationship Management

Despite the substantial differences in marketing approaches for B2B and B2C companies, both face the same types of challenges in competitive markets. Marketing managers need to focus on three primary tasks to attract new customers: accurately identifying customer needs, creating high-value products to meet those needs, and delivering corresponding product value messages to the target market. The detailed investigation of each of these processes supplies the core content for the remaining chapters of this text. At this point, however, it is worthwhile to note one fundamental principle related to acquiring new customers: Not all customers are equally valuable. In fact, there are usually some prospective buyers that companies should prefer to avoid. One approach to understanding this counterintuitive concept is customer relationship management (CRM).

CRM is a comprehensive strategy and process for acquiring, retaining, and partnering with selective customers to create superior value for the company and the customer. It involves the integration of marketing, sales, customer service, and the supply chain functions of the organization to achieve greater efficiencies and effectiveness in delivering customer value (Parvatiyar and Sheth, 2001).

CRM emerged in the 1990s as companies recognized the growing potential for integrating customer knowledge and information into readily accessible and usable databases. As desktop software applications have grown increasingly powerful, the integration of marketing, sales, and customer service operations within organizations has improved. With the exponential growth of e-commerce and electronic social media, the importance of these new ways to reach target audiences has also increased the focus on CRM as a marketing management tool.

The primary objective behind any CRM system is the creation of a robust knowledge base about customer behavior that provides reliable information for the development and execution of strategies that benefit both the company and its customers. In short, the aim is to improve the efficiency and productivity of marketing processes.

In practice, the term customer relationship management is subject to several interpretations. In its simplest form, it can refer to using marketing databases to improve the efficiency of promotional tactics such as direct marketing, mass media advertising, and sales promotions. In strategic terms, it is often used to refer to all marketing efforts to establish, maintain, and enhance relationships with customers and other supply chain partners. In its broadest sense, it can refer to "all marketing activities directed toward establishing, developing, and maintaining successful relationships" (Dwyer and Oh, 1987).

Profitable and successful applications of CRM in industry share two critical features. They emphasize the value of taking a long-term view of relationships, and they recognize that not all customers are equally profitable for an organization. This property is routinely referred to as customer selectivity.

The fact that not all customers or prospective customers are equally profitable for a company is simply an empirical truth, not a matter of strategy or planning. The critical issue for managers is understanding the most profitable way to respond to this reality. Companies must manage their limited resources selectively by targeting their marketing efforts to reach the most profitable segments of the market. The attractiveness of one customer or market segment may hinge on any number factors. These include location, market accessibility, price sensitivity, demographics, or other factors that may be directly or indirectly related to the prospective value of the buyer to the company.

Customer Retention and Loyalty

Customer retention can refer to both the activities that an organization undertakes to reduce the loss of customers and the rate at which an organization is successful at keeping its customers over a period of time. There are substantial benefits to keeping loyal customers and maintaining high customer retention rates.

The value of loyal customers within most business contexts is substantial. Loyal buyers represent a reliable stream of revenue that was established from the initial investment of marketing resources. The loss of a loyal customer represents both the loss of income and forfeiture of the investment. In addition, the establishment of an enduring, mutually beneficial relationship with a customer deprives competitors of that same opportunity.

Consistent with the principle of customer selectivity, it is important to recognize that selecting the right target customers in the first place will have a positive impact on customer satisfaction. This, in turn, improves retention, the prospect of building loyalty and hence profitability.

Loyalty = f (customer satisfaction + market selection)

Buyers who are hard to please or who constantly switch will come and go independently of how hard a firm works to win their loyalty. However, this inevitable loss of some difficult customers is in sharp contrast to the practice of customer churning.

The rate at which businesses lose customers is referred to as the customer attrition, turnover, or churn rate. For most companies, it is clearly understood that the objective is to minimize attrition for the reasons cited above. However, some companies intentionally engage in customer churning—a practice designed to maximize profitability from the initial customer sale without regard to building long-term loyalty. In some instances, this is a legitimate business strategy based on the nature of the product or service being sold. In other cases, however, it reflects the weakness of an organization that is simply unable to satisfy consumers better than alternative providers can. Unable to remedy the problem, these firms will try to offset poor product value by aggressively marketing to replace the tide of lost first-time customers with new ones each quarter. This is sometimes referred to as the "leaky-bucket model," since the company is frantically trying to add new buyers to the top of the pail faster than it is losing them through the hole at the bottom.

The new investments and expenditures required to find and win new customers guarantees that they will initially be less profitable to the firm than the existing, loyal base of consumers. As a general rule of thumb, it is considered five times more to costly to attract new customers than to retain current ones. In fact, a 5 percent improvement in customer retention rates can yield as much as a 25 to 85 percent increase in profitability (Dwyer and Oh, 1987).

A couple looking at washers and dryers in department store.

Relatively expensive purchases typically require the evaluation and approval of more than one decision maker. Marketers must be aware of this when creating their marketing plans and address it accordingly.

Somos/SuperStock

The specifics of systematic models for retaining customers differ substantially from one context to the next. Just as efforts to improve customer satisfaction must be uniquely tailored to the target market, retention programs must be suited to the characteristics of the loyal customer. The planning of most retention programs, however, follows four basic steps:

 Create specific profiles of loyal buyer segments.

 Determine the financial value of each loyal customer type.

 Determine the root causes for defection within and between segments.

 Develop and implement corrective action plans.

Some proactive retention plans are designed to reduce anticipated attrition rates by providing incentives to loyal customers. These might include customer reward or membership programs (awarding air miles or cash-back bonuses), special prices on the bundling of goods and services, or cross-promotions with other related products.

Efforts to better understand the true financial value of loyal customers have led to the use of metrics that measure the profitability associated with each customer over the lifetime of his or her association with a specific brand or company. F. Robert Dwyer introduced some of the earliest applications of customer lifetime value calculations to the marketing literature in the late 1980s. Though extensively developed in studies of catalog marketing, it has become commonly used to support marketing decision making in a wide range of contexts.

2.6 Maximizing Customer Lifetime Value

Knowing the financial value of each loyal customer type has several potential uses. It may determine how much should be spent to retain loyal customers. It also enables managers to determine how much can reasonably be invested to acquire different types of new customers based on the past behavior of different loyal-buyer segments. Similarly, it can direct strategy choices in terms of targeting specific segments. And knowing the value of different groups of buyers enables marketing managers to apply a return on investment (ROI) standard to the evaluation of targeted marketing programs and campaigns.

Two techniques to calculate the financial value of customer relationships are used extensively in both B2B and B2C markets: customer profitability analysis and customer lifetime value.

Customer Profitability Analysis

Customer profitability analysis (CPA) is a methodology for analyzing the profitability of a company’s current customers. This is most commonly done using internal data from activity-based accounting records. The procedure initially estimates all revenue coming from the customer, less associated costs. The costs should be developed to include not only the primary costs of producing and distributing the product, but also secondary marketing costs such as traveling to meet with the customer. Most CPA models assign each buyer to one of several levels or customer tiers based on net profitability.

One predictable result of customer profitability analysis is that it will reveal that a small number of customers account for most of the company’s profits. This is consistent with the Pareto principle or 80–20 rule. This common rule of thumb states that 80 percent of your profits will come from 20 percent of your clients. The significance of the Pareto Principle is that it should remind marketing managers to focus the bulk of their time and energy on the 20 percent of customers who matter most.

Customer Lifetime Value

In contrast to customer profitability analysis, which provides a snapshot of the current situation, customer lifetime value (CLV) analysis evaluates the future profitability of a customer. Though the determination of net profit relies on the same assessment of revenue and costs, the technique requires forecasts of future cash flows and profitability. The CLV for a specific customer is defined as the net present value of projected profits over the expected customer lifetime. Although a powerful financial technique, its value is necessarily limited by the accuracy of the forecasts.

In practice, many companies place a great deal of emphasis on CLV calculations because they require managers to explicitly recognize the importance of building customer loyalty by offering superior value and reliably delivering customer satisfaction over the long term. The reliance on net present value calculations also reinforces the concept that relationships with customers are vital long-term assets of the firm.

Once an organization has acquired experience using CLV analysis over an extended period of time, several other advantages to using this technique may become evident. Close examination of the factors contributing to loyal buyers’ net present value (NPV) will provide a better understanding of how various purchase-specific factors make differential contributions to profitability over time. For a given segment or class of buyers, these factors would include purchase size, frequency, and recency of purchase. Sensitivity analysis can provide additional insights into how changes in pricing strategy or other elements of the marketing mix may impact long-term profitability. CLV analysis on a segment-by-segment basis will also enable managers to make decisions about the relative attractiveness and importance of appealing to some groups of buyers over others. The development of sophisticated customer databases has been instrumental in enabling marketers to analyze vast quantities of information about the relationships between marketing activities and buyers’ behavior.

Customer Databases and Database Marketing

Customer databases are organized collections of qualitative and quantitative customer-related information that have been compiled to improve marketing performance. Information about both customers and prospective buyers is routinely collected and submitted to databases for a number of sales-related purposes.

Database marketing is the general term that has been used to describe any systematic approach to the collection and processing of consumer and company data. Increasingly, however, marketing-oriented organizations are also integrating other types of information with customer databases, including marketing mix information, general environmental observations, competitor data, and information about partners in the company’s value chain. At the strategic level, marketing managers use these data to evaluate target market strategies, and sales data can be used to analyze the efficiency and effectiveness of alternative configurations of the marketing mix. Historical data patterns can be analyzed to examine the impact of alternative pricing policies, different promotional mixes, changes in product design, and the like. Statistical modeling can be used to examine how sales and profits are impacted by simultaneous changes in multiple variables.

Evolution of the Coke bottle from 1899-2007.

The Coke bottle has evolved throughout the years. This image offers a visual of the successful and unsuccessful product designs. Which bottle shape seems to have withstood the test of time?

Corbis Wire/Corbis

Competitor, product, supplier, and a range of other marketing-related databases are also critically important to the effective management of marketing efforts. The information in these types of databases can be accessed to support customer service activities, generate sales leads, or identify opportunities for cross-selling additional products to existing customers. Increasingly, the availability of more customer-specific data has also enabled companies to provide more specialized offerings to individual customers. In fact, virtually all facets of customer relationship management can be facilitated and enhanced by the ready availability of information that well-designed database systems can provide.

Database marketing has demonstrated the potential to increase the cost effectiveness of marketing strategies by improving managers’ understanding of markets and specific market segments. The opportunity to develop initiatives targeted at the individual consumer level has been facilitated by amassing huge databases describing personal purchase histories and detailed demographic information. Marketers have also leveraged access to large commercially available databases to better understand the preferences of current and prospective consumers. However, the ready availability of so much individual, person-specific information has raised ethical and legal concerns related to personal privacy rights.

Ch. 2 Conclusion

This chapter has presented several perspectives on value creation and customer satisfaction. Marketing managers must remember that creating product value that satisfies the needs of customers is both a primary goal of the firm and the principal means of achieving the organization’s growth and profitability objectives. This marketing concept perspective can sometimes be lost in the process of identifying and implementing the strategies and methodologies required to enhance the competitiveness of the company. It’s important to remember that customer satisfaction is not simply compatible with the goals of the firm; it is essential to achieving them.

The short vignette at the start of this chapter illustrates several important truths about customer service. Excellent customer service should be consistent. Although it’s a cliché, it is true that you should treat every customer as your most important customer. Strategies geared toward allocating the best levels of service to the most important customers are risky at best. This is particularly true in the age of social media, where the influence wielded by a buyer may be wildly out of proportion to his or her potential value as an individual customer. In a digital/mobile age, you can’t be sure whether a given customer is one of those important ones.

Great customer service is personal. It is often about doing small things well and building positive relationships. Your customers want to know that you care enough to treat them as individuals. It can be a powerful marketing tool when done well and a huge disincentive to future sales when done poorly. A good customer service experience might be the one thing that keeps actual customers (e.g., Tinya’s mom) coming back, but it is often the thing that turns a prospective customer (e.g., Tinya) into an actual customer at some point down the road.

Finally, great customer service is everyone’s job—another truism, but worth remembering nonetheless. Every individual within the company that has any direct or indirect interaction with a customer is responsible for maintaining the highest possible levels of customer service. It means going the extra mile for your customers. This is what makes a positive, long-lasting impression, and there is no substitute for it. It can’t be faked; it has to reflect the company’s genuine concern for its customers.

Ch. 2 Learning Resources

Key Ideas

Critical Thinking Questions

 Is a marketing orientation absolutely essential to the success of every type of business? If you feel there are some exceptions, explain when this customer-focused perspective is not necessary to succeed.

 Knowing that value is about the relationship between product quality and price has implications for understanding how to improve buyers’ perceptions of value. Using office furniture as an example, explain how a manufacturer could shape customers’ perceptions of value by altering the terms of the product quality/price relationship.

 Products and services are best understood within the context of marketing management as bundles of benefits. Why? Explain how your family dentist and the services that he or she provides can be understood in this way.

 The value drivers for products and services include both tangible and intangible characteristics. Which types of characteristics are predominant in the provision of services? If you hire a CPA to prepare your taxes, what are the tangible and intangible attributes of the service you have purchased? Which kinds of products are easier to differentiate based on tangible features rather intangible ones?

 Some companies are well known for specific core competencies. In fact, they are often cited as examples of excellence in specific marketing functions and used to develop TQM/TCS benchmarks. For example, Lands’ End and L.L.Bean are recognized as leaders in direct marketing practices. Coca-Cola and Procter & Gamble are regarded as experts in advertising consumer packaged goods. FedEx is a leader in transportation innovations. Can you think of any companies that exhibit outstanding performance in one or more core competencies? What are the unique strengths of Disney? Netflix? Walmart? AT&T? Apple? Maytag?

 Review the eight basic CQI steps for improving customer satisfaction. Apply these to a process that you are familiar with from where you work, shop, or go to school. What benefits do you see in following an organized, systematic path of analysis? What problems, if any, do you encounter in applying the model?

 Value chain analysis includes two types of processes: breaking down the value delivery system into its component parts and examining the whole chain as an integrated delivery system. What types of opportunities to enhance customer satisfaction are you likely to miss if you rely on only one rather than both?

 Customer loyalty can be lost as a consequence of one bad interaction with a company. Can you give examples (hypothetical or actual) to illustrate the types of customer experiences that may result in the loss of a loyal customer? Are there examples of how a buyer might become loyal to a seller after only one positive interaction? Which type of experience is probably more likely? Why?

 Each year the National Institute of Standards and Technology (NIST) recognizes both private- and public-sector organizations that exhibit performance excellence with the Malcolm Baldrige National Quality Award (http://www.nist.gov/baldrige). The stated objective of the program is to improve the competitiveness and performance of U.S. organizations. Review the Baldrige Program’s website with particular attention to the success stories behind each of the recipients. How do the criteria used to determine award winners correspond to the value related concepts presented in this chapter?

 The brand manager for Widgets, Inc., is frustrated by the failure of prospective customers to understand just how good his widgets really are. Which models and techniques from this chapter would be useful in helping him isolate the source of the problem?

Key Terms

Click on each key term to see the definition.

added value

Refers to the addition of product features and benefits that exceed the typical buyer’s expectations.

benchmarking

The procedures for evaluating an organization’s processes and performance against the best standards within the same or different industries. Statistical tools are used extensively to objectively measure performance.

business-to-business (B2B)

Sales and related transactions between businesses (e.g., manufacturer-to-wholesaler or wholesaler-to-retailer sales).

business-to-consumer (B2C)

Sales and related transactions between business and consumers (e.g., retailer-to-consumer sales).

continuous quality improvement (CQI):

A system or set or processes intended to improve the quality of goods and services provided to consumers.

core competencies

Specific activities or skill sets at which a firm excels.

customer churning

This term can describe the loss of customers over time for any reason. It is often used specifically to refer to tactics intended to maximize profitability from an initial sale without the intention to build a long-term relationship or customer loyalty.

customer databases

Organized collections of qualitative and quantitative customer-related information that have been compiled for the purpose of improving marketing performance.

customer lifetime value (CLV)

A methodology for evaluating the future, long-term profitability of a customer from projections of future cash flows and customer-specific forecasts of profitability.

customer profitability analysis (CPA)

A methodology for analyzing the profitability of a company’s current customers from the analysis of internal accounting data.

customer relationship management (CRM)

A systematic strategy that addresses both the initial acquisition and the retention of customers. It requires the coordination and integration of all business activities and processes to provide superior value to customers. It also emphasizes the role of marketing in communicating with consumers to build long-term relationships and maintain customer loyalty.

customer retention

A term that can refer to both the activities that a company uses to reduce the loss of customers and the rate at which an organization is successful at keeping its customers.

customer satisfaction

A buyer’s subjective, experience-based assessment of whether a product meets his or her expectations.

customer selectivity

The ability of an organization to recognize that not all customers are equally profitable and the capacity to profitably use this knowledge to manage resources to reach the most profitable segments.

database marketing

A general term used to describe any systematic approach to the collection, processing, and use of consumer and company data.

expectations

The customer’s subjective feelings, anticipating the bundle of benefits that a product will deliver.

inbound logistics

All of the processes involved in bringing raw materials and unfinished goods into the company for conversion into final products.

loyal customers

Buyers whose purchase history demonstrates a commitment to one brand through a series of repeated purchases over time. Customer loyalty is typically rooted in sustaining high levels of customer satisfaction.

marketing and sales

The fourth element of the value chain, which includes product pricing and promotion activities (e.g., advertising, personal selling, and sales promotion).

marketing orientation

An emphasis on satisfying customer wants and needs as the basis for making business decisions. This is in contrast to a product orientation, which develops goods and services based on the company’s resources and skills rather than customer preferences.

monetary value

A term used in industrial product sales to indicate either cost savings or revenue improvements resulting from the purchase of a product.

operations

All of the activities that transform the inputs delivered by the inbound logistics systems into final products.

outbound logistics

The activities involved in shipping out and distributing final products (e.g., warehousing and transportation).

Pareto principle

A common rule of thumb that states that 80 percent of your profits or sales will come from 20 percent of your clients.

performance value

A subjective assessment of how well a product does what the buyer expects it to do.

price–quality correlation

The tendency for buyers to associate better product quality with higher prices.

product quality

The buyer’s perception of the sum of the benefits he or she receives from the product.

product supply system

An orientation to delivering products to the market that emphasizes manufacturing and distribution with less regard for consumer product preferences. This product-focused approach to marketing can be simply defined as selling what you can make rather than making what you can sell.

psychological pricing:

A class of price-setting tactics that are based on understanding how products create intrinsic satisfaction for the buyer.

reference price

The approximate price or price level that buyers expect to pay for a given product.

sensitivity analysis

A collection of analytical techniques that tests target variables (e.g., profitability) to assess how sensitive or responsive they are to changes in other variables (e.g., prices.)

service

The fifth element of the value chain, this comprises the actions undertaken by the organization to satisfy customers’ needs after the initial product sale has been completed (e.g., repair services and customer support).

total customer satisfaction (TCS)

A management philosophy based on the principles of TQM. The focus of TCS is the creation of processes for achieving the highest possible levels of customer satisfaction.

total quality management (TQM)

A comprehensive management philosophy centered on creating processes for continuous improvement of product quality.

value

The total package or bundle of benefits that a customer receives from the purchase and use of a product relative to the perceived costs of buying it.

value chain analysis

A systematic approach to understanding the sequence or chain of business activities that converts inputs into outputs of greater value. The end goal of this analysis is to identify opportunities to enhance the competitive position of the firm.

value delivery system

In contrast to the product supply system, the means of providing value to the market is rooted in first understanding the needs of consumers. This consumer-focused approach to marketing emphasizes customer satisfaction as its primary goal.

value drivers

The benefits most valued by the target; tangible or intangible characteristics that enhance the value of a product or service.

value propositions

Overt commitments or promises made by the seller to provide the buyer with a specific level of value or bundle of product benefits.

Web Resources

This article from the Database Marketing Institute provides step-by-step directions and illustrations for calculating customer lifetime value.

http://www.dbmarketing.com/articles/Art251a.htm

The Penn State University Agricultural Extension Service provides several interesting article in its Value-Added Marketing Series. Though most of the articles specifically relate to agricultural markets, the principles demonstrated are applicable across a wide range of business enterprises.

http://extension.psu.edu/farm-business/value-added-marketing-series

This article produced by the Chally Group provides a practical illustration of how the principles of TQM can be applied to a firm’s sales management functions to increase productivity and profitability.

http://www.psycheselling.com/TQSM-ExecBrief\_email.pdf

This site provides information on a wide range of CRM topics from the information industry’s perspective. The section specific to marketing includes advice on effective sales management, campaign strategy, email marketing, Internet marketing, and customer life cycle management.

http://searchcrm.techtarget.com/definition/CRMPart II: Market Analysis and Buyer Behavior

Part II of this text introduces market research, sales forecasting, and consumer analysis as interrelated paths to improving marketing managers’ understanding of the external environment. At a fundamental level, these three channels of investigation are about reducing the levels of uncertainty and risk confronting the firm. By improving the quality and quantity of accurate market-related information, managers diminish the risk of making costly mistakes and increase the likelihood of recognizing and exploiting profitable market opportunities.

Market research is the program of activities intended to gather information about customers and competitors. Sales and market forecasts help managers assess the impact of current programs and provide the data required to make strategic decisions on the allocation of company resources across the current portfolio of SBUs and to new ventures as well. Consumer analysis describes those managerial tasks intended to improve our understanding of buyer behavior and market segmentation. It provides the information required to shape strategic decisions about the selection of target markets, brand positioning, and the marketing mix.

Contents

Chapter 3: Market Research: Identifying Market Opportunities

Chapter 4: Evaluating Market Demand and Forecasting

Chapter 5: Analyzing Markets: Decision Making and Buyer Behavior

Chapter 3

Market Research: Identifying Market Opportunities

Businesspeople looking at graphs

istockphoto/Thinkstock

Learning Outcomes

 By the end of this chapter, you should:

 Understand how the Ansoff matrix model and SWOT analysis can be used to identify and evaluate new market opportunities.

 Recognize how PESTEL analysis is used in the process of environmental scanning and analysis.

 Recognize how the practice and process of market research is shaped by the ultimate goal of improving customer satisfaction.

 Know the steps involved in the marketing research process and recognize when research should and should not be conducted.

Ch. 3 Introduction

This chapter investigates the basic applications of market research and the market research process. Bringing together two themes from the previous chapters, we begin by looking at ways to apply market research methodologies to the search for new opportunities to better satisfy buyers. The Ansoff matrix model specifies four alternative routes to identifying new product and market prospects. The section that follows investigates the role of macro- and micro-environmental analysis in providing the practical, functional information required to shape and refine the organization’s marketing strategies. The concluding sections of Chapter 3 provide an in-depth examination of how market research studies are planned and executed. Topics include research design, data collection, analysis, and the presentation of the research findings.

\* \* \*

One of America’s largest manufacturers of children’s toys provides a highly regarded day care program for its employees. With the parents’ knowledge and consent, the company uses this setting as a product development and concept testing laboratory. Behavioral studies on how preschoolers interact with toys and with each other are routinely conducted in this realistic environment. Children’s responses to different colors, shapes, and sounds are tested, and the results are used to make toys more appealing to their peers.

On the last day of "Terrible Timmy’s" time in the program, his mom was thanking the day care staff for having looked after her son for the previous three-and-a-half years, even though he can be "quite a handful" at times. "Oh no," protested one of the research staffers. "He’s been just great! Fantastic track record on sound and color preferences especially," she gushed enthusiastically. "Are you planning any more?"

3.1 Market Opportunities and Growth Strategies

The American Marketing Association defines market research as "the systematic gathering, recording, and analyzing of data with respect to a particular market, where market refers to a specific customer group in a specific geographic area" (2011). Market research, or marketing research (terms used interchangeably throughout this text), provides managers with critically important insights into the customers they serve. As noted previously, decision makers need access to the best possible information about prospective buyers in order to create value in the minds of the consumers and deliver on promises of customer satisfaction. Since perceptions of value are rooted primarily in subjective impressions, one of the most basic goals of market research is to provide managers with an understanding of how consumers perceive competing brands or bundles of benefits within the market.

Customers browsing through Dell lap tops

Dell has withstood the market turmoil through successful promoting and growth strategies and by taking many market opportunities available to them.

Associated Press

Making sound marketing strategies at all levels of the organization requires thorough and reliable information about customers. Information derived from the careful execution of well-designed market research studies can be used to identify new marketing opportunities and direct the development of growth strategies.

In most industries and markets, growth is an essential strategic goal for many reasons. Economies of scale in production, distribution, and promotion often give the largest-selling brands cost advantages over competitors. With cost advantages come opportunities to enforce retail price leverage. Alternatively, confronted with the entrance of large new competitors or slowing rates of market growth, a minimum level of sales growth may be required to survive an industry-wide shakeout. The latter was evident as market demand for personal computers in the 1980s leveled off and the total number of competitors shrank from 832 to 435 companies (Day, 1997). Only those firms with substantial market share were equipped to survive the extended wave of price cutting and panicked selling that followed. Several successive cycles of booms and busts have continued to eliminate competitors in this industry over the past two decades until only a few dozen remain, dominated by big brands like Apple, Dell, and Hewlett-Packard.

The pursuit of sales growth and new market opportunities may also stem from other pressures such as the need to diversify the existing product portfolio or the decision to pursue the competitive advantages that come with market leadership. The range of motives for seeking growth also necessarily includes management’s obligations to shareholders and other investors. Overall, few firms in the increasingly competitive global marketplace are not pursuing new market opportunities and growth as part of their core mission.

Think About It

Market leadership refers to a company that holds the highest market share in a given product market. It is a desirable position to hold for competitive reasons not directly related to economies of scale.

What kinds of advantages would market leadership provide for technology-focused companies like Sony, Apple, or Nokia?

Strategic planning and analysis enables marketing managers to evaluate new market opportunities as well as growth strategies for existing SBUs. As we have already seen, techniques rooted in the Boston Consulting Group matrix model assist managers in deciding how best to manage the collection of SBUs under their direction. The strategic value of this approach is dependent on the reliability of the market research information.

Two techniques commonly used by marketing managers to find and evaluate new marketing opportunities are the Ansoff matrix and SWOT analysis.

The Ansoff Matrix Model

The Ansoff Product/Market Opportunity Matrix is an analysis tool used to identify new growth strategy options. First introduced by Igor Ansoff in 1957, it explicitly recognizes that new concepts must originate from one of four possible product/market combinations. The results from an Ansoff matrix analysis are a set of new ideas for alternative growth strategies that must be subjected to more-thorough investigation and detailed assessment. The four general classes of product/market growth strategy options identified by this process are described in Figure 3.1. These strategies include market penetration, market development, product development, and diversification.

Figure 3.1: Ansoff Product/Market Opportunity Matrix

The Ansoff Product/Market Opportunity Matrix takes into consideration the market penetration, product development, market development and diversification of new and existing products.

The Ansoff Product/Market Opportunity Matrix identifies growth strategy options from four possible product/market combinations.

Market Penetration Strategy

Market penetration strategy describes those initiatives that seek to increase sales of the firm’s existing products or services to its current markets. In one sense, it is about doing business as usual, but competing more aggressively and effectively. This can often be accomplished through more-competitive pricing and promotional strategies and tactics. By necessity, this requires capturing market share from one or more competitors. In comparison to the other three alternatives for growth, this is generally regarded as a low-risk option for growing the business.

This strategy can be referred to as the Wizard of Oz approach since the character of Dorothy eventually found happiness right in her own backyard. That is, because this approach is focused on serving existing customers with existing products, it should be as familiar as your own backyard. (There’s no place like home.) In addition, the organization is likely to have current, accurate information on customers and competitors, minimizing the need for additional research. For companies that are committed to achieving the highest possible levels of customer satisfaction, the market penetration strategy represents the most attractive path to building incremental sales.

Market Development Strategy

Bottle of Bayer aspirin

The creation of Bayer’s low-dose aspirin allowed the company access to an entirely new market and to customers with specific needs without changing their product.

Bayer HealthCare LLC

Market development strategy refers to those growth initiatives that are intended to increase sales by introducing existing products to new markets or new market segments. These new markets may be based on differences in geography, demographics, lifestyles, or behavioral characteristics such as benefits sought or purchase occasion. Though the products remain unchanged, other elements of the marketing mix may need to be adjusted to sell to the new target segments. This could include the establishment of new distribution channels, creation of new promotional messages, or revisions to pricing policies. In contrast to market penetration strategies, this approach to increasing sales requires the organization to acquire an understanding of new buyers’ needs. Unfortunately, market research efforts targeting unfamiliar segments of the market are often more expensive and subject to more initial design errors than ongoing studies aimed at current customer groups.

The potential success of market development strategies may rest substantially on core competencies within the company that relate to technical knowledge or expertise in the creation of superior goods and services. However, if a firm’s unique competencies relate primarily to its superior knowledge of current customer groups and their needs, then product development strategies may provide better opportunities for growth.

Consider the case of Bayer’s market development strategy. For more than a century, the company’s core product, aspirin, had been sold primarily as a medicine for the relief of minor pains and fever. However, when clinical research determined that a daily low dose of aspirin can reduce the risks associated with stroke and heart attack, the company responded by introducing several heart care brand extensions (e.g., Aspirin Regimen Low Dose). Without altering the core product in any way, Bayer successfully introduced new uses to new markets.

Following the introduction of its heart care line, Bayer also introduced Heart Health Advantage—a non-aspirin product designed to extend the brand’s strong reputation for high-quality medicines to new lines. Subsequent product line extensions of this type that provide new products to existing markets are categorized within the Ansoff matrix as part of product development strategy.

Product Development Strategy

Product development strategy entails selling new products to the organization’s current customer base. In contrast to market development, the focus here is on alterations and modifications to the product element of the marketing mix to improve its fit with the existing buyer segments’ preferences. These changes could include revisions to a company’s core product, functional changes in product packaging, new branding strategies, or extensions of an existing product line. A company that possesses a thorough and intimate understanding of how the current value proposition satisfies its current customers with its current products is more likely to be successful in efforts to sell new product concepts to these markets. Often the most profitable new opportunities to satisfy existing customers originate with the customers themselves. Both formal and informal research on clients’ needs and preferences helps companies keep pace with important shifts in target market preferences.

Product development strategies often require firms to extend their unique core competencies far outside their traditional markets. Though Bayer, for example, has remained a leader in over-the-counter pharmaceuticals, it has also aggressively pursued numerous prescription drug opportunities within its existing health care product markets. These include treatments for hypertension and respiratory infections.

The Arm & Hammer brand also provides good examples of product development strategy over the past 25 years. It has introduced a wide range of new products that serve the needs of those segments that were initially cultivated via the firm’s market development strategies in the 1970s. These new extensions of the brand name included an extensive array of fabric care (e.g., detergents, fabric softeners) and personal hygiene products (e.g., toothpaste, teeth whitening systems).

Diversification Growth Strategy

Diversification growth strategy involves introducing new products into new markets. The obvious disadvantage to this approach is that the firm has no previous product or market experience to build upon. In many instances, customer acceptance depends on the company’s ability to leverage a recognizable brand name to new customer segments. This strategy represents the polar opposite of market penetration and is certainly the most risky, as it requires the company to enter unfamiliar markets with products with which it has no prior experience. Consequently, it also has the most potential for sales growth. Some firms will either acquire outside SBUs or create a strategic alliance with an outside manufacturer to reduce the risk inherent in this type of strategy. In this way, they are effectively buying their way into new markets.

Since diversification strategy does not aim to leverage either market- or product-related distinctive competences related to the firm, it is sometimes regarded as a financial strategy more than the pursuit of new marketing opportunities. Ultimately, however, the responsibility for making new acquisitions work belongs to the marketing function of the organization.

Think About It

Starbucks has created a powerful, widely recognized brand identity.

Has it leveraged the power of this brand to pursue either markets or product development strategies?

What possibilities remain untapped?

The Ansoff matrix is a potentially valuable tool for identifying growth strategies. The four cells of the matrix are exhaustive in terms of specifying the four possible sources of new growth opportunities defined by market and product characteristics. The options uncovered by using this framework are, necessarily, only starting points. Subsequent evaluation, refinement, and testing of concepts is required to fully evaluate the profit potential of particular customer, market, or product strategies. A preliminary assessment of a new strategic concept’s viability can be determined by the application of SWOT analysis.

The SWOT Analysis

SWOT is an acronym for strengths, weaknesses, opportunities, and threats. SWOT analysis is a strategic planning method used to investigate how internal, company-specific factors (strengths and weaknesses) and environmental factors external to the firm (opportunities and threats) will impact the pursuit of a specific marketing venture. These ventures are typically a new product or service, often discovered through the application and analysis of the Ansoff matrix.

The SWOT analysis model is based on the premise that a thorough understanding of the strengths, weaknesses, opportunities, and threats related to a given proposal can provide marketing managers with insight into the feasibility and potential problems associated with introducing a new product or service. The ultimate objective of a SWOT analysis is to provide users with an accurate and realistic assessment of the situation facing the firm with respect to a specific market opportunity, enabling them to decide whether to proceed with the concept or abandon the plan.

Group of business people performing analysis.

Which would you rather have: a more rigorous or a more casual approach to SWOT analysis?

RubberBall/SuperStock

SWOT is a very flexible and adaptable analytical technique. However, the process can be only as rigorous and the results only as valid as the information used to construct the parameters of the analysis. Many managers do not recognize the potential value of SWOT analysis as a research-driven technique. Rather, they see it exclusively as a fairly casual brainstorming exercise that lets multiple parties provide input on a proposal on an informal basis. However, more disciplined applications of the SWOT technique, including custom-ordered market research, can provide much more managerially useful and reliable results.

For marketing managers, a rigorous SWOT analysis begins by defining the nature of the specific market opportunity in as much detail as possible. The next step in the process is to identify the internal and external factors that are relevant and important to the success or failure of the proposed new product or service concept. Many of these factors can be uncovered by examining the how the current value chain would enable the company to satisfy prospective buyers of this proposed product or service. SWOT analysis requires the user to group the relevant internal and external forces into one of four primary categories:

Internal Forces

Strengths: These are resources and skills that the company has acquired that specifically relate to the market opportunity being evaluated. Strengths include distinctive competencies or characteristics that give the company an advantage over others in the industry.

Weaknesses: These are factors related to the new opportunity in which the company is regarded unfavorably by consumers, or that make the company particularly vulnerable to competitors. Weaknesses include features or characteristics that leave the company at a disadvantage compared to competitors’ products or services.

External Forces

Opportunities: These are market-specific situations that would enable the organization to improve sales or profits, with special emphasis on those that others might exploit to gain competitive advantage if the organization fails to act upon them.

Threats: These are factors that may endanger or threaten the viability or potential value of this new opportunity. In some circumstances, these can be countered to create opportunities.

Figure 3.2: SWOT analysis

SWOT analysis table

SWOT analysis is typically developed by completing the interior cells of a 2x2 matrix where internal company-specific strengths and weaknesses intersect with external opportunities and threats.

As shown in Figure 3.2, SWOT analysis is typically presented and often interpreted in a 2x2 matrix where the internal company-specific strength and weakness factors are across the top row and the external factors of opportunities and threats are presented on the bottom. This format allows the user to compare and contrast each of these factors against the others. It provides, in a sense, a dynamic and interactive checklist of pros and cons by evaluating the opportunity being considered against each of the elements identified within the cells of the matrix.

The primary value in developing the 2x2 SWOT analysis matrix is to identify critical intersections between internal and external factors. Sometimes called matching, this is the process of aligning the strengths of the firm with opportunities while looking for ways to mitigate potential threats and company-specific weaknesses. This allows managers to render a preliminary determination on the feasibility and total market potential of the product or service opportunity being evaluated. Of equal importance, the intersection of internal weaknesses with external threats should signal managers to seek remedies.

Consider the example of a Dave Ingraham, the young entrepreneur in Chapter 2 who wants to open a small café in the northeastern college town. The SWOT matrix for his proposed coffee shop might look something like the one in Figure 3.3.

Figure 3.3: SWOT analysis for café

SWOT analysis for proposed cafe

The intersection of the potential strengths and weaknesses for the proposed café are compared to the opportunities and threats posed by the environment in a northeastern college town.

Dave sees the strengths of his concept as providing a good match or fit with the opportunities provided by the environment. The most critical matches for him include a good location and student-friendly atmosphere (strengths) that will cater to the needs of a large university population (opportunity). However, he needs to be concerned that the potential risks from rising material costs and narrow profit margins (threats) are amplified by his lack of managerial experience (weakness). Hiring expert managers or spending some time as an employee within this industry would be alternative ways to remedy this mismatch.

Think About It

Based on the SWOT analysis in Figure 3.3 and the description provided in Chapter 2, what other positive strength-to-opportunity matches do you see for Dave Ingraham’s proposal?

What are the negative weakness-to-threat intersections that will pose a problem for him?

SWOT analysis can be an effective model for evaluating new opportunities within many marketing contexts. Beyond the analysis of new products and services, it can be applied to investigating the potential attractiveness of new distribution channels, changes in supplier relationships, and SBU acquisitions. In every instance, however, the results of a SWOT analysis are not intended to provide a final decision. Concepts that pass this initial hurdle then require a more detailed evaluation and the subsequent development of a complete marketing plan.

The SWOT procedure described in this section can be classified as confirmatory analysis in the sense that it seeks validation for a specific new product or service proposal. However, SWOT analysis can also be applied in an exploratory analysis. In this case, new market opportunities or concepts are not defined prior to assembling information on the company’s general strengths and weaknesses. Opportunities and threats from the markets in which they currently operate are used to complete the matrix. The intersections of these forces are then explored to find new potential market opportunities. This approach is used less often in marketing contexts since the Ansoff matrix analysis provides many of the same insights.

SWOT analysis is also used in some instances to profile a firm’s competitive rivals. This is most frequently done with respect to specific market opportunities. If, for example, your firm is contemplating the introduction of varieties of flavored peanut butter to the adult market, creating separate SWOT matrices for each of your primary competitors relative to this new concept may identify some important considerations. These could include related market opportunities that you had not considered or potential threats that you had overlooked. Often this type of competitive assessment will focus on understanding competitors’ distinctive competencies, product differentiation, and brand positioning strategy.

Think About It

What problems are you likely to encounter when applying SWOT analysis to new product and service opportunities?

In addition to those situations discussed here, what other kinds of business situations could be investigated using the SWOT analysis approach described in this section?

Do you think this technique would work well in non-business contexts? Explain your answer.

3.2 Environmental Analysis

Marketing managers are tasked with shaping the elements of the marketing mix to fit the preferences and needs of the target market. This process does not, however, take place in a constant or unchanging environment. The dynamic external environment to which decision makers must respond and adapt comprises two distinct types of variables. Macro-environmental forces are those uncontrollable external variables that impact all firms within an industry. These include demographic shifts, prevailing economic conditions, cultural trends, and changes in the regulatory environment. The PESTEL framework, discussed in the following section, addresses these macro-environmental forces. Micro-environmental forces are external stimuli that selectively and discretely influence each firm uniquely and independently. Though not directly under the control of any single organization, some of these elements of the external environment can be managed and influenced to a significant degree. These micro-environmental forces include the behavior of a company’s suppliers, customers, and channel intermediaries such as independent wholesalers and retailers.

Marketing managers exercise direct control over a limited range of internal resources and decision variables through which they can respond to the threats and opportunities posed by the external environment. Primary among these tools are the marketing mix variables and managers’ discretion to identify segments and select target markets. The success of a marketing plan hinges on the ability to adapt the marketing mix to fit the changing character of both the target market and the larger context provided by macro-environmental forces and trends.

Understanding Forces and Trends: PESTEL Analysis

The process of systematically assessing how elements of the external environment will impact a business or market is termed environmental scanning. Factors of particular concern to marketing managers include those issues and trends that influence the attitudes and behavior of current and prospective target markets. Other points of concern focus on conditions relevant to economies, industries, allied companies (e.g., suppliers), and competitors.

Conducting an environmental scan can incorporate a wide range of information sources and research methodologies such as statistical trend analysis and data mining. However, each variation on the process shares the goal of providing managers with relevant information to improve the quality of marketing decisions. These decisions include choices about new opportunities nested in the strategic alternatives of market penetration, market development, and product development.

Although there are a number of ways to scan the external environment, among those models with the most comprehensive set of external factors is the PESTEL analysis. PESTEL is an acronym for the six environmental factors identified in the framework shown in Figure 3.4: political, economic, social, technological, environmental, and legal. These macro-environmental variables often appear as the source of opportunities and threats in SWOT analysis.

Figure 3.4: PESTEL analysis

PESTAL analysis diagram

Marketing managers use the PESTEL framework to facilitate a comprehensive scan of the external environment confronting the organization. Why do you think it is necessary to consider these factors?

Political Factors

Political factors are external macro-environmental variables that reflect how government forces impact the competitive market as a whole and the company specifically. This category includes trade restrictions, tax policies, employment regulations, and consumer protection legislation. General political stability and the role of government in providing for fair and safe markets can vary widely from one country to the next. Similarly, significance of political influences on business infrastructure can be substantially different when moving from one product category to the next.

Economic Factors

Currency exchange rate of different countries

When evaluating foreign market opportunities, volatile currency exchange rates add to the risk of new ventures and amplify the need for accurate market research.

istockphoto/Thinkstock

Economic factors make up a category of variables that relate to the prevailing overall condition and health of the economy in which target markets exist. Specific variables of concern include gross domestic product (GDP), discretionary income, consumer confidence, unemployment, inflation, interest rates, and currency exchange rates. Each of these factors can have a significant impact on product- and market-level decision making. Interest rates are of particular concern to companies in pursuit of growth opportunities, because as the cost of borrowing money directly affects a business’s ability to expand. Other economic factors directly impact consumers’ ability to afford the products being sold.

Social Factors

Social factors often represent the most important concerns for marketing managers because they reflect two critical classes of customer characteristics: culture and demographics. Culture embodies the shared beliefs, attitudes, and values of a society. Demographics describes the statistical characteristics of a population expressed by variables such as location, age, and employment.

The interaction of marketing and culture is a two-way street. Cultural meanings are transferred to products via marketing communications, making products more attractive to consumers who hold these values. In turn, the symbols and icons of cultures and subcultures establish foundational values for many types of product markets. For example, health consciousness is both a value promoted by marketers and a core cultural value shared across many consumer markets. The importance of children’s vitamins to good health and how this is expressed in marketing communications connects the advertiser’s brand-specific message to prevailing cultural norms about caring for one’s family. Similarly, marketers find opportunities to sell products at holidays that revolve around cultural rituals that create or affirm specific cultural meanings.

Demographic market characteristics assist marketers in understanding how different segments respond to the marketing programs as a function of personal variables such as age, sex, and income. Attitude research on consumers is often tied to distinguishing how different demographic segments feel about a product or service. Marketers rely heavily on demographics because they can be reliable indicators of how different segments perceive product value. They are also used extensively in the analysis of B2C markets because changes in most demographic variables are easily forecast. Free or inexpensive secondary data are readily available from a large number of government agencies and widely accessible online.

"Tween" Market Research

A youth marketing company with several Fortune 500 clients specializes in analyzing "tweens," the group of kids between 8 and 12 years old. A marketer interviews two young girls about their wishes, desires, and dreams as consumers. What does this information offer for the marketers of tween products?

Think About It

Do demographic factors such as age, sex, income, and family status influence the way we feel about brands? Consider the market for fast food. Some companies emphasize low prices. Others focus on healthy alternatives. Some appeal to prospects based on menu-specific features, while others emphasize everything but the food being sold.

Can these differences be tied to the demographic profile of the target market for these restaurants? Why or why not?

Technological Factors

Although technological factors are variables that impact some markets and businesses far more than others, all marketing managers need to be aware of the trends and shifts in this category. The dimensions of technological change that most often influence marketing processes include innovations in communication and channels of distribution. Companies at the leading edge of these types of changes can establish competitive advantages and create effective barriers to market entry. By pioneering innovative systems of interacting with customers, processing orders, and distributing products, Amazon.com was able to establish a sustainable competitive advantage rooted in brand awareness and scale economies that effectively prohibits many firms from competing with the company directly.

Environmental Factors

Electronics waste is collected for recycling at Wayne State University

Market demand for recycled electronic components has grown steadily over the past 15 years.

agefotostock/SuperStock

Environmental factors are primarily long-term ecological concerns that have the potential to impact all businesses at some level. These can be local/regional in scope (e.g., water shortages, chronic flooding) or global. Beyond issues associated with climate change, this category includes factors such as responsible waste disposal, pollution mitigation, and energy efficiency. A prime example of this trend is green legislative initiatives aimed at reducing landfill wastes from sources such as product packaging and the disposal of electronics. In many jurisdictions, "reverse value chain" laws prescribe the standards and processes for the safe recycling of consumer electronics and appliances. Although some industries such as farming and paper products are more directly impacted than others, environmental factors represent emerging growth opportunities for many more, as markets are transformed to reflect increasing awareness of business’s role in environmental stewardship.

Legal Factors

Legal factors in the macro-environment include laws and regulations intended to control the behavior of business organizations and special interest groups. These include antitrust laws, Occupational Safety and Health Administration (OSHA) regulations, consumer protection statutes, and product safety and health laws. State and local agencies often impose specific regulations to govern the pricing of consumer necessities and natural monopolies such as utility companies. Although some business leaders may resent what they regard as the "over-regulation" of markets and business practices, the objectives of maintaining fair standards for the protection of consumers and a level competitive playing field are generally recognized as valid regulatory goals.

\* \* \*

Each of the PESTEL model’s six factors will be of greater or lesser importance to any given company based on the character of the markets in which it competes. In general, the process of macro-environmental analysis should incorporate as many credible and reliable sources as possible to create a complete picture of relevant trends in the external environment. In many instances, the environmental scan will highlight the need to undertake custom-designed research studies aimed at answering specific questions about markets, customers, or the impact of particular marketing strategies.

Implementing the PESTEL Analysis

PESTEL analysis is a versatile diagnostic tool for helping managers understand the macro-environmental forces that can impact the attractiveness of alternative markets. The purpose is to identify those market-specific elements that may positively or negatively affect the marketing and sale of individual brands. It is often applied to the process of evaluating international options for market development. When used in this way, the specific characteristics of nations are the subject of the analysis.

One approach to implementing a practical PESTEL methodology is to score each option using standard measures for each of the six environmental factors identified by this framework. A list of potential indicators for each measure is provided in Table 3.1.

Table 3.1: PESTEL factors and indicators

PESTEL FACTORS INDICATORS

Political World Bank Governance Indicators, Central Intelligence Agency World Fact Book, Heritage Foundation Economic Freedom Index, Trade and taxation policies

Economic Gross Domestic Product and GDP per capita, GDP annual growth rate, Net exports, Balance of payments, Current account deficit, Foreign direct investment, Annual rate of inflation, Interest rates, Currency exchange rates, Unemployment rates

Social Population demographics, Income and wealth distribution (GINI coefficient) Literacy rate, Enrollment in educational programs, Human Development Index (HDI) Score (United Nations Development Program)

Technological Global Competitiveness Reports: World Economic Forum, Technological infrastructure: Central Intelligence Agency World Fact Book, Rates of innovation and technological obsolescence

Environmental Human Development Reports (United Nations Environmental Program), Waste and environmental management policies, Clean air, land, and water standards

Legal Transparency International, Corruption Index: http://www.transparency.org, Legal statutes on competition and employee safety, Consumer health and safety laws

Using standard measures that are directly comparable across countries enables analysts to evaluate the attractiveness of alternative market entry options. In many situations, managers will develop scorecards to systematically organize and analyze the attractiveness of alternative new markets on a fixed set of criteria, as shown in Table 3.2.

Table 3.2: New market attractiveness scorecard

 Country A Country B Country C Country D

Criterion Importance Weight (%) Rating (1–10) Assessment Rating (1–10) Assessment Rating (1–10) Assessment Rating (1–10) Assessment

Political

Freedom of press 11 8 .88 2 .22 7 .77 6 .66

Civil liberties 4 5 .2 3 .12 8 .32 5 .2

Economic

GDP per capita 16 10 1.6 4 .64 8 1.28 8 1.28

Foreign direct investment 12 9 1.08 3 .36 9 1.08 4 .48

Social

Median age 7 6 .42 10 .7 7 .49 4 .28

Literacy rate 4 5 .2 9 .36 8 .32 8 .32

Technological

Percentage household Internet access 16 9 1.44 8 1.28 8 1.28 7 1.12

Global competitiveness rank 7 9 .63 2 .14 9 .63 9 .63

Environmental

Percentage plastics recycled 4 7 .28 10 .4 6 .24 7 .28

Carbon emissions per household 7 4 .28 9 .63 8 .56 6 .42

Legal

Corruption index score 9 8 .72 1 .09 10 .9 8 .72

Government transparency ranking 3 10 .3 2 .06 9 .27 10 .3

Total 100 8.03 5 8.14 6.69

3.3 Market Research

A grocery store employee asking a customer to answer survey questions

Many companies use the "store intercept" technique. This technique allows the company to gather customer feedback cheaply and effectively.

Blend Images/SuperStock

Market research describes a broad array of processes related to the collection and analysis of information for the sake of improving market-related decision making. In some instances, the research process can be informal and inexpensive. This would include activities ranging from follow-up conversations with recent customers to routinely collecting data that are posted on the Internet. Alternatively, ambitious research studies such as in-field market tests or survey research that requires collecting data from tens of thousands of subjects can be very expensive. In every instance, however, marketing managers need to explicitly recognize the time and expense associated with the collection of market-related data for each type of study and determine whether the value of information exceeds the price.

Applications and Types of Research Studies

For many organizations, collecting customer and competitor information is an essential part of the drive to improve product value and customer satisfaction. Better market-related information is always required to make better decisions, especially in the face of dynamic and volatile market conditions. For many large corporations, an ongoing program of market research provides feedback to the organization on new opportunities, emerging market patterns, and changes in the competitive environment. Other research initiatives, however, are undertaken on a limited-term basis to provide specific information to address a specific question.

Whether part of an ongoing research program or a one-time custom designed study, the possible applications of market research generally fall into one of three categories, which are discussed in turn below.

Identify and Evaluate Marketing Opportunities

This first category includes research studies focused on finding new market opportunities and forecasting their financial potential. The types of research plans in this set include market segmentation studies, demand estimation research, and project feasibility assessment. Both the Ansoff matrix and SWOT analysis can play significant roles in shaping the research process once market opportunities have been tentatively identified.

Assess Potential Consequences of Marketing Decisions

Each of the four elements of the marketing mix can be the subject of separate or combined market research studies. Assessing the potential impact of proposed changes in the 4 Ps is a critical task for marketing researchers. Specific types of research in this second category would include new product market tests, comparative tests for alternative advertising plans, and experimental studies on the effect of price changes across product lines and market segments.

Monitor and Improve Marketing Processes

The third category often involves longitudinal studies. Longitudinal studies require the collection of repeated observations of the same variables over extended periods of time. These are sometimes referred to correlational studies when they are used to measure statistical relationships between two or more marketing variables (e.g., sales and advertising). By tracking the same relationships over an extended period of time, market researchers can identify reliable relationships and evaluate variability in sales and customer satisfaction as a function of changes in the firm’s marketing activities. These types of tracking studies can also be useful in evaluating customer perceptions of brand-specific variables such as image, awareness, recall, and preference.

In addition to gathering information from sources external to the firm, organizations often rely on internal sources of data to help them evaluate ongoing marketing programs and diagnose potential problems. This type of research on the effectiveness and efficiency of the firm’s marketing efforts often analyzes data from existing in-house databases. As noted at the close of Chapter 2, these databases typically include information on competitors and suppliers, as well as data specific to customers and sales. In many situations, however, marketing managers will need to turn to external sources of supply for market research services and data.

Suppliers of Marketing Research

Although an average business may spend between 25 and 50 percent of its annual marketing budget on research activities (Small Business Encyclopedia, 2011), not every organization has the ability or desire to engage in the collection and analysis of data on its own. More than $20 billion is spent each year on marketing services around the world. Approximately one-third of the total is spent in the United States alone (Honomichl Global Top 25 Report, 2010).

Commercial research vendors and external service suppliers provide a wide range of market research services to their customers. Full-service suppliers perform all marketing research functions for the client from the start of the project through its conclusion. This includes custom research designs, data collection services, and statistical analysis of the results. Limited service suppliers typically specialize in the provision of select services. These include online research specialists, companies that sell syndicated data, and firms that specialize in the study of specific markets or marketing functions.

3.4 The Marketing Research Process

Figure 3.5: The marketing research process

Diagram showing the marketing research process

The steps involved in the marketing research process are not always followed in a strictly sequential manner. Sometimes, information acquired at one level of the process will require re-evaluation.

The formal steps involved in the marketing research process are not intended to provide a one-size-fits-all recipe for designing effective studies. The objective of providing a step-by-step approach to the process is to impose a measure of discipline that will ensure an effective and efficient design of the resulting study. The six-step model illustrated in Figure 3.5 is intended to answer three basic research questions: What should we be investigating? How should we design the study? What will the results reveal? This final question is not intended to force a guess about the specific outcome of the research. Instead, it requires the researcher to be sure that the design of the study is intended to yield the information required to answer the question that was originally posed.

Define the Problem and Research Goals

The starting point for any systematic approach to market research is to specifically define the managerial, market-related problem and translate that problem into a research question. For example, a brand manager for a company that sells dessert toppings may be considering the launch of a line of reduced-calorie toppings. The related research questions might pertain to measures of anticipated consumer interest or product acceptance.

To provide the best possible guidance for the design of the study, research problems should be defined as narrowly and specifically as possible. If the problem is poorly defined at the outset or the initial specification is too vague, the time expense and direct costs associated with the study will be wasted. A good working definition of the research problem to be investigated should start with an understanding of the market-related question facing the firm. If the marketing manager is not directly overseeing the process, the research director must have a clear understanding of why the information is important and how it will be used. This should enable an accurate translation of the problem under investigation into specific and measurable research objectives and metrics.

The definition of the problem in this initial step is combined with the identification of goals simply because the two cannot be fully understood independent of each other. The intent of the research is to provide the information necessary to solve the problem under consideration. The objectives or goals, once understood, determine how the study must be designed to provide the information required to solve the problem.

Specify the Research Design

The initial decisions on how the research study should be designed and structured must reflect the nature of the research question being posed. Three classifications are used to identify different types of research designs based on the objectives of the research.

Exploratory research collects information about a problem under investigation in a loosely organized, unstructured, and informal manner. It is often used as a form of preliminary research to help define the underlying market-related problem more clearly and specifically. Qualitative techniques such as focus groups and depth interviews are routinely used for this purpose.

Descriptive research investigates the research question using methodologies that describe the level or metrics associated with market-related variables. In contrast to purely exploratory research, descriptive studies begin with a well-defined research problem. In fact, the researchers need to know the who, what, when, where, why, and how elements of the plan before undertaking any descriptive studies. The final product of descriptive research is a snapshot of the relevant market based on the characteristics selected for study.

Causal research studies examine the nature of cause-and-effect relationships between marketing variables. The setting for causal research studies can be either in the field (e.g., test markets) or in controlled settings such as focus group facilities or laboratories.

Identify the Information Source by Type

A woman eating a cookie and taking a survey at the Kroger Co. tasting center in Ohio

At the Kroger tasting center, customers participate in a research study by tasting cookie samples and completing a questionnaire with feedback. From this feedback, the company will adjust its recipe.

Associated Press

Information that is gathered in response to a particular research question is termed primary data. Primary data can be obtained from customers through personal interviews, surveys, or passive observation of their behavior. Gathering data through the direct observation of customers has several disadvantages over other techniques. It is unable to provide data on indiscernible personal traits such as beliefs, attitudes, awareness, and motivation. Personal interviews and surveys can typically sample many more people much more quickly. Asking subjects to provide information about themselves, however, also has its limitations. Potential respondents may decline to participate in the process, or their responses may be inaccurate. It is also possible that the willingness of some people to participate while others refuse can produce biased results based on the composition of the compliant sample.

Secondary data is information that has been collected prior to the study for unrelated purposes. Secondary data may be information that is internal to the firm (e.g., sales records) or external (e.g., census data). External secondary data may be either published data or syndicated, commercially available data. Government agencies such as the Bureau of Labor Statistics and the Census Bureau routinely collect and disseminate a great deal of information that is of significant value to marketing managers.

Secondary data have some advantages over primary data. It is already available and relatively inexpensive to acquire in contrast to the costs associated with obtaining comparable primary data. The principal disadvantage is that the available data may not accurately address the specific research problem. Consequently, secondary data is often used as a supplement to the primary data collected for the specific question under investigation.

Develop a Sampling Plan

The sampling plan refers to those elements of the research design used to select subjects from the research population of interest. The objective is to identify a subset of persons who will reliably represent the whole population. This principle is clearly evident when public opinion pollsters are conducting surveys prior to an election. A small but well chosen sample of the electorate can be used to accurately project the results for the whole population of voters.

Although there are statistical methods of determining the minimum sample size for any given study, larger samples will yield more reliable results. Consequently, designers must weigh the incremental cost of including more than the minimum number of subjects in the sample against the offsetting improvement in the statistical accuracy of the results.

Collect and Analyze the Data

The method of data collection is necessarily dependent on the overall research plan. It requires gathering information about customers, competitors, and markets by means of a broad range of techniques. Primary data can be collected through test market trials, in-home product testing, focus groups, consumer panels, and surveys. Survey data can be collected in face-to-face meetings, over the telephone, or online. Inaccuracies or errors in the data can result from flaws in the process of collecting the information. When using questionnaires, for example, the questions must be communicated clearly and free from the use of biased wording.

The process of data analysis usually begins with entering data into files for initial review and screening. If data need to be coded or mathematically transformed for subsequent analysis, it is usually done at this initial stage of the process. Descriptive statistics (e.g., frequencies, means) are created to inspect the data for obvious errors and missing values. Once the data set has been cleaned, statistical software is used to analyze the results of the study.

Present the Findings

The presentation of findings can be done in either a formal or informal format. In each instance, however, a written summary of the study’s results is prepared. Presentations by professional market research firms are typically more formal than those given by an in-house market research staff. Of primary importance in either setting is the clear communication of the results in a manner that addresses both the specified research objectives and the initial managerial question that prompted the study. Written reports typically contain an executive summary, a statement of the research objectives, an explanation of the methodology employed, an overview of the statistical results, interpretation of the findings, and the authors’ final recommendations.

Ch. 3 Conclusion

As stated at the outset, one of the most important roles of market research is to provide information that will reduce the uncertainty and risk confronting the firm. Consequently, the value of research is greatest when market conditions are most volatile and least certain. The intensity of head-to-head competition and instability of consumer preferences are two factors that increase the value of current, reliable market research. However, the relative importance, role, and scope of market research will necessarily differ from one organization to the next.

Organizations that embrace the marketing concept recognize that effective market research possesses the potential to improve customer satisfaction and brand loyalty. In fact, it is often said that market research is the listening part of the dialogue between buyers and sellers that is the process of marketing. It is certainly one of the most important means by which organizations can learn about customers' wants, needs, and preferences.

For the most part, marketing managers need to understand the essential elements of the process well enough to be good clients. First and foremost, this means knowing how to work with professional researchers to assist in the meaningful translation of marketing problems into research questions. The second most important role of marketing managers as consumers of research is to be critical customers. More than the professionals who execute the research studies, managers must recognize that research results are only of value when the information collected is relevant and specific to the challenges facing the organization.

Ch. 3 Learning Resources

Key Ideas

Critical Thinking Questions

 It is both logical and readily evident from experience that better information leads to better decision making. However, most managers routinely must make important decisions with far less information than they would like to have. What are the primary reasons for this information gap?

 Does the pursuit of customer satisfaction drive all market research decisions? If there are exceptions, what is the rationale for making them?

 Both value and customer satisfaction are subjectively experienced. How does this reality limit the utility and worth of market research?

 The chapter argues that growth is an essential strategic goal. Is this absolutely true in every circumstance? Can growth take on different meanings depending on the situation facing the firm?

 It is claimed that the Ansoff Product/Market Opportunity Matrix is exhaustive in terms of identifying all the possible sources for new growth strategy options. Do the four product/market combinations really cover every possible option?

 The Ansoff matrix identifies market penetration as a growth strategy. Can this really be considered a new growth strategy or is it just business as usual?

 Which would be a more expensive strategy to pursue in most situations: market development or product development? Why?

 The Bayer aspirin products example illustrates both market development and product development strategies in action. Select a service-oriented company with which you are familiar. How could you apply these two strategies to that organization?

 Does SWOT analysis work better in some situations than others? If so, why? What are the conditions under which it is difficult to use?

 Some managers simply don’t regard SWOT as a serious form of analytical tool. Instead, they regard it as only a brainstorming exercise. Can it be valuable as a brainstorming device? Can it be used in both ways to explore the same situation or opportunity? What do you miss out on by viewing it only one way and not the other?

 Marketing managers respond to complex and volatile environments with a limited set of tools over which they exercise direct control. These include the marketing mix variables and managers’ discretion to identify segments and select target markets. Are there circumstances in which companies can exert direct influence over the character of the markets in which they compete?

 The process of environmental scanning is a more challenging task in some markets and industries than others. Why? Are foreign markets more difficult to track than domestic markets?

 When using the PESTEL approach to environmental scanning, some considerations could fit into more than one of the six categories. Identify some of these and explain why they tend to span boundaries. Is this likely to be a problem when using this technique?

 Some of the six macro-environmental variables identified in PESTEL analysis can appear as the source of opportunities and threats in SWOT analysis. Provide examples.

 In PESTEL analysis, social factors often represent the most critical concerns for marketing managers. Why?

 Longitudinal studies require the collection of repeated observations of the same variables over extended periods of time. Provide three examples of marketing phenomena that can be measured or evaluated only by conducting longitudinal studies.

 Under what circumstances would exploratory research be the endpoint of a research study rather than a stepping stone to defining the real underlying marketing problem more clearly?

 Descriptive research describes levels associated with specific market-related variables. It is intended to give managers a snapshot of some aspect of the market in which they compete. Give three examples of common types of descriptive research.

 Causal research studies examine the nature of cause-and-effect relationships between marketing variables. Why aren’t all market research studies designed to demonstrate cause-and-effect relationships? Are other types of studies conceptually inferior because they do something less than this?

Key Terms

Click on each key term to see the definition.

Ansoff Product/Market Opportunity Matrix

A model to assist in the process of identifying new growth strategy options. It recognizes new product- and market-related opportunities as originating from one of four alternative strategies: market penetration, market development, product development strategy, and diversification.

causal research

Studies that investigate cause-and-effect relationships between marketing variables.

confirmatory analysis

Investigations seeking validation or confirmation for a specific new product or service proposal.

descriptive research

Studies using methodologies that describe the level or metrics associated with market-related variables. The final product of descriptive research is a snapshot of the relevant market based on the characteristics selected for study.

diversification growth strategy

A component of the Ansoff matrix that involves increasing sales by introducing new products into new markets.

environmental scanning

The process of systematically assessing how elements of the external environment will impact a business or market.

exploratory analysis

Open investigations undertaken without any prior assumptions about the validity or feasibility of the proposal under consideration.

exploratory research

Studies that collect information about a problem under investigation in a loosely organized, unstructured, and informal manner. They are often used as preliminary research to help define the underlying market-related problem more clearly and specifically.

longitudinal studies

These studies require the collection of repeated observations of the same variables over extended periods of time. They are also referred to as correlational studies when they are looking for statistical relationships between two or more marketing variables.

macro-environmental forces

Uncontrollable external variables that impact all firms within an industry (e.g., prevailing economic conditions, cultural trends).

market development strategy

A component of the Ansoff matrix that involves increasing sales by introducing existing products into new markets.

market leadership

A company that holds the highest market share in a given product market.

market penetration strategy

A component of the Ansoff matrix that involves increasing sales of existing products to current markets.

market research

The systematic gathering, recording, and analyzing of data with respect to a particular market, where market refers to a specific customer group in a specific geographic area.

marketing research process

A multistep procedure designed to answer three research questions: What should we be investigating? How should we design the study? What will the results reveal?

matching

The process of aligning the strengths of the firm with new opportunities while pursuing ways to mitigate potential threats and company-specific weaknesses.

micro-environmental forces

Uncontrollable external variables that selectively and discretely influence each firm uniquely and independently (e.g., behavior of a company’s suppliers and customers).

PESTEL analysis

An environmental scanning approach that examines six classes of external environmental factors: political, economic, social, technological, environmental, and legal.

primary data

Information that is gathered specifically in response to a particular research question.

product development strategy

A component of the Ansoff matrix that involves increasing sales by introducing new products into current markets.

sampling plan

Dimensions of the research design used to select subjects from the research population of interest.

secondary data

Information that has been collected prior to a study for unrelated purposes.

SWOT analysis

A strategic planning technique used to investigate how internal, company-specific factors and external environment impact the feasibility of new marketing ventures. SWOT is an acronym for strengths, weaknesses, opportunities, and threats.

Web Resources

This site provides free access to white papers and articles on a wide range marketing research techniques. Articles were written by market research professionals to illustrate best practices.

http://www.decisionanalyst.com/Artindex.dai

A practical site that provides users with a set of organized procedures to research a company or industry. Links to useful resource and data sites are also provided.

http://www.virtualpet.com/industry/howto/search.htm

This site is designed to provide entrepreneurs with guidance on how to investigate and analyze both potential customers and competitors. It includes a checklist of readily available data sources as well as information on market research methodologies.

http://edwardlowe.org

This website provides a thorough presentation on many important aspects of SWOT analysis. It includes useful tools, templates, and worksheets as well as several examples of the technique. Other links on the site include comparable levels of information on the application of the PESTEL analysis methodology.

http://rapidbi.com/swotanalysis/

This site provides a concise, yet sophisticated, introduction to the application of the Ansoff Matrix model as a tool for strategic planning.

http://www.mindtools.com/pages/article/newTMC\_90.htm

This site also provides a good introduction to the practical application of the Ansoff Matrix, including current examples for each of the four alternative growth strategies.

<http://www.soopertutorials.com/business/marketing/1787-intensive-growth-strategies-ansoffs-product-market-expansion-grid-2.html>

Chapter 4

Evaluating Market Demand and Forecasting

A compass on a financial newspaper page

Belinda Images/SuperStock

Learning Outcomes

By the end of this chapter, you should:

 Recognize the differences between market potential, available market, and sales potential.

 Explain the significance of the product usage gap and brand usage gap.

 Know the uses of short-range, medium-range, and long-range sales forecasts, as well as the limitations of related forecasting methodologies.

 Know the differences between qualitative and quantitative forecasting techniques and be able to describe the strengths and weaknesses of each.

Ch. 4 Introduction

This chapter examines the role of forecasting in evaluating market demand. The first half investigates the estimation of market demand and market potential, referred to collectively as demand measurement. This is concerned with the determination of current levels of market demand and market potential. The focus is exclusively on the analysis of existing markets in total without regard to market segmentation or brand-specific measures of demand. The second half of the chapter investigates sales forecasting. The methodologies discussed in this section focus on estimating future sales at the product and brand levels of analysis. These forecasts are focused on predicting what will happen to markets and brand sales in future periods.

Accurate forecasts of product sales and market potential are essential to survival when confronting uncertain environments. In the same way that other forms of market research provide the means for organizations to reduce risk in the face of dynamic markets, forecasting is a strategy for mitigating market-related hazards by providing timely information on the changes taking place. Although forecasting is primarily understood as a strategy for threat reduction, it can also provide insights on the potential of new market opportunities.

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When we hear the word forecasting, many of us first think of weather forecasts on our local television stations. Our second thought is usually about those all-too-frequent occasions when the meteorologists got it completely wrong and our family picnic was rained out.

Well, sales forecasting is also pretty far from being an exact science. Maybe you have heard the story about the two market forecasters who went deer hunting together. When a deer appeared 120 feet from their stand, the first forecaster carefully squeezed off a shot that missed by 4 feet to the left. His hunting partner hurriedly fired after him, but missed by 4 feet to the right . . . at which point the first forecaster began jumping up and down, shouting: "We hit it! We hit it!"

Yep . . . it's just like Yogi Berra said: It's tough to make predictions, especially about the future.

4.1 Demand Measurement

More accurate information will inevitably help marketing managers improve the design and performance of marketing plans. Historical data on patterns in the market (e.g., market shares, aggregate growth trends) and brand-specific information (e.g., sales, customer retention rates) can provide significant insight into previous marketing decisions. To effectively plan for the future, however, managers need access to general market and brand-specific information for both the present and future. Estimates of future demand can be created based on short-range, medium-range, or long-range forecasting horizons, as will be discussed later in the chapter.

The foundation required to create reliable forecasts, without regard to the time period in question, is a thorough and accurate understanding of the prevailing current or near-term market conditions. This requires a rigorous study of the individual components that make up the cumulative or aggregate level of total market demand available to the firm.

Assessing Market Demand

Whether evaluating the profit potential associated with a new market opportunity or considering revisions to an existing marketing program, marketing managers need to understand the basic parameters that define the markets in which they compete. Market demand is the total volume or amount of a specific product purchased by consumers over the complete range of prices at which it is sold. Market demand is usually expressed in terms of both the specific market and the time period. Consider, for example, the market for tablet personal computers in 2011. The level of market demand can be expressed in either total unit sales volume (e.g., 22 million) or dollar sales volume ($15.4 billion). The dollar volume metric is usually expressed in retail sales.

Market demand provides a snapshot in time of the market's overall size. More detailed information about current patterns can be disaggregated from the whole by examining how segments within the market behave in response to different price levels. Market research can provide insights on how other segment descriptors relate to sales (e.g., age, income, family size). Markets can also be analyzed geographically if those characteristics are relevant. For all marketing managers, it is essential to understand elements of current market demand, although some factors will be more important than others.

Market Demand Measures

The initial assessment of market demand provides the platform for subsequent financial analysis and projections. Whether based on the extrapolation of trends over time or rooted only in current period data, all forecasts rely on measures of current market conditions as a jumping off point. In situations where market demand is not particularly volatile, however, current period data are sometimes used in lieu of any forecasts.

A line of people waiting outside the Apple Store in London.

Apple markets products well and accurately forecasts market potential and sales. This has consistently resulted in lines of eager customers at store openings and product debuts.

Demotix/Corbis

The dimensions highlighted in an initial evaluation of market demand depend on the intended use of the information. Entrepreneurs seeking investment funding from venture capitalists will need to demonstrate the financial potential of a market. Production and operations managers need information about potential unit sales so that they can align manufacturing capacity with demand. Human resource managers for retailers will need to derive the demand for part-time hiring in the current period as a function of prevailing sales levels.

The most common and routine use of market demand metrics is as a scorecard to evaluate the effectiveness of the firm's marketing efforts. Determining which elements of the marketing mix contribute to the current period's sales, however, is not always a straightforward task. Some elements of the marketing mix may have an immediate impact on sales (e.g., sales promotions), others have a lagged effect (e.g., image-oriented advertising), and all of them have the potential to interact with each other. For example, intentional interactions often occur between changes in pricing strategy and advertising over time as managers gradually shift the positioning of a brand over several reporting periods. Consequently, current levels of market demand may reflect the results of one-time marketing events, the cumulative impact of marketing efforts over time, or the interaction of one organization's marketing initiatives with those of competitors. Invariably, all three types of effects are usually present in the sales results from the current period.

Accurate market demand measures set the stage for financial projections including the assessment of market potential and sales forecasting. The realistic evaluation of market potential includes both the appraisal of the available market for a product category and the sales potential that is specific to a given brand.

Measuring Market Potential

Market potential is a measure of the maximum total possible sales of a given product over a fixed interval of time. It is the mathematical product of the total number of potential buyers in a market multiplied by the average quantity purchased per buyer. This yields an assessment of market potential in product units. Total dollar sales potential can be determined by multiplying this measure by the average price of one unit. Total market potential may be stated in dollars or expressed in unit sales.

The available market for any product is made up of those buyers who possess both the interest and means to purchase the product under current market conditions. The target market for each brand is, of course, a subset of this group. Sales potential is a term that is often confused with market potential. However, sales potential is a brand-specific metric that provides an estimate of the portion of total market potential that a specific brand can reasonably expect to reach. In short, it is an estimate of the size of the brand's target market. When expressed in percentage terms, sales potential indicates the size of the brand's target market relative to the available market.

A Burger King at a shopping mall in Moscow.

International markets provide potential growth opportunities for companies like Burger King. What must marketers consider when evaluating an international marketplace?

Associated Press

The basic conceptual formula for calculating market potential remains the same in every circumstance. However, the application of the model must be uniquely tailored to suit the situation. Sometimes secondary data in the form of census information, other government statistics, or readily available data from other published sources (e.g., trade associations) will be sufficient to meet the needs of the analyst. In other instances, market research studies are needed to develop primary data specifically collected for this purpose. Internal company data is a third source of statistical information that is sometimes overlooked if marketing managers fail to consider how some types of historical data may relate to the evaluation of current opportunities. For example, the firm's market-specific sales databases may be applied to the study of product development opportunities. Similarly, the assessment of the market potential for a market development opportunity may be related to historical patterns in product-specific sales data.

Geographic market boundaries are largely irrelevant to the market potential for many products that are sold online. However, geographic conceptions of market potential still hold significance for many brick-and-mortar retailers, agribusiness firms, and service companies. The delineation of an organization's geographic trade area will be defined by the convergence of several factors such as the size and number of nearby competitors, the uniqueness of the product or service being offered, and the mobility of prospective buyers within the region.

The challenges related to geographic considerations increase substantially when companies begin to evaluate the market potential of foreign countries. Although the complexity of the related tasks is amplified, the fundamental conceptualization of market potential does not change.

Measures of Potential in International Markets

Given the simplicity of the concept, the challenges encountered in developing metrics and models to estimate market potential can be surprisingly complex. For example, one of the first steps that marketing managers must take when evaluating new international markets for their products is determining the financial potential represented by competing opportunities. Typically, analysts are charged with assessing the market potential across nations with widely disparate economies and cultures. Rather than simply comparing apples to oranges, it becomes a matter of comparing rambutan to jaboticaba. The challenge is particularly daunting when trying to identify measures that accurately reflect the true market potential of developing or emerging nations.

Figure 4.1: International Market Potential Index for 2010

A chart that shows the market potential rankings of countries.

Based on the information in the indexing study above, which countries seem to have the most and the least market potential and why?

http://globaledge.msu.edu/resourcedesk/mpi/

To address this problem, the Michigan State University Center for International Business and Economic Research (MSU-CIBER) annually publishes its Market Potential Index for emerging markets. As illustrated in Figure 4.1, this index value is calculated for the fastest-growing emerging global markets using the eight dimensions of market potential identified in Figure 4.2.

Figure 4.2: Dimensions and measures of market potential for 2010

A chart that shows the market potential rankings of countries.

This figure shows the dimensions that help influence market potential. Notice that some dimensions hold more weight than others. Why do you think this is the case?

http://globaledge.msu.edu/resourcedesk/mpi/

The use of multiple factors reflects different facets of market potential. Each factor is determined by multiple measures, and each is weighted relative to its importance to the overall potential of any given market. Some measures such as market size and economic growth rate make generally positive contributions to overall potential. Factors such as limited economic freedom and country risk (e.g., high political instability) reduce the Market Potential Index value.

Though this is far from being a perfect representation of market potential across all countries and products, it does provide analysts with a preliminary assessment. This is clearly a task worth pursuing, insofar as these countries with underdeveloped economies account for more than half of the world's population, and represent a huge sales potential for many types of products.

Think About It

Assessing market potential within an international context can be very difficult. However, the challenges confronting small-business owners and entrepreneurs are no less demanding. Assume that you are the owner of a small retail pet store in Columbia, South Carolina.

What types of market potential measures would interest you?

What inexpensive methods might you use to estimate the market potential?

4.2 Comparing Performance to Potential: Gap Analysis

As noted earlier, the most common use of market demand metrics is as a scorecard to evaluate the effectiveness of the firm's marketing efforts. Measures of market potential provide important baselines or benchmarks against which an organization can assess its performance. One of the most useful techniques for comparing sales potential to actual results is gap analysis.

Gap analysis is a term used to describe a range of contrasts of interest to marketing managers. Each of these comparisons examines actual performance relative to potential performance. Different types of gaps reveal different areas of potential improvement or growth for the organization. Marketing managers are particularly concerned with two market-related gaps that reflect a difference between current sales and sales potential: product usage gap and brand usage gap.

Product Usage Gap

The product usage gap is defined as the difference between total market potential and actual or current product usage by all customers within a given market. This contrast is based on two measures of industry-wide volume and is not directly related to the sales of any given brand. Significant gaps between market potential and actual usage indicates that there is an opportunity to stimulate primary demand for sales.

Product Usage Gap = Total Market Potential – Current Product Usage

Arizona ice tea products

Arizona Iced Tea products, once only popular in a small consumer niche, have increased in popularity and now appeal to soda and tea drinkers alike.

Associated Press

Consider the market for prepared iced tea. Not very long ago it was regarded as a niche market in the soft drink industry, limited to consumers who already enjoyed brewed iced tea but who might enjoy the convenience of bottles and cans. Marketers' perceptions in this regard limited estimates of market potential. Current usage was almost exclusively a function of product development—introducing a new variation of the product to current consumers. The introduction of brands like Snapple and Arizona Iced Tea increased the size of the total potential market through market development. That is, new users and higher rates of consumption were added to the market as new varieties were promoted to a wider audience.

In most instances, closing the usage gap is a higher priority for market leaders than companies that hold small market shares. The firms that have already achieved industry leadership are the most likely to benefit from expanding the size of the market as a whole. Market leaders sometimes opt to acquire the innovative emerging brands that pioneer new market segments as a cost-effective path to defending overall market share and rounding out the company's portfolio of brands within a category. This was the case when the Dr. Pepper beverages group acquired Snapple in 2008.

A concept that is closely related to the product usage gap is the market penetration index. This measure is simply the ratio of current market demand to potential demand. Low market potential index values indicate substantial growth potential for all the firms. High market penetration index values suggest the costs of bringing those relatively few new prospects into the market will be relatively high.

Brand Usage Gap

Most companies do not sell brands into every segment of a product market. This may be the intentional consequence of strategic planning or the result of limited resources. In either circumstance, product-level analysis of the usage gap between total market potential and current usage by all customers within a given market will yield a distorted picture of the firm's performance. If segments of the market where a company does not actively compete are included in the baseline measure of total market potential, the actual effectiveness of the marketing efforts on behalf of the existing brands will be underestimated. That is, an assessment of the competitive impact of brand-specific marketing programs will be diluted by contrasting current brand sales to a level of potential market sales that includes segments where the brand is not intended to compete. The calculation of a brand-specific measure called the brand usage gap is intended to compensate for that potential error.

Brand Usage Gap = Target Market Potential – Current Brand Usage

Brand usage gap is defined as the difference between potential sales to the target market and the current level of brand usage by customers within the targeted segment of the market. The gap provides an indication of how much potential growth is possible from taking market share away from competitors. In this sense, it relates most closely to market penetration strategies.

In a competitive market, it is highly unlikely that one brand can drive the brand usage gap to zero by eliminating the competition. Further, it is important to note that the presence of a gap does not necessarily indicate a problem or marketing failure of any kind. The value in calculating brand usage gap values over time is to help managers remain aware of the outstanding or residual financial value remaining in the market. The implications differ from simply tracking market share stability over time, especially in growing industries.

Consider the case of a leading brand in the young adult multivitamin and mineral supplements market. If the company's brand held a steady market share of 27 percent for five years, it might suggest that the market is stable and offers few opportunities for growth. However, if the number of young adults has increased by 45 percent over that interval, the brand usage gap as measured in dollars will have grown substantially. Consequently, brand managers may wish to pursue a more aggressive market penetration strategy since the total dollar volume and corresponding profits have grown so quickly. The cost of acquiring each additional percentage point of market share may have remained virtually unchanged, but the value of each incremental point has increased considerably.

An alternative measure that is closely related to the brand usage gap is the firm's share penetration index. This measure is simply the ratio of the brand's current sales to its potential sales. If the index values for this measure are low, the company may have opportunities to greatly expand its market share. Marketing mix strategies to build brand awareness and preference could yield substantial gains at relatively low cost. Much like the market penetration index, however, high share penetration index values suggest the incremental cost of acquiring additional share points will be relatively high.

Each of the gaps identified in this section suggests opportunities for growth that stem from a disparity between what consumers demand and the characteristics of the products offered by competing companies. It is important to remember, however, that not every gap can be bridged collectively by the sum of the alternative brands. Some sets of demands are simply beyond the market's scope or ability to meet. Similarly, each brand cannot realistically expect to meet the demands of every consumer in its defined target market.

One of the many valuable insights that can be gleaned from gap analysis is a better understanding of how the sales volume of a brand compares to its potential performance. These types of contrasts provide marketing managers with the opportunity to evaluate areas of possible improvement. Sales forecasts, however, serve a distinctly different purpose. These predictions about future sales are primarily intended to help marketing managers improve the match of company resources to anticipated brand-specific demand and improve the efficiency of marketing programs.

4.3 Sales Forecasting

Sales forecasting is generally regarded as a specialized subfield within the domain of market research that provides predictions about markets, customers, and competitors. Almost all forms of marketing-related forecasts relate either directly or indirectly to predicting future sales. Predictions are most often based on historical data, observed trends, and expert opinion. Accurate forecasts are essential to the efficient management of current operations, assessing new market opportunities, and evaluating the effectiveness of ongoing marketing programs. Reliable predictions of how brand sales will respond to future changes in marketplace dynamics are essential to reducing uncertainty, and consequently risk, to the lowest levels possible. Forecasts can span different time frames depending on the purpose of the forecast and availability of information.

Sales Forecasting

The accuracy of forecasting affects every aspect of the sales planning process. Perhaps the most critical part of forecasting is the sales forecast. How does forecasting affect the marketing of a product?

Short-Range Forecasting

Short-range forecasting refers to making predictions less than one year into the future. These are fairly routine forecasts that often reach managers' desks in the form of monthly or quarterly projections of sales. They provide some of the most critical data that are used in managing the operations of the firm. Short-range forecasts are essential to making scheduling and allocation decisions about near-term production capacity. Anticipating sales levels also permits manufacturers to keep the costs of carrying large inventories of raw materials and unfinished goods to a minimum. Accurate forecasts are particularly critical in labor-intensive manufacturing industries where human resource costs represent a large percentage of unit costs. Matching capacity to demand not only improves efficiency but also reduces the likelihood of stock-outs and shortages that result in dissatisfied customers.

Medium-Range Forecasting

Medium-range forecasting refers to annual forecasts or predictions. These projections are typically used as primary inputs to the annual budget planning process. This is the level of data most often used in setting or revising the marketing plan for each brand and SBU within the organization's portfolio. Allocations and adjustments to the marketing variables are often made in direct response to data from these forecasts.

The promotional mix elements (e.g., advertising, personal selling) are often the features of the marketing plan most directly impacted by sales projections. Although sales forecasts play a pivotal role in the establishment of sales budgets, they are not the same thing. Forecasts predict future sales, and budgets specify the planned allocation resources to accomplish the organization's goals. When used correctly, there is a cause-and-effect relationship between the two. The sales, advertising, and marketing budgets for a brand should be based on the goals for the brand as well as the corresponding level of forecast sales.

Long-Range Forecasting

Long-range forecasting refers to making predictions for periods greater than one year into the future. The most common use for these long-term projections is strategic planning. Since these predictions extend farther into the future, they are generally more difficult to construct and tend to be less accurate. However, they provide essential inputs to the process of shaping the strategic direction of the organization over the long run.

Both the providers and users of long-range marketing forecasts recognize the constraints and limitations associated with predictions about events more than a year in the future. These projections are necessarily more speculative in some markets than others. However, the discipline of having to specifically quantify the expectations associated with various options and scenarios is essential to good strategic planning. It improves the rigor and strengthens the commitment that participants bring to the process. However, even under the best of circumstances, the accuracy of short-range, medium-range, and long-range forecasts is necessarily limited by a range of complicating factors.

Think About It

As with other decision making aids we have looked at in previous chapters, marketing managers cannot afford to let forecasts do their thinking and decision making for them. There are risks associated with becoming too dependent on long-range predictions, just as there are negative consequences associated with ignoring short-term sales forecasts.

What can managers do to avoid these kinds of problems?

Limitations of Sales Forecasting

Customers browsing in at small local Bakery

Small companies, such as this local bakery, as well as large companies use sales forecasts to help them make decisions that will lead to improvement and success.

Ambient Images Inc./SuperStock

Sales forecasts are used extensively as critical inputs to decision making throughout both small and large companies. Accurate forecasts of sales are essential to making good decisions in areas related to operations management, human resource planning, and marketing. In marketing, these predictions are used to evaluate the potential profitability of new initiatives, evaluate the effectiveness of existing programs, and establish future directions for the firm. In light of the importance of sales forecasts, it is necessary to recognize the limitations and potential problems that are built in to the process of creating them.

Sales forecasts can only take into account a limited number of market-related conditions. Most forms of market forecasting rely on very limited statistical models of the environment. By definition, models are incomplete, abstract representations of the environment they represent. The real world is far messier, and it is very difficult to anticipate or assess all of the factors that will impact brand sales.

A closely related problem is that most forecasting models assume that the basic conditions and events observed in past periods will continue into the future. However, competitive environments are dynamic and subject to change. New entrants to the market, the introduction of substitute goods or new technologies, significant changes in the marketing mix decisions made by competitors, and one-time events or shocks to the market or economy cannot be anticipated by forecasting models.

A worker assembles an oven in a factory located in China.

Outsourcing manufacturing can reduce production costs and improve the firm's ability to compete on price in global markets.

Imaginechina/Associated Press

The accuracy and reliability of sales forecasts is also limited by the quality of available data. For example, some forecasting models require information on the marketing expenditures and allocation decisions made by competitors. Few firms have any incentive to make this type of information publicly available. In B2B contexts, prices and other terms of trade may change significantly from one customer to the next. Consequently, the data used to construct profiles of competitor behavior often need to be estimated before being subsequently used to construct forecasts. This added layer of potential error can render medium- and long-range forecasts unreliable in many industries.

Finally, market-related variables are always interacting in fairly complex ways that are difficult to capture in sales forecasts. Consider the case of a major appliance manufacturer from China that wishes to improve its U.S. market rank from fifth to third for convection ovens. In the span of 12 months, the company may opt to reduce retail prices, decrease advertising, and increase sales promotions to wholesale distributors. Assume that this is happening against the backdrop of a slowing national economy. The impact of any one of those changes is dependent on the others to a greater or lesser extent. That is, the net impact is almost certainly different from the sum of the individual changes. The interaction of these changes with the competitive response from other brands adds a second order or tier of complexity.

Think About It

Consider the case of the toy store owner who developed her sales forecasts based on economic indicators within her rapidly growing community and previous years' sales trends. She was anticipating 15 to 18 percent growth in the coming year, but actually lost nearly half her sales over the prior period.

Assuming that her forecasting model was specified correctly, what internal and external factors could possibly account for the huge discrepancy?

Though never perfectly precise in its predictions, the complex task of sales forecasting provides information that is essential to the firm. Short-, medium-, and long-range projections are used in many settings and applications. As with many other facets of the organization, being very good at forecasting future events provides a distinctive competence or capability that can be translated into a competitive advantage for the company. The section that follows examines the range of quantitative and qualitative forecasting techniques available to market analysts.

Why Good Forecasts Go Bad

Sales forecasts sometimes seem much more objective and unbiased than they are because they produce such precise quantitative projections. However, it would be naive to believe that the processes and outcomes related to the sales forecasting are immune from personal bias. "I have never seen (nor heard of) a sales forecast that was accurate, except by accident. The reason is simple: the politics of self-interest makes accurate forecasts virtually impossible" (Geoffrey, 2011).

It's human nature. Whether intentional or unintentional, sales forecasts are necessarily biased by the experience, priorities, and goals of the people involved in their creation. Consequently, the people most intimately involved with the preparation of sales forecasts often have much more faith in their accuracy than the sales force that is often most directly affected by them.

So, how do bad forecasts emerge from the offices of professionally qualified managers and experienced executives? The inaccuracy of many sales forecasts can be attributed to the unrealistic expectations of executives and their failure to acquire accurate input from the salespeople in the field (Warner, 2012). James Geoffrey (2011), the author of the world's most-visited sales blog, humorously describes the chaotic process of creating forecasts as a nine-step process:

Step #1: Top management needs a story to tell investors, and thus asks the sales manager for a forecast.

Step #2: The sales manager asks the sales reps what they think they'll sell, based upon their current gut feeling.

Step #3: The sales reps make a wild guess at what they might actually sell, and then subtract 10 percent as a fudge.

Step #4: The sales manager compares that forecast to the sales quota and adjusts both to match.

Step #5: The marketing group issues its own forecast, based upon statistics from a "market research" firm.

Step #6: The manufacturing group ignores all of the above and forecasts what it plans to manufacture.

Step #7: Top management looks at the three forecasts, throws them out, and then makes up numbers that will look good.

Step #8: The accountants juggle the books so that, regardless of what was sold, the quarterly report resembles the CEO's story.

Step #9: If, for some reason—like the laws of mathematics—Step #8 isn't good enough, the CEO fires the sales manager.

Though somewhat exaggerated, this nine-step model clearly illustrates how accuracy and forecasting discipline can be sacrificed to the serve the self-interest of multiple participants in the process. Accurate sales forecasting begins with a commitment to making effective use of tangible, objective sources of data. The initial forecast can be created from mathematical models that rely on trend analysis based on previous years' sales, seasonal buying patterns, recent marketing expenditures, and general economic factors. Once fine-tuned and tested against historical data, this type of model can provide a baseline to build from.

The refinement of mathematically driven sales projections by subjective judgment is both unavoidable and essential in many instances. To minimize the impact of self-interest bias at this stage of the process, Geoffrey suggests two basic strategies.

First, decouple forecasts from quotas. Sales quotas are valid tools in managing and motivating the sales force. However, they should not have a role in driving the development of forecasts. The de-coupling of sales quotas and forecasts, though difficult, should remove pressure from the process and enhance the accuracy of the information provided by the sales representatives in the field.

Second, eliminate unnecessary influencers from the process. If everyone within the organization gets involved in the forecasting process, it will necessarily reflect the sum of everyone's personal and professional biases. Starting with an independent, mathematically driven initial sales forecast, only marketing, manufacturing, and top management should be involved in the consideration of subsequent revisions. Any substantial changes necessarily require the evaluation of supporting data so that informed revisions can be made rather than changes driven by self-interest (Geoffrey, 2011).

4.4 Forecasting Techniques

A range of approaches and methodologies can be applied to the prediction of future sales growth. Some are dependent on modeling statistical relationships between data, while others rely on the expert opinion of business professionals. The choice of a sales forecasting technique in any given situation depends on several factors, including the required level of predictive accuracy, the availability of reliable data, and how far into the future projections need to be made. None of the existing techniques for forecasting sales is superior under all conditions. Both quantitative and qualitative methodologies have specific strengths and weaknesses. However, the appropriate application of multiple measures and techniques to any given problem will invariably serve to refine and fine-tune the accuracy of the final forecast.

Quantitative Forecasting Methods

Quantitative forecasting methods primarily rely on the analysis of historical data to predict future sales. The statistical techniques and data sets used in creating quantitative forecasts make the process relatively objective in contrast to methods that depend on the expert opinion and judgments of people. In general, most marketing managers are more confident in quantitative approaches when reliable data are available, the market environment is relatively stable, and their previous experience with specific forecasting models has demonstrated that the past can be a good predictor of the future events.

Simple Trend Extension

The simplest method for forecasting future sales from past sales is called naive forecasting. It assumes no volatility in sales whatsoever and simply predicts that sales for the next period will be the same as sales for the previous period. Though simple, the assumption of no change is seldom realistic.

St+1 = St where S = sales and t = time period

In relatively stable markets, there are situations in which the overall trend in sales growth is clear, but not flat. For example, year-to-year sales growth for pens and mechanical pencils typically mirrors the rate of change in population. Consequently, the rate of growth is slow, but positive and steady. If sales data over time exhibit a generally linear trend, the statistical method of simple linear regression analysis may be used to determine a trend line sales prediction for the future period's forecast. (The general principles of regression analysis are discussed in the section on multivariate regression analysis.)

Figure 4.3: Simple trend extension

A line graph that shows the number of sales increasing over time.

This line graph shows an increase in sales over time. Using a graph like this allows marketers to understand their products' trends and to predict their products' future success.

In simplest terms, this approach to forecasting the next period's sales is to graph the pattern of sales over time and simply extend the observed trend line for one additional period as shown in Figure 4.3.

Time Series

Quantitative methods of forecasting are based on an analysis of historical data specific to one or more intervals called a time series. A time series of data is a set of quantitative observations collected at successive points in time over a specified period. For example, the monthly sales of a given brand over a two-year interval would make up a set of time series data with 24 observations.

If the historical time series data set is used exclusively to predict future values of the same variable (e.g., 2007–2011 unit sales data are used to forecast 2012 unit sales), then the process is called a time series study. However, if the historical time series data are combined with other time series data sets related to the variable that we wish to forecast, the analysis is called a causal study. For example, if you combine the 2007–2011 unit sales data with a comparable data set on product pricing over the same interval to predict 2012 unit sales, it would be considered a causal analysis.

The purpose of both time series methods is to statistically isolate the underlying trends in the data from random noise and fluctuations. Once the trend is identified, the historical data provide the baseline measures from which predictions about future levels can be projected. Whether building a relatively simple time series study or a highly sophisticated causal model, forecasts derived from this approach typically feature four major elements: trend, seasonal, cyclical, and irregular components.

The trend component accounts for the gradual shifting of the time series data over a long period of time. This can be thought of as the core element of the forecast that provides the general projection of growth or decline for the product.

The seasonal component of a time series accounts for regular, recurring patterns of variability at specific times of the year. Many products exhibit some seasonality in sales as function of when they are used (e.g., snowblowers), specific purchase occasions (e.g., Easter baskets), or annual events (e.g., children's back-to-school lunch boxes). Figure 4.4 illustrates the linear trend and seasonal components of forecast demand.

Figure 4.4: Components for forecast demand

A scatter plot graph showing the components of Forecast Demand

This scatter plot diagram shows the components of forecast demand. With a diagram like this, a marketer can decipher the trend from the fluctuations and random noise of the market sales.

The cyclical component incorporates any regular wavelike pattern in the sequences of values. When graphed, these cyclical influences often appear as arcs rising above and dipping below the core trend line. These cycles are independent of any seasonal effects and can be very difficult to detect. Analysts need to understand the source of the pattern to determine whether these cyclical components can be expected to reliably recur in future periods.

The irregular component of a time series study is caused by short-term, unanticipated, and non-recurring factors that impact the observed values in the data set. The impact of these random, unpredictable events (e.g., a natural disaster, labor dispute) on the forecast values of the model cannot be predicted in advance.

The time series study approach to forecasting assumes that future demand can be predicted from the analysis of historical data. In this way, fairly objective methods are applied to mitigate the risks posed by future uncertainty. Time series studies of all kinds, however, can sometimes be fine-tuned to make them more accurate by transforming the data used as inputs to the statistical analysis process. Exponential smoothing, for example, is a process for weighting the observations from previous sales periods to place greater emphasis on the most recent data. This reflects the pattern most often observed in sales data: that historical observations gradually lose their value as time passes and market conditions change.

Multivariate Regression Analysis

Multivariate regression analysis is the most common technique used to carry out causal time series analyses. It is a statistical forecasting tool that identifies relationships between sales (the dependent variable) and one or more influencing factors (independent variables). If only one independent variable is used to forecast sales (e.g., household income), the model is called a simple linear regression, and the results can be illustrated by a line graph.

Microsoft Windows Vista software on the shelves of a Best Buy store in California.

Microsoft Windows dominates the word processing software market. To be this profitable, Microsoft examines the variables that affect its success in the market, such as college enrollment and business patterns.

Associated Press

This mathematical relationship can be used to predict future values of sales based on changes in the independent variable. When more than one independent variable is considered, however, it is called a multivariate regression.

The multivariate regression approach to forecasting permits analysts to identify multiple variables that have a causal influence on future sales. Consider, for example, how many factors might contribute to the retail sales of word processing software. Among the variables that would have the most direct influence is computer sales. However, a simple model using historical sales data on word processing software and retail computer sales could be made more accurate by including other factors that are not as directly related to software sales. Growth rates in college enrollment or even the population of high school students might have predictive validity. For forecasts within a specific geographic market, population growth, employment levels, and patterns in home business startups might have explanatory power as well. The power of multivariate regression analysis to investigate these relationships is based on the identification of variables that are significantly correlated with retail software sales.

Forecasters can incorporate a wide range of possibly useful variables in initial model trials to test their explanatory power against historical data. The statistical models in the form of mathematical formulas will indicate which variables have significant correlations with the dependent variable. Some will have a positive relationship with sales (e.g., competitors' prices), while others may have an inverse relationship (e.g., own brand prices). By running practice tests against different subsets of time series data, some correlations between the two will emerge as truly causal in nature. The final model that emerges from this iterative trial-and-error process will include the set of mathematical relationships between variables that are the most effective in predicting future sales.

Multivariate regression analysis is a potentially powerful tool. It can incorporate a wide range of variables and evaluate their reliability as sales predictors. Among the marketing mix variables most commonly included in these causal models are changes in advertising expenditures, sales promotions, and pricing at various points in the channel of product distribution. Causal approaches to forecasting tend to be complex and provide the means to recognize a wide range of potential influences on product sales, including interactions between independent variables.

Qualitative Forecasting Methods

Quantitative forecasting methods rely exclusively on inferences from the extrapolation of trends in historical data to predict future sales. By contrast, qualitative forecasting techniques utilize the judgment and expert opinion of knowledgeable professionals to generate forecasts. A primary advantage to these methods is that they can be applied in situations where historical data are not available. However, even in contexts where historical sales data are readily available, qualitative forecasting methods can be used to qualify or fine-tune statistical projections.

Expert opinion is a subjective approach to forecasting that relies exclusively on the judgment of individuals who possess specialized knowledge of buyers, competitors, and products. Companies often rely on experts from a variety of sources to provide their unique insights on the market. These sources may include customers, suppliers, channel intermediaries, trade associations, or consultants. The opinions provided by these experts may be influenced by quantitative forecasts, but their forecast is typically an independent extension of judgment beyond projections grounded in historical data.

The complexity of competitive business environments poses a significant challenge to statistical forecasting. It simply cannot account for all of the factors and interactions between factors that influence market-related behaviors at any given time. The advantage of expert opinion and judgment over statistical forecasting methods is the ability of the human mind to synthesize information from a wide range of qualitative and quantitative sources.

The Delphi method is a qualitative method that relies on the interaction of multiple expert sources to develop forecasts through group consensus. Although the specific steps in the methodology may differ from one organization to the next, the process is relatively simple. Initially, the company that wants to develop a forecast contacts a group of experts from different backgrounds to answer the same set of structured questions about the future of the product or brand of interest. Each of the experts completes his or her responses independently and returns them to a coordinator. Subsequently, each participant in the process receives feedback about the anonymous responses of the other forecasters. In this second iteration, the team members return their revised responses based on the input from round one.

This Delphi process is an iterative one that continues until there is a relatively high degree of agreement and certainty among the forecasters' responses. Although there are many variations on the specific procedures used, in every instance the objective of this endeavor is to build a consensus view of future events.

Expert panel methods are similar to the Delphi method insofar as they rely on the opinions and judgment of many professionals. However, expert panels are assembled and brought together to directly share and compare views. Individuals' forecasts are each given due consideration before the participants begin working to converge on one common forecast for the future.

In most instances, the expert panel is drawn from diverse professional backgrounds (e.g., academics, corporate executives, consultants). However, there are times when the forecasting task requires a gathering of individuals with a common background. Some companies routinely gather their sales representatives to provide insights on the market and sales forecasts for the next period. Since members of the sales force are in immediate contact with both existing customers and prospective buyers on a daily basis, they can be a valuable and reliable source of marketing intelligence.

The gathering of the sales force described above is sometimes combined with simple quantitative forecasting. In this version, called the sales force composite method, each salesperson prepares forecasts for his or her own territory. Prior to gathering together as an expert sales panel, the forecasts are consolidated across products, brands, and geographic regions and distributed for subsequent discussion by the whole group.

A group of executives having a meeting

Accurate forecasting requires both the analysis of historical data and subjective judgments about the future.

Photodisc/Thinkstock

Another variation on the basic model of expert panels is the jury of executive opinion. In this version, participation is limited to the top executives within a company. Though farther removed from the field than salespeople, executives possess a perspective on the larger trends and market developments that is essential to making good decisions on new products and emerging technologies.

Simulation is a final variation on the use of expert opinion that can be combined with any of the procedures described above. A simulation consists of providing experts with several written, conceptual scenarios of the future based on clearly defined assumptions. Participants are asked to respond to the scenarios by indicating which they believe is most likely to occur. In many instances, the discussions about the validity and reliability of the assumptions built into each of the scenarios provide valuable insight by itself. However, the final product of this procedure is the same as with other forms of qualitative forecasting: to build a consensus prediction of future events.

Market methods of sales forecasting are qualitative techniques that do not depend on the expert judgment of business professionals, but rather rely on the opinion of current customers and prospective buyers. However, it is worth noting that market surveys are not typically designed and executed only for the sake of forecasting, since many of the same insights can be gleaned from a combination of the company's internal data and external published sources.

Similarly, market tests are used to gauge consumer responses and assess the viability of a wider product introduction or market rollout. The results of these field tests for new product concepts are intended to assess the interest of potential customers in buying the product. The actual sales forecasts and other measures of a product's potential are completed prior to field testing a new product concept.

Ch. 4 Conclusion

Quantitative forecasting methods provide predictions of future sales based on the analysis of historical sales data and anticipated future market conditions. Qualitative approaches allow marketing managers to incorporate the judgment and opinions of experts within the field. Forecasts enable companies to evaluate current performance and prepare for future sales levels. The prediction of slowing or declining sales provides an opportunity for firms to re-evaluate their marketing plans and explore alternative opportunities for growth.

Accurate predictions of future demand growth enable organizations to compete and function more effectively by making their operations more efficient. Reliable sales forecasts can facilitate more efficient production planning, improve customer service, and generally improve the allocation of the firm's resources to match consumer demand. In this way, the competitive advantage provided by better sales forecasting can result in lower costs, higher margins, and improved levels of customer satisfaction and brand loyalty.

Ch. 4 Learning Resources

Key Ideas

Key Terms

Click on each key term to see the definition.

available market

Those buyers who possess both the interest and means to purchase a specific product under current market conditions.

brand usage gap

The difference between potential sales to the target market and the current level of brand usage by customers within the targeted segment of the market.

causal study

An analysis in which historical time series data (e.g., sales) are combined with other time series data (e.g., advertising expenditures) related to the variable being forecasted (e.g., future sales).

cyclical component

The element in a time series study that incorporates any regular wavelike pattern in the sequences of values.

Delphi method

A qualitative forecasting method that relies on the interaction of multiple expert sources to develop forecasts through group consensus.

expert opinion

A subjective approach to forecasting that relies exclusively on the judgment of individuals who possess specialized knowledge of buyers, competitors, and products.

expert panel methods

A qualitative forecasting method that relies on the opinions and judgment of many professionals. Unlike the Delphi method, however, expert panels are assembled and brought together to directly share and compare views.

exponential smoothing

A process for weighting the observations in time series data to place greater emphasis on the most recent observations.

gap analysis

A variety of comparisons that examine the difference between actual performance and potential performance on measures of interest to marketing managers.

irregular component

The element of a time series study that is caused by short-term, unanticipated, and non-recurring factors that impact the observed values in the data set.

jury of executive opinion

The top executives within a company serve as an expert panel to consider long-range trends that may impact the organization.

long-range forecasting

Making predictions for periods greater than one year into the future.

market demand

The total volume or amount of a specific product purchased by consumers over the complete range of prices at which it is sold.

market methods

Qualitative sales forecasting techniques that rely on tapping the opinion of current customers and prospective buyers.

market penetration index

The ratio of current market demand to potential demand level.

market potential

A measure of the maximum total possible sales of a given product over a fixed interval of time.

Market Potential Index

A multi-factor index of market potential for emerging global markets created by the Michigan State University Center for International Business and Economic Research.

medium-range forecasting

Making annual forecasts or predictions.

multivariate regression analysis

The most common technique used to carry out causal time series analyses. This statistical forecasting tool identifies relationships between sales (the dependent variable) and one or more influencing factors (independent variables).

naive forecasting

The prediction that sales for the next period will be the same as sales for the previous period.

product usage gap

The difference between total market potential and current product usage by all customers within a given market.

qualitative forecasting techniques

Using the judgment and expert opinion of knowledgeable professionals to generate forecasts.

quantitative forecasting methods

Using the analysis of historical data to predict future sales.

sales force composite

A two-part qualitative forecasting technique. The organization's sales force serves as the expert panel. Additionally, however, each salesperson prepares forecasts for his or her own territory. Prior to when the expert sales panel comes together, the forecasts are consolidated and distributed for later discussion by the group.

sales forecasting

A specialized subfield within the domain of market research that provides predictions about markets, customers, and competitors. Almost all forms of marketing-related forecasts relate either directly or indirectly to predicting future sales.

sales potential

The portion of the market potential that a firm can reasonably expect to reach. An estimate of the size of the brand's target market.

seasonal component

The element of a time series study that accounts for regular, recurring patterns of variability at specific times of the year.

share penetration index

The ratio of the brand's current sales to its potential sales.

short-range forecasting

Making predictions less than one year into the future.

simple linear regression analysis

A statistical forecasting tool that identifies relationships between sales (the dependent variable) and one correlated factor (independent variable).

simulation

A qualitative forecasting procedure that begins by providing a panel of experts with several written, conceptual scenarios of the future based on clearly defined assumptions. Participants interact to reach consensus on which scenario and set of assumptions represent the most likely depiction of future events.

time series

A set of quantitative observations collected at successive points in time over a specified period or interval.

time series study

An analysis in which historical time series data are used exclusively to predict future values of the same variable.

trend component

The element in a time series study that accounts for the gradual shifting of the time series data over a long period of time.

Web Resources

This website is an excellent general reference site on forecasting and forecasting methodologies. It includes a forecasting dictionary as well as the Standards and Practices for Forecasting. This is a statement of 139 principles that are used to summarize knowledge about forecasting.

http://www.forecastingprinciples.com/

This website is owned by an independent research firm that actively monitors consumer-related trends in more than 120 countries worldwide. The site includes free access to a monthly trend briefing and an archive of previous findings on information related to emerging trends and patterns in consumer markets around the world.

http://www.trendwatching.com

This website is a white paper briefing on the unique challenges of sales forecasting that confront manufacturers. It provides a good overview of the value and obstacles related to accurate forecasting based on a market research study conducted in December 2009. In total, 274 manufacturing executives and managers employed in their operations, sales, IT, supply chain, or manufacturing production business units participated in the study.

http://www.right90.com/whitepapers/answering\_the\_sales\_forecasti...ge\_for\_manufacturersFINALPRINT.pdf

The Michigan State University Center for International Business and Economic Research (MSU-CIBER) publishes its Market Potential Index, which marketers use as a preliminary assessment to evaluate emerging global markets.

http://globaledge.msu.edu/resourcedesk/mpi/

The Census Bureau website provides the most comprehensive source of U.S. demographic and economic statistics. Resources on this site include the American Factfinder, Current Industrial Reports, Economic Census, Industry Series, and Statistical Abstracts.

<http://www.census.gov/>

Chapter 5

Analyzing Markets: Decision Making and Buyer Behavior

Family getting the keys to their new home

Lifesize/Thinkstock

Learning Outcomes

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

 Understand how personal, social, cultural, and economic conditions influence buyer behavior.

 Know that the processes that direct how consumers evaluate and select brands depends in part on their involvement with the purchase situation and product.

 Realize that a teaching or cognitive learning approach to influencing brand preferences requires active involvement by the buyer.

 Be able to describe the organizational buying process and the three types of buying situations.

 Recognize the significance of the buying center and its influence on decision making in B2B contexts.

Ch. 5 Introduction

This chapter examines the two classes of markets to which businesses sell their products: organizational buyers and the ultimate consumers. The organizational market is made up of businesses or other institutions that buy raw materials, semi-finished products, and fully finished products with the intent to resell final goods into the retail consumer, enduser market. The consumer market includes individual purchasers as well as households, families, and other purchasing retail groups.

We will begin by examining the environmental influences and decision making processes that are specific to the individual, retail consumer. We will then briefly review how personal, psychological, and cultural factors impact markets before turning to a close examination of how the buying decision process directs purchase behavior. The closing sections of the chapter examine organizational buying behavior. They explore how business-to-business markets differ from retail consumer markets. This includes an investigation of the three classes of B2B buying situations, the steps involved in the buying process, and the identification of the participants involved in the business purchasing process.

Marketing managers need to understand the decision making processes of individuals and organizations in order to influence their product and brand-specific choices. Knowing the methods that different individuals and groups use to evaluate alternatives enables marketers to develop segment-specific marketing programs to impact the outcome of these choice processes. However, brand preferences and choice decisions are not created in a vacuum. Cultural, social, and personal influences have direct and indirect impacts on how consumers make decisions.

\* \* \*

One of the reasons that market researchers rely on the study of large numbers of consumers is that individual behavior is subject to wide variability. But it is still surprising when professionals in their respective fields are the outliers . . . the exceptions to the norm.

Consider the case of Nancy Gerhardt, a 31-year-old real estate agent from Chicago who relocated to the Tallahassee, Florida, area. As she explained to her new Sunshine State colleagues, when it came to buying a house for herself, she was a great client to work with because she knew exactly what she wanted: "I really am my own favorite client!" In the Tallahassee metro area, she was intent on finding a modern, maintenance-free condo or townhome with low homeowners' association (HOA) fees. She insisted on living within walking distance of city amenities and downtown shops. She'd settle for two bedrooms and one bath, just as long as her new home met her three Cs criteria: carefree, contemporary, and close to where the action is.

You can imagine the surprise of her colleagues when, only three weeks later, she closed on the purchase of a three-bedroom, two-bath 1920s Craftsman-style bungalow in the remote suburbs outside the city limits. It wasn't near "the action" or much else other than houses, though it did have beautiful gardens and a huge yard to mow. Her explanation for this choice from among the hundreds of homes available was concise. "Well . . . I know it isn't exactly what I said I wanted," she offered with some embarrassment, "but I couldn't help myself. It just looked so . . . ummmm . . . so cozy!"

5.1 Social and Economic Influences on Consumer Behavior

The decision making behavior of individual consumers is significantly affected by environmental influences in two distinct ways. Cultural, social, and personal factors impact the product wants, needs, and preferences of individual purchasers; these factors also shape their perception of the available brands. Psychological influences shape consumers' motivations to buy and their assessment of the importance of each purchase situation. The role of marketing within this context is to provide prospective buyers with brand-specific information and images consistent with the influence of all of these different factors. That is, marketing is most effective when working with the flow of these sources of influence rather than struggling against the tide. Marketing is most efficient when adapting to the nature of the customers we serve rather than trying to change them. This is a particularly important consideration with respect to the influence of cultural factors on buyers' behavior.

Cultural Factors

As discussed in chapter 3, cultural and social factors are critically important concerns for marketing managers because they profoundly impact consumers' receptivity to the marketing efforts of the firm. As product strategies aim to satisfy the preferences of clusters of buyers, the significance of these factors is amplified insofar as they provide bases for understanding important shared characteristics within market segments.

The Indian Chicken Maharaja Mac from McDonalds

The Indian Chicken Maharaja Mac reflects McDonald's responsiveness to cultural preferences.

Demotix/Corbis

A buyer's cultural background is evidenced by his or her beliefs, attitudes, values, and customs. The differential impact of culture on purchase behavior is sometimes difficult to discern, however, because its effects are so pervasive. As both consumers and marketing managers, culture filters our perceptions of the world around us, and it can be difficult to detach ourselves from our built-in biases. For example, perceptions of what kinds of food are most appetizing are initially directed by the culture we are immersed within, and these beliefs are reinforced as we grow and develop until they are an integral part of our makeup.

Cultural background heavily influences many personal, social, and economic activities. It can impact our shopping habits, our attitudes toward brands, and personal values and priorities. Promoting U.S. brands to foreign countries is an obvious instance where marketing managers need to be keenly aware of the impact of cultural differences on purchase behavior. Less obvious, however, is the need to re-shape the cultural content of marketing programs when a company wishes to target consumers who have emigrated from other countries. Less obvious still is that not everyone born in the United States shares the same cultural roots.

Hispanic Teen Consumers

A consumer research group is studying Hispanic teens to get an understanding of consumer behavior. In addition to being consumers in their own right, Hispanic teens influence the purchases made by other generations within their families. What would marketers have to consider when appealing to a cultural group?

Subcultures are groups of people who are differentiated from the broader culture in which they live by shared beliefs and characteristics that identify the group as distinct from the whole. These factors often include geographic region, ethnic origin, racial identity, religious beliefs, occupation, political traditions, and other factors that make the members of the subculture more like each other than those outside the group. In many instances, these affiliations with specific subcultures impact consumer lifestyles and, consequently, purchase preferences.

A group of elderly people talking on a porch

Senior citizens are among the largest and most influential age-defined segments for many types of products.

Comstock/Thinkstock

Age is among the most common bases for segmenting markets and the basis for understanding several different subcultures. People of the same age group tend to have had similar life experiences and share more preferences and values. As consumers move through their life cycle, their product preferences change as well. Since the market for many types of media are reported according to age and sex of the audience, age is a particularly useful basis for tracking buyer behavior. As marketers develop marketing mixes to suit the tastes and preferences of specific age segments, it is relatively easy to find corresponding media through which they can be reached.

Consider the characteristics of senior citizens as an age subculture. People over 65 years of age have very different health concerns than younger cohorts. They value living independently, an issue that younger generations seldom pause to consider. As a group, family ties and close friendships have greater significance for this generation than for others. They have more leisure time than other age segments, and many enjoy the discretionary income to pursue favorite hobbies and pastimes. Some purchasing patterns are well established for this subculture, and brand loyalty is higher for this segment than all others. Each of these characteristics and values has substantial implications for marketing to this subculture that makes it distinct from every other generation.

Think About It

The baby boom generation includes those born between 1946 and 1964. Generation Xers were born between 1965 and 1985. Those in Generation Y were born between 1986 and 2002. Generation Z includes those born in 2003 and later. Pick one of these age cohorts and describe how their shared history has shaped their values.

How can these shared values be related to creating brand preferences?

A wide array of subtle and apparent differences exists within any nation's cultural mix. Consider how differences are expressed in how everyday events such as birthdays, weddings, and funerals are observed. Subcultures can vary widely—from the holidays they observe; to the attitudes they exhibit toward matters such as debt, negotiating, shopping, and consumption; to their views on subjects like gambling, global climate change, and professional sports. The differences of direct relevance to marketing managers are those that impact brand preference and purchase behavior. In addition to the impact of cultural context, consumers' personal economic circumstances and social class standing also have direct bearing on their behavior in the marketplace.

Think About It

Did you grow up in a Ford or Chevy household?

Does your family eat the evening meal at the same time that you did growing up?

Is your preferred brand of peanut butter rooted in your personal background and culture?

For which products and brands that you regularly purchase can you see a cultural connection?

Personal Economic Factors and Social Class

Discretionary income and disposable income are related measures of earnings that play large roles in both the ability and willingness of consumers to purchase nonessential goods. Disposable income is the amount of money that households have available to spend after income taxes have been accounted for. This measure is often used by economists as a key indicator to evaluate the health of the economy at large. Discretionary income is the spendable portion of disposable income available to households after deducting the cost of necessities such as shelter. This measure is of more direct interest to most marketers since consumers have the freedom of choice to spend this money in accord with their wants rather than their needs.

Discretionary income can be thought of as a pool of dollars that is available on a competitive basis. Those products and brands best suited to meeting the emotional and psychological needs of potential buyers are able to capture a share of that pool. The aggregate size of the pool, however, is subject to the ups and downs of the economic cycle. Sales of particularly expensive luxury items are often hurt disproportionately during extended periods of economic stagnation or decline.

It is tempting to regard the role of economic factors in consumer decision making as strictly a matter of dollars and cents. However, a number of psychological considerations are at work here as well. Consumer confidence is an assessment of how optimistic consumers feel about the future state of the economy and their personal financial situation. High levels of confidence in the future tend to produce higher levels of discretionary spending in the present. It is important to note that purchase behaviors typically change in anticipation of future events, not in response to current conditions. In this sense, consumer confidence is regarded as a leading economic indicator.

Social class is an economic construct used to describe a person's standing or place in society. It is usually determined by a combination of economic and social factors including occupation, income, and education. Social classes tend to promote the establishment of an economic hierarchy where groups attain greater or lesser status in their communities. Consumers often assert their current social status through the brands they buy. However, in many instances, the purchase of high-status or prestigious brands reflects the aspirations of the buyer to ascend to a higher social level. Buyers using brand-specific purchases to convey a high status image is referred to as conspicuous consumption. This pattern of buying high-end brands to impress others can be readily observed in the markets for fashion, luxury cars, and fine wines.

Some brand strategies intentionally appeal to the drive for conspicuous consumption. Aspirational brands are those that many status seekers may wish to own, but cannot. Both premium pricing strategies and quantity limitations imposed by the manufacturer create an artificial scarcity that enhances the desirability of the brand. The portion of the market that hopes to someday be able to afford the purchase is sometimes referred to as the aspirational audience for the brand.

Think About It

One of the best places to find aspiration brands is in the pages of magazines. Many readers of magazines that focus on fashion, cars, celebrities, and fine living are escaping into an environment that is very much unlike their current situation. Advertisements within these publications offer readers the opportunity to share in this "better world" by purchasing their products.

Identify three magazines that seem to be directed to an aspirational audience. What brands are featured in their pages?

What type of message or appeal are the advertisers using to reach their intended target market?

The level of discretionary income that defines a market segment is often a good predictor of brand preference for basic, functional, low-status expenditures (e.g., laundry detergent). Social class, however, can be more relevant to understanding the basis for brand preferences when the product involved contributes to the self-image of the buyer or is intended by the buyer to convey information to others about himself or herself (e.g., country club memberships).

5.2 Psychological Influences on Consumer Behavior

Psychological influences are those unique, personal factors that impact consumers' motivations to purchase and shape their perception of the importance of the purchase. Factors such as learning, memory, and motivation play key roles in how consumers experience and respond to marketing efforts, particularly advertising. As consumers we assign different levels or degrees of importance to purchasing situations as a function of their relevance to our lives. This perceived relevance of a product to our wants and needs is termed involvement.

Motivation

Woman shopping for her daughter's jeans at the Justice Store.

For many consumers, there are multiple influences on product preference and brand choice. Above, a woman shops for her daughter's jeans at a Justice store. Why did she choose Justice?

Associated Press

Consumer motivation refers to the internal state or processes that drive people to purchase products or services that they believe will fulfill conscious and unconscious wants and needs. Marketing strategies are oriented toward creating products that deliver a bundle of benefits that will satisfy the drives of target customers.

Beyond the basic need for life's essentials such as food and shelter, there are a number of types of needs that motivate people to purchase goods and services. For example, some food purchases stem from motivations other than simply hunger. Neither chocolate nor pizza is essential to survival. Clothes are necessary, but designer jeans are not. Given discretionary income, consumers can choose to simultaneously meet basic needs while expressing taste preferences or their individual sense of fashion and style.

The desire to belong or fit into certain groups or subcultures is reflected by purchases that convey status or affiliation with the group. The drive to relax or have fun directs purchases of games, toys, and recreational equipment. Products geared primarily toward satisfying the drive for experiential pleasures are sometimes termed hedonic products. Many vacation and resort services, for example, are geared toward providing customers with a luxurious and relaxing escape from their everyday lives. In many contexts, the role of motivation in shaping behavior is mediated by the consumer's involvement.

Think About It

Many marketing campaigns that target Generation Y and Generation Z make the claim that their brand will allow users to express their individuality. Since these brands are being sold to millions of customers, why would this approach to satisfying the buyer's need for uniqueness be successful? Think of examples where this type of promise is being made both explicitly in the language of the advertisement and implicitly through the use of images.

Involvement

Involvement is a pivotal concept in marketing. It is a measure of the perceived relevance or importance of a product to our wants and needs. Consumers' involvement with a product category or brand is typically described along a continuum ranging from high to low importance. As the American Marketing Association explains it, "High involvement products are seen as having important personal consequences or as useful for achieving important personal goals. Low involvement products are not linked to important consequences or goals" (2011).

The level of importance assigned to a purchase, however, is unique to the individual and his or her motivations. Purchasing a new cell phone may be a critical decision for one buyer if she feels that this product will significantly contribute to her satisfaction with daily life or make a personal statement to others. Another buyer may simply see functional or utilitarian value in being able to make calls when away from home.

A 1999 Jolly Green Giant advertisement for their frozen vegetables

This humorous ad focuses on the brand's image of consistently providing a quality product to its customers since 1925. What makes the Jolly Green Giant an appealing spokesperson?

Associated Press

Although product involvement is specific to the individual consumer's level of interest, certain characteristics tend to make the purchase decision for some products more involved than others. For example, buyers often spend more time and effort evaluating brands for purchases in product categories that are relatively unfamiliar or expensive. Any product decisions that are seen as either physically or psychologically risky will typically raise consumers' level of attention in the purchasing process as well. By contrast, products that are inexpensive, frequently purchased, and require a minimum of thought or effort are low involvement products. Virtually all routine or impulse buys are low involvement purchases.

In many instances, market strategies are designed to increase prospective buyers' motivation to buy and involvement with the buying process. Advertising techniques used to heighten interest in a brand include entertaining messages, celebrity endorsements, and various attention-getting special effects, as well as value and price promotions.

Understanding whether a product corresponds to a relatively high or low involvement purchase decision is an important consideration in the determination of brand strategy. If a purchase is important to a consumer, then buyers can be engaged in thinking about the merits of one brand versus the available alternatives. Auto makers, for example, can promote their products by providing detailed information about the specific attributes of the product (e.g., gas mileage, safety rating) only because buyers are motivated to listen and learn. Appealing to buyers as thoughtful, rational consumers can only be effective if they are motivated to pay attention to the information and incorporate it into their decision making.

The strategy of appealing to intellect and reasoning will not be effective for buyers in low involvement contexts. Although products like frozen vegetables can be differentiated by marketers on the basis of tangible attributes (e.g., freshness, color), the task is more difficult since buyers simply are not that interested in the relative merits of one brand over another. As a consequence, you often see promotional themes for low involvement product categories appealing to buyers on the basis of emotion rather than intellect. The use of attractive models, cute baby animals, and animated spokespeople (e.g., the Jolly Green Giant) reflects an effort to make shoppers like the brand without having to learn anything specific about the category.

Think About It

On any given day, thousands of advertisements in the mass media are intended to influence consumers' preferences based on seemingly irrelevant gimmicks. Talking animals, animated super heroes, talking infants . . . it is a very long list. Identify three brands from the same low involvement product category and explain how each employs a different tactic of this sort to position its brand against competitors.

Learning

Marketers would like all of their prospective customers to learn everything about the products they sell. However, the proliferation of competing brands and advertising messages overwhelms the buyers' ability to keep track of all the information they are bombarded with on a daily basis. In fact, consumers have little incentive to pay any attention to most media messages. In this climate, it can be very difficult for marketers to impact brand preference. Knowing whether consumers view the purchase of your product as a high or low involvement decision should dictate how you approach the process of teaching them about your brand.

Learning is the term used to describe the process by which people acquire new knowledge and preferences, which in turn provides the basis for enduring changes in behavior. It is important for marketers to understand how consumers learn about products and services if we want to influence their behavior. The process by which consumers learn about products within a high involvement context differs substantially from low involvement situations. In high involvement circumstances, consumers are motivated to acquire more information about brands to improve the outcomes from their purchase decision. Under low involvement, the consequences of a suboptimal brand choice are not sufficiently serious to warrant much evaluation of alternatives. Based on this contrast, marketers need to be aware of two paths to teaching consumers about their brands: behavioral learning (low involvement purchases) and cognitive learning (high involvement purchases).

Behavioral Learning and Low Involvement

Behavioral learning describes passive learning that takes place in response to external events. One of the primary forms of behavioral learning is classical conditioning. In classical conditioning, a previously known stimulus that elicits a positive response is repeatedly paired with another, neutral stimulus. When a subject experiences this paired association of stimuli several times, he or she passively learns to associate the previously neutral stimulus with the pre-existing positive feelings associated with the initial positive stimulus.

This principle was first established by Ivan Pavlov in his famous experiments on training dogs. The repeated pairing of a ringing bell with the presentation of meat powder caused the dogs to learn the association between the two stimuli. In subsequent experimental trials he observed that the dogs would salivate at the sound of the ringing bell, even in the absence of the meat powder. This model of learning without conscious effort has direct applications to the process of shaping consumer preferences under low involvement.

The use of attractive models, celebrity endorsers, star athletes, cute children, lovable puppies, poignant family scenes, amusing animated figures, memorable musical themes, and generally positive imagery in advertisements is often intended to serve as the positive or previously learned stimulus. New brands or unfamiliar brands are the neutral stimulus. The repeated pairing of the two will increase the strength of the associations between the two stimuli over time and reinforce the transfer of emotional content from one to the other. In markets that are overcrowded with both competing brands and media advertising, this approach to shaping preferences without the deliberate participation of the audience can be very effective given sufficiently high levels of repetition.

Think About It

The ability to influence individuals' attitudes without any effort or awareness on their part is a potentially powerful marketing tool. However, the use of classical conditioning in advertising has raised some ethical concerns within consumer advocacy groups.

Can you think of any ethically questionable practices related to the use of this persuasion strategy?

Are there certain groups of consumers who should be shielded from this practice?

Cognitive Learning and High Involvement

Cognitive learning describes an active learning process based on information processing within the mind of the consumer. The process is typically prompted by the perceived need to make a decision or solve a problem. In contrast to the passive learning that takes place under classical conditioning, cognitive learning requires both the motivation to think about an issue and the dedication of some portion of the individual's conscious attention.

There are many different models of cognitive learning, but each of them is centered on the processes by which consumers acquire, process, retain, and retrieve information. For marketing managers, the important endpoint of the process is the formation and persistence of an attitude.

In simplest terms, an attitude is the feeling of liking or disliking something. It is a relatively stable and enduring emotional or affective response that directs our behavior toward the object of the attitude. Insofar as products are bundles of benefits, an attitude toward a product represents an individual's summary evaluation of how good the bundle is relative to his or her needs. The marketing efforts of a firm can influence attitudes via two routes. The first is through classical conditioning as discussed in the previous section. The alternative is through the cognitive learning path where exposure to new information creates new attitudes or alters existing ones.

To impact attitudes through cognitive learning, marketers need to carefully examine the bundle of benefits provided by a product to understand which product attributes are most important to a given target market. These key attributes will be those elements of the product that most significantly impact brand choice and provide the basis for positioning your brand in a competitive market. Marketers rely extensively on multi-attribute models to understand how consumers' attitudes and behaviors are shaped by their perceptions of product attributes.

Think About It

Suppose that you needed to replace your car in the near future.

How would you describe the bundle of benefits that you would be looking for?

Which features or attributes are "must haves" and which are optional for you?

Can you prioritize that list of features and specify the order of importance?

If a car salesperson knew what this list looked like, how could she use it to help her make a sale?

Multi-Attribute Models

Of all the psychological factors that can influence purchase decisions, attitudes are the most powerful. In the absence of interference from factors beyond people's control their attitudes will determine which brands they buy, which stores they shop in, how they choose to finance large purchases, and so on. Multi-attribute models investigate the organization of consumer attitudes toward brands as a composite of beliefs about product attributes. In this model, attitude is a function of the beliefs about brand attributes that the consumer regards as essential to the product, weighted by the importance of those categories of beliefs. This formulation of how attitudes are created and changed can be expressed mathematically.

Figure 5.1: Multi-attribute model of attitude

The multi-attribute model of attitude towards a brand.

The components of consumers' attitudes toward a brand are their beliefs about how well it performs on any given attribute (bi) and the importance that the buyer attaches to that attribute (wi).

The multi-attribute model shown in Figure 5.1 demonstrates that a buyer's attitude toward a brand is a function of the beliefs that he or she holds about its attributes. Specifically, the three elements this model of attitude comprises are attributes, beliefs, and important weights. The bi elements of the model reflect consumer beliefs about how well a given brand performs on any given attribute. The wi elements of the model refer to the importance weight that buyers attach to any given attribute. Consequently, a consumer's attitude toward a brand is dependent on his or her beliefs about how well the brand delivers the promised attributes and the importance that he or she attaches to each of these attributes or benefits.

A shopper looking through the Sears department store looking at refrigerators.

Comparison shopping for product information is consistent with the multi-attribute model of attitude development.

Associated Press

Consider the example of a consumer's attitude toward different brands of refrigerators. Having already made some preliminary choices about minimum style and performance features (e.g., must be a stainless steel, side-by-side model with in-door ice dispenser), the buyer is primarily concerned with evaluating the alternative brands on four remaining product attributes: price, freezer volume, energy efficiency, and vegetable crisper capacity. (Additional features may be considered but may not be important enough to be mathematically significant.) Further assume that there are four brands under consideration (Brands A through D). Importance weights are assigned to each of the four attributes on a 1 to 10 scale, where 10 is most important. Attribute evaluation scores for each brand are also scored on a 1 to 10 basis, where higher numbers reflect levels of benefits closer to the buyer's ideal point.

Several marketing applications for the multi-attribute model can be gleaned from an examination of the sample data provided in Table 5.1. The analysis of survey data from a large number of prospective refrigerator shoppers will enable marketing managers to define different market segments based on the benefits or attributes that they weight most heavily. There may be a price segment, an energy efficiency segment, a style segment, a functional value segment, and so on. A multi-attribute approach to the study of markets can reveal which combination of benefits is most important to a given target market. The application of this model in market research contexts can illustrate how attitudes provide a summary evaluation of how good the benefits bundle is relative to the needs of different segments.

Table 5.1: Multi-attribute example

Attribute Beliefs (bi)

 Importance (wi) Brand A Brand B Brand C Brand D

Price 7 8 9 6 3

Freezer Volume 5 9 3 3 3

Energy Efficiency 4 4 5 6 9

Vegetable Crisper Capacity 2 8 2 1 9

Attitude Score 133 102 83 90

From a strategic perspective, the bi and wi measures of multi-attribute models provide information that can be used to assess the level of differentiation between brands and establish goals for brand positioning. Multi-attribute models of consumer attitudes supply the data required to create the types of positioning maps shown in Chapter 1. Maps of this sort are typically used to examine the gaps that exist between a brand's desired positioning strategy and the market's current perceptions.

The multi-attribute model is not intended to provide a precise, accurate depiction of how consumers use information to form attitudes in every circumstance. Over time, however, it has proven to be a very good descriptive and predictive model when applied to the study of large groups or market segments. As a tool for planning marketing strategy, it can be used to answer several key questions about consumer behavior. Properly specified, it can indicate how consumers use information to evaluate alternative brands and which product benefits are of greatest importance to a given segment of the market.

Think About It

Apply the multi-attribute model of attitude formation to the process that you might use when making decisions about your next major purchase (e.g., car, computer).

How accurately does the model describe the process you are likely to go through in reaching a decision?

What are the advantages to marketing managers of examining behavior within the context of this type of model?

Attitude Formation Under Low Versus High Involvement

For both low and high involvement products, purchase decisions are driven by specialized attitudes that we refer to as brand preference. In both contexts, attitudes are formed through learning. Under low involvement, learning typically occurs without the active mental involvement of the individual. The repeated pairing and linking of stimuli as described by the classical conditioning paradigm is one of the most common paths to attitude formation under low involvement. In addition, consumers can learn attitudes from the rewards or outcomes associated with past behavior via instrumental conditioning.

Instrumental conditioning is a form of passive learning that occurs based on the punishment and rewards associated with a specific behavior. Within many low involvement contexts, an individual will modify his or her behavior over time due to its consequences. Coupons and rebates, for example, are intended to provide shoppers with positive reinforcement of their brand purchase behavior and encourage future purchases. Ideally, satisfaction with the product itself should be the primary source of positive reinforcement. Under high involvement situations, attitudes are learned from the processing of information about the object of the attitude. Information may come from direct experience with a product, experiences shared by friends, or exposure to marketing-controlled information sources such as advertising.

Procter & Gamble Co. products Tide with Downy, Crest with Scope, and Puffs with Vicks

Even successful product launches like the Puffs Plus Lotion brand can be modified to extend its appeal by adding new features such as the soothing scent of Vicks.

Associated Press

The three primary means by which marketers can directly influence buyers' attitudes are evident from the mathematical formulation of the multi-attribute model. Marketing programs can try to change consumers' beliefs (bi values) about their brand relative to competitor brands. For example, Puffs might advertise that its brand is stronger than competing brands of facial tissue. However, it can also try to leverage the impact of attributes for which it already has high brand-specific scores by increasing their perceived importance and importance weights (wi values). If the Puffs Plus Lotion brand is already recognized as gentler on one's skin than competitors' brands, the brand manager might decide to promote the relative importance of tissue softness to personal comfort and skin care. Finally, marketers can choose to add new attributes to the set of considerations that consumers use to evaluate alternative brands. For example, a facial tissue manufacturer that can't compete on other product qualities (e.g., strength, softness) could introduce a new feature such as the infusion of antimicrobial gel into its brand.

If initially successful, subsequent marketing efforts for this new brand could focus on raising awareness of the risks associated with common household germs to elevate the weight (wi) that consumers attach to this new feature. Alternatively, advertising messages could be aimed at reinforcing buyers' belief (bi) that this new brand is best at fighting common household germs. Some combination of the two is most likely for this emerging brand and would provide a viable path to improving buyers' attitudes toward this new competitor.

5.3 The Purchase Decision Process: A Five-Stage Model

Just as marketing managers need to understand how attitudes direct purchase behavior, they need to understand the process by which consumers make decisions about the products they buy. Purchase decisions are made in a series of stages that result in the selection of one alternative over other competitive choices. Decisions related to purchase of high involvement products typically require greater attention and mental effort than low involvement decisions. In fact, the habit-strength related to some low involvement purchases (e.g., buying chewing gum) makes the actual process nearly automatic.

The five-stage model described in this section relates specifically to high involvement decision making. Since the consequences of low involvement decisions are less important to consumers, the cognitively intensive processes of searching for relevant information and thoughtfully evaluating alternatives are generally omitted. Consequently, the corresponding three-step model for low involvement decision making is far simpler.

Figure 5.2: Low versus high involvement decision processes

The low involvement decision is: problem recognition to purchase decision to post purchase evaluation. The high involvement decision process involves: problem recognition, information search, evaluation of alternatives, purchase decision and post purchase evaluation.

The buying center roles include influencers, gatekeepers, deciders, buyers, and users. How do these relate to one another?

It is worth remembering that the distinction between high and low involvement decision making illustrated in Figure 5.2 is not intended to be absolute. High and low involvement anchor the endpoints of a spectrum, and purchase decisions may share some characteristics of both extremes. In addition, the unique characteristics of the purchasing occasion or context can shift the perception of a product's importance from one extreme to the other. Buying a watch at the hotel gift shop because you left yours at home is a much different experience than buying a watch as a gift on your 25th wedding anniversary.

To illustrate the purchase decision process five-stage model, we will follow one high involvement decision process from start to finish. We will consider how a 30-year-old woman decides to find an obstetrician for the first time.

Problem Recognition

Problem recognition (consumer buying) is the first stage in the five-step purchase decision process model. It occurs when a consumer becomes aware of a need that must be met and recognizes that a particular product or service is required.

So, what factors might trigger thoughts about selecting an obstetrician? Learning that you're pregnant. Turning 30 years old. Hearing that a close friend or relative is pregnant. News stories on fertility. A husband's remarks about starting a family. Possibly even advertising.

Information Search

Once consumers recognize an important (high involvement) problem, they typically initiate an information search that will help them better understand and solve the problem. An internal search is the process of scanning memories for relevant product information. An external search relates to the acquisition of new information from sources outside ourselves such as advertising, Internet searches, and discussions with friends.

In the case of the woman looking for information on choosing an obstetrician, she is likely to draw information from friends, family members, her personal physician, health care websites, advertising, media stories, and personal interviews with potential providers.

The intensity of an information search is reflected by the number of alternative brands evaluated, the number of sellers or providers considered, the number of external sources consulted, and the total time spent searching. In general, consumers continue the search until they feel that the added value of new information fails to cover the time costs associated with searching. Consumers use this information search process to reduce risk in the same way that organizations use market research. For consumers, the potential risks associated with making a poor decision include financial risk, psychological risks, and risks to our physical well-being.

Think About It

Some people actively pay attention to car advertisements long before they ever seriously consider buying their next car.

Do you think that this behavior can be attributed to their long-range planning and desire to be sure they make a good decision once the time comes?

Or do some people just enjoy keeping up on cars?

Evaluation of Alternatives: Multi-Attribute Model

The evaluation of alternatives within a high involvement context relies on the same basic processes described in the section on the multi-attribute model. However, this stage of the model also includes the task of narrowing the set of all possible choices to a few. The total number of brands that the buyer knows about make up his or her evoked set. However, the specific alternatives being actively considered by the decision maker may be a considerably smaller subset of the total. This is termed the consideration set. One goal of marketing programs is to ensure that the company's brand is part of the consideration set for its target markets.

In the case of a woman seeking an obstetrician illustrated in Table 5.2, the type of practice may be a useful filter or screen in the initial narrowing down of the consideration set. The available alternatives may include private obstetric practice, group practice, MD in practice with a nurse-midwife, and clinic/hospital-affiliated obstetrician. Assuming she decides to narrow the field to hospital-affiliated obstetric care, the consideration set is further narrowed down and the remaining options are considered more carefully. Our best conception of how this evaluation process is carried out is provided by the multi-attribute model described in a preceding section.

Table 5.2: Application of the multi-attribute model to choice of obstetric care

Attribute Beliefs (bi)

 Import. (wi) Hospital A Hospital B Hospital C Hospital D

Location 9 4 9 3 8

Latest Technology 7 7 6 9 8

Caring Staff 6 5 5 1 8

Nutrition Counseling 4 6 2 1 2

Attitude Score 139 161 100 184

It is possible that many more attributes would be considered in this situation, such as flexible hours for appointments, woman physicians on staff, physicians' willingness to answer questions, home-like delivery and post-delivery rooms, natural childbirth support facilities, and so forth. However, it is unlikely that the fifth or sixth most important attributes would make a significant mathematical difference since their importance weights (wi) would be low by comparison to the first four. This mathematical principle is also reflected in reality since people have a limited capacity for processing information and are typically seeking to maximize brand performance on a relatively small set of features. Brand attributes that are used by consumers to discriminate between brands in this multi-attribute process are termed determinant attributes. At most, lesser-weighted brand attributes sometimes serve as tie-breakers.

Purchase Decision

After the consideration set has been evaluated, consumers will usually choose among the contending brands at the purchase decision stage. In some instances, however, they may not feel confident in their decision and will opt to return to the information search stage. Uncertainty may also stem from the marketing efforts of competing brands. As each brand stresses attributes on which it excels, the importance weights assigned by consumers may become unstable.

In most instances, however, the evaluation stage produces a ranked set of preferences. In the absence of intervention by other factors (e.g., insurance companies, husband's objections, special circumstances), the consumer will move toward the selection of the most preferred alternative. In the example we have been following, the woman searching for obstetric care would probably select Hospital D and then proceed to the next iteration of decision making as she tries to identify the best physician for her within that hospital.

Post-Purchase Evaluation: Satisfaction or Remorse

Throughout this description of the five-stage model, the purchase decision process has been described as rational and logical. Cognitive learning has been the operative route to decision making with little thought for the role of affective or emotional influences on the decision process. This reflects the nature of the high involvement purchasing process. Since the consequences of the purchase are significant, the tendency is for consumers to be relatively systematic about the process—even when they are not aware of it.

The relatively higher levels of risk associated with the purchase of high involvement products, however, also carries substantially higher risks for negative emotional outcomes. Whether or not customers are satisfied with their experience of a product is determined by how well the delivered bundle of benefits matches the expectations they held prior to buying it. Feelings of dissatisfaction can produce cognitive dissonance, sometimes called buyer's remorse. This is often the direct result of the "insecurity that a buyer feels about the appropriateness of the purchase decision after the decision has been made" (American Marketing Association, 2011). Efforts by salespeople or customer service representatives to reassure buyers following a significant purchase is part of marketing efforts to reduce this form of post-purchase dissonance and address buyers' concerns.

Who Is the Internet Shopper?

As recently as 2000, research on the impact of online shopping had predicted a behavioral revolution that would eliminate many brick-and-mortar stores from the retail landscape (Evans and Wurster, 2000). Though the change has not been as radical as predicted, the Internet has provided great opportunities for startup companies and is the fastest growing retail channel for many existing brands. Despite its popularity with many consumers, however, it is far from becoming the most common path for consumer shopping. In fact, online sales account for about 3 percent of total retail sales in the United States (Laudon and Traver, 2008).

There is little doubt, however, that the global impact of online retailing will continue to grow in importance. European and Asian consumers make almost twice as many purchases as North American online shoppers and the rate is even higher in developing countries than in developed markets (ACNielsen, 2005).

So . . . what do we know about Internet shoppers? Who are they and what distinguishes them from traditional retail customers? Research published by Brashear, Kashyap, Musante, and Donthu in 2009 provides some answers.

As might be expected, Internet shoppers typically have higher incomes, Internet usage levels, and computer ownership rates than those who do not shop online. Online shoppers are also motivated by shopping convenience to a greater extent than traditional consumers. In contrast to those who shop exclusively at traditional retail stores, online consumers also tend to be more innovative and willing to try new products and services. Similarly, Internet shoppers also demonstrate relatively high levels of impulsive buying in response to the stimuli provided by the shopping environment. And, finally, Internet shoppers also tend to be more receptive to both direct marketing and advertising appeals when compared with those who do not shop online.

To promote the growth of online sales volume in the near term, marketing managers will need to tailor the Internet retail environment to fit the preferences and tendencies of current Web-friendly customers. Among other considerations, this means making the online purchasing process as convenient as possible. Special online promotions, coupons, and discount pricing can also be emphasized to target the impulsiveness of online buyers. To extend the popularity of online shopping beyond the ranks of current customers, however, Web designers will need to broaden the appeal of the online shopping experience to different types of customers. How to facilitate this growth remains the subject of extensive research and speculation.

5.4 Business-to-Business Markets

Organizational markets are composed primarily of manufacturers, wholesalers, retailers, and government agencies. These business-to-business, or B2B, buyers purchase goods and services for their own operational needs, for use in the production of other products, or for resale. An integral feature of B2B markets is derived demand. Organizational buyers' demand for materials is derived from the anticipated sales of finished goods to retail consumers. A summary of some essential differences between business markets and consumer markets is provided in Table 5.3.

Table 5.3: Business versus consumer markets

Market and Buyer Characteristics Business Markets Consumer Markets

Number of Buyers Relatively few and often similar Many and very diverse

Size of Purchases For products that are used regularly, businesses often buy large volumes Smaller purchase volumes, typically less expensive goods

Concentration of Buyers Higher levels of geographic concentration Widely dispersed

Time Required to Complete a Sale Transactions often require multiple interactions between buyer and seller Sales often completed at first visit to retailer

Standardization of Products Products are often custom designed to meet buyer's unique specifications Usually standardized products with some variations within models

Product-Related Expertise of Buyers Transactions are managed by professional buyers and influenced by in-house experts Usually limited by the purchaser's prior experience with the product

Prices: Fixed or Negotiated Usually negotiated Typically nonnegotiable other than for large purchases

Number of People Involved in the Decision Making Process Usually several, increasing according to the cost and importance of the purchase Limited sphere of influencers—usually family members

Most Common Type of Promotions Personal selling Mass media advertising

As shown in Table 5.3, B2B markets are characterized by fewer and larger buyers than are typically found in B2C markets. Relationships between buyers and sellers are typically closer, and there is a greater emphasis on personal selling rather than advertising. Prices are negotiated more often in B2B markets than B2C markets, and the average dollar value of a purchase is typically much larger as well. However, the purchasing behavior of organizational buyers closely resembles the high involvement model of retail consumer purchase behavior in many significant ways. The remaining section of this chapter highlights those ways.

In the investigation of retail buying, we distinguished between low and high involvement types of purchases based on the perceived importance of the product to the buyer. The corresponding division of buying situations for organizational customers distinguishes among three types based primarily on the complexity of the purchase and the level of problem-solving required to complete the transaction successfully.

Straight Rebuy

The straight rebuy is a habitual decision that corresponds to the low involvement purchases made by B2C buyers. Straight rebuy processes are used to repurchase inexpensive, low-risk products with which the company's purchasing agent is already familiar. In most instances, new purchases are simply reorders to replace depleted inventory or stock. Alternative brands or vendors are not typically considered or evaluated unless there is some dissatisfaction with current suppliers. Routine purchases of everything from office supplies to the standardized components used in manufacturing (e.g., nuts, bolts, screws) are examples of straight rebuys.

Modified Rebuy

Desk supplies in desk drawer

An example of a straight rebuys is routine purchases of office supplies. What other examples can you think of?

Fancy Collection/SuperStock

A modified rebuy involves limited decision making and problem-solving. Modified rebuy processes are used when the purchase situation is less complex than new-task buying, but more involved than a straight rebuy. Some information search and acquisition is required to reach decisions, and a limited number of alternatives may be evaluated. In many instances, modified rebuy situations are initiated by product users within the organization who want to revise product specifications or change suppliers. In health care settings, for example, physicians are often very selective about the tools of their trade. If they are dissatisfied with the quality of medical supplies (e.g., gloves, instruments, patient gowns), they will often initiate the process of changing vendors.

New Task Buying

New task buying is the most complex of the three buy classes. A new task requires greater effort in gathering information and evaluating alternatives because the company has not previously made a similar decision. As a consequence, more people within the organization are typically involved in the decision making process for new task buying than for the other two types. This is particularly true if the product being purchased is relatively expensive and the firm has not had direct prior experience with its use. The dynamics and processes involved in new task buying most closely correspond to the high involvement purchase model developed in the previous sections of this chapter.

5.5 Participants in the Business Buying Process

The organizational purchasing process for important decisions is typically influenced by many people within the firm who interact and collaborate in a decision making unit referred to as the buying center. As illustrated in Figure 5.3, the buying center is not defined by a specific place or spatial location within the firm. Instead, it is typically a cross-functional entity comprising all the people who participate in or influence the decision making process. The value of the buying center as decision making unit stems from the team members' opportunities to share knowledge and concerns related to important buying decisions.

Figure 5.3: Participants in the buying center

The buying center roles involves, influencers, gatekeeper, decider, buyer and users

The buying center roles include influencers, gatekeepers, deciders, buyers, and users.

It is important to note that the primary motivation behind the processes involved in organizational buying and the creation of buying centers is risk reduction. Just as retail consumers can engage in intensive periods of information search to improve the outcomes of important buying decisions, corporations allocate valuable human resources to buying center teams to minimize the likelihood of making bad choices on major purchases.

Composition of the Buying Center

To function effectively, buying centers require input and collaboration from a range of functional departments and operational groups within the organization. These typically include marketing, accounting, finance, and operations management. Technical experts are required to serve as resources to the team when technical purchases are being considered. The composition and number of people making up the buying center will vary, depending on the complexity and requirements of purchase being planned. However, there are five roles that can usually be identified within any fully functional center:

Buyers: Professional purchasing specialists who identify suppliers, arrange terms of sale, and carry out the contractual procedures required to facilitate the sale of the product.

Users: People within the firm who will be end users of the product being purchased.

Influencers: Individuals who attempt to affect the outcome of the process, often through the expression of their expert opinion. Operating within their area of expertise, they may offer suggestions on the functional or technical specification of product requirements.

Gatekeepers: People within the organization who control the flow of relevant purchase- and product-related information.

Deciders: The individual team member or members who make the final purchase decision.

Stages in the Business Buying Process

The term buy phases is used exclusively to describe the stages that organizations follow when making purchasing decisions. The seven stages in the business buying process resemble the five-stage purchase decision process model for retail consumers. Each of the seven steps is illustrated in Figure 5.4 and explained in the section that follows.

Figure 5.4: Stages in the business buying process

The buying process is: problem recognition, general need description and product specification, supplier/source search, personal solicitation, supplier selection, making the transaction or ordering process routine and performance review

Stages in the B2B buying process include: problem recognition, product specification, supplier sourcing, personal solicitation, supplier selection, making the transaction, and performance review.

Problem Recognition (organizational buying): The process is initiated when a problem or need is recognized. This can result from either factors internal to the company (e.g., mechanical breakdowns in old equipment) or external factors. The marketing program of a supplier, for example, may persuade the firm to consider replacing aging equipment.

General Need Description and Product Specification: This is the stage where the problem that was initially identified is translated into a general need description (e.g., 60 new vertical lathes) and then a set of product specifications. Technical specifications for a lathe might include load capacity, feed rates, and turning speed.

Tall Genicom laser printer advertisement, 2007

This advertisement for TallyGenicom laser printer is directed toward business customers. How is it appealing to this particular consumer group?

Associated Press

Supplier/Source Search: This describes the processes used by buyers to identify potential suppliers through the Internet, trade directories, catalogs, and advertisements. An essential task of suppliers' marketing programs is to make their company known to prospective buyers. This corresponds to breaking into the consideration set for retail buyers.

Proposal Solicitation: At this point in the process, buyers invite qualified and approved suppliers to submit proposals. This can be a very complex procedure if the product is technically complex or unusual.

Supplier Selection: Part of the output from the buying center process is usually the development and implementation of a supplier evaluation model. It is a multi-attribute model of the type previously described that is used to systematically evaluate alternative suppliers. In a sense, the buying center is explicitly executing the model that consumers are implicitly following in their purchase deliberations.

Making the Transaction or Ordering Process Routine: For parts and materials orders, organizations will usually try to create a standardized routine for future product reorders. For some major purchases, the provision of required maintenance, service, and accessory products will be planned and scheduled. Automatic reordering systems are often used to support just-in-time inventory systems. This usually signals the beginning of a long-term relationship with the preferred supplier. Maintaining this customer's satisfaction, however, must become a high priority for the supplier who earns this business opportunity.

Performance Review: In this final stage, the buyer systematically and periodically reviews the efficiency and effectiveness of chosen suppliers. Information for this review process is typically acquired from material end users within the organization since these are the people most directly impacted by the quality of supplier performance. The consequences of a dissatisfied customer may include financial penalties or adjustments to the terms of the contract at the time of renewal. In the worst case scenario, the organization may discontinue the relationship with the supplier completely and solicit a new round of proposals from competing vendors.

Think About It

The selection and purchase of pharmaceutical drugs by physicians and hospitals seems as though it should be a straightforward process based on the needs of patients and the efficacy of alternative drugs.

Can you identify any marketing tactics that drug makers might use to influence these purchasing decisions that are not directly related to promoting the benefits of the products they are selling?

Can you cite examples from other markets and industries?

Ch. 5 Conclusion

Retail consumers and organizational buyers share some common characteristics in their approaches to decision making. For important purchases, both groups search for information as a means of mitigating the risk of making poor choices. The end-user market for consumer goods is influenced by a wide range of social, cultural, economic, and psychological forces. Some of these are unique to the individual while the impact of others spans large segments of the economy. The process of organizational purchasing is generally free from many of the seemingly extraneous forces that influence retail consumers. The process is designed to provide a highly rational approach to purchasing products and solving problems. It is important to remember, however, that the judgment exercised by people operating within these logical and highly structured buying processes is occasionally going to be influenced by factors unrelated to the objectives of the system. In some instances, marketers intentionally introduce these unrelated factors as part of their efforts to sell products.

Ch. 5 Learning Resources

Key Ideas

Critical Thinking Questions

 Identify five distinct subcultures with which you are familiar. For each one, explain what makes people in that group different from the culture at large. Can you explain how meaningful market segments could be created from each of these subdivisions?

 Do families make decisions differently than individuals? If so, how? Would this significantly change the nature or application of the multi-attribute model presented in the chapter?

 People sometimes adopt aspects of their spouse's cultural background. Since these beliefs, values, and practices are not the ones these people were raised with, are they likely to impact market behavior as reliably as the innate aspects of their original culture?

 Marketers often assume that the preferences and behaviors associated with specific age-defined subcultures are relatively constant over time. Since the actual membership of age segments (e.g., 25- to 34-year-olds) changes constantly, is this assumption valid?

 How can segmentation by religious affiliation or spiritual beliefs be used to improve the effectiveness and efficiency of marketing programs for some products? Provide examples.

 Consumer confidence is a leading economic indicator in the sense that high levels of confidence in the future tend to produce higher levels of discretionary spending in the present. It also works in reverse for low levels of confidence. Do you believe that this relationship is equally strong for optimistic and pessimistic expectations?

 Since a consumer's level of involvement with a product is specific to each individual, how can it be used effectively in the planning of marketing programs?

 Some people seem more naturally resistant than others to learning about products and brands from advertisements. Why might this be the case?

 A student once commented in class that she had never been influenced to buy anything because of an advertisement. The instructor replied, "How would you know?" What do you think he meant by that?

 Many researchers believe that it is impossible for more than six product attributes to contribute to the choice of one brand over another. Using the multiattribute model of attitude formation, explain why you agree or disagree with that statement.

 According to the multi-attribute model, attitudes drive behavior and beliefs drive attitudes. This should make the analysis and prediction of brand choice pretty straightforward. What factors are likely to reduce the explanatory and predictive accuracy of the model in real life?

 How has the Internet changed the way in which consumers search for information about products? Provide examples to support your observations.

 Setting aside the comparisons made in the chapter, how do you think retail buying and organizational buying behaviors differ from each other?

 Consider the three different types of B2B buying situations: straight rebuy, modified rebuy, and new task buying. Where do you suppose the greatest number of transactions occurs? Greatest dollar volume? The highest average purchase price? Why?

 Many organizations have become increasingly dependent on the Internet to facilitate different stages in the organizational buying process. Which ones are most commonly handled online? What are the advantages associated with using the Internet for these activities? The risks?

Key Terms

Click on each key term to see the definition.

aspirational audience

The portion of a market that hopes to someday be able to afford the purchase of high-status brands.

aspirational brands

Brands that status seekers would like to own for the purpose of demonstrating their wealth or high social status but cannot afford to buy.

attitude

The feeling of liking or disliking something. It is a relatively stable and enduring emotional response that directs our behavior toward the object of the attitude.

behavioral learning

A form of passive learning that takes place in response to external stimuli and events.

buy phases

Stages that organizations follow when making purchasing decisions.

buyers

Professional purchasing specialists who identify suppliers, arrange terms of sale, and carry out the contractual procedures required to facilitate the sale of the product.

buying center

A cross-functional decision making unit composed of all the people who participate in or influence the decision making process.

classical conditioning

A form of behavioral learning in which a previously known stimulus that elicits a positive response is repeatedly paired with another, neutral stimulus. When a subject experiences this paired association of stimuli several times, he passively learns to associate the previously neutral stimulus with the pre-existing positive feelings associated with the initial positive stimulus.

cognitive dissonance

Feelings of dissatisfaction or insecurity that a buyer feels about the purchase they have made.

cognitive learning

An active learning process based on information processing.

consideration set

The specific brand alternatives being actively considered by the decision maker from among the evoked set.

conspicuous consumption

Buying and displaying expensive brands as a way to convey a high status image.

consumer confidence

An assessment of how optimistic consumers feel about the future state of the economy and their personal financial situation. It is generally regarded as a leading economic indicator.

deciders

The individual team member or members who make the final purchase decision.

determinant attributes

Brand features that are used by consumers to discriminate between brands in the multi-attribute purchase decision process.

discretionary income

The spendable portion of disposable income available to households after deducting the cost of necessities such as shelter.

disposable income

The amount of money that households have available to spend after accounting for income taxes.

evaluation of alternatives

This stage in the high involvement purchasing process entails the evaluation of alternative brands in accord with the processes defined by the multi-attribute model.

evoked set

Total number of brands that the buyer knows about in the product category he or she is evaluating.

external search

This relates to the acquisition of new information from sources outside ourselves such as advertising, Internet searches, and discussions with friends.

gatekeepers

People within the organization who control the flow of relevant purchase- and product-related information.

general need description and product specification

The stage where the problem that was initially identified is translated into a general need description.

hedonic products

Brands geared primarily toward satisfying the drive for experiential pleasures.

influencers

Individuals who attempt to affect the outcome of the process, often through the expression of their expert opinion. They may offer suggestions on the functional or technical specification of product requirements.

information search

The second stage in the five-step purchase decision process model; occurs when consumers seek information to help them better understand and solve the problem.

internal search

Seeking relevant product information from a scan of one's own memory.

involvement

The perceived relevance or importance of a product to our wants and needs.

leading economic indicator

A statistical measure that points to positive or negative changes in the national economy ahead of the actual changes.

learning

A term used to describe the process by which people acquire new knowledge and preferences.

making the transaction or ordering process routine

Efforts to standardize the process for subsequent routine orders and future product reorders.

modified rebuy

A B2B purchase decision that involves limited decision making and problem solving.

motivation

The internal state or processes that drive people to engage in goal-oriented behavior. Within the context of marketing, an internal drive to purchase products or services that consumers believe will fulfill conscious and unconscious wants and needs.

multi-attribute models

Conceptual and mathematical models that specify consumer attitudes toward brands as a composite of beliefs about product attributes, weighted by the importance of those categories of beliefs.

new task buying

The most complex of the three buy classes. A new task purchase requires greater effort in gathering information and evaluating alternatives because the company has not previously made a similar decision.

organizational markets

B2B buyer markets composed primarily of manufacturers, wholesalers, retailers, and government agencies.

performance review

The buyer's systematic, periodical reviews of the efficiency and effectiveness of current suppliers.

post-purchase evaluation

The final stage of the purchase decision process where consumers respond with satisfaction or remorse to the choice they have made.

problem recognition (consumer buying)

First stage in the five-step purchase decision process model; occurs when a consumer becomes aware of a need that must be met and recognizes that a particular product or service is required.

problem recognition (organizational buying)

The process is initiated when a problem or need is recognized.

proposal solicitation

The stage in the purchase process where buyers invite qualified and approved suppliers to submit proposals.

purchase decision

The fourth stage of the purchase decision process, where consumers choose between the contending brands.

purchase decision process five-stage model

An illustration of the steps involved in high involvement decision making.

social class

A division or group within a society that shares a similar social and economic status.

straight rebuy

A habitual purchase decision typical of the low involvement purchases made by B2C buyers.

subcultures

Groups of people who are differentiated from the broader culture in which they live by shared beliefs and characteristics that identify the groups as distinct from the whole.

supplier selection

The evaluation and selection of the winning supplier, usually based on the results of a supplier evaluation model.

supplier/source search

The processes used by buyers to identify potential suppliers.

users

People within the firm who will be end users of the product being purchased.

Web Resources

A site created by Professor Lars Perner that includes a broad array of information on the topic of consumer behavior. Much of the content on Professor Perner's site addresses advanced topics in the field.

http://www.consumerpsychologist.com

A creative and thought-provoking examination of the impact of social class in America. It is a companion website to the PBS documentary "People Like Us."

http://www.pbs.org/peoplelikeus/

This site is the home of the U.S. Consumer Product Safety Commission, which is charged with protecting the public from dangers associated with unsafe consumer goods. The site includes information on product recalls, child safety issues, and reports on past investigations.

http://www.cpsc.gov

This site is a special section of the Psychology Today website devoted to reporting on psychological research on topics including advertising, the impact of social status, and decision making.

http://www.psychologytoday.com/basics/consumer-behavior

This site is a link to the article "Predicting Consumer Behavior with Web Search," from the Proceedings of the National Academy of Sciences (Goel, Hofman, Lahaie, Pennock, and Watts, 2010). It illustrates how the volume of queries on search engines can be used to predict near-time events. They cite examples related to opening weekend box-office revenue for feature films, first-month sales of video games, and the rank of songs on the Billboard Hot 100 charts.

[http://www.pnas.org/content/107/41/17486.full.pdf+html](http://www.pnas.org/content/107/41/17486.full.pdf%2Bhtml)

Part III: Market Segmentation, Product Differentiation, and Brand Positioning

Part III of this text focuses on the three core elements of marketing strategy: segmentation, differentiation, and positioning. Though often treated as discrete topics, they constitute an interwoven web of strategic decisions that establish the basis for how an organization will relate to its customers and competitors. Segmentation of the product market and differentiation of the brand are introduced as the precursors to positioning, although the actual process tends to be more interactive and less linear in reality. Segmentation helps managers better understand the market. Differentiation sets the brand apart in ways that are meaningful to the target segment. Positioning provides the means by which we can compete most effectively against other brands for that unique cluster of consumers.

The final outcome of strategic planning at the brand level will always be a positioning strategy. Positioning is a complex construct based on understanding how target consumers' preferences are shaped by their perceptions of product attributes and brand-specific benefits. It is the most important strategic concept in marketing management: It establishes brand objectives and provides the compass that directs all subsequent marketing mix decisions. Part III concludes in Chapter 8 by examining the dynamic nature of competitive markets and alternative strategies rooted in the firm's level of relative market dominance. The essential features of effective marketing programs at this level of analysis are wholly dependent on the identification of significant target markets, the meaningful differentiation of the brand from competitors, and product positioning decisions based on relevant consumer preferences.

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Chapter 7: Product Differentiation and Brand Positioning

Chapter 8: Market Attractiveness and Competitive Strategies

Chapter 6

Market Segmentation and Target Marketing

Woman standing at the end of a row of small gift bags

ès/SuperStock

Learning Outcomes

By the end of this chapter, you should:

 Identify the role of market segmentation in developing a marketing strategy and understand the rationale for segmenting markets.

 Recognize the different levels of market segmentation.

 Identify the steps in the market segmentation process.

 Recognize each of the primary categories of bases for segmenting consumer markets.

 Identify the bases used to segment business markets.

 Specify the criteria necessary for useful and effective marketing segments and describe four basic strategies for reaching target markets.

Ch. 6 Introduction

No individual product or marketing mix can satisfy every consumer in a given product market. In most cases, the potential market for a product or service is simply too diverse or heterogeneous to be treated as a single or uniform target market. Market segmentation enables companies to adapt different marketing mixes to appeal to the unique needs of specific, homogeneous target market segments. This strategy creates growth opportunities and higher levels of customer satisfaction. The optimal variables used to segment any given market depend on many factors, including trends in buyer demand, the benefits being sought by consumers, and the characteristics of competing brands.

Market segmentation describes both a process and strategy by which the total market for a product is divided into smaller parts or segments. Managers create segments by clustering prospective buyers according to distinctive shared traits or factors in order to construct subsets of customers with similar needs. The resulting segments are said to be homogeneous with respect to these dimensions. As a consequence, consumers within each segment are more similar to each other on these factors than they are to buyers assigned to other segments.

The first half of this chapter investigates the purpose and strategic significance of segmenting product markets with a primary emphasis on the identification of target markets. The general rationale supporting four alternative levels of segmentation is addressed. The second half of the chapter examines the processes involved in segmenting markets. A four-step model is introduced to identify discrete clusters of buyers that will yield the best possible opportunities for profits and competitive leverage. The creation of these segments is necessarily guided by a relentless focus on customer needs and the firm's drive to satisfy its selected customers. The criteria and bases used in the specification of useful market segments are discussed and four basic strategies for reaching target markets are introduced.

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Oftentimes big opportunities can come disguised as small technical problems. In the late 1980s, Bob Bennett solved what might seem like an insignificant engineering challenge: how to combine a microwave oven with a compact refrigerator/freezer into a single operating unit that would not overload conventional electrical circuits. The solution was simple. He built in a separate circuit between the two units that automatically turned off the refrigeration side whenever the microwave oven was engaged. This limited the total amount of current that the combined unit could draw to 10 amps. He approached General Electric with this innovative concept, but the company had little interest.

Within five years of its introduction, product sales exceeded $12 million. However, the key to the success of this venture was not solely dependent on a technological innovation. From the inception of the company, Bob Bennett had a clear understanding of the strategic significance and necessity of market segmentation. Today, the home page of MicroFridge (www.microfridge.com) is organized according to the company's six primary target markets: individuals (home users), academic institutions, hotels, governmental/military, seniors, and office product suppliers.

6.1 Strategic Rationale for Segmenting Markets

Market segments are clusters of prospective and current customers who are similar to each other in ways that lead them to respond to a firm's marketing mix similarly. Marketing managers create or detect segments as a means of improving brand performance and profitability. The essential principle of segmentation is to divide the total market into distinct submarkets based on similar wants, needs, behaviors, or other characteristics to enable companies to better serve the specific wants and needs of smaller groups. Segmentation enhances customer satisfaction and provides marketers with opportunities to build segment-specific competitive advantages.

The strategic significance of segmentation in competitive markets is substantial. It permits companies to focus their limited resources on building greater levels of customer satisfaction within a limited cluster of buyers. By concentrating their efforts in this way, organizations can optimize both the efficiency and effectiveness of marketing programs.

Perhaps less obvious is the strategic value of segmentation in making the firm more responsive to market dynamics. Companies that have focused their resources on specific segments have a greater understanding of buyers' wants and the character of the operating environment. Consequently, they should be better prepared to respond to changes in the behavior of their suppliers, intermediaries, and competitors than firms with a broader market focus.

Marketing to Segments

Gerber baby food products.

Gerber is one of the most popular baby food brands in the world. What factors other than geography can affect the company's sales?

Associated Press

The importance of segmentation to the success of the firm's marketing programs, however, depends on several market-specific characteristics. As product markets mature, the rate of overall sales growth declines. In many product markets, sales growth may remain negligible for years and sometimes decades. This is particularly true when overall population trends are unfavorable to the sales of specific products. For example, the sale of baby care products is dependent on the prevailing birthrate within a given geographic market. In the absence of aggregate sales growth, the battles for market share often intensify. Segmentation takes on greater strategic importance within this context as firms compete to build sales volume at each others' expense by finding better ways to satisfy segment-specific preferences. In this sense, each segment becomes a unique battlefield in an ongoing war.

Other types of market-specific characteristics that impact the value of segmentation include changes in the economic and cultural composition of buying groups. As markets become more diverse in these ways, profitable opportunities to refine or redefine segment profiles emerge. This pattern is often observed in developing nations around the globe. As incomes, educational levels, and lifestyles go through transitions over time, marketers have opportunities to appeal to new clusters of buyer preferences.

Think About It

Cultural shifts within national boundaries can be more difficult to detect than changes in other countries. Identify three significant cultural changes within this country's borders that have taken place in the past decade. Be specific. Identify the subcultures at the center of the change process and those groups being most directly impacted.

How have these changes created new marketing opportunities?

How have they affected the ways in which brands compete?

Market segments can be created based on any product or buyer characteristics that will yield the most efficient and effective approach to selling the product in a competitive market. This often includes the refinement of old segment definitions as well as the creation of wholly new segments within established product markets. In some instances, the study of alternative market segmentation opportunities may lead to brand extensions.

Brand Extensions

Febreze scented candles in packaging

Febreze extended its brand from exclusively air freshener sprays to include candles and scented oil.

Associated Press

Brand extensions are new products or services introduced under the same brand name as existing goods. Familiar examples of successful brand extensions include Jell-O Instant Pudding, Harley Davidson Apparel, Febreze Candles, and National Geographic Television. Brand extensions represent an effort to capitalize on the positive impressions and values associated with the existing brand name. This can have the synergistic effect of increasing brand awareness and profitability across multiple product categories. As with other forms of product development, a successful brand extension requires extensive knowledge of the selected market segments.

The failure to understand the unique preferences, values, and attitudes of targeted market segments can result in failed extensions and damage to a valued brand name. Examples of brand extensions that reflect a weak linkage between the core brand identity and the new product concept include Smith & Wesson Mountain Bikes, Colgate Kitchen Entrees, Hooters Airlines, and Cheetos Lip Balm. In addition, it is important to remember that even a seemingly successful product launch can work against the brand's significance to target segments if it blurs or dilutes the brand's identity or positioning.

6.2 Levels of Market Segmentation

As noted in Chapter 1, it is a common misconception that market segments are somehow preexisting divisions of the market that the marketing manager needs to discover. This is not the case. Marketing managers can create market segments based on any product or buyer characteristics that will be useful or profitable. Consequently, markets can be segmented at various levels based on the intended use of the information and the character of the market itself.

In a cost-free environment, the best path to satisfying buyers would be to provide a unique, custom-designed product and marketing plan for each individual consumer. Although this is possible in some instances, in most contexts sellers need to develop programs suited to clusters or pools of buyers to make them profitable. The most effective and efficient segment size for this purpose can be thought of as the optimal level of market segmentation. There are four levels of market segmentation: mass marketing, segment marketing, niche marketing, and customized marketing.

Mass Marketing

In mass marketing, the seller does not differentiate between prospective buyers at all. Every individual within the market is part of the company's target market. Sellers make no effort to create separate marketing mixes to suit different types of buyers according to their preferences and needs. In most instances, this strategy results from a perception that there are no significant product-related differences between potential buyers. Alternatively, marketers may pursue this path if they cannot identify discrete market segments apart from the whole that are financially viable. Some products that are regarded as commodities (e.g., water softener salt) can be sold this way. Mass marketing is sometimes referred to as undifferentiated marketing.

Henry Ford's marketing strategy for the Model T is often held up as one of the most successful applications of mass marketing. By offering buyers the same car "in any color as long as it is black," he was able to capitalize on the scale economies related to the mass production, mass distribution, and mass promotion of one product for all consumers. This approach to selling has grown increasingly difficult, however, as consumers gain access to more channels of distribution (including e-commerce), increasing levels of global competition, and a growing array of media sources and information.

Segment Marketing

Segment marketing, or differentiated marketing, is a term used to describe marketing strategies that differentiate between customer groups within a product market. In contrast to mass marketing, this approach enables sellers to execute marketing plans for individual brands targeting specific clusters of prospective buyers. Matching marketing mix decisions to the preferences of targeted segments generally improves the fit between the brand and consumers' needs, thereby providing higher levels of customer satisfaction. In many markets, the decision to pursue some specific segments rather than others may also limit the range of relevant competitors challenging the brand.

Although there are many different bases on which sellers segment markets, identifying the specific benefits consumers seek from the product category is often the first tier of investigation in defining fairly broad segments. Segment marketing is characteristic of many of the products we purchase frequently, such as most consumer packaged goods, popular lines of apparel, and electronics. Most items sold through big-box retailers and chain grocery stores fall into this category. Segment marketing is more narrowly targeted than mass marketing but less precise in practice than niche marketing.

Mass-Market Competition

Frontera salsas proved to be best sellers in Whole Foods Markets around the U.S. Now, Frontera wants to go up against mass-marketed products made by the likes of Tostitos and Pace. How is Frontera marketing its brand? Which consumer group does it interest?

Think About It

Breakfast cereals seem like a pretty basic household staple, right? Yet the typical grocery store will stock more than three dozen brands from companies such as Kellogg's, General Mills, Quaker, and Post. Many of these seem to be similar.

Are any brands being mass marketed? If so, which ones?

Who is the target market for some of the brands with which you are most familiar? Why can't large companies be more successful by mass marketing a smaller number of core brands, thereby reducing the expenses related to marketing a large number of different brands to several smaller market segments?

Niche Marketing

By concentrating on even smaller segments of the market, niche marketing allows the organization to create more narrowly focused marketing plans for its brands than segment marketing approaches. Niche marketing is also known as concentrated marketing. At this level of segmentation, marketers use a narrower range of distribution channels and media options to reach a smaller market containing fewer direct competitors.

Often, the motivation for targeting these narrowly defined niche markets is the recognition that buyers' needs are not being met by existing product and brand alternatives. If the group described by this gap is large enough to be sufficiently profitable, the opportunity can be pursued by either small or large firms within the industry. However, relatively small organizations require less potential profit to make these types of new opportunities worthwhile. In addition, the lack of direct competition from large firms may make these niche markets especially attractive to smaller competitors.

Bottle of Fat Tire beer on a bar countertop

The Fat Tire brand, which stems from the New Belgium Brewing Company, reflects the potential profit from niche marketing.

Associated Press

This reality has given rise to ventures in virtually every sector of the economy. Many of the fastest-growing advertising agencies in the United States are small, specialized "boutique" firms that focus on serving the unique needs of a limited client base. The success of microbreweries and craft breweries such as the New Belgium Brewing Company, which sells the Fat Tire brand, also reflects the profit potential in niche marketing. The Internet has enabled the proliferation of companies serving unique product and service niches ranging from home-delivered gourmet pretzels to accounting services for small business payrolls.

In some instances, very large organizations may create fairly autonomous SBUs to independently sell to niche markets to defend the firm from losing market share on a piece-by-piece basis. Consider the strategy pursued by Birds Eye frozen foods group. Brands such as Freshlike, Voila!, and Steamfresh enable it to pursue segment marketing strategies to compete effectively in large segments of the market. However, it also appeals to a narrow market niche with its McKenzie's brand, by reaching buyers who want vegetables used primarily in the southern U.S. subculture. These include speckled butter beans, collard greens, okra, turnip greens, black-eyed peas, field peas, and purple hull peas.

Customized Marketing

Customized marketing, or micromarketing, represents the most extreme form of market segmentation insofar as each prospective buyer is treated as a separate segment for marketing purposes. In contrast to the previous levels of market segmentation, the marketing plan for each customer is fitted to his or her own unique needs and preferences. Within consumer markets, this approach can most commonly be seen in the sale of custom-tailored clothing and shoes. Other examples are often seen in the high-priced end of consumer goods markets where one-of-a-kind homes, interior furnishings, jewelry, musical instruments, boats, and designer cars can be custom ordered for clients with the ability to pay. In fact, tailor-made products that convey significant prestige to their purchasers are available in almost every consumer product market.

Customized marketing is more prevalent in business-to-business market transactions than in consumer markets. In B2B exchanges, product specifications, terms of sale, and distribution are often negotiated on a one-to-one basis. Prime examples of customized marketing are found whenever products are built to the buyer's unique specifications (e.g., manufacturing equipment, enterprise application software) and the price is negotiated. The primary advantage to customized marketing is the seller's ability to precisely meet the buyer's needs. When financially feasible, this level of market segmentation provides the best opportunity to fulfill the marketing concept's promise.

6.3 Procedure for Segmenting Markets

As noted previously, the essential rationale for segmenting markets is to create clusters of prospective buyers that will yield the best opportunities for profits and competitive leverage. These positive outcomes stem from delivering the highest possible levels of customer satisfaction by selling into discrete segments or clusters of buyers within a given product market.

Think About It

It can be a chicken-and-egg problem. The foundation principles and overriding philosophy of marketing maintain that products should be developed based on a prior understanding of prospective customers' needs. However, is it possible to segment a product market in a strategically meaningful way before you have a product to sell?

How can you reconcile the necessity of having a product before segmenting a market based on buyers' characteristics with the need to understand the buyer before developing a product?

Neither the academic discipline of marketing nor professional practice has established a set of procedures for segmenting markets that is best in all situations. In fact, many managers develop their segmentation schemes on a purely intuitive level of analysis, based exclusively on their unique and intimate knowledge of the product and prospective clusters of buyers. However, a wide variety of more systematic approaches to segmenting markets can be applied according to the unique demands of the task (Foedermayr and Diamantopoulos, 2008). The market segmentation process model presented here provides a flexible four-step approach that can be applied across a fairly broad range of situations.

Step One: Identify Primary Segmentation Bases

A large number of customer-related variables can be applied to the process of constructing a market segmentation plan. Many of these are discussed in detail in the section that follows. However, most initial efforts at market segmentation begin with an understanding of the product-related benefits sought by buyers. This reflects what we've discussed previously regarding the functional value of the marketing concept as a competitive philosophy, the motivational roots of buyer behavior, and the primary importance of customer satisfaction in the design and execution of marketing programs.

Consider the toothpaste market example that we first encountered in the discussion of market segments in Chapter 2. Based on product benefits, you can initially identify several potential segments. These benefits include hygiene-related factors such as the ability to fight cavities and prevent plaque buildup and gingivitis. They also include aesthetic/cosmetic benefits such as the ability to whiten teeth and freshen breath. Other benefits include sensory features such as flavor, appearance, and texture. Additionally, there is almost always a price-sensitive branch in consumer product markets that seek the lowest possible cost.

Using a benefit segmentation approach, the preliminary division of the market could identify four primary benefit classes: hygiene, aesthetics, sensory, and price. Each of the subdivisions within the four, however, could be further delineated and treated as a separate, discrete segment unto itself. For example, "whitens teeth" and "freshens breath" could be treated as independent segments. In most situations, the initial tendency should be to break the market into as many meaningful and unique benefit-driven segments as possible. If subsequent analysis determines that a segment is too small to financially justify being recognized as a separate cluster of buyers, it can be absorbed into the next-most-closely related segment.

Colgate, "Simply White," toothpaste

Colgate "Simply White" toothpaste targets the "whiter teeth" benefit segment.

PR Newswire/Associated Press

Recall that each benefit segment may recognize more than one set of potential benefits from using toothpaste. Those who seek whiter teeth are not indifferent to either the taste of competing brands or their ability to fight cavities. However, this segment can be uniquely identified as the group whose highest priority is whiter teeth. In fact, all segments within this particular product market may value all four basic classes of product benefits. However, they will differ from each other in the relative importance attached to each.

Not all market segmentation efforts need to begin with a study of product benefits. Selection of other segmentation bases or variables may stem from the specific objectives of the analyst. Market geography, for example, may be a primary concern for retailers that overrides other considerations in some instances. At times, marketing managers may develop specialized segmentation models based on either their unique experience and intuition or a systematic study of existing customer data. Alternatively, the efforts of a competitor to redefine the market through changes in its marketing mix may also prompt a reevaluation of existing market segment schemes. In each of these instances, however, remaining mindful of the essential benefits that a buyer is seeking from the brand must remain one of the primary considerations. In this sense, all market segmentation plans should be developed as benefit-segment plans to some degree.

Step Two: Name Segments and Develop Profiles

The second step in the process is to name each segment and develop a detailed profile for each. This involves identifying those characteristics that are most closely related to each segment's purchase behavior. Managers should recognize at the outset of this stage that the intention is to simply describe those who buy in response to specific benefits. The purpose is not to isolate the motives for their behavior.

For example, managers might name those customers who place the highest value on the aesthetic benefits of toothpaste The Sociables (Haley, 1995). As illustrated in Table 6.1, the segment profile might include demographic descriptors (teens, young adults, unmarried), lifestyle characteristics (socially active, health-conscious), personality traits (outgoing, independent-minded), and other descriptive factors.

Table 6.1: The segment profile

Segment Name

 The Sensory Segment TheSociables The Workers The Independent Segment

Principle benefit sought Flavor, texture, appearance Brightness of teeth Decay prevention Price

Demographic strengths Children Teens, young people Large families Men

Special behavioral characteristics User of spearmint-flavored toothpaste Smokers Heavy users Heavy users

Brands disproportionately favored SeaFresh, Aim Stripe Aquafresh, Ultra Brite Crest, Colgate Brands on sale

Personality characteristics High self-involvement High sociability High hypochondriasis High autonomy

Lifestyle characteristics Hedonistic Active Conservative Value-oriented

The value in creating detailed profiles of market segments is twofold. Initially, it provides details that can improve the precision of market potential estimates. As market- and product-related research databases have grown in their depth of detail and sophistication, the availability of nondemographic information on prospective buyers has grown exponentially. This enables managers to create estimates of segment potential based on an ever-growing set of descriptive variables.

The second set of uses for segment profiles relates to the marketing mix. The choice of distribution channels, promotional messages, and product pricing strategies is often directed by segment profiles. Knowing the lifestyle and personality of the target market, for example, will shape the choice of advertising media, spokespersons, and message settings. Knowing who your target market is will also drive decisions about where and how to distribute the products you sell.

Step Three: Evaluate Financial Potential

This stage combines two closely related parts: evaluating the market potential for each alternative segment and estimating the cost-benefit trade-offs associated with pursuing each segment as a target market. This process is sometimes referred to as qualifying market segments.

The potential profitability of any given market segment depends on several factors. These include the current size of the segment, projected rates of sales growth, and the costs of accessing or reaching the segment. The question of access can refer to physical barriers such as distance and topographical obstacles (e.g., rivers, mountains). However, it also refers to the availability of cost-effective distribution channels and efficient media to reach the segment with promotional messages. Other considerations include the number and size of entrenched competitors, the costs associated with changes required to meet the needs of these buyers, and the fit between segment demands and the current business model.

In some circumstances, companies will undertake a process called market mapping at this stage of the process. This requires decision makers to identify all of the additional marketing mix activities, investments, and financial consequences associated with actively targeting a segment-specific opportunity. Though every situation will differ, the ultimate goal at this stage of the process is to determine the financial attractiveness of each market segment. Organizations base such determinations on their competitive strengths relative to competitors and customer needs.

Think About It

Imagine yourself as the marketing manager of a company that sells travel luggage. Your current product line includes hard-sided and soft-sided suitcases, rolling luggage, and garment bags. After extensive research, you have identified a new product opportunity in the travel duffle bag product segment.

How would you go about constructing a market map to identify all of the additional marketing mix activities, investments, and financial consequences associated with pursuing this opportunity?

If you need information on the range of products available within the category, go to http://www.luggage.com.

Step Four: Select Target Market(s)

The final stage in the market segmentation process is to select the specific market segment or segments to target. The criteria driving this choice are not exclusively financial. As marketing managers consider their options, they need to be cognizant of those features that make a financially viable segment a good fit for the organization. These factors may include the opportunity to reach new types of customers, a distinct competitive advantage within this segment, and a close correspondence between the firm's core competencies and the new market opportunity. We address the specific criteria for evaluating alternative segments and target market strategies in the closing sections of this chapter.

This stage of the process will typically include drafting a preliminary marketing plan to rough out the primary features of the marketing mix strategy. This provides an interactive opportunity to revise both the target segment definition and the intended product strategy. Similarly, this part of the process can also identify the need to engage in more market research before proceeding to product development or a product launch.

Market segmentation is a critical component of the process of marketing management. It helps organizations sharpen their focus and improve the fit of their product offering to target customers. It can be effective in improving profit margins and reducing the intensity of direct competition with other brands. Managers develop useful market segments on the basis of a wide range of buyer characteristics. We will discuss in detail the specific factors or bases that are most often used to construct segments in the sections that follow.

6.4 Bases for Segmenting Consumer Markets

A characteristic or factor that varies between groups, but which is relatively constant within groups, is a useful basis for segmenting markets. Marketers use four primary bases or classes of variables to segment consumer markets. These include geographic, demographic, psychographic, and behavioral bases.

Geographic Segmentation Bases

Geographic segmentation reflects the importance of understanding the features that define where prospective buyers live. The guiding principle is that tastes and preferences vary according to one's geographic setting. Geographic market segmentation factors of importance include country, region, climate, population density, and population growth rates. How people live is impacted by their geographic surroundings, and this can have substantial effects on their consumption patterns and habits. Knowing where people live within an urban market can also provide information about income levels and the character of their retail surroundings. Similarly, climate affects primary demand for many products (e.g., snowmobiles) and shapes preferences for several consumer goods (e.g., clothing). Immigration and migration patterns are also of importance to marketers seeking to understand the influence of subcultures on brand choice.

Geographic segmentation is not intended to suggest that all prospective customers within a given location will make identical brand choices. For most consumer packaged goods, however, brand-specific demand does vary by geographic region. Regional trends of sales for fruit-flavored sodas—Vernors, PibbXtra, and Dr. Pepper, for example—reflect differences in regional tastes. Category demand may also shift according to regional tastes and variations in climate as it does for salsa, barbeque sauce, and iced tea sales. Perhaps more than any other group, retailers need to understand geographic segmentation as a critical factor in evaluating new store locations.

Demographic Segmentation Bases

Demographic segmentation relies on using population statistics to effectively differentiate between buyers with different brand preferences. These variables include income, age, sex, ethnicity, education, occupation, home ownership, religion, social class, and family status. Demographic segmentation is the most common approach to market segmentation. This is due to the ready availability of market-specific demographic data and the prevalence of age and sex as the primary descriptors of media audiences. For this reason, demographic descriptors play a unique role in assessing the financial viability of segments. A primary source for demographic data and analysis in the United States is the Census Bureau.

Kellogg's Cereal, Got Milk ad

Animated advertisements are often targeting households with children.

PR Newswire/Associated Press

Sex or gender is frequently used as a starting point to define market segments since so many products, such as clothing, magazines, and health care items, are gender-specific. Age is also used in the initial stages since it readily discriminates between users and non-users for many product categories such as toys or denture adhesive. Consumption patterns for products like milk also shift as consumers age. Marketers design and promote products differently to meet the wants of different age groups. Gradual changes over time in other demographic variables also relate to changes in purchasing patterns. Stages in the family life cycle and consequent changes in the size of family units impact demand for many types of household products.

Income has historically been regarded as the most important basis for distinguishing between groups of consumers. Ernst Engel, a 19th century statistician, was the first to investigate the relationship between changes in household income and consumption behavior. Engel's law states that as income increases, the proportion of income spent on food falls. This empirical principle has remained unchanged over the years. This has implications for strategic planning, as marketing managers anticipate how an economic recession would impact spending patterns within segments. In recent generations, however, economists have also observed that an increasing portion of household income is allocated to both recreation and education expenditures as household incomes increase.

Psychographic Segmentation Bases

In psychographic segmentation, managers use characteristics such as lifestyle, personality, values, and attitudes to define the preferences of clusters of similar consumers. Using these segmentation bases, the focus is primarily on applying the psychological and lifestyle attributes of buyers to identify the behavioral profiles of different customer groups. For example, psychographic analysis may determine that people who like classical music and believe in traditional social values will prefer drinking wine to beer.

In contrast to demographic profiles, managers must collect data that are specific to the task in order to develop psychographic profiles. Survey research and focus groups are typically used to collect information about subjects' attitudes, interests, and activities.

Psychographic segmentation is of particular importance to the positioning and promotion of high involvement products. Since, by definition, consumers' experiences with these types of goods have relatively great personal importance to them, marketers must understand the psychology and lifestyles of the segments they wish to serve. By dividing a product market into segments with similar psychological characteristics, values, and lifestyles, marketing managers can position brands to satisfy the psychological and emotional needs of consumers. Further, psychographic profiles enable marketers to portray their brands as being compatible with, if not essential to, daily lifestyle decisions.

Think About It

Automakers use psychographic segmentation when planning the introduction of new models. Identify three models that were introduced to the North American car market over the past five years. Use the carmakers' websites to do a little research on the features and options available. Check online sources for copies of past or current advertisements.

Starting with the name chosen for the brand, build a psychographic profile of the intended target market for each. Enhance your description by providing a demographic description as well. Once you have completed the three profiles, check your work by comparing it against the information provided by online sources such as motortrend.com, caranddriver.com, and edmunds.com. They do not report specifically on demographics and psychographics, but you can glean a great deal of information about the intended buyer that will either support or refute your analysis.

Lifestyle Segmentation of the Organic Food Market

Consumer demand for organically produced foods has grown dramatically since the mid-1990s. What began as an industry at the margins of the economy, targeting a small market niche, has bloomed into an industry with $24 billion in annual sales in 2009, accounting for nearly 4 percent of total U.S. food retail sales (Organic Trade Association, 2010). Market growth is expected to continue in a range between 25 percent (Finch, 2005) and 40 percent (NPD Group, 2009) over the next decade. The popularity of organic and local foods reflects something more than simply the consequences of evolving consumer preferences. Consumers are expressing their identities and consumption values through these purchases (Finch, 2005; Senauer, 2001).

Segmentation is an important tool for marketing managers seeking to understand the attitudes and motivations of specific customer groups rather than focusing on how an "average" consumer thinks and behaves. Lifestyle segmentation aims to profile buying groups on the basis of psychographic variables such as values and attitudes. One of the primary purposes behind focusing on psychographic factors rather than demographics is that it helps marketers to develop advertising strategies that tap into buyers' motivations for choosing one brand or type of product over another.

A research study by Cong Nie and Lydia Zepeda (2011) identified four distinct groups or clusters of organic food consumers: rational, adventurous, careless, and conservative uninvolved consumers.

In the study's nationwide sample of 956 U.S. food consumers, 29 percent were identified as rational consumers. Rational consumers were active organic and local food shoppers. Approximately 18 percent shopped regularly at farmers' markets, 10 percent were regular organic food shoppers, and 56 percent were occasional organic food shoppers. This group tended to have relatively low brand awareness and high price sensitivity. They valued the healthfulness and safety of food, and many reported following special diets. An above-average proportion of this segment (24 percent) belonged to a fitness club. They were also more knowledgeable about organic agriculture than average consumers and more likely to be involved in environmental protection.

Adventurous consumers composed 24 percent of the sample. Members of this group enjoyed cooking and were the ones most likely to pay close attention to label information. Approximately 16 percent of them were regular organic shoppers, and 65 percent were occasional organic shoppers. They visited farmers' markets more frequently than other segments.

Careless consumers (18 percent of the sample) were generally the least interested in food-related issues, and none had ever been to a farmers' market. Health- and nutrition-related food issues were not priorities for this cluster of buyers. They valued convenience more highly than other segments and indicated that they did not enjoy cooking. None of the buyers in this segment was a vegetarian, and most had never intentionally bought an organic food item. Their level of environmental concern was the lowest among the four groups.

Conservative uninvolved consumers made up 29 percent of the sample. This group also placed a high priority on convenience in buying and preparing foods. They were less likely than the average consumer to buy organic foods, but they were the group most concerned about brand names. Less than 2 percent of this segment was likely to shop regularly for organic food. Relatively few of them belonged to a fitness club, and only 2 percent belonged to an organized environmental group of any kind.

This lifestyle approach to profiling segments is significantly different from a demographic-based approach. It provides much more information on the values and priorities that motivate behaviors rather than simply describing the age, sex, and income of each group. Nonetheless, the study described here does report on these demographic factors. Based only on the lifestyle descriptions of these four segments, what would you guess about their demographic profiles? If you are interested in checking your intuition against the actual data, the full article includes information about each segment's average age, income, household size, educational attainment, race, and region.

Behavioral Segmentation Bases

Behavioral segmentation focuses on how consumers relate to the product being marketed. The brand preferences and product choice behavior of consumers within target segments can be readily influenced by some psychological variables and purchase situations. The relevant variables include purchase occasion, product usage rates, brand loyalty status, attitude toward the product, and benefits sought from purchase of the product. Marketers usually cite benefits sought as the best starting point from which to segment product markets. However, attitude toward the product and usage traits are sometimes preferred if brand preferences are well established.

The key difference between behavioral bases and the previous classes of segmentation factors is the emphasis on the relationship of the consumer to the product being sold. Differences in usage rates between segments, for example, are often used to identify heavy-user, moderate-user, and light-user market segments. This can be a very useful approach to market segmentation in light of the Pareto principle, or 80-20 rule, introduced in Chapter 2. Recall that 80 percent of profits typically come from 20 percent of customers. As such, identifying the heavy-user segment will enable marketing managers to direct their marketing programs toward buyers who can contribute the most to the firm's financial success.

Selecting target segments based on high levels of existing brand loyalty can provide similar advantages for the firm. This is the operative principle behind the reward programs offered by many airlines. However, both light-user and low–brand loyalty market segments still have value. They may represent opportunities to build greater sales volume by encouraging more consumption by light-user segments and reinforcing brand preference among low loyalty segments.

Understanding the occasions that prompt consumers to purchase a product can be useful in some circumstances. Knowing that many college students eat breakfast cereal as a snack food has led some sellers to offer varieties that are intended to be eaten without milk. Many charter airlines segment markets according to the occasions that prompt passengers to fly (e.g., business, vacation). Each occasion is accompanied by different service expectations. Knowing what customers prefer enables the companies to better satisfy customer needs.

Benefit segmentation and attitude segmentation are two very important and closely related approaches to grouping customers. Benefit segmentation focuses on the product attributes that buyers seek and the corresponding benefits that they expect to receive from the purchase. Buyers' attitudes toward brands provide an assessment of how effectively the purchased product delivers the benefits promised. Understanding these relationships is usually an essential starting point to effectively segmenting markets.

6.5 Bases for Segmenting Business Markets

Some of the market segmentation bases used in consumer products markets can be applied to business-to-business markets as well. These include geographic, demographic, and behavioral factors. However, differences in the nature of both the products sold and customers served allow for the application of some additional bases as well.

Geographic B2B Segmentation Bases

Oil pumping unit

Where do you think oil pumping units like this one are usually located, and why do you think that is?

Associated Press

Business-to-business markets are characterized by a smaller number of potential buyers than consumer markets. Buyers tend to be relatively large and more geographically concentrated as well. Geographic segmentation focuses on the location, concentration, and distribution of customers. Companies purchasing oil drilling equipment, for example, are clustered in a relatively small number of locations worldwide; buyers of aircraft engines are clustered near assembly plants. Regional geographic variables related to rates of economic and industry-specific growth are often incorporated when considering how to segment B2B markets on a global basis.

Demographic B2B Segmentation Bases

Demographic segmentation tends to focus on bases that reflect the size of the account, such as number of employees and sales revenues. It also tends to focus on those bases that directly impact potential for sales growth, such as derived demand based on projected growth in the sale of final products. How buyers will use the product they are purchasing is another common approach to segmenting B2B markets since it directly impacts the nature of the sales task. For example, companies that purchase paint pigments for application to their own products will have different requirements than companies simply intending to sell paint to retailers under their own label.

Behavioral B2B Segmentation Bases

Marketers often use behavioral factors such as loyalty to the seller, past usage patterns, and average order size to enhance a segment profile and qualify prospective buyers. In some instances, markets can also be segmented according to how buyers make purchase decisions. Knowing whether decision making authority rests with a solitary purchasing agent or relies on a complex buying process can impact the allocation of the seller's sales force across a market. Similarly, knowing where a prospective buyer is in the buying process for a complex purchase will dictate the type of personnel deployed to call on an account.

As with B2C markets, segments can be constructed based on whether buyers are heavy users, medium users, light users, or nonusers. This is essential to understanding the level of effort and service required to make sales. Similarly, relatively new companies typically require more time and higher levels of personal attention to facilitate transactions and close sales than long-established firms.

North American Industry Classification System

Since the focus of much B2B marketing is to sell goods and services that facilitate other organizations' business operations, segmentation by account type is a common, intuitive first step. Account categories could include distributors, wholesalers, and retailers since buyers within these clusters are likely to share some needs. The logic behind this approach can be extended to using the North American Industry Classification System (NAICS) to segment business markets.

The NAICS classification system was created in 1997. It is a collaborative effort by Mexico, Canada, and the United States to classify businesses by the type of activity in which they are primarily engaged. NAICS industries are identified by a 6-digit code that designates a company as belonging to one of 20 broad sector categories, shown in Table 6.2, based on the first two digits. The third digit designates the subsector, the fourth identifies industry group, and the fifth digit indicates particular industries. The final digit designates national industries.

Table 6.2: North American Industry Classification System

Code NAICS Sectors Count

11 Agriculture, Forestry, Fishing, and Hunting 485,049

21 Mining 30,000

22 Utilities 28,128

23 Construction 1,466,475

31–33 Manufacturing 639,802

42 Wholesale Trade 726,617

44–45 Retail Trade 1,759,455

48–49 Transportation and Warehousing 409,355

51 Information 257,500

52 Finance and Insurance 607,795

53 Real Estate Rental and Leasing 692,527

54 Professional, Scientific, and Technical Services 3,682,218

55 Management of Companies and Enterprises 34,297

56 Administrative Support; Waste Management and Remediation Services 1,142,973

61 Educational Services 301,099

62 Health Care and Social Assistance 1,172,862

71 Arts, Entertainment, and Recreation 290,976

72 Accommodation and Food Services 654,017

81 Other Services (except Public Administration) 1,662,196

92 Public Administration 203,073

The information conveyed by a company's NAICS code is, for B2B markets, comparable in many ways to the demographic profile of target segments developed by B2C firms. It can be used to identify the number of potential customers in a given region, their size, and potential applications for a given seller's products. Commercially available databases can be used to translate a target segment NAICS code into the names of prospective buyers, and very specific profiles of the prospects can be readily developed from these same sources.

6.6 Evaluating Segments and Selecting Target Market Strategies

The segmentation of B2C and B2B markets is not possible in all cases. To develop effective market plans, target market segments must satisfy three basic requirements. They must be measurable, accessible, and substantial.

Requirements for Target Market Segments

To be measurable, segments must be identifiable by marketing metrics for which data are readily available. This could include measures of sales potential, market size, purchasing power, and customer profiles.

Segments are considered accessible if they can be effectively reached and served through existing marketing channels. That is, the implementation of marketing plans specific to the target segment can be effectively delivered via the media and channels of distribution that are currently available.

Substantial refers to the question of whether or not the market segments are sufficiently large and profitable enough to pursue. When evaluating the range of alternative segments available to the firm, only those recognized as large enough to warrant the creation and delivery of a unique marketing mix need be considered.

By definition, target market segments are relevant only when members of one target segment respond to a given firm's marketing programs differently than members of other segments. The attractiveness of each target market segment can be impacted by many consumer, competitor, and company considerations. The factors that impact the appropriateness and financial viability of alternative target markets are identified in Table 6.3.

Table 6.3: Factors impacting appropriateness and financial viability of alternative target markets

Consumer Characteristics Competitors Within Segment Correspondence With Company

Number of buyers Number Strengths/resources

Growth potential Size Strategic objectives

Sales potential Relative strength Existing channels

Profit potential Resources Distinctive competences

Target Market Strategies

Once the evaluation of the alternative segments is finalized, marketing managers can select from among a number of strategies to reach their chosen target market. The determination of the best possible option will be influenced by many factors. These include market dynamics, the pattern of consumer demand, the intensity of competition, the size of the firm, and its pricing structure for related products. However, all target market strategies fit within at least one of four strategy patterns.

Single-segment concentration strategies emerge when managers opt to focus their marketing resources on serving one segment exclusively. This option may be preferred by default within relatively small or newly launched companies due to limited resources. It has the advantage of permitting the company to focus on serving the needs of the most attractive market segment exclusively. Properly executed, this should translate into competitive advantages arising from the execution of an unambiguous positioning strategy and sharply focused marketing plan. The exclusive appeal to plus-sized women allowed the Just My Size brand to build a valuable franchise with a very loyal market segment. Its initial success with hosiery created subsequent opportunities to sell casual clothing, swimwear, and sleepwear to this customer base.

John Deere ride-on lawn mower.

John Deere's product-centered specialization features a broad array of branded equipment within the grass-mowing product market.

PR Newswire/Associated Press

Multiple segment specialization is a more challenging and more complex response to the set of alternative buying clusters identified during the process of segmenting the product market. Firms that possess the required resources may opt to target several of the most attractive segments with either a solitary brand or multiple brands. Many large consumer packaged goods companies, such as Procter & Gamble and Kraft, use this strategy to create a web of brands that provides total market coverage across multiple product categories. Alternative executions of multiple segment specialization include product-centered and market-centered specialization.

Product-centered specialization is a company's planned strategy to sell across several segments within a single product market. Consider John Deere's array of branded equipment within the grass-mowing product market. The company markets models suited to every application and segment, ranging from small residential yards to the needs of large commercial landscapers. Product-centered specialization strategies sometimes correspond closely to the strategy of market development, which focuses on the introduction of existing products to new markets as a means of increasing sales.

Market-centered specialization is a strategy that concentrates on responding to the specific needs and preferences of a particular segment of consumers across multiple product categories. An example of this strategy is provided by Sears. It targets the same middle-class, homeowner segment of consumers across product categories such as kitchen appliances, water heaters, air conditioners, sewing machines, outdoor grills, and vacuum cleaners with the Kenmore brand. Such strategies may correspond to the product market development strategies that build sales by introducing new brands to existing market segments to better serve existing buyers.

Ch. 6 Conclusion

In the final analysis, all market segmentation schemes depend on an understanding of the benefits that buyers seek from the products they purchase. In some instances, segment profiles will be defined by the careful and analytic application of research to describe each benefit cluster in greater detail. At other times, segment profiles are largely an intuitive outcome based on marketing managers' understanding of the demographic and behavioral characteristics of their customers. In either case, the value of developing specific segment profiles and strategies can be judged by its contribution to the success of brands and products. In short, the best segments and segmentation strategies are those that work best.

Consider the MicroFridge story that was introduced at the beginning of this chapter. The origin of the company and its subsequent success relied on understanding the needs of different market segments, and this is clearly evident from the different types of information provided to each prospective purchasing group. Its products deliver safety, convenience, and value in different proportions based on segment-specific characteristics. Recently introduced models for the home user segment, for example, are available in a wider array of sizes and include features such as charging stations for personal electronic devices. Additionally, the company recently introduced a model specifically designed for use in garage and workshop spaces. The continued success of the company into the future will remain dependent on finding innovative ways to meet the evolving needs of its target markets.

Ch. 6 Learning Resources

Key Ideas

Critical Thinking Questions

 Why is market segmentation an essential part of developing an overall marketing strategy? Should segmenting the market into smaller groups of buyers always be the first step in devising a strategic plan for a brand?

 What is the difference between product-level and brand-level segmentation? When does it make sense to do one rather than the other?

 What is the likely consequence for a brand manager who decides to ignore or skip over the question of segmentation and identifying a specific target?

 Brand extensions can be tricky. Consider the following brands of consumer goods: Apple, Levi's, Marlboro, Chevrolet, and Purina. What types of brand extensions could capitalize on the positive image and impressions associated with each of them? Name some that obviously would not work.

 Explain the concept of mass marketing to someone outside your class and ask him or her to identify five products that are mass marketed. Consider the list. How many of them truly fit the definition of mass marketing? Can you think of any brand for which different consumer segments don't actually exist?

 Will successful niche marketing inevitably expand the size of the targeted segment to a point where it is no longer just a niche? Provide examples to support your position.

 Why does the customized marketing level of market segmentation represent the epitome of what the marketing concept is all about?

 Could you devise a plan to segment the market for audio books without doing any research? Why might the process of market segmentation seem so natural? What are the advantages and disadvantages to following a formal step-by-step approach to the process?

 Consider a favorite television sitcom or novel with which you are very familiar. Chances are that you know enough about each fictional primary and secondary character to make some educated guesses about their brand preferences. Now, develop a market segmentation plan for cars or restaurants using each character as a representative of one particular market segment. Provide a segment profile that includes geographic, demographic, psychographic, and behavioral bases.

 To be useful as target markets, segments must be measurable, accessible, and substantial. If you developed a new line of clothing for recently divorced men who had been previously married for 15-plus years, would this target market meet the three criteria for "good" segments?

Key Terms

Click on each key term to see the definition.

accessible

To be effective target markets, segments must be able to be effectively reached and served through existing marketing channels.

behavioral segmentation

Dividing markets based on how consumers relate to the product being marketed in different circumstances. Common behavioral variables include purchase occasion, product usage rates, brand loyalty status, attitude toward the product, and benefits sought from purchase of the product.

brand extensions

New products or services introduced under the same brand name as existing goods in an effort to capitalize on the positive image or values associated with the existing brand name.

customized marketing

The most extreme level of market segmentation that treats each prospective buyer as a separate segment. Customized marketing is also known as micromarketing.

demographic segmentation

Dividing markets by using identifiable social characteristics of individuals and groups that have been shown to effectively differentiate between buyers with different brand preferences. These variables include income, age, sex, ethnicity, education, occupation, home ownership, religion, social class, and family status.

geographic segmentation

Dividing markets with an emphasis on the importance of understanding where prospective buyers live and how this impacts their brand preferences.

heterogeneous

Composed of individuals with dissimilar product-related wants and needs.

homogeneous

Composed of individuals with very similar product-related wants and needs.

market-centered specialization

Concentrating on the specific needs and preferences of a particular segment of consumers across multiple product categories.

market mapping

The process of identifying the additional marketing mix activities, investments, and financial consequences associated with actively targeting a new segment-specific opportunity.

market segmentation

The process and strategy by which the total market for a product is divided into smaller parts or segments of customers that have similar wants and needs with respect to a specific product.

mass marketing

The level of market segmentation that does not discriminate or differentiate between prospective groups or segments of buyers. Mass marketing is also known as undifferentiated marketing.

measurable

Effective target segments must be identifiable by marketing metrics for which data are readily available. This could include measures of sales potential, market size, purchasing power, and customer profiles.

multiple segment specialization

Targeting several segments with either a solitary brand or multiple brands.

niche marketing

The level of market segmentation where an organization creates narrowly focused marketing plans for very small segments. Niche marketing is also known as concentrated marketing.

North American Industry Classification System (NAICS)

A coding system created by Mexico, Canada, and the United States to classify businesses by the type of activity in which they are primarily engaged. It is frequently used to analyze and segment business-to-business markets.

product-centered specialization

Selling across several segments within a single product market.

psychographic segmentation

Dividing markets based on the psychological and lifestyle attributes of buyers such as personality, values, and attitudes.

qualifying market segments

The process of evaluating the market potential for each alternative segment and estimating the cost-benefit trade-offs associated with pursuing each segment as a target market.

segment marketing

The level of market segmentation that differentiates between customer groups within a product market by executing separate marketing plans for individual brands. Segment marketing is also known as differentiated marketing.

single-segment concentration strategies

Focusing marketing resources on serving one segment exclusively.

substantial

To serve as effective target markets, segments must be sufficiently large and profitable enough to pursue.

Web Resources

This is a site developed by professionals in the field of market research to provide both basic and advanced content on the topic of market segmentation. It includes a substantial amount of useful material, but the specific segmentation examples are among the most practical entries.

<http://www.market-segmentation-market-research.com>

Chapter 7

Product Differentiation and Brand Positioning

Variety of Campbell's soup cans on store shelves

Associated Press

Learning Outcomes

 By the end of this chapter, you should:

 Understand the nature of the brand as the primary unit of analysis in marketing management and its relationship to brand awareness and image.

 Conceptualize key brand-related concepts including brand equity, loyalty, and perceived quality.

 Recognize the significance of product positioning as the key element of marketing strategy that drives all of the marketing mix decisions.

 Develop a practical understanding of how to identify the best positioning strategy for a brand within a competitive market.

 Appreciate the strategic significance of product differentiation and know the alternative bases for differentiating a brand from its rivals.

 Recognize that the essential character of services makes them difficult to differentiate from one another and identify the available bases for differentiating the quality of one service provider from another.

Ch. 7 Introduction

A brand can be defined as a “name, term, design, symbol, or any other feature that identifies one seller’s good or service as distinct from those of other sellers” (The American Marketing Association, 2011). Brands can be assigned to identify a single product, a collection of related products, or all items of goods and services created by a single seller. The most essential function of a brand name is to uniquely identify one product or family of products as distinct from others. The brand provides a conceptual foundation to which sellers can attach product attributes, promotional messages, and perceptions to shape a unique identity in the marketplace.

The first sections of this chapter focus on the meaning of brands and branding. The concept of brand equity is introduced as a means of capturing the value and significance of creating powerful product identities. Building from this base, product positioning and differentiation are explored. A four-step positioning process model is introduced based on an understanding of the linkages between buyers’ perceptions of brands and their product-specific needs and expectations. The final section of the chapter focuses on product differentiation and its relationship to product strategy. Three potential sources for effectively differentiating one brand from its competitors are identified: tangible attributes, perceived benefits, and price.

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It is common to hear people in nonmarketing areas of business management doubt the impact of marketing programs. A brand manager for a large West Coast retail chain found an interesting way to respond to a colleague when she expressed her doubts about the power of branding. He challenged her to put her skepticism to the test. “Over the next few days, try replacing your 7-year-old’s favorite brand of cereal with a similar one. Remove the brand-identifying patches and logos that are stitched into her sneakers and backpack. Replace your 5-year-old son’s Mickey Mouse DVD with one featuring Mighty Mouse. They’re about the same, right? And insist that the kids change brands of toothpaste before they go to bed tonight.” I guess we can’t know the outcome of this test with certainty since she was unwilling to make even one of the changes he proposed.

7.1 Building Brand Image and Brand Awareness

Brand image is a term used to refer to the perception of a brand in the minds of current and prospective buyers. Sometimes referred to as brand identity or brand personality, it is a composite of what the brand means to the buyer in terms of attitudes and expectations. A consumer’s perception of brand image serves several important functions. It simplifies the shopping process. If a buyer was pleased by a prior purchase, the brand enables him or her to find the same product again next time. In this way, brand names convey information to buyers about product attributes, quality, and consistency. Over time, this promotes brand loyalty among satisfied customers.

Maxwell House coffee jars and cans on store shelves

Familiar and consistent packaging themes promote brand awareness and recognition for Maxwell House coffee.

Associated Press

In all markets, brand names enable buyers to organize information about competing products in their mind. Brands provide anchor points to which positive and negative associations are attached over time. These attachments may even extend across generations. Preferences for Maxwell House coffee, Ivory soap, or Ford trucks may be built on perceptions carried forward from parents to children. As we saw in Chapter 4, an individual’s attitude toward a brand provides the psychological framework for organizing product knowledge in a systematic way.

The brand is typically the unit of analysis and planning for marketing managers. Marketing plans and specific marketing mixes are usually created to promote, distribute, and sell products identified by one specific brand name. In this sense, the function of the marketing mix for any given product is to shape buyers’ perceptions of the brand’s image. Central to this task are the promotional elements of the marketing mix. Advertising messages, sales presentations, publicity events, and sales promotions are all intended to shape the target market’s perception of the brand. Decisions related to pricing strategy, distribution channels, and the quality of the product itself also impact the process of building a brand image. In the final analysis, brand images are created by customers based on the influence of marketer-controlled inputs, the counteracting impact of competitors’ marketing programs, and the customers’ direct experience with the brand and its alternatives in the product category.

Brand awareness is a general measure of consumers’ knowledge of the existence of a brand. It is the first preliminary step in the purchase decision process that ultimately leads to a sale. Since it is a necessary prerequisite to sales, it is a primary marketing objective for all brands. As a commonly used performance metric, brand awareness is expressed as the percentage of the target market that recognizes or knows of the brand by name. Top-of-mind awareness is measured by asking customers to indicate the first brand that they recall when the product category is mentioned as a prompt.

Think About It

Ask some friends outside of class which brands come to mind when you mention the following product categories: car tires, toothpaste, fast food, and canned soups. All of their answers won’t be identical, but certain brands will usually wind up on top. If you were to pose this question to a random sample of 1,000 people, the percentage of people responding Goodyear, Crest, McDonald’s, and Campbell’s would be higher than the brands’ actual market share.

Why should this be the case?

The relative value of high brand awareness in any specific situation will depend on several factors. For low involvement products (e.g., candy), the absence of brand awareness may represent a low barrier to sales since consumers exert relatively little effort in the decision-making process. In this context, simply being an unfamiliar name could be an advantage if the buyer is seeking a new experience. For first-time buyers in high involvement product categories (e.g., home appliances), the brand name itself represents a unique bit of information that is often relied upon as an indicator of product quality. The lack of confidence that comes from having no experience in the category tends to inflate the value of familiar brand names as first-time buyers seek to minimize the risk of making a poor choice. Consequently, newlyweds shopping for appliances often look for brand names that they are familiar with from their childhood.

Think About It

Although perceptions of brand image tend to become very well established over time, consumers who are new to any purchase situation represent a blank slate for marketers. Consider the way that colleges and universities work to shape the initial impressions of prospective students and their parents. Long before setting foot on the campus, potential recruits are often inundated with positive images and messages about schools, particularly from online sources. Compare this process to way in which both real estate agents and banks approach first-time home buyers.

How do these types of customers and brands differ?

What brand features are typically stressed to persuade each of these audiences?

Over time, familiar brand names become synonymous in consumers’ minds with the products that they represent just as personalities are inseparable from people. The unique identity and corresponding attitudes acquired by a brand name have substantial value when they are consistently reinforced by positive experiences with the product. These positive associations in the mind of the consumer have real, tangible market value that is often referred to as brand equity.

7.2 Brand Equity Management

Brand equity is, in simplest terms, the value of a brand based on consumer attitudes about positive brand attributes and the favorable consequences of brand use. When considered in greater depth, however, brand equity can also be appreciated as a fairly intricate, multifaceted construct. Figure 7.1 illustrates the full complexity of brand equity as developed by David A. Aaker (1996).

Figure 7.1: Aaker’s model of brand equity

Aaker's model of brand equity

The brand equity concept is complex and multifaceted. It encompasses many dimensions of the relationship between consumers and brands.

In this dissection of the concept, brand equity is defined by a set of five underlying classes of assets that contribute to a positive perception of the brand name in the mind of the buyer: brand loyalty, brand awareness, perceived quality, brand associations, and other proprietary assets.

Dimensions of Brand Equity

In B2C markets, brand loyalty refers to the reliable tendency of consumers to consistently purchase the same brand within a given product class. In B2B markets, the emphasis tends to shift from product-specific loyalty to consistency in buying from the same supplier repeatedly over time, rather than purchasing across multiple suppliers within a category. In both kinds of markets, the value of brand loyalty to sellers is multidimensional. A core constituency of loyal buyers provides sellers with a degree of both operational and financial stability from a base of reliable sales. It reduces the costs of marketing and improves unit margins on sales to loyal customers. It also provides a buffer against competitive threats and a platform for attracting new customers.

Brand awareness is a stepping stone, an essential first step to creating sales. Though awareness by itself does not convey brand preference, higher levels of awareness provide a more familiar platform or stage upon which to build positive attitudes toward the brand. In the absence of additional information, B2C consumers tend to have greater confidence in brand names with which they are more familiar.

Smucker’s jelly products on a store shelf.

The positive brand associations that consumers have with Smucker's jelly products have been created and reinforced over a span of more than 100 years.

Associated Press

Perceived quality of the brand is instrumental to a buyer’s assessment of product value and, ultimately, satisfaction with the purchase of the product. Though necessarily a subjective appraisal, both B2B and B2C consumers become experts in judging product quality over the course of repeated category purchases. Consequently, the ability of a brand to meet or surpass quality expectations provides buyers with reasons to repeat brand purchases. As an integral feature of the bundle of benefits delivered by the product, quality is essential to product differentiation and positioning strategy.

As discussed at the outset of this chapter, brand associations define brand image. One possible outcome of building positive brand associations over time is the opportunity to leverage these existing attitudes to promote the successful launch of related products through brand extensions. For example, the positive brand equity in Smucker’s jams and jellies was used effectively to launch its brand of peanut butter in a very competitive consumer market. Brand extensions of this type leverage positive attributes (e.g., brand awareness, product quality) while reducing related marketing costs and lowering the risk of a new product trial for consumers.

The category of other proprietary assets includes legally protected intellectual property such as copyrights, trademarks, and patents. Though primarily intangible assets, items such as scientific discoveries, manufacturing innovations, and artistic works have taken on greater importance and value in the information age. Computers and the emergence of the Internet pose challenges to intellectual property protection laws; such laws were developed in an era when machine patents were intended to protect proprietary assets within manufacturing industries. Providing comparable safeguards to protect the expression of ideas through software programs, algorithms, and source codes has been problematic. Preventing the piracy of games, music, and movies via the Internet remains a huge challenge.

Counterfeiting Brands

The theft of intellectual property is probably most familiar to consumers in the form of pirating software and books and illegally downloading music from the Internet. However, the illegal appropriation and use of trademarks, brand names, and patent-protected goods and processes represents a serious form of competition to the victims of intellectual property theft. In the short term, sales and profitability are damaged directly. In the long term, however, the theft of intellectual property has the potential to discourage companies from investing in new product development and innovation.

Effective intellectual property protection is essential to promoting innovation in many types of industries. Software development, pharmaceutical R&D, and even entertainment-related industries require the legal means to protect proprietary ideas and products. Just as traditional industries are discouraged from investing in new products if they have no guarantee of realizing the full economic benefit of their creations, creative intellectual endeavors can be also be suppressed if financial incentives are reduced due to brand counterfeiting.

According to FBI, Interpol, World Customs Organization, and International Chamber of Commerce estimates, roughly 7 to 8 percent of world trade every year is in counterfeit goods. That is the equivalent of as much as $512 billion in global lost sales. Of that amount, U.S. companies lose between $200 billion and $250 billion. This type of theft has a major impact at home, too. According to the U.S. Chamber of Commerce, the theft of intellectual property costs 750,000 U.S. jobs a year (International Trade Administration, U.S. Department of Commerce, 2012).

The retail sale of counterfeit goods and online piracy of intellectual property pose a serious threat to businesses by exposing their legitimate goods to unfair competition at home and abroad. However, the impact of counterfeit goods can be particularly damaging to a brand’s reputation for quality if the imitation products are poorly made. For most products, the inferior quality adversely impacts the level of satisfaction that a customer derives from its use. For pharmaceuticals, however, the impact of counterfeits can be deadly.

It has been estimated that 1 to 2 percent of drugs sold in North America are fraudulent. Worldwide, drug counterfeiting generated an estimated $75 billion, according to the Center for Medicine in the Public Interest. Of particular concern is evidence that counterfeit pharmaceutical sales are increasing at nearly twice the pace of legitimate pharmaceutical sales—approximately 13 percent annually (Center for Medicine in the Public Interest, 2012). The composition of fraudulent drugs can include glue, chalk, and pesticides, as well as a wide range of additional toxic and potentially fatal elements. People consuming counterfeit drugs are at risk for serious health problems including unexpected side effects, allergic reactions, and a worsening of the health condition the drug was intended to treat or cure.

The sale and distribution of counterfeit drugs has serious implications throughout the world. The World Health Organization’s (www.who.int) malaria eradication initiative has suffered significant setbacks over the past few years due to the sale of fake pharmaceuticals. The latest and most effective treatment for malaria comes from a plant originating in China known as artemisinin. However, its effectiveness is being undermined by fake and poor-quality anti-malarial drugs that are also being traced back to China and are flowing into Africa and Southeast Asia. Counterfeit anti-malarial drugs not only are potentially harmful to the individuals who consume them, but also may help the malaria parasite develop an immunity to artemisinin (ABC News, 2012). Though it is difficult to precisely calculate the impact of the damage, there’s no doubt that it is substantial since hundreds of thousands of packets of fake anti-malarials are in circulation annually.

Measuring Brand Equity

Although brand equity could be a potentially valuable metric for marketing managers to use in evaluating the value added by marketing programs, there is not a single generally accepted basis for assessing it. However, two measures of brand equity can be used to provide an inexact appraisal of a brand’s equity value.

A Starbucks coffee shop in New York.

Consistent quality and taste are important ingredients in Starbucks’ recipe for differentiating itself from competitors.

Ambient Images Inc./SuperStock

The price premium that a branded product commands above and beyond the retail price associated with generic or unbranded competitors provides a general approximation of the brand’s equity value. For example, if buyers are willing to pay 25 percent more for Starbucks coffee over generic competitors, the difference can be attributed to brand equity. This is an ROI perspective that recognizes the value of past expenditures on efforts to market the brand as investments in building equity.

An alternative, less specific assessment of brand equity can be made based on consumer attitude research. The target market’s strength of positive product-specific associations for a given brand demonstrate brand equity. Assessing the relative strength of one baseline brand versus others can provide a valuable perspective on the brand equity of competitors within a product market. Of equal value, this type of research can reveal opportunities to reinforce weak spots in the market’s perceived quality of a given brand.

Building substantial brand equity is ultimately dependent on how consumers perceive the value and characteristics of the brand relative to its nearest competitors. One of marketing managers’ primary responsibilities is to create a blueprint for developing the most advantageous impression possible of a brand. The term most often used to describe this strategic imperative is product positioning.

7.3 Positioning Strategy

Product positioning is defined as “the way consumers, users, buyers, and others view competitive brands or types of products” (American Marketing Association, 2011). The term is also commonly used to describe the strategy used to achieve the intended position in the market relative to competing brands. It is an essential, central concept in the process of marketing management. Following market segmentation and the selection of a target market, managers need to determine how the brand will be positioned relative to competing brands within the product market. All of the marketing mix decisions that determine the success or failure of the brand are based on this core strategic decision.

The purpose of product positioning is to communicate and establish the intended brand image in the mind of the target audience. How the brand is positioned relative to its competitors must reflect an understanding of the target market’s needs and the competitive advantages inherent to the brand. Successfully positioned brands are clearly understood by the intended audience. They are aware of the brand, understand the benefits of using the brand, and know how the brand is different from competitors’ products. The ultimate objective of positioning in this regard is to provide a brand that is understood by the intended customer as fitting his or her needs and preferences better than any available alternatives.

Both tangible and intangible perceived differences contribute to the process of differentiating a brand and establishing the desired position in the consumer’s mind. An emphasis on the promotion of product features related to the substantial, physical qualities of the product (e.g., monitor screen size or resolution) is generally preferred when communicating a positioning strategy for high involvement products. The lack of substantive points of differentiation and consumer motivation to evaluate brands for low involvement products favors reliance on broad conceptual themes (e.g., popularity with peers).

Without regard to the primacy of tangible or physical characteristics in the positioning of a brand, a perceptual dimension is invariably involved simply because the process ultimately takes place in the mind of the consumer. This becomes increasingly evident over time as buyers learn to associate the physical characteristics of the product with the brand. That is, the customer’s perception of brand image or personality comes to represent a composite of the underlying tangible traits. This imaging effect occurs in both B2C and B2B markets.

7.4 The Positioning Process

The critical importance of positioning in driving marketing mix decisions warrants the development of a systematic, process-oriented approach to making this core strategic decision. The positioning process described here is intended to aid managers in establishing brand image goals and developing the strategic path to achieve them.

Step 1: Identify the Competitive Set

Since a brand’s position is defined by its relationship to competitors’ products, it is essential to begin with an understanding of who the competitors are. These are not always limited to others in the immediate product market. Consider the case of the Jollibee fast-food restaurant chain based in the Philippines. The company entered the U.S. market in 1998 featuring an eclectic menu of burgers, rice-based meals, noodle dishes, hot dogs, pasta, and fried chicken. When evaluating the market to determine Jollibee’s nearest competitors, it is apparent that not all of its rivals are fast-food restaurants. The menu items drawn from authentic Southeast Asian cuisine only have direct counterparts in traditional, full-service restaurants. Consequently, its competitive set includes the usual fast-food alternatives as well as some Asian-inspired fine dining restaurants. Similarly, within the fast-food category, some competitors will be positioned closer to Jollibee’s desired brand image than others. How the company defines its target market will determine who its closest competitors are.

Step 2: Determine Target Market Perceptions

Developing an effective positioning strategy requires a thorough understanding of the target market. This necessitates reliable market research on the composition of customer attitudes with particular emphasis on the target benefit segment of interest. The most essential information required to create the best possible fit between the brand and target market is the focus of the multi-attribute model of attitude formation presented in Chapter 5. Using this approach to market research, three critical questions must be answered before the best positioning strategy can be determined. What product attributes or benefits do these customers use to evaluate alternative brands? How important are each of these dimensions to the construction of their product-related attitudes and decision-making? How do each of the brands compare on the most heavily weighted attributes?

Jollibee restaurant in Daly City, California.

Jollibee positions its brand in part on the basis of several intangible qualities such as value, fun, and originality.

Associated Press

Based on the responses to these questions, marketing managers can determine the key elements of brand differentiation and positioning that will have the greatest value in creating the desired brand image in buyers’ minds. These elements may be functional, tangible product attributes or something more abstract and conceptual. In highly competitive markets, the benefits most earnestly prized by consumers may be delivered equally well by multiple competitors. In these cases, the focus of the differentiation strategy may be on less important features where brands are truly distinct from each other or shift entirely to abstract attributes unrelated to the performance characteristics of the product.

In the case of Jollibee, the target market for its U.S. franchises seems to be families with young children. Research would need to determine which product features are most important to this segment when choosing a fast-food restaurant. The alternative tangible attributes could include factors such as location, availability of a kid’s menu, variety, nutrition, and product quality. However, intangibles such as good value for money, a fun place, and something different could also play a significant role in the differentiation and the ultimate positioning of the brand.

Step 3: Analyze the Positions of the Brand and Its Competitors

Working from the market research collected in the preceding stage, the next step is to evaluate the brand’s strengths and weaknesses relative to competitors’ brands and the target consumers’ expectations of an ideal brand. In most cases, brand perceptual maps or positioning maps are created to compare competitive brands on the attributes or benefits that the target market regards as most important. Figure 7.2 is a simple positioning map for local fast-food alternatives based on the summary criteria of price and quality.

Figure 7.2: Positioning map for fast-food restaurants

Positioning map for fast-food restaurants includingThe Work, Wendy’s, Jollibee’s, Subway, Burger King, and McDonald’s.

Understanding how brands compete on the basis of price and quality is often a first step in the development of a more detailed and thorough understanding of the positioning strategy.

Consider the specific competitive challenge confronting Jollibee foods as a result of its decision to enter the U.S. fast-food market. The competition from solidly entrenched rivals such as McDonald’s, KFC, and Pizza Hut poses a formidable obstacle. When evaluating the strengths and weaknesses of the Jollibee brand concept against these alternatives, marketing managers might identify opportunities along several important dimensions. In terms of menu variety and uniqueness, for example, the product array offered by this newcomer differs substantially from the usual mix of fast-food options available in most markets. In addition, an uncompromised focus on serving children and their parents might also provide a significant and valued point of product differentiation. However, although this new franchise would need to provide good value for money in meeting the needs of its target market, the ability to compete directly on price with price leaders such as McDonald’s may not be feasible.

Positioning maps are a particularly useful tool for marketers since they can be used to provide visual representations of how rival brands are perceived. These charts can be designed to convey the information in any manner the user finds most helpful. Statistical techniques such as multidimensional scaling (MDS) enable researchers to display more than two product attributes on the same map by translating data into a visual representation of the pattern of similarities between objects. In Figure 7.3, MDS is used to plot research data on customers’ perceptions of competing car brands. Brands perceived to be most like each other are nearest each other, and those most different from one another are placed at a greater distance.

Figure 7.3: Multidimensional scaling illustrates elements of brand positioning

Multidimensional scaling for research data on customer perceptions of car brands.

Multidimensional scaling on customer perceptions of car brands illustrates sharp contrasts between the positioning strategies of different manufacturers.

In some instances, the target customers’ ideal brand is also plotted on positioning maps to provide a point of reference. It is important to keep in mind, however, that the best positioning strategy for any given brand is not simply to provide the maximum level of performance or benefit on one specific attribute. Rather, it is the unique combination of features and benefits that determines how successfully a brand will appeal to its target market.

Step 4: Determine Combination of Attributes

When all customers within a target market converge on a common ideal brand position, each firm will compete for their business by positioning its brand as near to the ideal point as possible. Since no brand can ever be perfect in this respect, the resulting positioning strategy for each competitor is a compromise between providing a little more of one attribute at the expense of another. Consumers respond to the alternative pairings of attribute levels according to their personal preferences and the product’s price. This is consistent with buyer perceptions of product value (Chapter 2) as the buyer’s estimation of the overall bundle of benefits received from the product relative to the price paid to acquire them. The trade-offs that target customers make in this situation reflects their personal valuations of the importance and worth attached to each product attribute or benefit.

The alternative situation exists when more than one ideal point exists within a target market. For example, buyers may want both whiter teeth and fresher breath from the toothpaste they buy, but the specific importance of each benefit and the preferred combination of benefits shifts from one subset of the target market to the next. In this case, the strategy for each competitor is to provide the best possible fit of its brand with a portion or microsegment of the target market by positioning closest to a demand cluster.

In both instances, the essence of the positioning strategy is to deliver a combination of product benefits that meets the needs of the customer better than alternative brands. This usually entails the consideration of more than two product attributes, however, since price is also an important factor in many buyers’ decisions. The relative importance of product price to the value equation for any given segment of the market is initially identified in the process of market segmentation that precedes positioning analysis.

The final determination of the best combination of attributes to occupy the desired position in target consumers’ minds is a pivotal point in marketing the brand. All of the marketing mix decisions for this brand follow from this determination. In terms of the overall competitive strategy for the brand, it specifically establishes the primary bases and direction for differentiating one brand from the others.

Think About It

Go to Jollibee’s website (http://www.jollibeeusa.com/) and read about the company’s mission, values, and vision. Review the information provided under the “About Us” tab to get a clear sense of the corporate culture. Then review the Menu and Services sections in detail.

Based on the information that you have acquired about Jollibee and your existing knowledge of its fast-food competitors, how do you think the company should compete in the U.S. market?

Specifically, what combination of attributes and benefits will enable Jollibee to occupy the desired position in target consumers’ minds?

7.5 Differentiation Strategies for Products

Product differentiation is the process of meaningfully distinguishing one product or brand from another in a way that renders it more appealing to a given target market. The strategic intent is to provide the brand with a sustainable advantage over competitors. This means providing buyers with value-added differences or product improvements that directly contribute to greater customer satisfaction. Ideally, the basis for differentiating one brand from the pack should also be difficult for competitors to imitate.

There are three potential sources for differentiating one brand from competitors within the category: tangible brand attributes, perceived product benefits, and price. Price advantages, as discussed in previous chapters, are typically grounded in economies of scale and experience curve effects. Consequently, it is an option usually reserved for the larger competitors within an industry. Differentiation strategies based on product attributes or benefits can be built into the brand in many ways. The annotated list of differentiation factors provided here identifies several of the variables most commonly used to differentiate one brand from another.

Physical Appearance: Form, Shape, Style, and Size

A 1949 Volkswagen silver beetle.

Volkswagen built its early reputation in the United States on product reliability.

Transtock/SuperStock

One of the most obvious differences between competing brands in any given product category is the physical appearance. Many successful brands can be readily recognized simply from the shape of the product or packaging. Consider, for example, the distinctive shape of a Volkswagen Beetle, a KFC bucket, or a Pringle’s potato chip. The appeal of economy-sized packaging or convenience-sized products depends on the buyer’s lifestyle.

Although style preferences are subjective matters, the styling of a product is a physical or tangible attribute. Many consumer products are differentiated primarily on style-related dimensions. For some market segments, style is the primary determinant and the course of brand preference for everything from cars and clothes to mountain bikes and home appliances.

Colors also play a significant role in product differentiation. Consider how fan perceptions of NFL and college football teams are tied to the team colors. Would McDonald’s or Wendy’s seem the same if their familiar signage were in black and green? If Black & Decker power tools weren’t black and orange anymore, would they still be the same?

Product Features and Attributes

Product features are the elements of the product that relate to its basic utility or functions. They are the attributes that improve or impede the functional value or operation of the product. Core features are those that are essential to the product’s function (e.g., a fuel-injected engine in a car). Supplemental features are those elements that enhance the level of performance (e.g. a fuel-injected engine with a supercharger). Most consumer goods categories include several brands with added features that enhance product performance. With respect to how new features are included and incorporated into existing brands, marketing managers need to be particularly mindful that buyers are responding to the overall bundle of benefits being sold. Consequently, additional features must be consistent with the target segment’s expectations of product quality and compatible with their perception of the brand’s image.

Think About It

Product features are a key element in differentiating one brand from another. However, the natural forces of competition make it difficult to sustain meaningful differentiation on this basis for very long in most markets. Consider how quickly consumer electronics evolve over time. New features that are initially unique to one brand are quickly copied by rivals.

Patents seem to provide limited protection in this regard. Why?

What other steps can marketers take to extend the effective life of brand differentiation strategies that are rooted in tangible, physical features?

Adding new features can accomplish several objectives for marketing managers. It can renew customers’ interest in a brand and keep it current with respect to shifting consumer priorities. Environmentally friendly, minimal packaging designs and the use of post-consumer recycled materials are opportunities for packaged goods companies to respond to the contemporary concerns of many buyers. New features can also be an effective strategy for extending a brand’s reach to markets or market segments. Specializing products to provide a better fit with the preferences of new clusters of buyers is an example of the multiple-segment specialization strategy introduced in the previous chapter.

The risks of adding additional product features to differentiate a brand are associated with losing sight of what the customer wants. Whether trying to improve the brand’s fit with existing buyers’ preferences or pursuing an entirely new target market, marketing managers need to make decisions based on a sound understanding of what customers are seeking from the product they are buying. Too often, the tendency is to add features because we can, because competitors already have, or because management believes it would improve the product.

The addition of new features, as with other bases for brand differentiation, comes with costs attached. The most common costs relate to production and promotion of the new product element, though new distribution-related costs are almost inevitable when any changes are made to standardized consumer goods. As with every element of the marketing plan, the costs associated with alterations to the brand’s core or supplemental features must be treated as investment in future sales and evaluated based on their projected rate of return.

Performance Level and Consistency

Performance level refers to the brand’s operational capabilities with respect to the product’s essential functional attributes. In short, how well does it do what it is intended to do? The performance level and quality of a brand are primarily comparative measures. Prospective buyers typically have a range of choices that correspond to the trade-offs between price and quality, called product value. The extent to which consumers are willing to pay more for better performance and product quality determines their perceptions of value. Distinguishing between groups of buyers along the value preference dimension is a common way to segment product markets. Sears and Best Buy are among the stores best known for using this approach, breaking down product lines into good, better, and best categories.

Marketing managers need to identify the preferences within their target markets and create product offerings that correspond to the range of performance levels their buyers desire. The brand options made available by competitors will also impact product positioning strategies in this regard. As product markets grow increasingly mature and competitive, companies need to differentiate their brands by providing better overall value than competitors’ brands. This requires providing buyers with higher levels of quality and performance for the same or less money.

Maintaining consistent and reliable levels of product performance and quality over time is essential to building a valued brand image, a trusted identity, and positive brand equity. Consistency extends beyond the quality of the product itself to other marketing mix considerations. The promotional strategy for the brand must shape and reinforce a consistent perception of the brand over time. The distribution strategy and all of the elements of the supply chain must work together to ensure reliable availability of the brand. If a product is unavailable, some potential new customers will be forfeited to those brands that are on the shelves; some previously loyal buyers could be lost once they are compelled at try an alternative brand due to stock-outs.

Durability

The meaning of product durability is highly variable and relates to the nature of the product being sold. It is a usually a measure of how long a product will continue to exist or perform as it was designed to work without significant deterioration or loss of function. In B2B contexts, it is frequently used to refer to the operational effectiveness, efficiency, or capacity of a product when it is being used under routine conditions.

The value of durability is greater for some types of products than other. Many inexpensive products within a category (e.g., $3 wristwatches), convenience purchases (e.g., Styrofoam coolers), and fashion-specific purchases (e.g., a purse to match shoes) are not bought with durability in mind. For other types of products, however, the brand’s reputation for long-lasting performance warrants substantial price premiums in the market. Dr. Martens boots, Craftsman tools, Maytag appliances, and Oshkosh B’Gosh clothing are some of the brands that have built their brand image on durability. However, B2C products that excel in this area can be found in almost every conceivable product category.

Other Differentiation Factors

A pedestrian passes by a Craftsman tool display in the window of a Sears store.

Craftsman built its brand image on the trust customers had in the Sears brand name.

Getty Images News/Getty Images

The range of possible bases for differentiating one product from another includes other possibilities as well. The choice of distribution channels and retail outlets can make a significant impact on how prospective buyers view alternative brands. The manufacturer’s provisions for obtaining service after the sale, product warranties, and the perceived ease of repairing a damaged product also can be used to differentiate brands. And promotional messages and themes, independent of the tangible characteristics of the brand, always provide an opportunity to establish a unique brand image or personality within the target market.

Many goods sold in both B2C and B2B markets are a composite of both products and services. When parity exists between the product dimension of competitors, companies often seek to differentiate their brand along service lines. Further, many valued goods consist almost exclusively of services, such as education, health care, and financial and legal services. In both situations, differentiating services and service providers from each other encompasses some unique opportunities and challenges for marketing managers since services themselves are largely intangible.

7.6 Differentiation Strategies for Services

The character of services can make them difficult to differentiate from one another. Since services are intangible, they cannot be easily displayed or demonstrated. All of the physical appearance bases of differentiation associated with products have little relevance. The quality of services is typically dependent on and inseparable from the talents of the service provider and, in many instances, services are produced and consumed simultaneously (e.g., education, dental care). Overall, the quality of services provided is often more difficult for buyers to evaluate than product quality. These characteristics render conventional product segmentation bases much less useful.

In both business-to-consumer and business-to-business markets, the most commonly used bases for differentiating brands of services are order and delivery; installation and instruction; and maintenance, repair, and complaint response. Each of these features represents ways in which service managers can provide added value and higher levels of service quality.

Order and Delivery

Domino’s Pizza delivery driver leaving the restaurant to deliver a pizza.

Domino’s Pizza rose to prominence as a national chain with its 30-minute delivery guarantee.

Associated Press

To be of value, a service needs to be provided where and when the buyer wants it, regardless of whether the good being sold is entirely a service or primarily a product. One way that marketers can help bridge the gaps posed by time and space is to make the process of placing an order as simple and straightforward as possible. Increasingly, for almost every type of hybrid product/service sold, this means online ordering. For these products, the online environment provides the initial point of buyer–seller contact and interaction. Whether ordering a pizza for delivery, buying e-books, or scheduling a plumber, the simplicity and ease of the ordering process has a direct bearing on buyers’ willingness to return to the site on future occasions.

Delivering the product or service to the customer is of equal or greater importance to creating customer satisfaction. The dimensions of importance to product delivery include speed and accuracy. High levels of performance on these two elements are typically expected by customers as a matter of professionalism in B2C markets and basic competence in B2B markets. Failure to meet customer expectations in terms of providing quick, on-time delivery will create negative differentiation of the brand or service provider in buyers’ minds.

Installation and Instruction

For goods that have a substantial service component, installation may be required. This refers to all of the actions required to make the product perform in accordance with its intended operation and the seller’s commitment. This includes everything from setting up household appliances (e.g., washers and dryers) to large commercial installations that may require weeks to complete (e.g., enterprise application software, oil refinery processing equipment).

In many instances, a customer’s employees will also require specialized training services from the seller on how to properly use the equipment. In some B2B contexts particularly, complex products require substantial instructional or consulting services for a lengthy period following the initial sale. These services may be provided on-site or online. Increasingly, sellers use online videoconferencing to help buyers learn how to make the best use of the products they have purchased.

Maintenance, Repair, and Complaint Response

Once the initial purchase and installation have been completed, many types of products require extended service after the sale. The maintenance and repair service features provided by a company are intended to maintain the product in good working order and keep the ongoing relationship with the buyer on the best possible terms. It provides opportunities at regular intervals for the seller to renew his or her commitment to customer satisfaction and reinforce a positive brand image through the provision of necessary services. Complaints from buyers should be regarded as irregular or unplanned opportunities to preserve or create satisfied customers.

The quality of post-sale customer service varies substantially across many product categories. Consequently, excellent service after the sale provides opportunities to positively differentiate one brand from many of its competitors. The efficiency and effectiveness of a firm’s response to customers’ calls for help with products impacts more than how one specific buyer feels about the seller. Their level of satisfaction with these encounters is reflected in both informal (e.g., word-of-mouth, blog postings) and formal (e.g., published customer satisfaction ratings) communications. Companies noted for their excellence in service after the sale recognize that prompt and helpful responses to their customers’ most urgent concerns have a disproportionately great impact on customer loyalty.

Ch. 7 Conclusion

The primary strategic goal of brand differentiation is to shape a unique brand image and capture a competitive position that better meets the preferences of the target market than competing brands. Market segmentation, brand positioning, and product differentiation combine to reduce the threats posed by direct competition in the product market category. As the identity of brands becomes thoroughly integrated into the minds of consumers, the costs of competing decrease, unit margins increase, and opportunities to build on the equity of a well-established brand become evident.

In most cases, successful differentiation will shift the nature of the brand’s marketing emphasis farther away from price-based competition to value- and benefit-oriented approaches. When successful, this enhances the perceived value of the product for the target market and reduces buyers’ price sensitivity, thereby creating opportunities to maintain a premium pricing strategy. One consequence of this shift is to increase the relative prominence of distribution and promotional strategies in the marketing mix. The unique contributions of market segmentation, brand positioning, and product differentiation to the development of a firm’s competitive marketing strategies are examined in Chapter 8.

Ch. 7 Learning Resources

Key Ideas

Critical Thinking Questions

 Based on your personal experiences, do you think that consumers are consciously aware of how brands work? Under what circumstances might buyers realize that a specific experience with a product is impacting their attitude toward the brand?

 Brand loyalty is typically much stronger for consumers over the age of 50 than for younger age segments. Why do you suppose that this is true? Are future generations of consumers more or less likely to be brand loyal?

 Brand loyalty requires positive reinforcement over time. Would a bad personal experience with a brand do more damage to brand loyalty for low or high involvement products? Why?

 Many consumers regard the theft or piracy of downloaded music, computer games, and movies as “less wrong” than stealing the same products from store shelves. Why do you think they might feel this way? What can sellers do to counteract that belief?

 It was stated that brand equity can be measured by the price premium consumers are willing to pay for a brand relative to its generic alternative. Under what circumstances might this be misleading?

 Brand positioning is a central concept within marketing management since all marketing mix decisions are driven by positioning strategy. What would happen if a manager tried to develop a marketing plan without first reaching a decision on brand positioning?

 Brainstorm with your colleagues to come up with a new restaurant concept for your community. Identify the target market. Determine how to differentiate it from competitors. Work through the four-step model for developing a positioning strategy. Did you work through an iterative process or a fairly linear one to reach the final positioning strategy? Why?

 Based on the work you completed for the previous question, identify all of the different types of bases that you might use to differentiate a restaurant from its competitors. Name which ones you are most unlikely to use and explain why.

 When devising a differentiation strategy for a product/service hybrid, would you be more likely to focus on the product features or service features? Provide examples to support your answer.

Key Terms

Click on each key term to see the definition.

brand

A name, term, design, symbol, or any other feature that identifies one seller’s good or service as distinct from those of other sellers.

brand associations

The positive and negative impressions that consumers link to the outcomes related to buying and using a specific brand. They are reflections of the perceived brand image.

brand awareness

A general measure of consumers’ knowledge of the existence of a brand; the first preliminary step in the purchase decision process that ultimately leads to a sale.

brand equity

The value of a brand based on consumer attitudes about positive brand attributes and the favorable consequences of brand use. It is a multifaceted construct defined by five underlying classes of assets: brand loyalty, brand awareness, perceived quality, brand associations, and other proprietary assets.

brand image

The perception of a brand in the minds of current and prospective buyers; a composite of what the brand means to buyers in terms of their attitudes and expectations. Sometimes referred to as brand identity or brand personality.

brand loyalty

The reliable tendency of consumers to consistently purchase the same brand within a given product class.

microsegment

A term used to describe a small, limited, precisely identified division of a market. It refers to a targeted sub-segment or component of a larger defined segment.

multidimensional scaling (MDS)

A set of related statistical techniques that enables researchers to visualize information in ways that help identify patterns of similarities or dissimilarities in data. MDS can display information about two or more product attributes on a perceptual map to evaluate the perceived distances between competing brands.

perceived quality

The consumer’s subjective opinion of of a brand’s or product’s capability to meet his or her expectations and product-specific needs.

positioning process

A four-step model used to identify the best positioning strategy for a brand. Steps include identifying the competitive set, determining target market perceptions and determinant attributes, analyzing competitors, and determining the attributes required to meet positioning objectives.

price premium

The additional monetary value that a customer will spend for a specific branded product above and beyond the retail price associated with generic or unbranded competitors.

product differentiation

The process of meaningfully distinguishing one product or brand from another in a way that renders it more appealing to a given target market.

product positioning

The way that consumers view competitive brands or types of products. The term is also commonly used to describe the strategy or strategic plan that is developed to achieve the intended position in the market relative to competing brands.

proprietary assets

Tangible or intangible items that contribute positive economic value to a brand. This includes legally protected intellectual property such as patents, trademarks, and copyrights.

top-of-mind awareness

A measure indicating which brand is first recalled when customers are prompted by the name of the product category.

Web Resources

This website links to a long and detailed PowerPoint presentation on the topic of product positioning that was created by Dr. Ed Forrest, a professor of marketing at the University of Alaska–Anchorage. It is very informative on the topic of brand positioning strategy and contains many good examples and illustrations.

http://www.cbpp.uaa.alaska.edu/afef/BA343-wk5-Positioning.ppt

This website provides many interesting observations and insights on the topic of product differentiation for small-business owners.

<http://www.more-for-small-business.com/product-differentiation.html>

Chapter 8

Market Attractiveness and Competitive Strategies

Cans of pepsi and coke in a grocery shelf

Associated Press

Learning Outcomes

By the end of this chapter, you should:

 Understand how Porter's Five Forces impact the attractiveness of competitive product markets to prospective market entrants and challengers.

 Recognize that analyzing competitors' strategies, goals, strengths, and weaknesses is essential to successful brand management in competitive markets and identify the four dimensions that should be considered when assessing competitors' capabilities.

 Understand how a brand's relative market share or degree of market dominance shapes its strategic choices and responses to competitors' actions.

Ch. 8 Introduction

Chapters 6 and 7 explored the three primary elements of strategic market planning: segmentation, differentiation, and positioning. This chapter focuses on the nature of competitive markets, competitors, and four classes of alternative strategies based on levels of relative market dominance.

To understand the rationale and value of each of the alternative market dominance strategies, it is necessary to appreciate the nature and dynamics of the competitive environment in which they must be implemented. This is fundamental to evaluating the attractiveness of market segments and market opportunities. One approach to systematically investigating the structure of competitive markets is Porter's Five Forces Model.

This chapter begins with an investigation of the specific factors that determine the level of competitive intensity within any given product market. The sections that follow focus on competitor analysis from the perspectives of buyers and competing sellers. Particular emphasis is placed on understanding competitors' brand strategies, strengths, and weaknesses. The chapter concludes with an examination of how a brand's relative market dominance shapes its strategic choices and limits the range of responses to competitors' actions. Alternative strategies are presented for market leaders, challengers, followers, and niche competitors.

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It is sometimes argued that the analysis of competitive strategy and efficient markets should be the exclusive domain of economists rather than allowing marketers to dabble in the field. If you ever find yourself starting to agree with that sentiment, consider the old joke about the two economists walking along a sidewalk together. One of them sees a $20 bill on the ground and exclaims: "Look! There's a $20 bill lying on the sidewalk over there." The other economist replies: "Don't be silly. There can't be a $20 bill over there. If there were, someone would have picked it up by now."

8.1 Porter's Five Forces: Determining Market Attractiveness

Porter's Five Forces Model provides a general framework for industry analysis that identifies the factors that determine the competitive intensity within a product market. Markets that are less competitive are usually more attractive for prospective entrants, since high levels of head-to-head brand competition tend to reduce the overall profitability of any given market. Throughout the discussion of this model, shown in Figure 8.1, we will use examples from the airline industry to illustrate each of the five forces.

Figure 8.1: Porter's Five Forces Model

A framework for industry analysis

Porter's Five Forces Model provides an industry analysis framework based on five factors that determine competitive intensity. Three of these forces relate to direct competitive threats. Two stem from the threats posed by the bargaining power of suppliers and customers.

Three of the five forces within the model relate to direct competitive threats from established rivals, substitute products, and new entrants. The remaining two sources of threats come from the bargaining power of suppliers and the bargaining power of customers. Changes in the circumstances or behavior of any one of these five market forces typically require a re-evaluation of the firm's competitive strategy. Each of the five forces and its significance is described here.

Threat of New Entrants

One of the reliable lessons of economics for marketing managers is that profitable markets will attract new competitors. These challenges may arise from wholly new market entrants or the introduction of new brands from current competitors. Over time, the effects of price competition for market share will drive down the profitability of the market for all brands. As markets mature and growth slows, conditions approximating perfect competition will push prices lower and per-unit profits toward zero for many smaller brands.

Two Pan Am A300-B5 jets on a runway

Intense competitive rivalry forced Pan Am into bankruptcy in 1991. Can you think of an example, other than airlines, where new entrants have drastically shaped a market?

Associated Press

In defense of profitability and their market share within specific target segments, brands will look for ways to erect barriers to market entry. Barriers to market entry, or barriers to competition, are "the economic, legal, technical, psychological, or other factors that reduce competitive rivalry below the level that would otherwise occur naturally. Barriers include branding, advertising, patents, entry restrictions, tariffs, and quotas. Product differentiation is a barrier to competition" (American Marketing Association, 2011). As previously described, there are a myriad of ways to differentiate a brand from competitors' products. To construct an obstacle to competitors entering the market, however, those that directly strengthen the fit between the brand and its target segment will be the most effective. The objective is to eliminate any distance or gap between buyers' preferences and brand-specific benefits that would create an opportunity for a challenger to squeeze in. Consequently, high levels of brand equity represent a substantial barrier to entry insofar as they reflect customer satisfaction and the firm's commitment to building brand loyalty over time.

The arrival of new entrants has dramatically reshaped the U.S. airline industry over the past few decades. Regulation had limited the opportunity for new competitors to enter the lucrative domestic U.S. airline industry prior to the passage of the Airline Deregulation Act of 1978. In the 10 years that followed, 22 new domestic airlines (e.g., People's Express) were formed. Additionally, 43 foreign carriers (e.g., Laker Airlines) entered the U.S. market. As a consequence of direct competition from more efficient operators, several major airlines filed for bankruptcy over the next 20 years. These included Eastern, Midway, Braniff, Pan Am, Continental, America West Airlines, and TWA. More than 100 smaller airlines went bankrupt or were acquired by larger competitors (U.S. Centennial of Flight Commission, 2003). Over this interval, average paid fare declined approximately 30 percent in inflation-adjusted terms (Aviation Magazine, 2012).

Intensity of Competitive Rivalry

One of the most frequently used measures of competitive rivalry is industry concentration. The Industry Concentration Ratio is calculated by the U.S. Census Bureau for each of the major NAICS classification categories. It identifies the aggregate market share for the 4, 8, and 25 largest firms in most product markets. High four-firm concentration ratios indicate that relatively few companies within an industry control a large portion of the market. Consequently, these markets are recognized as being less competitive. Conversely, a low concentration ratio indicates that the industry is more likely to be highly competitive.

Battles of competitive rivalry are often fought with marketing mix weapons. Price wars and aggressive pricing policies are fairly obvious indicators of intensive competition. However, price-based competition often damages the financial outcomes for all of the competitors within a given market.

Channels of distribution are also used to pursue competitive advantage over competitors. In pursuit of building sales and market share, one strategic alternative is to expand the scope of distribution channels and outlets through which a given brand is sold. However, the costs associated with building and maintaining extensive distribution networks often exceed the corresponding profit potential. If selected without sufficient regard to the image of the brand being distributed, poor channel choices can also inflict damage on the perceived quality or value of the product as well.

Advertising and other forms of promotional strategy are the most commonly deployed weapons in competitive market battles. Both the nature of the messages used and the total volume of advertising messages are indicators of how intensively brands are working to steal sales away from each other. In no-growth markets, additional sales can be captured only by taking market share away from competitors' brands.

The product dimension of the marketing mix can also provide clear indications of how competitive a given market may be. Meeting buyers' changing expectations by providing higher-quality products is evidence of high competitive intensity. High levels of product innovation may also signal aggressive efforts to capture sales in fast-growing markets. This is evident in many technology-intensive markets such as telecommunications, information processing, and medical equipment. In rapidly evolving product and services markets, technological innovations may be essential to simply maintaining one's competitive position.

In the airline industry, the intensity of competitive rivalry has always had a direct impact on the profitability of both large and small competitors. Although no one firm has been able to dominate the industry in recent history, the eight largest carriers combined account for about 90 percent of total revenue, as illustrated in Figure 8.2 (U.S. Department of Transportation, 2011).

Figure 8.2: Airline domestic market share November 2010–October 2011

Graph shows the airline domestic market share for November 2010-October 2011, Delta with the highest revenue and SkyWest earning the lowest.

This graph illustrates airline domestic market share for November 2010–October 2011, with Delta securing the highest total revenue passenger miles and SkyWest earning the lowest.

U.S. Department of Transportation, 2011

Intense competitive rivalry is expressed within the industry in setting fares, particularly for those profitable routes with origins and destinations at the strategic hub airports that account for most passenger miles. Although non-price promotions such as frequent flyer rewards programs remain an important dimension for promoting airlines, it is clearly a price-driven market. High fixed costs, slack capacity at most times of the year, low brand differentiation, and the ready availability of pricing information online all fuel the intensity of competitive price rivalry between carriers.

Threat of Substitute Products or Services

Substitute products represent a different kind of competitive threat than is posed by either new entrants or competitive rivals. These are alternative products, rather than alternative brands, that are regarded by consumers as acceptable replacements for other products. There are a wide range of substitution types, each of which makes markets less attractive opportunities.

The appropriateness of one product as a substitute for another is most often based on the intended use of the product. That is, they possess a shared functional equivalence based on the buyer's perception of how each can satisfy a need in a specific situation. For example, airlines may be an acceptable alternative to one's own car if the need is to travel long distances. However, planes have no utility if the objective is to travel to the corner convenience store.

In any given situation, the value associated with a substitute product is a function of how well it fits the customer's needs. Buyers are generally more likely to switch if the substitute offers better value for the price being charged. Consequently, the substitute product's value can be impacted by its quality, performance, and the costs associated with switching.

Switching costs refer to any obstacle to a buyer's change of brands, products, or suppliers. These types of barriers can take different forms, depending on the nature of the product market. The costs of time and frustration that buyers might anticipate in switching from a landline telephone to a cell phone for the first time will reinforce product-level loyalty for some types of consumers. Poor customer service and low levels of customer satisfaction, however, will necessarily push consumers over the threshold toward alternative solutions. Often the switching cost barriers that keep buyers from trying substitute products are tied to an aversion to new technologies, emotional links to existing product types, and the social consequences of change.

The viability of substitutes for air travel are dependent on several customer- and situation-specific factors. In principle, travel by car, bus, or train should be a close substitute for air travel. In fact, the switching costs between air travel and these potential substitutes are quite low. Consumer preference for one form of transportation over any other, however, is necessarily a function of distance, time, and convenience as well as price. Business travel, particularly long trips, and emergency travel tend to favor the airlines over ground transportation. On the other hand, leisure travelers are generally more price-sensitive and more likely to consider substitutes to airlines when evaluating their transportation options. Some forms of preplanned transportation such as for family vacations may actually favor ground transportation over airlines even when the relative price of each is disregarded.

The Competitive Impact of Switching Costs

The significance of switching costs and their impact on brand choice are far from being fully understood. Marketers traditionally looked primarily at the financial costs associated with switching brands, such as the need to acquire and install new equipment. Increasingly, however, the role of psychological switching costs is coming under scrutiny. Psychological switching costs include the inconvenience associated with adapting to a new brand, costs associated with learning how to use a new product, and the emotional and psychological risks associated with making a change. Within this context, brand loyalty represents a substantial switching cost for many customers.

In most situations, even consumers who do not regard themselves as brand loyal maintain a bias in favor of sticking with brands they have used in the past if the product's performance was satisfactory. They require the promise of significantly greater benefits to switch to a new and unknown alternative. Consequently, consumers are sensitive to the relative advantages and disadvantages of any change rather than absolute differences (Gourville, 2003). The same is true for their perception of differences in product prices. They tend to evaluate the relative price difference between brands in light of the psychological costs of switching rather than evaluating price levels as absolutes.

The conventional view of switching costs and brand loyalty is that these obstacles to changing brands should reduce competitive rivalry and increase product prices. In short, they should behave like barriers to entry in that regard. However, research by Dubé, Hitsch, and Rossi (2009) provides surprising evidence to the contrary. They studied the buying behavior of 2,100 households in a large Midwestern city over a two-year interval for orange juice and margarine purchases. Psychological switching costs were observed in the form of loyalty to preferred brands such as Tropicana orange juice and I Can't Believe It's Not Butter margarine.

Contrary to expectations, this study found that average market prices for both of these products fell as switching costs increased. That is, as the psychological costs associated with changing brands increased over time, the per-unit market price decreased. Analysis of the data demonstrated that prices were as much as 18 percent lower with than without the switching costs associated with brand loyalty. Only at exceptionally high levels of switching costs did the researchers observe any significant potential to make markets less price competitive.

This outcome is counterintuitive based on our conventional ways of thinking about markets, brand loyalty, and pricing. Doing research on this type of phenomenon in a real-world setting is quite difficult, and a variety of factors can bias the results or lead to erroneous conclusions. However, there is a growing conviction among marketing practitioners that switching costs are a far more important and complex dimension of strategy than has been previously recognized.

Bargaining Power of Customers

Low price signs in a Walmart store in Las Vegas, Nevada

Large retailers such as Walmart often squeeze significant price cuts from suppliers and use their market power to compete on price at the retail level.

Associated Press

The attractiveness and profit potential within a product market are also directly impacted by the extent to which buyers have the ability to impact the terms of sale. Customers' bargaining power directly impacts sellers' ability to maintain or increase prices. The relative power of customers within any given market depends primarily on the size and number of buyers relative to sellers.

When there are relatively few buyers for a given product, the potential market for sellers is necessarily limited. Aware of this advantageous position, buyers may opt to pit competing sellers against each other to negotiate the best possible prices and terms. When a single customer represents a large portion of the potential market, sellers have little choice but to compete aggressively for that business. Brand differentiation is a particularly vital countervailing force against the power of large customers by providing a value-based defense against being pushed into head-to-head price competition.

The same principles apply when one large buyer purchases a substantial portion of the market's total output. Large retailers such as Walmart and Sears often exact significant price cuts from sellers in product categories where they dominate retail sales (e.g., home accessories and large household appliances). Manufacturers sometimes seek to mitigate the bargaining power of large buyers by emphasizing end-user promotions that directly reinforce brand preference. In this way, consumer-oriented advertisements and sales promotions can strengthen brand-specific demand and provide offsetting leverage for manufacturers in future negotiations with large retailers.

Many large corporations have travel departments that facilitate travel arrangements for their employees. The opportunity to coordinate airline-related purchases by pooling all of the firm's travel requirements within one buying unit provides the buyer with substantial leverage when negotiating with major carriers. In most circumstances, however, purchasers lack the ability to collaborate with other buyers to strengthen their bargaining position. Individual consumers are limited to exercising the leverage that comparison shopping on the Internet provides. Though this can be substantial in some situations, individual consumers are unable to negotiate airfares from a position of relative strength or advantage. Airlines will quote fares to these prospective buyers primarily according to route demand. High-demand routes covered by multiple competitors provide an increased number of nearly perfect substitutes. Consequently, prices for these flights will be more competitive.

Think About It

Heinz ketchup and Skippy peanut butter are two products that grocery retailers recognize as "must-carry" brands. How did they achieve this position?

How could they use this bargaining power as leverage against the demands of large retail grocery chains like Kroger's and Albertson's?

Bargaining Power of Suppliers

The power wielded by the sellers that supply raw materials, component parts, and services to other organizational buyers can make markets more or less attractive to companies that consider selling finished goods in the market. The dynamics related to the bargaining power of suppliers are comparable to those noted for the bargaining power of buyers.

Suppliers' ability to impact the terms of sale within a given market is primarily dependent on the size and number of alternative suppliers available to buyers. When there are few alternative sources of supply to any given market of organizational buyers, suppliers can leverage this market power to demand relatively high prices for the resources they control. When the goods and services provided by market suppliers are highly differentiated, their market leverage approaches that of monopoly power.

Providing highly specialized raw materials or component parts that are essential to the continuing operation of the customer also elevates the switching costs confronting the buyer. In many instances, key suppliers to an organization have cooperated in the development of ordering and inventory systems for the buyer. Product specifications, delivery schedules, order sizes, packaging, and other features may be custom tailored to the needs of the customer. Consequently, switching to a new supplier might require costly adjustments to daily operations of the buyer.

In the airline industry, it is tempting to consider the primary supplier to be airplane manufacturers. Firms such as Boeing and Airbus enjoy substantial bargaining power and leverage over their current customers due to the high switching costs associated with changing airplane types. These costs include training engineers to maintain the new aircraft and training pilots to fly them (RBB Economics, 2002). However, human capital represents a larger investment for airlines each year as employee compensation contributes the largest portion of the airline industry's operating expenses. The relative bargaining power of employees has been evident in several union strikes since the deregulation of the industry. The downward pressure on airfares over this time has pushed airlines to trim wage rates and benefits at all levels. The bargaining power of different employee groups, however, will necessarily vary according to the types of employees and whether they are unionized.

Porter's Five Forces Model provides a conceptual, analytical basis for evaluating the attractiveness of markets. This flexible methodology for investigating the relative strength of competitors, buyers, suppliers, and the potential to attract new entrants can be applied at the level of market segments, markets, or industries.

Ultimately, customers and competitors are the two primary factors impacting marketing strategy in most markets. The need to have a thorough understanding of each target market's preferences and characteristics has been addressed in preceding chapters. The next section of this chapter provides a systematic framework for investigating and analyzing competitors.

8.2 Analyzing Competitors and Competitor Strategies

The day-to-day practice of marketing management is most clearly focused on creating bundles of benefits that satisfy target customers. This is both appropriate and essential. However, it's a mistake to view the relationship between a given brand and target market as existing in isolation. Marketing plans are sometimes developed as though competing brands are entirely static and have no plans of their own. Worse, it is often implicitly assumed that competitors' brands will not respond to others' new marketing mix initiatives.

Just as marketers need to have a thorough understanding of customers, it is equally important for them to study the strategies, objectives, and strengths of competitors. This section introduces a framework for organizing the analysis of competitors and provides a basis for building strategies on the basis of this information.

Southwest Answers the Competition

When Southwest Airlines became a major player in the industry, a number of new airlines fought for their success. How did Southwest analyze their competitors' business and counter their strategies?

Identifying Competitors

To create effective marketing programs, it is necessary to appreciate the nature and character of competition within your target market. The first step in the process is to identify the specific competitors for your brand, including those alternatives or substitutes that extend beyond the immediate product type being sold.

Identifying competitors is a critical first step in the process of competitor analysis since the failure to identify all of the brand's relevant challengers can limit the effectiveness of brand strategy. The failure of movie studios to recognize the emerging competitive threat from television in the 1950s was disastrous for the industry. Throughout the past 25 years, soda companies have repeatedly underestimated the threat posed by sports drinks, non-carbonated flavored drinks (e.g., iced tea), bottled water, and energy drinks.

There are two basic approaches to identifying any given brand's competitors. Product based approaches rely on the classification of competitors according to the objective attributes of the brands being sold. For example, the competitors for Pilot ballpoint pens would simply be identified as other brands of ballpoint pens. This is a straightforward product orientation that defines competition based on how company managers perceive the competitive product class rather than how consumers perceive the set of relevant alternatives. Though still commonly used in some industries, this view is incompatible with the fundamental philosophy of marketing, as it is more likely to lead to errors of omission than the alternative.

The alternative path to identifying a brand's competitors is termed the market approach. This method classifies competitors based on customer attitudes, perceptions of the benefits offered by potentially competitive brands, and buyers' market-related behaviors. The focus of this approach is that customers, not brand managers, define the competitive set. Using the market approach, marketing managers can identify three levels or tiers of competitive brands based on the perceptions of target market customers: product form, product class, and generic competitors.

Uni-ball gel pen

Gel pens, such as those by Uni-Ball, are considered product form competitors of ballpoint pens. Can you think of product form competitors for other items?

PR Newswire/Associated Press

Product form competitors are those brands of products or services within the same product category. This is the narrowest definition of competition, and the brands sold in this class are often referred to as direct competitors. Consequently, the product form competitors for Pilot ballpoint pens would be other similar pens (e.g., ballpoints, porous points, gel-ink pens) in a comparable price and quality range.

Product class competitors are brands that provide similar bundles of benefits and functions, but lie outside the immediate competitive set. For Pilot ballpoint pens, this would include more sophisticated writing instruments (e.g., fountain pens, calligraphy pens), mechanical pencils, felt-tipped markers, and the like.

Generic competitors include all kinds of products that the customer may regard as serving the same basic need on a particular usage occasion. If the consumer were a student looking for a way to take lecture notes, then digital voice recorders, notebook computers, and even a smartphone with the appropriate app could serve as generic competitors to Pilot ballpoint pens.

This final tier of competition reflects extraordinary rather than ordinary circumstances. Although the products in this category are unlikely to represent a source of significant competition as markets currently exist, they often provide clues about where future competitors or new market opportunities may arise. This might include pens or highlighter markers with voice recorders in the tips.

Think About It

Consider DiGiorno's frozen flatbread pizza. What brands, products, or services would you classify as product form, product class, and generic tier competitors?

The different tiers of competition have relevance for marketing managers on two levels. In strategic planning, they provide important context for environmental scanning and analysis of the competitive environment. In terms of marketing plan development, knowing the identity of competitive brands at each of the three tiers has implications for brand positioning strategy.

The ultimate objective of positioning strategy at all three levels of competition is to provide a better bundle of benefits for your target customers relative to the offerings of competitors. However, knowing which brands compete in each of the three tiers should shape the priorities and objectives of the marketing plan in this respect. The direct competitors within the product form tier warrant the primary focus of the plan's efforts to differentiate and promote the brand.

The need to address threats from product form and generic competitors must be lesser priorities since they represent lesser threats in most instances. However, forward-looking market leaders may wish to engage these lower-tier competitors when specific threats are recognized on the horizon. This is sometimes observed when manufacturers promote the superiority of their product category's ability to meet buyers' needs. This would be the case for promotional campaigns developed by leading names in the railroad industry that have taken aim at the deficiencies in shipping freight via air or over-the-road truck haulers.

Understanding Competitors' Objectives

Understanding competitors' brand-specific objectives can provide clues about their future plans and strategies. Despite the value of secrecy and confidentiality in business, many companies routinely leak information about future goals through information posted on company websites, interviews given in trade publications, and conversations between company sales representatives and clients. Careful observation of markets can also provide insights on the future plans for a company.

Think About It

A well known marketer of pasta sauce routinely tracks its competitors' purchases from suppliers of spices and glass jar packaging. These clues help the company anticipate competitors' changes in the flavor profiles, varieties, and package sizes of their brands.

How might you use marketing intelligence of this sort to anticipate changes in future trends for the sales of sport utility vehicles?

Changes in the objectives for any given brand are invariably accompanied by revisions in the marketing activities that support the brand. Consequently, new market share, growth, or profitability goals will require the development of different strategies. This may impact any or all dimensions of the marketing mix.

Monitoring Competitors' Strategies

Strategy is driven by objectives. As discussed in previous chapters, the primary areas of strategic planning include market segmentation, product differentiation, and brand positioning. In turn, the goals established for each of these strategic drivers dictate the requirements of the marketing mix as defined by the marketing plan for the brand.

When considering how to monitor strategic shifts among competitors, marketing managers should be cognizant of those changes that are readily evident from the routine monitoring of the competitive environment. Pricing is an easily tracked and highly visible dimension of the marketing mix for every brand. Changes in product pricing by a competitor may signal a strategic shift and definitely require the attention of competing brand managers. A change may reflect a new strategy in quality/value positioning, shifting unit costs, or plans to build sales volume. Accompanying changes to other marketing mix elements should help to diagnose the larger strategic issues underlying the price change.

Changes in the composition of the product being sold, channel strategy, and promotions also provide signals that the target market for competitive brands may be shifting. Shifts that reposition a brand to bring it into closer competition with another often prompt rapid and aggressive responses as brands move to defend their territory. Shifts to previously underserved microsegments or regions of product space may signal a competitor's recognition of untapped potential.

In B2B contexts, sales literature, trade promotions, and information leaked by sales representatives are excellent sources of information. For B2C markets, advertising and changes in the pattern of media buying are good sources to monitor for changes in competitors' strategies.

Assessing Competitors' Strengths and Weaknesses

An employee fills a drug counting and packaging machine for the pharmaceutical drug company, Roche

Pharmaceutical company Roche has a high innovative capacity, enabling it to widen the gap between itself and market followers. Can you think of another company with a high innovative capacity?

Associated Press

The strengths and weaknesses of competitors both define and limit their strategic alternatives to a significant extent. There are four primary dimensions that should be considered when assessing the capabilities of competitors: innovative capacity, operating capacity, marketing capability, and financial strength.

Innovative capacity refers to an organization's ability to develop and market new products or services. Although this can be difficult to assess, firms with a history of making substantial resource commitments to research and development are likely to continue on that path into the future. In industries where research and development (R&D) is both costly and risky (e.g., prescription pharmaceuticals), the gap between highly innovative companies (e.g., Roche, Eli Lilly) and the least innovative (e.g., generic drug manufacturers) is both substantial and consistent. Firms that possess the resources and talent to regularly introduce new products pose a greater long-term challenge than market followers.

Operating capacity is a measure of a firm's manufacturing or service-producing potential within existing product and service lines. In capital-intensive sectors (e.g., automakers), creating additional productive capacity in the short term is difficult. Consequently, companies operating at or near full capacity will be unable to threaten competing brands with new strategic initiatives that require more production. Conversely, the promise of greater economies of scale in production and lower unit costs may encourage firms with substantial unused productive capacity to reduce prices to build sales volume.

Think About It

How do economies of scale and operating capacity relate to "thinking intensive" industries (e.g., software development) where human capital and creativity is the primary limitation on higher levels of production?

Marketing capability refers to competitors' ability to competently market new products or services. Some companies, for example, simply lack access to distribution channels or other prerequisites to successful launches. Some firms simply lack the corporate DNA to successfully launch new brands due to a lack of skilled management personnel. However, even firms with proven track records for successfully launching new products may differ substantially in terms of the aggressiveness and innovation that each brings to the process. Knowing that a given firm tends to plan extensively and move deliberately suggests opportunities for more nimble marketers to meet competitive threats earlier. More daring, less risk-averse firms, however, may pose a greater threat. Even unsuccessful product launches by these firms have the potential to disrupt established market dynamics and damage sales throughout a given product market.

Financial strength is an essential ingredient to every successful company. However, limited financial resources can severely limit the strategic alternatives open to even successful organizations. Large, diversified firms can allocate marketing costs across a broad base of product lines and enjoy significant cost advantages when introducing new brands or revised product strategies. These advantages are particularly evident in the lower costs associated with using an established sales force to market the product through existing distribution channels, to reach a market that already recognizes the brand or parent company. These unique economies most often accompany market leaders to a greater extent than market challengers or followers.

Think About It

Companies with highly publicized financial problems can become vulnerable to competitors. How might competitors take advantage?

The end result of analyzing competitors and competitor strategies should be a clearer set of expectations about how the dynamics of the market may change in the near future. Though forecasts of this nature are necessarily somewhat speculative, they provide a platform from which to consider how a given brand can best respond to a range of potential challenges. The sections that follow investigate how this information can be used to determine which of four alternative dominance strategies are best suited to the dynamics of the market.

8.3 Market Dominance Strategies

In Chapter 1, we identified Porter's three generic competitive strategies for pursuing new market opportunities: product differentiation, cost leadership, and market focus (1980). The decisions made with respect to these alternatives sets an enduring tone for how best to market and position a new brand in competitive markets. In this section we consider strategy on a different level. Based on Porter's Five Forces Model and the analysis of competitors, we can consider an alternative dimension of brand strategy based on how a brand's relative market share shapes its strategic choices and responses to competitors' actions.

Market dominance reflects the strength of a brand relative to competitors, and brand market share provides a convenient, though imperfect, measure of this construct. A superior measure is provided by relative market share, as introduced in Chapter 1. Relative market share is simply the ratio of one brand's market share to the market share of the category's largest competitor. This effectively provides a comparison of each brand's share to that of the market's dominant competitor.

Market dominance strategies are based on a given brand's relative dominance within a specified product market or target segment. The four alternative strategies presented in this section arise from the consideration of how relative dominance influences the role that brands play within any given market: leader, challenger, follower, or nicher.

Market Leader Strategies

The market leader is the brand that is dominant within its market. By definition, it holds the position of market share and relative market share leadership. Economies of scale will typically enable that firm to produce the product or service at a lower unit cost than competitors. Consequently, it may exert significant influence on prevailing price levels. Due to its leadership position and relative size, it is less vulnerable to the bargaining power of buyers and suppliers than other brands. Of the four alternative dominance strategies, it is the most adaptive insofar as there are very few strategic options not available to it.

Market leaders will gain the most from overall growth in market demand if their sales increase in proportion to their market share. Consequently, leaders often pursue strategies intended to expand the market by attracting new users, developing new uses for the product, or promoting greater product usage per occasion.

Market leaders are often the companies that are the most committed to product research and the most innovative in the development of new products. They also tend to leverage their financial resources to improve the efficiency of product production, customer service, market research, and distribution technologies.

The deeper pockets that come with market leadership also provide the number one brand with sufficient resources to increase sales and market share at the expense of their smaller rivals. When targeted by the market's largest brand, most competitors will find it difficult to mount a financially comparable defensive response due to the lack of resources. However, in many instances they can defend their brand well enough to make the market leader's cost of capturing additional share points higher than their financial value warrants.

Market Challenger Strategies

Smiling airline employees at an American Airlines check-in counter.

American Airlines is a market challenger with strong brand awareness and the potential to gain market share against larger competitors.

agefotostock/SuperStock

A market challenger is a second-tier brand. It is a strong and well-positioned brand that lacks the dominance held by the market leader. It is regarded as a challenger insofar as it is engaged in an aggressive strategy to gain market share. It typically has unambiguous ambitions to secure the top spot in the market. It may pursue this goal by targeting the industry leader directly (e.g., Avis versus Hertz, Colgate versus Crest, Ford versus Toyota, Pepsi versus Coke). However, it may find greater success in focusing on multiple smaller competitors that are less able to defend their market positions.

The determination of the most appropriate target is often dictated by the positioning strategy of the market challenger. To effectively leverage its brand image and equity, the challenger needs to pursue brands that are conceptually close to its own in the minds of consumers. Other considerations include an assessment of how vigorously alternative targets are likely to defend their positions.

Market challengers and attackers in general have the advantage of deciding when and how they will launch a raid on another brand's position. As illustrated in Figure 8.3, there are five alternative attack strategies open to market challengers: frontal, flank, encirclement, guerilla, and bypass (Kotler and Singh, 1981).

Figure 8.3: Alternative attack strategies for market challengers

Diagram of five attack strategies to market challengers

Market challengers and attackers have five alternative attack strategies available to them: frontal, flank, encirclement, guerilla, and bypass.

(Kotler and Singh, 1981)

In a frontal attack, the challenger confronts the defender's brand position directly with a marketing mix that provides the buyer with superior product quality and value.

A flank attack aims at a specific weakness in the targeted brand's market position. For B2C markets, this could be in relation to a specific geographic market where the brand is underperforming relative to expectations or comparable territory averages. In all kinds of markets, the weak spot may be due to a gap between buyers' preferences and expectations and brand performance. The failure to consistently create satisfied customers always provides a potential invitation to a competitor's attack.

The encirclement attack is comparable to a flank attack with one exception: It is launched against multiple points of vulnerability or weakness in the defender's position.

A guerilla attack is characterized by an intermittent hit-and-run approach to competitive strategy. It is typical of a smaller brand attacking a larger one. The attacker uses a series of small assaults, often across a range of multiple market mix variables. An intense but brief mass media blitz might be followed by a series of unpredictable short-term price incentives to buyers mixed with unconventional brand assaults through social media channels. Though generally less expensive than traditional attack strategies, it risks disproportionately strong responses from its target, intent on defending its share against a smaller challenger.

A bypass attack is the least confrontational approach to building category sales. Rather than confronting the entrenched position held by a market leader, this strategy aims to pursue new opportunities that have not yet been exploited. This is most likely to be a strategy option in markets where technological advances by smaller firms enable a challenger to pioneer new ways of meeting target customers' needs by leapfrogging over existing technologies.

Market Follower Strategies

A market follower is a financially secure firm that does not occupy the most dominant position and is content to hold its market share rank. In some instances, the lack of overall market growth or entrenched positions of competitors makes this a logical strategy choice. Like market leaders, followers need to defend their market share position by responding to both new opportunities and threats in a manner proportionate to their position and resources.

Market followers pursue a conservative strategy. The firms that pursue this alternative are often committed to serving the specific needs of their target customers, and their dedication to one segment may lead to forgoing opportunities elsewhere. The advantage to this perspective is the opportunity to cultivate a very loyal customer base.

Other advantages may also accrue to firms that follow the example set by market leaders. They often copy product innovations and business practices that have proven to be successful for others without incurring the risks and development costs. Their focus and commitment to serving their customers well minimizes the likelihood of direct competitive attacks on their position. Similarly, they are unlikely to invest in costly market share battles with other brands.

Market Nicher Strategies

Market nicher strategies are characterized by brands that concentrate their resources and efforts on relatively small target markets. This is directly comparable to the focus strategy previously presented. Limiting the marketing plan to small, narrowly defined target market segments enables the creation of the best possible fit between brand and consumer. Ideally, the target niche chosen should be large enough to be profitable, but small enough to be ignored by the larger brands within the category.

The profit goals that shape this strategy tend to emphasize unit margins rather than volume sales. Market shares are small, and the firm usually builds a loyal customer base slowly by providing a unique bundle of benefits that is unlike any other in the market. Often these specialized goods and services are aimed at the high end of the market, commanding price premiums over most other category brands. The limited size of the market, however, also allows the company to minimize marketing-related expenditures.

The Next Big Thing

Coke invests in niche products it thinks could become a phenomenon, like coconut water. Why do you think coconut water is a niche product, and how will Coca Cola market it for the niche consumers?

Ch. 8 Conclusion

Understanding the features that make a market attractive to prospective competitors is certainly important to marketing managers. Similarly, being able to analyze the strengths and alternative strategies available to existing competitors also plays a critical role in shaping the marketing mix strategy for a given brand. Each of the four market dominance strategies identified has specific strengths and weaknesses, and each is appropriate under certain circumstances.

For brand managers, however, it remains of paramount importance to remember that consumers are the sovereigns of the marketplace. Although it is essential to understand the competitive dynamics of the market, understanding customers' needs remains a higher priority. Nonetheless, effective managers will learn how best to integrate the information gleaned from both competitor and consumer analysis to create a sustainable competitive advantage and satisfy the requirements of the marketing concept—that is, to achieve the goals of the organization by satisfying customers' wants and needs better than the competition.

Ch. 8 Learning Resources

Key Ideas

Critical Thinking Questions

 Porter's Five Forces Model is intended to provide a conceptual framework to help managers evaluate the competitive dynamics of product markets. Do you think that it is well suited to this purpose? Are there changes you would want to make so that the model would be more managerially useful? Why?

 Implicit in the design of Porter's model is that managers will have enough information about their markets to make the framework useful for decision making. Do you think it is a realistic assumption?

 Should government be added as a sixth force in Porter's Five Forces Model? Why or why not?

 Consider "software development" as a hybrid product/services market. Brand positioning and high levels of customer satisfaction can be effective barriers against the entry of new competitors into this market. Do you think these things tend to be more or less effective over time than patents and copyrights?

 Market share battles are typically fought with marketing mix weapons. Choose a product category of interest to you and explain how each of the 4 Ps could be deployed in a battle to build market share. How would market leaders use these weapons differently than challengers and nichers?

 How can market leaders build switching costs into their relationships with buyers to reduce the likelihood that they will change brands? Provide examples.

 Is it ethical to build in these types of "penalties" to keep customers from switching brands? Creating loyal customers is a better solution, but which is more effective? Explain.

 The text describes several forms of marketing intelligence—ways of monitoring your competitors' actions and intentions by scanning the environment for clues. Identify at least three techniques for monitoring the competition that are not provided in the text.

 This chapter makes the argument that customers and competitors are the two primary factors impacting marketing strategy in most markets. What are some exceptions to this principle? Under what circumstances can other factors drive strategy?

 The chapter concludes by reiterating the point that consumers are the sovereigns of the marketplace. In effect, it says that it is more important to respond to them than to competitors' behavior. Do you agree? If you believe that managers need to take account of both forces and hold a balanced perspective, do you advocate a perfectly even 50-50 balance? What will make the balance shift from one side to the other?

Key Terms

Click on each key term to see the definition.

barriers to market entry

Also known as barriers to competition, these are factors that reduce the level of competitive rivalry within a market. Barriers in any given context may include economic, legal, technological, cultural, and psychological features. Product differentiation, branding, advertising, patents, entry restrictions, tariffs, and quotas may all function as effective barriers to competition.

bypass attack

This strategy involves avoiding the target competitor's position entirely. It often requires the introduction of substantially new products, new technologies, or significantly different business models. The objective is to change the nature of the market itself.

encirclement attack

This strategy involves surrounding or enveloping target competitors, often by producing a range of brands that are similar to the target product. The objective in this instance is for each new brand to steal away a small portion of the target competitor's market share. It is sometimes described as laying siege to a competitor.

financial strength

A measure of the firm's depth of financial resources relative to its needs.

flank attack

A strategy designed to exert pressure against competitive brands without engaging in a head-on confrontation. It typically involves launching new marketing programs that target segments that are not deemed essential or central to the success of the target brand. This may include introducing a new brand to meet the needs of a particular market niche.

frontal attack

This refers to a direct head-on assault against one or more close competitors, typically requiring the commitment of substantial resources.

generic competitors

All kinds of products that the customer may regard as serving the same basic need on a particular usage occasion. This final tier of competition reflects extraordinary rather than ordinary buying circumstances.

guerilla attack

This differs from conventional marketing programs that are aimed at confronting competing brands with sustained initiatives. This kind of attack is launched at irregular and unpredictable intervals, often using unconventional means intended to wear down the target through a long series of minor attacks.

Industry Concentration Ratio

Identifies the aggregate market share for the 4, 8, and 25 largest firms in most product markets. High four-firm concentration ratios indicate that a relatively few companies within an industry control a large portion of the market.

innovative capacity

An organization's ability to develop and market new products or services.

market challenger

A strong and well positioned second-tier brand that lacks the dominance held by the market leader. It is regarded as a challenger insofar as it is engaged in an aggressive strategy to gain market share. Challengers may pursue one of five attack options including frontal attacks, flank attacks, encirclement attacks, guerilla attacks, and bypass attacks.

market dominance

The strength of a brand relative to its nearest competitors. Often measured by brand market share or relative market share.

market follower

A financially secure firm that does not occupy the most dominant position and is content to maintain its market share rank. Typically follows a conservative strategy and often follows the example set by market leaders.

market leader

A brand that is dominant within its market. It holds the position of market share and relative market share leadership.

marketnicher

A brand that concentrates its resources and marketing efforts on relatively small target markets. This is directly comparable to the generic focus strategy.

marketing capability

Ability of competitors to competently market new products or services.

operating capacity

A firm's manufacturing or service-producing potential within existing product and service lines.

Porter's Five Forces Model

A framework for industry analysis that identifies the five factors that determine the level of competitive intensity within a product market. Those factors include the threat of new competitors, the intensity of competitive rivalry, the threat of substitute products, and the bargaining power of both customers and suppliers.

product class competitors

Brands that provide similar bundles of benefits and functions but lie outside the immediate competitive set.

product form competitors

Brands of products or services within the same product category. This is the narrowest definition of competition, and the brands sold in this class are often referred to as direct competitors.

switching costs

Obstacles to a buyer's change of brands, products, or suppliers.

Web Resources

Harvard Business School's weekly online business strategy newsletter, Working Knowledge. Each edition includes a section devoted to marketing and marketing strategy.

http://hbswk.hbs.edu

The online home of INSEAD, the French acronym of the former European Institute for Business Administration. It has international graduate business programs in Europe, Asia, and the Middle East. Its Knowledge site provides free access to English-language articles and research bulletins from around the world.

http://knowledge.insead.edu

The biweekly online magazine of the Wharton School of Business, Knowledge@Wharton. Each edition includes a section devoted to marketing and recent developments in the field of marketing planning and strategy.

<http://knowledge.wharton.upenn.edu>

Part IV: Product and Pricing Decisions

Part IV of this text combines two elements of the marketing mix, product and price. The pairing of these two reflects a fundamental old truism about business: Nothing happens until someone sells something. No one is certain who first made that observation more than 100 years ago, but no one has ever challenged its validity and it's what marketing is all about. Product and pricing decisions fulfill a unique role in the process of selling something since they have a more direct connection to generating revenue for the organization than any other business activity.

A product is the unique value and bundle of benefits that the company has to offer the market. It's the solution that buyers purchase from the firm to solve their problem. Price is the form of payment, a standardized measure of the value that buyers convey to the seller in exchange for the product. Though pricing is typically one of the most critical decisions facing any seller, it is just as certainly the least understood. And only when product and price come together in the right relationship to each other and to the market can something happen that benefits both parties to the transaction. Hence, product and pricing decisions are essential to making the marketing concept work.

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Chapter 9: Product and Service Decisions

Chapter 10: Pricing Strategies and Tactics

Chapter 9

Product and Service Decisions

Detective examining products on supermarket shelf with magnifying glass.

Ikon Images/Getty Images

Learning Outcomes

By the end of this chapter, you should:

 Understand basic product concepts, and be able to identify how each of four different product levels contributes to the quality and value that buyers receive from the brands they purchase.

 Define how services differ from goods and how the unique features of services pose special marketing challenges.

 Develop a practical understanding of how the new product development process shapes the course of innovation within both small organizations and large corporations.

 Recognize the Product Diffusion Curve and product adoption process.

 Understand the Product Life Cycle and appreciate its value and limitations in guiding the development of brand strategy.

Ch. 9 Introduction

In previous chapters, we have been systematically developing our understanding of products and services in conjunction with the investigation of other topics in marketing management. The overall plan of attack for this chapter is to briefly consider a few additional core concepts about products and services before examining the strategic significance of three critical processes: new product development, product diffusion and adoption, and the Product Life Cycle.

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Sometimes the new product development process doesn't go precisely the way it is described in the books. Consider the case of a toy company that was evaluating the financial potential of a project called My First RC. The RC in question was an inexpensive remote control helicopter intended for children 12 years of age and younger. The remote control technology itself was just a simplified version of the scheme used in advanced models. However, the product design team had worked for nearly two years to develop a helicopter prototype that was sturdy enough to withstand the demands of younger children playing with it outdoors across a diverse range of wind and weather conditions. To make the small copter heavy enough to be stable in outdoor flight, the final model was a little clunkier and less maneuverable than the team would have liked.

The plan was to build future product sales in the company's highly profitable remote control products division by introducing the base technology to a relatively young market. The concept had passed the initial screening process and preliminary business analysis. The next step in concept testing was to solicit the reactions of a focus group to a working prototype of My First RC. Less than a week before the focus group meeting, the market research team sent a request to the designers. "We'd like to demo this product indoors . . . at the conference facility. Could you possibly replace the copter blades with new ones made from a safer material?" The new blades were provided six hours before the meeting. They were less rigid and less brittle than the hard plastic ones on the original model. They were lighter, more flexible, and not as sharp-edged.

The response by parents invited to participate in the focus group was enthusiastic. . . . they loved the idea of a safe, indoor RC helicopter. Even when the focus group moderator tried to push them toward evaluating the concept as an outdoor toy, they were adamant that this was a great, active toy for indoor use. A second, unintended consequence of the new blades was that the copter was now lighter and more maneuverable than the initial prototype. Sales in the first two years of this product introduction were 540 percent higher than initially projected for the outdoor model.

9.1 Basic Product Concepts

A product can be defined in multiple ways. In Chapter 1, we initially identified the product as one of four variables in the marketing mix, related to both the tangible and intangible dimensions of ideas, goods, services, or some combination of the three. We explicitly recognized the role of products in the marketing concept as the means of satisfaction of customers' wants and needs. That is, products are developed specifically "for the purpose of exchange in the satisfaction of individual and organizational objectives" (American Marketing Association, 2011).

At several later points in the discussion of consumer behavior, brand management, market segmentation, and product positioning, we identified products as bundles of attributes. Although the most important of these attributes are the benefits that consumers derive from using the product, other features, functions, and alternative uses can also be included in this definition. It is what the organization has to offer the intended target market as a means of satisfying customer needs. It is also the element of the marketing mix that ultimately generates revenue for the company.

Two additional terms often encountered within the domain of product management are product mix and product line. A product mix is simply the complete collection or set of products offered for sale by an organization. It is inclusive of all product lines.

A product line is most often used in reference to a group of products that are related to each other by virtue of sharing a common target market. However, lines can also be defined as sets of products that share similar uses, technologies, distribution channels, or other relevant features.

To complete our understanding of products, we need to add a few additional dimensions of this concept to the foundations established thus far.

Product Levels

Recognizing that products can be better understood as bundles of attributes or benefits is a critical insight for marketing managers. However, the total product consists of more than what is consumed or utilized by the buyer. Products are composed of four levels, each of which contributes uniquely to the value that customers receive. These levels are referred to as the core benefit, secondary benefits, basic product, and augmented product.

Core benefit represents the primary or essential value that the customer derives from the product being purchased. When renting a car, for example, the core benefit to the driver is transportation.

Secondary benefits are provided by features of the product that enhance the primary value provided by the product. An automatic transmission, cruise control, and a GPS navigation system are features that make the customer's driving experience more pleasant and efficient. Although the car would still provide the renter with basic transportation if these features were absent, their presence enhances the value of the rental purchase.

Basic product refers to the tangible components and features that constitute the product being purchased. In simplest terms, it is the sum of the physical characteristics of the good being sold. Using the auto rental example, the physical characteristics of the car itself make up the basic product being acquired for a limited time. In the case of items frequently purchased at a drugstore, for example, the actual products are the items in the shopping bag at the end of the trip.

Augmented product refers to additional features and benefits that provide added value to products even though they may not be the primary drivers or core benefits in the purchase decision. Providing online check-in, perks for frequent customers, and special concierge services at popular destinations would be elements of the augmented product for car rental companies. Although the specific features of the augmented product will necessarily differ from one type of product to the next, there are several elements common to many types of B2B and B2C purchases. These include exceptional customer service and sales support, product guarantees and warranties, and accessibility. Accessibility relates to how easy the product or service is to obtain. Maintaining adequate inventories, same-day delivery, and 24-hour availability are all elements of product accessibility.

Although marketers often focus on the quality of the actual product being sold, each of these four product levels makes important contributions to the overall value enjoyed by purchasers. Consequently, marketing managers must recognize that the final product that reaches the customer is derived from many decisions not directly related to product design. The critical importance of branding, for example, was investigated at length in Chapter 7. Two additional areas of importance to successful product marketing are packaging and labeling.

Product Packaging

A package is defined as the container used to protect, promote, transport, and/or identify a product. It may be primary (containing the product), secondary (containing one or more primary packages), or tertiary (containing one or more secondary packages). Packaging generally refers to the process by which packages are created, although it can be synonymous with package (American Marketing Association, 2011). Most tangible consumer products are sold within a package that serves several purposes. Although the primary function of packaging is to protect its contents, the manner in which a product is packaged can also enhance the convenience of using the product or deliver a promotional message. Packaging decisions generally fall into one of two categories: packaging for distribution and packaging for final customers.

Packaging for Distribution

Packaging for distribution includes the activities involved in designing and creating the containers for a product during its transportation from the manufacturer, through the channels of distribution, to the point of retail sale or purchase. It typically contains multiple packages for individual resale. Since it is usually subjected to significant physical stress as it passes through the distribution channel, it needs to be designed to withstand these forces. Depending on the distribution path, products may require specific protection from being crushed, wide temperature variations, vibrations, water, and other threats. As a general principle, this type of transport packaging needs to provide more effective protection against damage-related losses than packaging for final customers.

Packaging for Final Customers

An RFID tag

Retailers seeking to reduce shoplifting sometimes rely on RFID tags like this one that can be detected by devices at store exits.

Hemera/Thinkstock

Packaging for final customers is primarily the container that the final buyer receives at the time of purchase. Packaging at this retail level of marketing often makes the product more appealing and also protects it from damage. In this sense, retail packaging can contribute to the value offered by a product in four distinct ways:

Image: The graphic elements of a package as well as its physical design may attract attention to the brand and promote a specific brand image. It can also contribute to the brand's visibility within the store. As noted in Chapter 7, image-specific elements of marketing communications can shape perceptions of brands.

Convenience: Many containers have features that add convenience in product handling, storage, opening, resealing, dispensing, and disposal. In addition, some containers add value and convenience for consumers by enabling easier portion control. Single-serving containers, for example, hold an amount of the product suitable for individual use.

Product Integrity and Security: The design of containers can significantly reduce the risks posed by both intentional product tampering and unintentional product damage from routine handling. Additionally, some product packages are designed to minimize the potential for pilferage through the use of anti-theft devices, such as radio-frequency identification (RFID) tags that can be detected by devices at retail store exits.

Information: Packages communicate information on the proper use and disposal of the package or product. This is particularly critical with packaged foods, pharmaceuticals, and medical products.

The specific information included on a product's package can make significant contributions to the successful execution of a marketing plan for many types of products. The following section briefly considers the role of labeling in package design.

Product Labeling

The term label refers to any information attached to a product for the purpose of naming it and describing its use, its dangers, its ingredients, its manufacturer, and the like. Package labeling typically includes more information than simply the brand name. Most distribution and final consumer containers include printed information to assist the intermediary or end customer. For consumer products, label features serve several important purposes.

Various nutritional information labels

Labeling requirements for consumer products are established, regulated, and enforced by the FDA and the FTC with the authority granted to them by Congress.

Associated Press

Most importantly, labels identify the product and brand being purchased. As noted in the previous discussion of brand identity, the brand name conveys the perception of a brand in the minds of current and prospective buyers. Consequently, a package label can communicate a composite impression of what the brand means to buyers in terms of their attitudes and expectations.

The design elements and features of product labels also serve to capture the attention of shoppers. The use of color, shape, and high-impact words and phrases can lead prospective first-time buyers to pause long enough to evaluate the product. This is particularly important since the label is often the first thing a shopper encounters. Both the appearance of the label and its information content will shape first impressions.

Labels also include information related to environmental issues and legal disclosure requirements. Increasingly, labels provide information that assists potential buyers in assessing the environmental impact of the product and its eventual disposal. For many categories of products, sellers of food and pharmaceutical products are required by law to list ingredients, nutritional data, and usage warning information. However, food marketers also use labels to provide consumers with recipes and product usage suggestions to promote satisfaction with the product and additional sales.

Since the late 1970s, labels for most products sold in retail outlets have been required to include a Universal Product Code (UPC) to help sellers speed up the checkout process and improve inventory management. And for companies selling into international markets or domestic markets with diverse cultural roots, bilingual or multilingual labels may be needed.

Think About It

For one eight-hour period, make it a point to be aware of all the labels you encounter. Consider the label-maker's intention for each of them. Consciously categorize each of the labels according to the function or purpose it is intended to serve.

Which category did you encounter the most?

Is almost every label a part of that category in some way? Why?

What did you learn about the way in which you notice or fail to notice the information provided by labels on a regular basis?

Classifications for Goods

There are substantial differences in how marketers approach strategy development for consumer and industrial markets. Individual consumers who purchase goods for themselves spend far less each year than the average industrial customer, but each individual among the 7 billion people worldwide may act as an independent decision maker. Decision making in industrial settings, as we saw in Chapter 5, often depends on input from multiple sources within the organization.

Consumer Goods Classes

Consumer goods can be classified according to the way in which individuals shop for them. Specifically, most products intended for sale in B2C markets are categorized by where and how frequently they are purchased. There are four primary classes of consumer goods: convenience, shopping, specialty, and emergency goods.

Convenience goods are products that appeal to a very large portion of the B2C market. They are typically consumed and purchased frequently. Examples include food, beverages, household cleaning products, and personal care items. These products are sold in very high volume, and the unit price per item tends to be relatively low. Consequently, buyers see little value in comparison shopping on price since such effort will yield insignificant savings. Unit margins are typically low due to competitive pricing pressures. Companies need to sell large product volume to realize substantial levels of profitability. As a direct consequence of this dynamic, firms seek to distribute their products through as many retail outlets as possible.

Shopping goods are products purchased and consumed less frequently than convenience goods. These are more expensive purchases; buyers are willing to invest more time comparison shopping across brands and between retailers to locate the best values. These products are usually higher involvement purchases than convenience goods, but less involving than specialty goods. Examples include consumer electronics, clothing, home decor, and household furnishings. Since the market for these goods is substantially smaller and sales volumes lower than for convenience goods, marketers are more selective when recruiting distribution outlets to sell their products.

A woman shopping for an Audi while talking on a cell phone.

Luxury cars, like Audi's A6, are classified as specialty goods since they are expensive and infrequently purchased. Buyers tend to devote substantial time and energy to making the best choice.

Associated Press

Specialty goods are products that are relatively expensive and infrequently purchased. Consumers are deliberate and selective when making these high involvement decisions. In the absence of prior experience or brand loyalty, consumers may comparison shop extensively before reaching a decision on which brand provides the best value relative to their wants and needs. Examples include high-end automobiles, fine wines, and designer clothing. The target market for each class of specialty products is typically small, and the number of outlets selling the products is limited.

Emergency goods are products that a consumer may seek due to sudden, unexpected events. Buyers often rush to select the first viable option encountered. For example, when confronting an unexpected snowstorm in October, a consumer who needs a snow shovel will not typically shop around to find the best price.

Industrial Goods Classes

Industrial goods can be classified according to the way in which they enter the production process and their cost to acquire. These items are used directly or indirectly in the transformation of materials to create products for resale. The purchase patterns and behavior governing industrial buying were discussed in Chapter 5. There are four basic classes of industrial goods: materials, parts, capital goods, and operating and business supplies.

Materials include both basic raw materials and processed or manufactured materials. Raw materials are products obtained through digging, mining, harvesting, drilling, and fishing. These are the essential ingredients in the production of higher-order manufactured goods. Processed materials include goods created through the processing or refinement of basic raw materials. Corn, for example, can be transformed by refining processes to create ethanol, which in turn can be used to power production equipment and manufacturing facilities. Price, reliable supply, and on-time delivery are major considerations when companies are evaluating potential suppliers. If the supply–demand balance in materials markets is subject to significant changes over time, the purchase process will most closely resemble the modified rebuy situation.

A circuit board.

Prefabricated circuit boards are classified as parts since they enter the manufacturing process for other products without any further change in their basic form or design.

iStockphoto/Thinkstock

Parts are finished goods that enter the manufacturing process for other products without any further change in their basic form. Basic components are products used within more advanced components such as electrical wire. Advanced components are finished goods that can be combined with basic components to produce intermediate pieces of a larger product. The circuit boards in consumer electronics, for example, only have functional value when used to combine component parts in accord with precise technical specifications. Finding a reliable source for parts tends to be less difficult than securing reliable sources for raw materials in many instances. Consequently, many buying situations for parts conform to the straight rebuy model of industrial purchasing once relationships with good suppliers have been established.

Capital goods are long-lasting installations and equipment that are used in the production or management of finished products. Equipment includes portable items such as factory machinery, tools, computers, and forklifts that facilitate production and operations activities. Installations include office buildings, factories, and fixed-location equipment (e.g., power plants). Installations are among the most expensive capital purchases that any organization can make. This purchasing process always corresponds to the new task buying situation and procedures described in previous chapters.

Operating and business supplies are short-lived goods used to support the routine operations of the firm. Operating supplies such as lubricating oil for machine tools are products specifically used to support the production function. Business supplies are those items used to support the maintenance and repair activities of the firm, as well as the daily office activities of the organization. The purchase of these goods is typically done on a straight rebuy basis for the organization.

9.2 Service Essentials

Though the term product refers to both goods and services, there are some characteristics that are specific and exclusive to the provision of services. A service is an intangible product that does not result in the ownership of material goods that can be stored or inventoried. The benefits derived from consumption of a service are uniquely dependent on the knowledge, talents, and abilities of the service provider. Services possess four characteristics that have direct implications for how they should be marketed: intangibility, perishability, inseparability, and variability.

Services are intangible insofar as they lack a physical or material nature. Unlike tangible goods, services cannot be touched or examined before they are purchased. Life insurance coverage, for example, is not something the buyer can hold in his or her hands. The written policy may be evidence of the purchase, but the actual benefit from acquiring the insurance is intangible. Prospective buyers of services often experience greater difficulty in evaluating the quality and value of services than tangible physical goods.

A stylist arranges the hair of a female customer.

Quality and skill of the provider are crucial to the successful marketing of personal services, such as haircuts.

Associated Press

Services are perishable in the sense that they cannot be stored or inventoried. Airline seats that are not sold for a Monday flight cannot be set aside and sold on Tuesday. If an appointment with an attorney is not kept by the client, the opportunity to provide legal services on that occasion is lost. One marketing response to the perishability of services is to manage customer demand. Reservation systems, for example, allow business managers to match service capacity to market demand. And airlines will often use off-peak price discounts to shift nonbusiness travel demand to nights and weekends.

Services differ from physical goods since the delivery of any given service is inseparable from the service provider. Surgeries will not happen in the absence of the surgeon. Haircuts cannot be given without a barber. Personal services of this kind are particularly dependent on the presence of a specific provider. Most customers are not content to have their hair done by just anyone with a license and a pair of scissors. This linkage between service quality and the abilities of the provider is referred to as variability.

The quality of service provided is variable as a function of who provides it. Not all professionals are equally skilled or capable of delivering a consistent quality of service on each occasion. Consequently, consumers develop preferences for one provider over another based on differences rooted in both objectively and subjectively experienced attributes of the performance. A buyer may prefer one plumber over another based on the observed quality of his or her work or one concert violinist over another based on subjective aesthetics.

It is important to remember that most products are a hybrid of goods and services. Consider a home inspection that is performed for a prospective property buyer. The creation of a home inspection report (a good) is an integral part of the product being sold. However, it is wholly dependent on the provision of the inspection itself, the intangible dimension of this service. A can of soup sold in the grocery store may seem to be a wholly tangible product. However, the transaction cannot take place without the accompanying retail services provided by the store.

A critical consideration when marketing services is to be mindful that each service encounter is unique. It can never be perfectly duplicated, and it can never be created under precisely the same circumstances and conditions again. However, consumers typically assign great importance to service consistency, and the difficulties that buyers confront when trying to evaluate intangibles complicates the marketing challenge significantly. Consequently, managers must recognize the need to maintain consistently high standards of service quality and find ways to effectively relate the quality and value of their offering to buyers.

Think About It

Conventional business wisdom traditionally held that marketing intangible services was substantially more difficult than marketing tangible goods. However, some experts are now arguing that the task of selling services to the next generation of consumers is becoming much easier because they have grown up with social media and the Internet.

Do you agree? Why would this be the case?

9.3 New Product Development Process

The development and introduction of new products is essential to survival and success in many product markets. The critical importance of innovations in fields such as pharmaceutical research and the high-tech sectors is apparent. However, slow-growth markets such as household products and prepackaged food are committed to the process of product development and commercialization as a primary means of sustaining sales growth in mature market categories. In all circumstances, new products provide businesses with the opportunity to better satisfy their customers' shifting preferences and gain profitable advantages over competitors.

Product Development

Frontera salsas proved to be best sellers in Whole Foods Markets around the U.S. Now, Frontera wants to go up against mass-marketed products made by the likes of Tostitos and Pace by developing a new product. What steps do they take to create their product? How do they market this product?

Since the introduction of new products on a regular basis is essential to the survival of many businesses, organizations often follow established product development procedures to improve the odds of success. Independent of the organizational structure supporting the exploration and commercialization of new ideas, the development of new products can often be described by a process model comprising six stages, as depicted in Figure 9.1. These stages include idea generation, screening, concept development and testing, business analysis, market testing, and commercialization. It is worth noting, however, that radically new and innovative discoveries, inventions, and product concepts often arise apart from the systematic corporate business model presented here.

Figure 9.1: New product development process

Six stages of how new products are developed

Since many organizations require a stream of new and innovative products to remain successful, marketers often rely on formal models to systematically guide the process of new product development.

Idea Generation

Bridgestone 2012 prototype for an airless Tire that never goes flat.

New products are essential to success in many product markets. Bridgestone is developing and testing a range of innovative prototypes, including an airless tire that never goes flat.

Associated Press

The first stage of the new product development process requires gathering a pool of ideas for subsequent consideration and evaluation as potential product introductions. The initial idea behind new product concepts can originate from many sources. Small firms often rely on brand managers, production personnel, salespeople, and customers to identify new opportunities. Larger, multi-department companies may create a new product committee or task force composed of members from several departments to take formal responsibility for the tasks associated with creating and evaluating new product concepts. Depending on the specific requirements for successful innovation within a given industry, many large organizations create permanent research and development, or R&D, units to steer the pursuit of innovative products in specific directions.

Many of the market research techniques discussed in Chapter 3 can be used at the idea generation stage of the process. The Ansoff matrix for finding growth opportunities can be a particularly useful framework for identifying new product concepts. Some organizations also use independent market research firms to conduct focus groups with consumers, channel intermediaries, and sales personnel. Direct customer feedback via comment cards, toll-free numbers, and website forms can also help uncover better ways to satisfy buyers' needs.

Screening

In Stage 2 of the process, the ideas generated in the previous step are critically evaluated to identify the most-attractive options. Large groups of new concepts are typically judged against a set of fixed criteria or scored using a formula that estimates the likelihood of successful commercialization. Under both schemes, three primary questions dominate the screening process:

 Does the idea fit within the organization's overall strategy?

 Does it build upon the resources and core competencies of the company?

 Does it have sufficient market potential to warrant further inclusion in the process? (Urban et al., 1998).

If the screening process is performed periodically, judges may need more than one round of deliberations to reduce the pool size to a manageable number of alternatives. In multiple- round scenarios, different filters are applied at each successive step in the process. Once a relatively small number of ideas remains, preliminary estimates of sales and profit potential may be used as the final consideration when deciding to move acceptable candidates on to the next stage of the process.

Concept Development and Testing

To have customers, channel intermediaries, and employees contribute to the evaluation process, each of the remaining concepts must be transformed from simple ideas to testable forms of the product or concept. If the idea for a chocolate cheese soup survived the screening process, the next step would be to produce samples for taste tests. If the idea being considered is a combination snowboard and personal watercraft, the concept may be presented to audiences in the form of an actual prototype or simply as sketches and diagrams. Concept board presentations or storyboards are used as the testable form of the product when the production costs associated with producing a functional prototype or model are prohibitive.

Feedback from the different groups of participants in the testing process is most often gathered by conducting focus group studies. Favorable and unfavorable reactions to the concept boards, prototypes, or actual sample product are used to evaluate and filter out relatively weak product concepts in much the same way as the screening process judged the merits of initial product ideas. Information typically collected at this stage of the process includes measurements of interest, liking, likelihood of buying, and value or pricing-related perceptions.

Advances in technology have impacted concept development and testing for some types of products in recent years. Three-dimensional designs and graphics can be displayed on computer screens to solicit consumer response. Both non-working and working models or prototypes can be inexpensively created with current CAD/CAM (computer-aided design and computer-aided manufacturing) technologies. Virtual reality and other computer-simulated environments have also been used in some instances for concept tests that include both visual and nonvisual sensory stimuli.

The New Product Development Process at Campbell's Soup

Campbell Soup Company has a long history of successful product innovations. Within its soups division alone, the company has redefined the category over the years by introducing microwavable soups, Chunky soups, Select Harvest premium soups, Healthy Request brands, and low sodium soups. The drive to generate innovative, new ideas is an essential feature of the corporate culture at Campbell's. "Powered by a relentless focus on the consumer and a radically different approach to innovation, we are extending our product platforms into new mealtime occasions and packaging formats, and responding directly to new consumer expectations. We are focused on rebuilding relationships with our existing consumers and establishing connections to new ones. Simply put, our mission is to reinvent our products and our company for a new era" (Campbell Soup Company News Release, 2012).

Innovative concepts developed from in-house research, focus groups, customer comments, and other sources reflect changes in the tastes and interests of its target customer groups. Some ideas in development reflect an emerging global awareness on the part of target customers. These include varieties of pouch soups in distinctive flavors such as Coconut Curry and Moroccan Chicken. An upscale line of aseptically packaged soups called "Campbell's Gourmet Bisques" includes varieties like Thai Tomato Coconut and Tomato Roasted Garlic Bacon.

The idea screening process used by the cross-functional innovation teams that manage the new product development process at Campbell's Soup is guided by several growth-related objectives. These include profitable growth in North American markets, expansion of the brand's international sales, and sales growth in healthy foods categories.

Concept testing for food producers such as Campbell's often begins with in-house product trials. Brand managers and members of the innovation team are often the first to sample new products. Once the products are refined and approved, the test kitchen facilities may prepare batches for sampling in the company cafeteria and employee households. Positive feedback from these critical audiences is essential if the product is going to move forward in the process.

Those concepts that have survived the new product development process to this point will usually be subject to market testing in regions selected to be demographically representative of the intended target market. This experimental market introduction provides brand managers with the opportunity to forecast the sales and profit outcomes that can be anticipated from a full-scale market launch. If these projections demonstrate significant profitability, the brand will typically be rolled out nationwide.

Business Analysis

The next step in the new product development process is to subject the surviving product concepts to rigorous business analysis to evaluate their financial potential. Typically, very few of the initial ideas considered at the beginning ever reach this point in the process. The viability of the remaining candidates is determined by their projected costs, sales, profits, return on investment, cash flow, and long-term growth potential. This level of detailed scrutiny in the business analysis phase is far more detailed and thorough than any financial considerations raised previously in the process.

The techniques and procedures of most direct relevance to this stage are those for evaluating market demand and forecasting sales, as discussed in Chapter 4. The primary objective is to provide an accurate assessment of the best and worst case scenarios for the product's financial impact on the firm, as well as estimates of the most likely outcome. This requires extensive research, analysis, and planning since multiple scenarios must be evaluated to reflect alternative marketing plans. Consider the series of consequences associated with simply increasing the retail price point for a proposed product. Sales shift in response to declining demand. The fixed and variable cost profile will be altered due to changing economies of scale in production as total output is reduced. Profit forecasts and marketing budgets will have to reflect the impact of reduced unit sales and increased contribution margins per unit. Then consider that multiple scenarios based on a wide range of alternative marketing plans need to be evaluated to determine the best possible plan for introducing the product.

Both in-house and external market research are required to complete the business analysis. The responses of both consumers and competitors must be reckoned with to derive the sales forecasts, production-related costs, and financial projections associated with a possible product launch. If the forecast outcomes warrant the required level of investment, the development of a specific launch strategy commences.

Where's the Marketing Plan?

Conventional descriptions of the new product development process often indicate that the next step for ideas that survive the business analysis stage is the development of a marketing plan. That is true to the extent that marketing plans are sometimes formalized at this stage. However, throughout the process to this point, the essential elements of a marketing plan for products that survive the gauntlet have already taken shape. Marketing mix decisions are made on an "as needed" basis to facilitate completing each phase of evaluation. The target market for the product must be tentatively determined at the outset. Pricing decisions are made to enable forecasting. Promotional and positioning decisions often must be made prior to concept testing the product with an audience. Distribution plans need to be tentatively made to determine both product-related costs and sales potential. Product details are inevitably refined at each step of the process. All of the marketing mix elements are, of course, interrelated and interdependent. Consequently, changes to one will trigger corresponding and iterative changes to all. Additionally, refinements to the final marketing plan will continue throughout the process and well into the future for products that are introduced to the market.

Market Testing

Products that reach the market testing stage have been carefully considered and thoroughly investigated. At this point, companies frequently create a unique marketing plan for the exclusive purpose of market testing the product. A market test is essentially an experimental market introduction, conducted on a limited basis, within a carefully selected sample of the intended target market. The primary goal of the test is to enable marketing managers to project the sales and profit consequences of a full-scale market launch.

In contrast to concept testing, real customers respond to the actual product and other dimensions of the marketing mix under actual marketplace conditions. Among the most frequently employed models of market testing is making the product available to a small geographic sample of the target market (e.g., one city), which proportionally receives the full marketing effort that has been planned for a full-market product introduction. Positive customer reactions and strong sales performance are required to trigger a full-scale product launch on a market-wide basis. Negative outcomes may doom the product or suggest the need to refine the marketing mix before retesting the product once more.

It is worth noting that not all products are test marketed prior to executing a full-market launch. In some instances the costs of a test market exceed its value. This is particularly true if the financial risks associated with a full launch are relatively modest. In other situations, the company may be sufficiently impressed with the results from concept testing and the business analysis to skip a test market in favor of a full market launch. Occasionally marketing managers will opt to avoid market tests for fear that the public exposure of the product will enable competitors to preemptively introduce a directly competitive brand before its own full-scale launch can be executed.

Think About It

By now you have probably already thought about it and asked yourself, isn't there a simpler way to organize the process of new product development? Does it have to be so elaborate?

Consider this: What would be the positive and negative consequences of skipping one or two of the steps in the process thus far?

Commercialization

Chili confectionery, chocolate covered chili husk

Regional tastes must be considered when designing the final commercialization strategy. Where might a small chocolatier want to consider rolling out its new chili confections? Why?

Westend61/Corbis

If the market test results are sufficiently positive, the product will probably be introduced to a wider market. Commercialization is the final stage in the development cycle for a new product. It marks the organization's commitment to marketing the product to the broader target market and subsequent execution of the product-specific marketing plan.

This process of commercialization is sometimes rolled out progressively over various geographic segments of the market according to a predetermined schedule. This is particularly desirable if there's reason to believe that some geographic segments are likely to be more profitable than others. For example, spicier foods tend to sell better in the south and west portions of the United States than in the north and east. This rollout pattern of commercialization is also warranted if the company lacks the financial resources to introduce the product to all potential geographic segments of the intended target market. A gradual or phased market rollout also enables the company to fine-tune its marketing mix as the product enters new geographic markets.

Marketers also recognize that there are distinct advantages to targeting prospective buyers who are most likely to be early purchasers of the product. Identifying and reaching consumers who are predisposed to try innovative products as soon as they become available represents a strategic priority for the commercialization of many brands. Research on this issue has determined that statistical models of the new product adoption process conform to a bell-shaped diffusion curve usually referred to as the Product Diffusion Curve.

9.4 Product Diffusion Curve and Adoption Process

The concept of the Product Diffusion Curve (PDC) is loosely based on medical models that describe how contagious diseases spread through a population. That is, the PDC explains how information and the acceptance of new products spread through a market. As popularized by Everett Rogers (1962), the underlying principle is that once a target population buyer is initially exposed to information about a new product, definable groups of consumers will acquire the product at different rates as a function of certain group characteristics. In most instances, the new product adoption process can be modeled in the form of a bell-shaped diffusion curve. The managerial value of the PDC lies in identifying five specific adopter categories into which different types of consumers are most likely to belong: innovators, early adopters, early majority, late majority, and laggards. An illustration of the PDC is provided in Figure 9.2.

Figure 9.2: Product Diffusion Curve

The Product Diffusion Curve (PDC) follows a bell graph pattern.

The Product Diffusion Curve groups consumers into clusters or buying segments according to how quickly they adopt new products.

Innovators are the first people to adopt a new product or innovation and they represent the first 2.5 percent of adopters. They tend to be more willing to take risks and are often the youngest in age of the five typologies, especially in technology-related markets. As illustrated in Figure 9.2, they represent a small percentage of the market that is at the forefront of adopting new products. These people are often regarded as well-informed enthusiasts within the product category and eager to try the latest innovation. They are typically less price sensitive than others, and their behavior within test markets is often closely tracked. Unfortunately, their attraction to new products means that they are not usually brand loyal consumers.

Early adopters are the second fastest category of adopters, 13.5 percent of buyers, making up a larger share of the market than innovators. They are also attracted to innovative new products in categories that interest them, but they are less impulsive and more practical about decisions to buy new things. An important characteristic of people in this category is their tendency to convey their experiences to the early majority. Consequently, their opinions are important to a product's long-term success since they serve as both a key buying cluster and as opinion leaders to others.

The early majority accounts for 34 percent of all buyers. They also enjoy new and innovative products, but they tend to wait for positive opinions and reviews from others (early adopters) before purchasing. The adoption of new products by the early majority is essential for sustained profitability. However, many products fail early in their life cycles because they are rejected by this category of consumers and those that follow.

The late majority category makes up 34 percent of buyers, corresponding in size to the early majority in many instances. These consumers will adopt an innovation later than the average member of the target market. They are quite cautious and reliably take a wait-and-see approach before trying something new. However, once this category begins buying into the new concept, marketers begin to capture their highest rates of profitability.

Laggards make up the final 16 percent of buyers and are the last group to adopt new product innovations. These buyers are, quite simply, skeptics. If the new product is replacing an older form of the product (e.g., audio CDs replacing cassette tapes), they may not buy into the new form until they have no other options. They tend to be older than the average consumer and among the most price sensitive since they do not recognize substantial value in the new product. Since they are relatively disinterested in the product, marketing plans typically focus very little effort on them.

An understanding of the general shape and character of the Product Diffusion Curve reinforces the importance of developing a marketing plan that recognizes meaningful differences within the intended target market for a new product. The impact of opinion leadership is pivotal in the eventual success or failure of new concepts. It is important to recognize, however, that the true distribution of consumers across the five categories and corresponding steepness of the slope of the curve will differ between markets and always relates uniquely to the nature of the product being introduced. However, the PDC does provide a valuable strategic perspective on the adoption of new products that should be considered in the development of marketing plans for new product launches.

9.5 Product Life Cycle

The Product Life Cycle (PLC) is a conceptual model that describes the four stages that a product typically passes through from its origins until its demise. Initially developed by Raymond Vernon (1966), its validity and value are greatest when applied to an analysis of general product classes (e.g., canned dog food) rather than specific brands (e.g., Alpo). Nonetheless, the PLC can be a useful strategic planning tool for understanding the dynamics of a product's lifespan in terms of its sales history. Further, understanding a given product's position within the context of its life cycle can enable the manager to make better decisions in shaping the marketing plan for a specific brand. Figure 9.3 provides a graphical representation of the PLC.

Figure 9.3: Product Life Cycle

The Product Life Cycle (PLC) includes market introduction, growth, maturity and then the decline of sales.

The Product Life Cycle is a conceptual model of a product's lifespan that is closely aligned in principle to the Product Diffusion Curve.

There are four primary assertions made by the Product Life Cycle:

 Products have a limited life.

 Product sales pass through distinct stages, each having different implications for the seller.

 Profits from the product vary at different stages in the life cycle.

 Products require different marketing strategies at different stages of the life cycle (American Marketing Association, 2011).

Although the characteristics of the PLC for any given product will be unique to that product and its market, most products exhibit patterns of aggregate category sales and profits that correspond to four distinct stages: introduction, growth, maturity, and decline.

Introduction

The introduction stage of the PLC corresponds to the commercialization and launch of a new type of product or product form. This first stage is sometimes further divided into two substages: early and late introduction stages. The introduction stage is characterized by the following market-related conditions:

Competition: Direct competitors may be absent for the first-to-market brand of this product. However, there is still competition for sales in the form of existing alternatives or substitute product types that address similar customer needs. If the product is successful in gaining acceptance from innovators and early adopters, competing brands will typically enter the product market in the latter half of the introductory stage.

Target Market: At this stage, innovators and early adopters compose the target market. As the product nears the close of the introductory stage, the emphasis shifts exclusively to winning market share battles among the early adopters division of the market.

Footwear on sale for an additional 25% off at a sporting goods store

Marketing managers use a range of sales promotions and pricing incentives to introduce new brands, encourage the movement of inventory through distribution channels, and phase out obsolete lines.

agefotostock/SuperStock

Product: Initially low sales volume, unformed consumer preferences, and uncertainty regarding the financial viability of the product tend to limit the range of options and features made available on early forms of the product. In the latter phase of this stage, new competitors introduce greater product variability and choice to the market, though the total number of brands remains low.

Price: Marketers often engage in a strategy termed market skimming by which prices are initially set at a relatively high level. This approach to maximizing per unit revenue corresponds to minimal price sensitivity of buyers in the innovator category. Prices will be lowered gradually in response to competitive pressure as additional brands enter the market.

Promotion: Aggressive promotional campaigns focus on raising product awareness and educating prospective buyers on the benefits associated with the new product in the initial phase of this stage. The top priority for the sale force is often securing distribution for the product. As brand-versus-brand competition intensifies toward the close of the introductory stage, promotional themes typically shift to emphasize benefits and features that are brand specific.

Distribution: Substantial sales promotions targeting marketing intermediaries are commonly used to expand the product's distribution network. The total number of product distributors continues to increase throughout this stage, and many offer consumers more than one brand to choose from.

Profits: The costs associated with establishing the sales network, building product awareness, and confronting new competitors usually exceed profits at this stage. The organization incurs losses in anticipation of future profitability.

The overall strategy for the first few market entrants is to create both product and brand-specific awareness while generally educating customers about the new product. Promotional campaigns typically emphasize product features and benefits that will attract innovators and early adopters. For many types of products, sales promotions are used extensively to accelerate the process of building sales volume. Examples of products currently in this stage of the PLC include electric cars, 3-D television, tankless water heaters, holographic projection systems, and emerging multimedia conferencing technologies.

Growth

The beginning of the growth stage of the PLC is marked by the point at which profitability becomes positive. The rapid rate of category sales toward the midpoint of the growth stage is an indication that sales of the product have moved beyond the early adopters and reached the early majority. This is also the stage at which many competitors begin to show profits despite a predictable growth in the number of competitors. It is primarily the profitability of the category, after all, that attracts the new entrants at this point. In this highly competitive climate, establishing brand differentiation and preference becomes a top priority for marketing managers. The growth stage of the PLC is characterized by the following market-related conditions:

Competition: As the number of competing brands grows, the battle for market share intensifies. Price-driven competition may have the unintended consequence of delaying purchases by some early and late majority buyers if they are anticipating future price reductions. Toward the end of this stage, the battles for dominance within the largest segments of the market often intensify.

Target Market: The initial emphasis on early adopters gradually transitions to the early and then late majority groups. The intensity of competitive rivalry drives managers to position their brands for progressively narrower target segments. Sales volume throughout the industry grows steadily, and new market segments and niche markets are often identified. Toward the end of the growth stage, the heavy demand created by the majority groups begins to level off and sales may continue to grow, but at a decreasing rate of growth.

Product: The product evolves substantially throughout this stage of the PLC. The "basic product" that was introduced in the first stage adapts to the expressed preferences of the market as discrete benefit segments emerge. More features are incorporated as buyers grow increasingly sophisticated and demanding. Product lines tend to lengthen as companies seek to reach a growing diversity of consumers while differentiating themselves from competitors. Toward the close of this stage, marketers recognize the need to trim back product lines in the interest of efficiency and in response to slowing market growth.

Prices: The range of price points expands as product lines lengthen. Prices may initially remain high, especially in segments where market demand is strong. The entrance of more competing brands, however, will inevitably drive prices lower over the span of this stage of the PLC. Toward the close of the growth stage, it is common to see average retail prices fall rapidly in response to slowing category growth. Companies need to defend market share and maintain sales volume to retain economies of scale and corresponding cost advantages. Price wars are sometimes a symptom of the close of the growth stage.

Promotion: Promotions are initially focused on sharpening the brands' positioning relative to specific target markets. As competition intensifies and growth slows, the financial consequences associated with losing market share increase. Promotional spending, particularly among market leaders, often increases substantially as they battle for share points. Heavy spending on sales promotions is a common tactic aimed at stimulating customers to buy.

Distribution: Marketers work to secure and reinforce those channels of distribution that are most essential to reaching their chosen target markets. Toward the end of this stage, distributors will begin critically evaluating those relationships as product demand slows. Many distributors will reduce the number of brands they carry.

Profits: For early market entrants, product development costs have been recovered and unit profits increase in the preliminary phase of the growth stage. Economies of scale also contribute to higher profitability as sales volume grows. Toward the end of this stage, however, declines in prices and production and growing marketing-related expenses begin to erode per-unit profit levels. Profits associated with the industry as a whole begin to level off toward the close of the growth stage.

At the outset of the growth stage, the priority for marketers is sales growth. In an environment where sales are accelerating, the strategic emphasis is on providing a brand that serves buyers' needs better than the competition. Significant numbers of new brands, attracted by the profitability of the product category, intensify the positioning battle to win the hearts and minds of consumers. Products currently in this phase of the growth stage include home water purification systems, e-books and e-readers, smartphones, tablet computers, Blu-ray discs, and digital video recording systems.

The closing phase of the growth stage is quite different. Firms fight to hold their share in the face of declining rates of sales growth. Price becomes the weapon of first resort for many poorly positioned brands that are struggling to survive, depressing profitability throughout the industry. Maintaining market leadership, however, will enable a brand to remain viable as the industry transitions to the maturity stage of the Product Life Cycle. Many types of laptops and portable media players may be nearing the end of the growth stage.

Maturity

The maturity stage of the PLC can be identified by the range where the rate of sales growth reaches an industry-wide sales peak. This occurs primarily because most potential customers have already purchased the product and the market has become saturated. Since aggregate sales have leveled off, the only opportunity to increase sales is to increase market share—that is, take sales away from another competitor. Consequently, this part of the PLC initially tends to reflect a hotly contested competitive environment.

The maturity stage of the PLC is characterized by the following market-related conditions:

Competition: Very aggressive head-to-head competition for shares marks the maturity stage. Weaker brands tend to drop out of the market or merge with competitors. Eventually the market becomes stable, consisting of relatively few large competitors and some small niche brands.

Target Market: Virtually no growth is seen in the target market at this stage. Sales often consist almost exclusively of repeat purchasers seeking to replace their current product.

Product: Though brands differentiate to improve their fit with their target market, competition for the largest market segments tends to promote the standardization of brands to a great extent. The homogenization of consumer tastes over time reinforces this trend.

Price: Initially average retail prices fall as weakened competitors try to remain viable. Price wars are common. Toward the end of this stage price levels stabilize.

Promotion: This stage is initially characterized by aggressive advertising and promotions intended to steal market share from competitors. As the market finds its own point of share equilibrium toward the end of this stage, the surviving competitors cut back on promotion expenditures.

Distribution: Distributors often continue to reduce the number of brands they will carry.

Profits: Industry profits fall rapidly throughout the early phase of maturity. Profit levels eventually stabilize as both market shares and competitive marketing expenditures level off.

In the early parts of the maturity stage, the key objective for brands is simply survival. This is challenging as the market "shakeout" process eliminates the majority of smaller brands. In many instances, size in the form of market share is the essential key to remaining viable. Many successful brands in established product categories are thriving in the maturity stage as cash cows for their companies. This is a common situation in consumer packaged goods where well-established names such as Coca-Cola, Kraft Macaroni and Cheese, and Reynolds Wrap enjoy high, stable market shares in low-growth categories. Products such as fax machines, personal DVD players, desktop telephones, and desktop personal computers are also likely occupants of this stage of the PLC.

Decline

A product form or category has arrived at the decline stage of the PLC when the market is no longer able to sustain itself. The only significant strategic choice remaining is the determination of a market exit strategy. There are two basic alternatives: A company can simply let the brand continue, without any substantive marketing support, until it fails to generate enough profit to justify its existence within the company's portfolio of brands. Alternatively, management could seek a buyer for the product while the brand still has market value. Often large companies are interested in divesting themselves of product lines that simply are not profitable enough to be bothered with. A smaller firm, however, might find the rate of return on the purchase of such a brand more than satisfactory.

Product categories typical of the decline stage include VCRs and videocassettes, paper bank checks, electric typewriters, electronic word processors, photographic film, and fax machines. These products are gradually passing through the final stage of the PLC, having been displaced by better technologies. Individual brands within the category will remain on the market only as long as justified by their financial contribution to the firm.

Strengths and Weaknesses of the PLC

The Product Life Cycle, like other conceptual models, is not intended to be prescriptive. It is a decision-making aid, not a substitute for critical analysis and thoughtful planning. It has the potential to provide a general level of guidance on brand management strategies as they relate to general product-market conditions. It also has the potential to focus managers' attention on how market dynamics drive industry sales.

It is necessary to note, however, that the model has some fundamental limitations. It does not apply to all kinds of products in all circumstances. The market behavior of some products departs radically from assertions made by the model. Sales patterns associated with fads and fashions are often cited as deviating from the basic shape of the PLC curve. Similarly, it can also be difficult to ascertain the length of each stage and where any given product currently resides along the PLC curve.

The fundamental principle asserted by the model, however, is an important one for marketing managers. Markets are dynamic, and marketers need to be responsive to those changing conditions. The Product Life Cycle should be regarded as one of the many marketing models that are intended to make managers think about important features and characteristics of the environment in which their brands compete.

Ch. 9 Conclusion

Although every element of the marketing mix is essential, it is hard to escape the primacy of the product. The product is the basis of the firm's viability to the extent that it satisfies target customers' needs or fails to meet their expectations. Contributions from a wide array of professionals are needed to make the tasks of product planning, production, and marketing successful. The coordination and integration of these efforts across all the stages of the Product Life Cycle is one of the most vital roles played by marketing managers.

In the three chapters that follow, we will examine the contribution of the remaining marketing mix elements to the efficient and effective positioning and sale of the product. Product positioning will remain a central consideration in the development of the marketing mix, since it explicitly recognizes both the perceptions of buyers and strategies of competitors. In Chapter 13, we will revisit the concept of product once more to investigate how boundaries between the traditional conception of tangible products and the provision of intangible services are blurring as we transition from a manufacturing-based to a service-based economy. In the closing chapter of the text we will examine the unique challenges and opportunities posed by marketing products in a competitive global economy.

Ch. 9 Learning Resources

Key Ideas

Critical Thinking Questions

 Explain how understanding the four different levels of products (bundles of attributes) can lead to thinking creatively about promotion, distribution, and pricing. Can it help organizations identify new product concepts?

 Most of the time, product packaging and labeling are not very interesting. However, there are always exceptions. Identify several unique product packaging or labeling features in products that you find interesting. Explain how these features contribute to the value you derive from the product.

 Consider the four basic classes of industrial goods: materials, parts, capital goods, and operating and business supplies. To which of the five classes of consumer goods do each of these types of industrial products most closely correspond? Some are easier to assign than others; think outside the box. Explain the rationale for the matches you made.

 Explain how economies of scale work for services. Be specific.

 Most products are hybrids of goods and services, making it truly difficult to distinguish one type of product from another in every case. It has been argued that the Internet has blurred the distinction between goods and services even more. Explain why this might be true.

 Service bundling (e.g., cable television, Internet, and telephone services together) is an option in the same way that bundling tangible goods is an option for brand managers. Give three examples of services bundling that you are familiar with. Is it more difficult to bundle services? Why?

 Portfolio analysis in the form of the BCG Matrix was introduced early in the text. What role does a new product introduction typically fill within the BCG Matrix model? Why is it an important part of a healthy brand portfolio?

 Sometimes new product introductions cannibalize an existing brand within an organization's portfolio. Is that a good thing? Is it a necessary thing?

 What elements of the new product development process relate directly to the marketing concept?

 Should customers or companies be primarily responsible for the safe and environmentally sound disposal of old and worn-out products? Use television sets to illustrate the rationale supporting your opinion.

 Identify a company that you are familiar with and evaluate how the environmental movement and emphasis on sustainability will necessitate the development of new products.

 At which stages can social media and the Internet impact the process of new product development? How? Be specific.

 How is the process of commercializing new industrial products or consumer products with infrequent purchasing rates (e.g., computers) different from launching frequently purchased products? What kinds of measures or metrics are used to assess the success of the launch for infrequently purchased products versus frequently purchased ones?

 What sorts of marketing-related factors within the organization will be related to the successful introduction of new products? What kinds of sales incentives are likely to do more harm than good in building consumer demand for a new brand?

 Consider a product category that you are very familiar with. Explain how the Product Life Cycle can provide cues to category brand managers about the execution of the marketing plan. Can it give different direction to different types of brands depending on their relative size and market share? Explain.

Key Terms

Click on each key term to see the definition.

augmented product

Features and benefits that provide added value to products even though they may not be the primary driv­ers or core benefits in the purchase decision.

basic product

The tangible features that constitute the product being purchased.

capital goods

Long-lasting industrial installations and equipment used in the production or management of finished products.

convenience goods

Consumer products that are typically consumed and purchased frequently.

core benefit

The primary or essential value that the customer derives from the product being purchased (e.g., transportation).

emergency goods

Consumer products that are sought in response to sudden, unexpected events.

label

Any information attached to a product for the purpose of naming it and describing its use, its dangers, its ingredi­ents, its manufacturer, etc.

market test

An experimental market introduction, conducted on a limited basis, within a carefully selected sample of the intended target market. The primary goal of the test is to enable marketing managers to project the sales and profit consequences of a full-scale market launch.

materials

Industrial goods including both basic raw materials and manufactured materials.

new product development process

A con­ceptual model describing the cultivation of an idea from its initial beginnings to its introduction to the market as a new prod­uct. The development of new products in this model is described in six sequential stages: idea generation, screening, concept development and testing, business analy­sis, market testing, and commercialization.

operating and business supplies

Short-lived goods used to support the routine operations of the firm.

package

The container used to protect, promote, transport, and/or identify a product.

packaging

The process by which packages are created.

packaging for distribution

Activities involved in designing and creation of containers for a product during its trans­portation from the manufacturer, through the channels of distribution, to the point of retail sale or purchase.

packaging for final customers

Activities involved in the design and creation of con­tainers that the final buyer receives at the time of purchase. Packaging at this retail level can contribute to the value offered by a product in four distinct ways: maintain­ing product integrity, promoting of the brand image, enhancing the convenience associated with using the product, and pro­viding valuable information to the buyer.

parts

Finished industrial goods that enter the manufacturing process for other prod­ucts without any further change in their basic form.

product

One of four variables in the marketing mix, related to both the tangible and intangible dimensions of ideas, goods, services, or some combination of the three. Bundles of benefits created specifically to meet the needs of specific target markets for of satisfying organizational objectives.

Product Diffusion Curve (PDC)

A model illustrating how the acceptance of new products spreads through five adopter segments or categories within a market: innovators, early adopters, early majority, late majority, and laggards.

Product Life Cycle (PLC)

A conceptual model that describes the four stages that a product typically passes through from its origins until its exit from the market: intro­duction, growth, maturity, and decline.

product line

A group of products that are related to each other by virtue of sharing a common target market. Lines can also be defined as sets of products that share similar uses, technologies, distribution channels, or other relevant features.

product mix

The complete collection or set of products offered for sale by an orga­nization, inclusive of all product lines.

secondary benefits

Features that enhance the primary value provided by the product (e.g., cruise control, GPS navigation system).

service

An intangible product that does not result in the ownership of material goods that can be stored or inventoried. The benefits derived from consumption of a service are uniquely dependent on the knowledge, talents, and abilities of the service provider. Services possess four characteristics that have direct implica­tions for how they should be marketed: intangibility, perishability, inseparability, and variability.

shopping goods

Consumer products purchased and consumed less frequently than convenience goods. These are more expensive purchases, and buyers are will­ing to invest more time comparison shop­ping across brands and between retailers to locate the best values. These products are usually higher involvement purchases than convenience goods, but less involving than specialty goods.

specialty goods

Consumer products that are relatively expensive and infrequently purchased. Consumers are deliberate and selective when making these very high involvement decisions.

total product

A conceptualization of products as consisting of four levels, each of which contributes to the value that customers receive from their purchase. These levels are the core benefit, second­ary benefits, basic product, and augmented product.

Web Resources

This website includes an article by John Walsh entitled "Reverse Logistics and the Total Product Life Cycle" from the November/December 2007 issue of Reverse Logistics Magazine. It examines the concept of the Product Life Cycle from the perspective of reversing the conventional supply chain sequence to reuse products and materials that have been previously sold as finished goods.

http://www.rlmagazine.com/edition08p42.php

This is a site that provides excellent resources specific to topics in the area of new product development. The Product Development Forum section also provides an exhaustive new product development glossary of terms.

http://www.npd-solutions.com

This links to a page of the U.S. Federal Trade Commission's website that addresses legal requirements and practical guidelines related to product labeling.

http://www.ftc.gov/os/statutes/fplajump.shtm

Many issues specific to labeling and packaging consumer commodities can also be found by searching the U.S. Food and Drug Admnistration site:

<http://www.fda.gov>.

Chapter 10

Pricing Strategies and Tactics

Three price tags, and one red sale tag.

Sung-Il Kim/Corbis

Learning Outcomes

By the end of this chapter, you should:

 Understand the different approaches to price setting, based on costs, customers, and competitors, that can be used to meet organizational objectives.

 Recognize how alternative pricing goals and objectives can shape pricing policies.

 Appreciate the significance of price elasticity of demand product as a measure of how consumers respond to changes in product pricing.

 Develop a practical understanding of promotional pricing as a set of alternative tactics for stimulating near-term product sales.

 Understand the far-reaching impact of product pricing decisions on brand management and product strategy.

Pricing is the judgment that translates potential business into reality—yet it is still the least rational of all business decisions. (A. Walker, Harvard Business Review)

Pricing policy is the last stronghold of medievalism in modern management—largely intuitive and even mystical. (J. Dean, American Marketing Association)

Price setting in this country is approached like Russian roulette—to be engaged in only by those contemplating professional suicide. (David Aaker, author and consultant)

Ch. 10 Introduction

Pricing is one of the most important, yet least understood, dimensions of marketing strategy. Despite the growing role of nonprice factors in the marketing process, there is no escaping the direct cause-and-effect relationship between pricing decisions and profitability. As increased competition from international competitors and the growing sophistication of buyers have pushed market prices down for many goods and services, marketing managers have had to become more knowledgeable in both the art and science of setting prices.

\* \* \*

It should be evident from the quotations at the start of this chapter that many business professionals have trouble fully comprehending pricing strategy and concepts. Marketing management can be a complex process, and often the interrelationships among price, opportunity cost, and value in a given situation can evade our understanding for a time. Consumers, however, sometimes understand these complexities quite well.

Clint's son Ryan had been pestering him for weeks to get a puppy. As the holidays drew nearer, the 6-year-old's appeals grew more persistent and intense. Clint wanted to get his son a dog, but the household finances were tight and he was reluctant to take on another mouth to feed at this time. He also worried that the responsibilities of caring for a dog might be too much for an only child in a single-parent household. Yet despite his concerns, Clint brought home a Basenji puppy named Gumby on Christmas Eve.

What can we say about pricing? Clint felt fortunate to pay only $65 to adopt the dog from the local humane society. However, he had to pay $578 in customary and necessary veterinary bills over the first three months of the dog's time with the family. Another $55 for an annual license. An average of $14 per week for food, treats, and dog toys. The price of owning and caring for Gumby easily exceeded $1,500 before the end of the first year.

What of opportunity costs? Clint had trouble meeting his mortgage payments twice that first year and lost some sleep because of it. He opted to put off getting the pair of new glasses for himself that he needed . . . at least for a little while. The $1,500 down payment he needed for a new bass boat just wasn't there that year or the next.

And value? Value is always determined by the perception and experiences of the consumer. Gumby is 11 years old today; Ryan is 17. Gumby remains a boundless source of happiness for the family. He's been to lots of family picnics in the park, enjoys playing Frisbee, and helps everyone have a great time on the annual trip to the beach. Gumby has always been there at those times when Ryan was home alone due to the demands of Clint's job, and he generally keeps an eye on the place when no one else is there.

Maybe the purchase of Gumby was a poor decision at the outset. Maybe both the price and opportunity cost exceeded the value for a brief period, but what do you think of the return on this investment over time?

10.1 Approaches to Price Setting

A product's price is simply the payment given by a buyer to a seller in exchange for goods or services. Buyers seek to minimize the payment required to obtain goods as a basis for maximizing the value they receive. Sellers generally endeavor to secure higher prices to increase the revenue from each sale; pricing decisions are always critical to the firm's achieving its overall financial goals. Consequently, the process of setting prices must be based on a fundamental understanding of what the organization is trying to accomplish with its pricing strategy.

As illustrated in Figure 10.1, marketers often think of the alternative pricing options available to them as bounded or constrained by three Cs: costs, customers, and competitors. Pricing products below cost cannot be sustained in the long run. Pricing beyond customers' willingness to pay will not be successful. Setting prices that fail to deliver a competitive value will lead to a brand's demise in competitive markets. In general, there are three approaches to making pricing decisions, and each uniquely reflects the priority of one of these three Cs.

Figure 10.1: The constraints on pricing options

Pricing options consider customers, competitors and costs

The pricing tasks that confront marketing managers require an assessment of alternative strategies that are constrained by product-related costs, competitors' strategies, and customer perceptions. Each of these is a critical element of the pricing environment that must be evaluated.

Cost-Based Pricing

Cost-based pricing decisions rely on an understanding of production- and marketing-related costs as the key elements in determining a product's initial or standard price. It uses the product's break-even point to identify a price floor, the minimum selling price that will cover the product's variable and fixed costs at a given level of production. Any prices set above this floor will provide the seller with a profit margin on each unit sold. Cost-based pricing techniques consist of simply adding a fixed percentage or monetary (dollar) value profit margin to the established price floor.

This approach is easy to use and logically infallible as long as actual costs are known. It is regarded by some managers as a conservative approach to setting prices since the price floor represents a break-even point where unit revenues match unit costs and all product-associated costs are recovered. In this sense, the cost-recovery or break-even price is recognized as the minimum unit price for the product being sold. Markup pricing and cost-plus pricing are two of the most commonly used methods for making cost-based pricing decisions.

Markup pricing is a pricing method favored by many large retailers. The price for any given category of products is set by establishing a fixed percentage increase or markup on top of the initial product cost to arrive at a retail price. By utilizing a common fixed percentage for all of the brands within a category (e.g., small kitchen appliances), the retail price is a direct reflection of wholesale price paid for the merchandise. Consequently, the ranking of brands according to price remains the same as the products move through the channel of distribution. This is an important consideration in many categories where brand price is intended to provide consumers with cues about product quality and value.

Two electricians install solar panels on the roof of a home.

Cost-plus pricing is often used by electricians and other skilled tradespeople, because time- and labor-related costs are often independent of material costs.

Ralph Clevenger/Corbis

Cost-plus pricing is similar to markup pricing. Instead of using a fixed percentage markup to arrive at a final price, however, cost-plus pricing simply adds a fixed monetary amount. This approach is commonly used throughout the service sector of the economy where time- and labor-related costs are often independent of material costs. An electrician who is hired to install a new ceiling fan will determine a total price for the job based on time plus materials. Since the type of fan is unlikely to impact the time or labor required to install it, the estimate for the job will often be stated as a fixed fee to cover the cost of his or her time plus the cost of materials to be used. The buyer is made aware from the outset that deviations in the price of the job will depend on any changes in material costs and that labor costs will remain constant.

For many types of sellers, the simplicity and conservative features of cost-based pricing make it an attractive pricing policy. However, these approaches do not reflect consumer preferences or product demand in any meaningful way. Consequently, products may be priced either higher or lower than what the market will bear. This can result in the loss of sales if the product is overpriced and missed profit potential if underpriced. An alternative pricing methodology that corrects this fundamental limitation of cost-based pricing is customer-based pricing.

Customer-Based Pricing

Customer-based pricing is also sometimes referred to as demand-driven or value-based pricing since prices are derived from buyers' perceptions of value rather than the seller's cost. This approach to setting prices includes two specific pricing policies for new and emerging products that are addressed later in the chapter: price skimming and penetration pricing.

Among the most widely adopted variants of value-based pricing strategies is Economic Value Estimation (EVE). The fundamental principles of EVE are straightforward: "A product's total economic value is the price of the customer's best alternative (the reference value) plus the economic value of whatever differentiates the offering from the alternative (the differentiation value). Differentiation value may have both positive and negative elements" (Nagle et al., 2011). An illustration of this technique is provided in the following feature.

Economic Value Estimation

Is using EVE complicated? Not really. For the sake of illustration, let's do the analysis on a product innovation for light- and heavy-duty commercial trucks. The TRIM brand fluid cooler is an after-market device designed to cool transmission fluid to prevent excess heat buildup in the transmission case, which leads to early transmission failure. The original factory-installed fluid cooling equipment in most commercial vehicles is simply a stack of flat, long, oval loops of tubes located inside the plastic tank-top of the radiator. Hot transmission fluid is pumped into one end of the cooler and is cooled by the radiator fluid surrounding the tubes. In contrast to this design, TRIM's cooler is a set of coiled tubes mounted in front of the radiator. Instead of relying on radiator coolant to cool transmission fluid, it uses direct air flow. This design creates a wider temperature differential between the transmission fluid and the cooling medium than the standard equipment can, thereby increasing the amount of heat that can be pulled from the transmission fluid versus the standard equipment.

Automated robot arms welding trucks in assembly plant

Car Culture/Corbis

TRIM would like to sell this product to truck manufacturers. Prices for the conventional fluid cooling equipment are based on the length of tubing required to make each product model, since each type of truck requires a slightly different configuration. Currently, original equipment suppliers to the major automakers charge $.82 per inch for the metal tubing used in this application.

As shown in Table 10.1, TRIM brand managers have identified four distinct sources of differentiation value for their product relative to its competitors:

 Tube Length: Higher rates of heat transfer due to using air as the cooling medium will reduce the number of coils and the length of tube required for each application by $.04 per inch for light-duty and $.09 per inch for heavy-duty trucks based on laboratory performance tests.

 Radiator Performance: Due to the reduced size of the fluid cooler, the improved air flow to the radiator improves the cooling capacity of the radiator, allowing for a smaller radiator. This impact is estimated at $.08 per inch for the larger applications and about $.03 per inch for the smaller applications.

 Weight Reduction: Due to the reduced radiator size described above and the resulting reduction in size of the front end of the vehicle for the engine cooling module, the overall weight reduction improves fuel efficiency, which adds to the value of the vehicle to the customer. Economic value equals about $.01 per inch for both classes of trucks.

 Extended Transmission Life: Every year more than 14 million transmissions fail. A 20-degree reduction in the operating temperature of a transmission system can double the life of the equipment. Though difficult to evaluate, the economic value related to the cooler operating temperatures achieved by the TRIM product is estimated at $.02 per vehicle.

Table 10.1: Economic value estimation

 Light-Duty Trucks Heavy-Duty Trucks

Reference Price $.82 per inch $.82 per inch

Reduced Tube Length .04 .09

Enhanced Radiator Performance .03 .08

Weight Reduction .01 .01

Extended Transmission Life .02 .02

Value Estimate Price per Inch $.92 per inch $1.02 per inch

Make sense? Does a dollar or so per application seem like it would make much difference? The market potential for this application is more than 8 million vehicles annually. The average tube length for this type of application exceeds 30 inches. Do the math: What price per inch should TRIM brand managers quote to the major automakers for this innovative product? Why?

Apply this process to brands in a category that you are very familiar with. Be sure that you recognize how the process "rewards" better brands with higher prices and discounts inferior quality brands.

Economic Value Estimation is a very useful tool for developing profitable pricing strategies for many types of goods and services. Consider a brand that is well positioned and superior to competitors' alternatives for a given segment of the market. The price of the buyer's next-best alternative is the buyer's reference value or basis for comparison. The EVE approach emphasizes capturing the value added by the preferred product based on the greater economic value of the brand. In principle, the price for the superior brand should reflect the differentiation value (or value added) plus the reference value price of the closest competitor's brand. Consequently, this new price should approximate the maximum price that buyers will be willing to pay for the better brand.

An important implication of EVE is that success does not depend on having the best brand. Instead, the objective is to price the product in line with customers' expectations and understanding of the value your brand represents relative to alternatives. Consequently, negative differentiation values are just as much a valid consideration in pricing as positive ones. Aside from brand-specific differences, negative values can also stem from costs incurred by the buyer, especially in business-to-business sales contexts.

Consider the purchase of new machine tools for a product assembly facility. Would buying a new brand of equipment in place of the current brand result in having to retrain employees? Would it mean changing inventory requirements? Could it make some of the buyer's existing parts inventory obsolete? Each of these is a potential basis for negative differentiation that needs to be accounted for in establishing prices that are consistent with buyers' expectations of value.

In every purchase situation, buyers also confront an element of risk and uncertainty when making a change of any kind. Consequently, purchasing agents or other people in charge of making buying decisions for a company may require extraordinary improvements in product performance or quality to justify taking a risk on a new brand or supplier.

The primary advantage to customer-based pricing strategies is that they explicitly recognize and account for differences between competing brands and consumers' responses to superior product value. Objectively assessing and measuring the motivations for buying and the product values that motivate customers also promotes a more practical appreciation of product positioning and market segments based on how each cluster of buyers evaluates economic value in the brands it buys. This is a compelling argument for applying EVE to making pricing decisions. However, it cannot be meaningfully applied in every instance. In some circumstances, making pricing decisions based on competitors' actions is more appropriate.

Competition-Based Pricing

Competition-based pricing decisions are made by organizations in response to the prices charged by competitors. Several types of company objectives are consistent with this approach. For example, firms may be pursuing competitive advantage by setting prices below their nearest competitors' prices. Alternatively, they may set a price higher than their closest competitors' prices as a means of positioning their product as a premium brand.

It is reasonable to expect competitors to react to changes in each other's pricing strategies. In fact, many brands often rely on competitors' price behavior to provide indicators of where prices should be set. Monitoring market prices is a relatively inexpensive form of market research that is essential to maintaining a viable competitive strategy in most B2C markets. The task of tracking prices, however, is generally more difficult in many B2B markets. The sale of products custom built to buyers' specifications and negotiated prices in some B2B markets make the gathering of data and the process of making meaningful comparisons difficult.

Most marketing mix decisions, including pricing, should include a review and assessment of competitors' behavior. In the case of pricing strategy, the value of this information is in direct relationship to how price-competitive the product market is. By definition, price competition has a more direct and substantial influence on sales in price-competitive markets. However, the positioning and market share of competing brands may either accentuate or mitigate the role of pricing for each firm.

Brands that dominate markets and are recognized as market leaders will generally be less influenced by competitor pricing. They are, in fact, more likely to be exercising their market power to set baseline or standard prices in accord with their own marketing strategy. They act as price leaders in this regard. In highly competitive situations where a distinct market leader may not exist, each brand needs to be more cognizant of how its nearest competitors price their brands. Knowing how competitors will respond to any change in pricing strategy is just as important as knowing prevailing price levels. To use competitors' prices as standards against which to make brand management decisions, marketers also need to be aware of how aggressively and how rapidly competitors will respond to price changes.

Although there are no absolute rules for how to use competitor prices as a basis for shaping a brand's pricing strategy, companies tend to be consistent in responding to their direct competitors in one of three ways:

Below-Competition Pricing: Companies that are pursuing market share growth will often respond to changes in prevailing market prices by keeping their prices below those of their closest competitors.

Man walking into a Family Dollar store.

Family Dollar stores compete for customers and sales by pursuing a clearly defined below-competition pricing strategy.

agefotostock/SuperStock

Above-Competition Pricing: Brands that have achieved quality leadership and highly specialized niche brands will often maintain their prices above those of competitors in support of their brand image. The generally positive relationship between perceived product quality and price often requires high-end brands to increase their price relative to competitors to reinforce their positioning strategy.

Parity Pricing: Brands seeking to compete on a basis other than head-to-head price competition often simply match changes in their nearest rivals' prices. Parity pricing to match the price by similarly positioned brands also provides a simple method for setting the initial price of new brands in competitive markets.

It is important to note that pricing changes should rarely be made exclusively in response to competitors' actions. By the same basic logic, marketers need to recognize that establishing a new price is not the only type of response that can be made to competitors' pricing changes. Customers are responding to product value, which is a function of both price and quality. Isolated changes in competitors' prices may afford marketing managers with opportunities to consider more significant revisions to the marketing mix. Rather than simply reacting to price changes or mimicking them, marketers may have the opportunity to reshape the whole product offering or bundle of benefits that the product represents. Superior product value may rest in adding new features, improving levels of core product quality, revising distribution channels to improve availability, or providing greater convenience through changes in product packaging.

Think About It

Iced coffee.

iStockphoto/Thinkstock

Attracted by a seemingly lucrative market for premium fresh-brewed coffee, Dunkin' Donuts and McDonald's have expanded their product lines in recent years to offer an increasing variety of premium coffee blends, cappuccino, and espresso drinks. Though Starbucks has traditionally been perceived as the quality leader within this market, these competitors are making substantial inroads.

What do consumers want? Taste and value.

Who offers the best blend?

Based on your perception of how these brands compete, which one(s) could initiate an across-the-board price increase on the price of the products and expect the others to follow suit? Why?

What is the net impact on product unit sales and revenue if everyone goes along? If only one follows the price leader?

Simply following a market leader's price moves may seem like the easiest pricing path and the one least likely to get a company into trouble. However, making pricing changes without regard for the objectives and goals directing the management of the brand is a hazardous practice. Any decision to revise pricing policies should be thoughtfully considered and subject to thorough analysis before proceeding. Though price changes are easily executed, the financial and strategic consequences are often substantial and enduring. In light of this, it is essential that all pricing decisions be made with the organization's pricing objectives in mind.

10.2 Pricing Objectives

As part of the market planning process, companies have great latitude in deciding how a brand's price should contribute to its positioning and the overall strategy for the product. The primary goal of any given pricing strategy will typically be focused on achieving one of four major objectives: profit maximization, market share maximization, price skimming, or quality leadership.

Profit Maximization

The pricing objective for many brands is to maximize current profits based on projections of the relationship among price levels, associated product costs, and corresponding levels of consumer demand. This is a common objective for established brands since the firm has had time to develop a reliable understanding of both price–demand and price–cost functions. It also tends to be a more appropriate goal for brands in the maturity stage of the PLC, since market-related dynamics and volatility have stabilized.

Profit maximization may be an objective that is poorly suited to new and emerging brands since the nature of the relationships among price, demand, and product costs are less understood. Similarly, market dynamics tend to be more volatile, and finding the right price may be a matter of chasing a moving target. Placing too much emphasis on near-term measures of profitability can adversely impact the long-term performance of emerging brands if other growth-related goals are ignored.

Market Share Maximization

A market share maximization pricing objective may be of particularly great importance for firms trying to secure a substantial position within a new or emerging market. It is a goal that is also consistent with market penetration strategies where the intended effect of higher sales volume is to reduce unit costs of production and distribution. This penetration pricing strategy is sometimes observed in the marketing plan for new products where initial prices are set artificially low to build sales volume and market share. After securing customer acceptance and a foothold in the market, prices are subsequently increased to capture higher levels of profitability.

Although the primary aim of penetration pricing strategy is to maximize the quantity sold by offering buyers a low price, it also affords brands with a measure of protection and defense against the threats posed by impending competition. By reducing the short-term profitability incentive to enter the market, firms pursuing this option often enhance their long-run financial prospects. This is particularly true in circumstances where large decreases in unit cost result from cumulative volume increases.

Price Skimming

An alternative to penetration pricing is a technique referred to as price skimming. In the initial stages of category growth and development, the first brands to pioneer the market may choose to set prices at a level that is much higher than can be sustained once competitors enter. This price skimming strategy enables the product innovators to recover development and preliminary marketing costs before the arrival of competing brands drives prices lower. The sustainability of this strategy over time hinges on several factors related to the dynamics of the market, including barriers to entry. The effects of applying the price skimming methodology to gradually lower the price of a product over time are illustrated in Figure 10.2.

Figure 10.2: Price skimming graph

Price skimming involves lower the price for a product over time

This graph illustrates the consequences of lowering product prices gradually over time. At each successively lower price point, additional levels of revenue and profitability are captured.

Several prerequisite market conditions must be met for price skimming strategies to be successful. To justify the strategy on a revenue basis, a sufficient number of buyers in the critical PDC innovator category must be willing to pay the relatively high price of being the first to own this innovative new product. Similarly, the higher unit costs associated with limited production cannot be so high that they negate the additional margins associated with the higher price. From a positioning perspective, it is also essential that the skimming price be consistent with and convey a brand image of high quality and high customer value.

Quality Leadership

Quality leadership is a pricing objective based on the utilization of higher prices to signal superior product quality to both competitors and consumers. As discussed previously, consumers often rely on price as an indicator of quality, particularly when they are unfamiliar with a product category. The intent behind establishing quality leadership as a goal is to promote and reinforce a brand's positioning strategy as a quality leader within the category.

The appropriateness of this goal depends largely on the category context. In mature markets, it is often difficult to successfully challenge entrenched brands that occupy the "high quality" positions in buyers' perceptions. And it can be even more difficult to carve out a space for multiple co-leaders on the dimension of product quality. Changes in the character of consumer preferences, however, sometimes create opportunities. Although there are a small number of quality leaders in different sectors of the home appliance market (e.g., Maytag, Whirlpool), none yet dominates that highest-quality market position for consumers who attach the greatest priority to energy efficiency or environmental friendliness. That is, a clear "green quality" leader hasn't emerged for many home appliance categories.

10.3 Price-Related Factors Influencing Consumer Demand

A number of factors inside and outside the organization impact consumer demand for products. The firm's goals and strategic plan for the product represent the most obvious and prescriptive of the internal factors. Internal constraints that can limit demand in the short run include unanticipated spikes in product-related costs and limited production capacity. Though the influence of each can be profound and complex, these factors are generally under the direct control and management of the company in the long run.

External influences on consumer demand pose a more difficult challenge for price setting insofar as these are influences beyond the organization's direct control. However, understanding and responding to these factors is an essential part of the price setting process. In previous chapters we have addressed many of the psychological factors that impact consumers' demand for products as well as specific brands. Kent Monroe explored many of these subjective influences on perceptions of price throughout his career (1973, 2002). These included the role of reference prices and the positive relationship between a brand's price and buyer perceptions of quality.

In this section we briefly examine two additional sets of factors and their impact on consumer demand. We consider the factors that drive price elasticity of demand and how this measure serves as an indicator of consumer response to changes in product pricing. In the next section, we will investigate the role of promotional pricing strategies as the organization's best short-run pricing alternative for directly impacting product sales.

Pricing Strategies

The price itself takes into consideration what customers will pay. What are the factors that companies must consider in order to price their products for their target customers?

Price Elasticity of Demand

Price elasticity of demand (PED) is an economic measure of the responsiveness of the quantity of a good demanded to a change in its price. It is expressed as the percentage change in quantity demanded in response to a 1 percent change in price. The mathematical formula for the coefficient of price elasticity of demand is:

PED = % change in quantity demanded = ?Qd/Qd

% change in price ?P/P

The mathematical value of the PED ratio is almost invariably negative in normal product markets, since an increase in price will typically produce a decline in the quantity demanded by buyers. By convention, the negative sign is usually disregarded and the value of the equation is simply expressed according to its absolute value.

The demand for a good is regarded as being relatively inelastic when the PED is less than 1.0 in absolute value. This indicates that a change in price will have a disproportionately small effect on the quantity of the good demanded. In this scenario, the percentage change in quantity demanded is smaller than the percentage change in price. Consequently, if the price is raised, total revenue increases.

Demand is regarded as relatively elastic when its PED is greater than 1.0 in absolute value. In this condition, changes in price have a disproportionately large effect on the quantity demanded. Under these conditions, the percentage change in quantity demanded is greater than the percentage change in price. Therefore, if the price is raised, total revenue will decrease.

When the percentage change in quantity is equal to the percentage change in price, the value of PED will be 1. This is referred to as unit or unitary PED. In this circumstance, price changes will not affect total revenue over the range of prices where this assessment of elasticity is valid.

The PED for a product can be influenced by many factors:

Availability of substitute goods: PED will be higher when more close product substitutes are available. The availability of substitutes allows buyers to switch to less expensive alternatives or better product values when the price of their usual brand increases. The relative willingness of buyers to switch to other goods in the face of higher prices is called the substitution effect.

Men looking at adidas shoes on display.

Companies such as Adidas strive to differentiate their brands and execute positioning strategies designed to build brand loyalty and reduce their customers' willingness to switch to substitute goods.

Getty Images Entertainment/Getty Images

Percentage of income: The higher the percentage of the buyer's income that is needed to acquire the products, the higher the elasticity tends to be. In general, consumers are simply more price sensitive to products that are more expensive.

Necessity: The more necessary the consumer believes a good to be, the lower the PED will be. That is, consumers are much less likely to discontinue buying the product in response to a price increase. This effect is evident in the sale of both over-the-counter and prescription drugs.

Duration: If a price increase persists over time or buyers believe that it will remain in effect for the foreseeable future, they will be more inclined to seek out alternative, substitute goods. Consequently, the PED will increase over time. An increasing number of car-bound commuters faced with the prospect of higher gas prices, for example, will seek alternative forms of transportation over time.

Brand Loyalty: Buyers' commitment or attachment to specific brands will reduce their sensitivity to price increases, resulting in more inelastic demand.

For marketing managers, price elasticity of demand for a given brand can be applied to estimate the anticipated change in quantity demanded for a proposed price. It is a useful tool for analyzing alternative strategy scenarios on a what-if basis. In general, however, the value of the results from these types of conceptual experiments is limited by the reliability of the information used in the analysis and the realism of the underlying assumptions.

PED-based projections of how price changes will impact demand and revenue are based on the assumption that no other relevant market changes will occur at the same time. This includes an assumption that competitors will not respond to a price change in kind. However, the likelihood of nothing else changing in the market but the price of a single product is, in reality, quite small. Measures of elasticity are also of limited utility insofar as they are only valid for a given point in time. The shifting tide of consumer preference and underlying market dynamics necessarily invalidate their reliability over time.

It is reasonable to conclude that the price elasticity of demand provides a statistically sound basis for assessing the general consequences of price changes on demand and total revenue. Market dynamics and the sensitivity of markets to factors other than price, however, limit the predictive reliability of the methodology. Despite its practical limitations, PED can be a valuable tool for projecting the general direction of market responses to a brand's change in price. As such, it can provide important insight into the development of effective product pricing strategies.

A Closer Look at PED

Since their first encounter with the concept of price elasticity of demand is typically in an economics class, marketing managers sometimes mistakenly believe that the PED concept is simply too abstract to be of much practical use. But what could be more practical and potentially valuable than knowing the most likely change in quantity demanded or total revenue that will result from a change in price? PED market tests and analysis can be applied to determine the optimal pricing strategy for many types of products.

Spanakopita

iStockphoto/Thinkstock

Consider the challenge of setting the retail price for an innovative new frozen Greek entree: spanakopita, or spinach pie in buttered filo dough. Although products like frozen shepherd's pie and Cornish pasty meat pies are somewhat comparable, they only provide vague guidelines and loose constraints for price setting. Field pricing tests in matched markets throughout the United States could be used to ascertain the price elasticity of demand for the product. Data on the quantity response to alternative retail price points could be compiled to estimate the PED over the range of prices tested. These data could be used to identify the relative elasticity of demand to price changes from one point to the next. This, in turn, could provide the marketing manager with the information required to determine the optimal price point in terms of maximizing revenue and profitability.

You might be inclined to guess that the PED for spanakopita will be elastic over the relevant range of prices tested. This could be inferred from some of the factors listed above. The product is not, for example, a necessity. However, other factors would support the belief that PED may be inelastic over some range of relevant price options. Since it is an inexpensive purchase and has few close substitutes, consumers may be relatively insensitive to the product's price. It is precisely these types of uncertainties that make doing PED field tests so valuable.

It is critical to note, however, that PEDs will shift over time in response to competitive behavior, changing economic conditions, and the evolution of consumer tastes and preferences. It is also essential to remember that setting the product's price is often intended to accomplish objectives beyond simply maximizing total revenue. Building brand awareness and market share, for example, may dictate setting lower introductory prices than the analysis of the PED alone would indicate.

This chapter initially identified three approaches to setting prices that differed based on their orientation to product costs, customer preferences, and competitive pricing. Understanding price elasticity can make positive contributions to the development of pricing strategy under all of these general frameworks. The same can be said of understanding the essentials of promotional pricing.

10.4 Promotional Pricing

Price changes in response to competitors' behavior tend to be fairly permanent revisions or long-term adjustments to brand strategy. They reflect an enduring shift in the overall marketing plan for the product. However, product prices can also be adjusted for shorter intervals on a temporary basis. This is most frequently done as part of a promotional pricing effort.

Promotional pricing is a term used to describe a diverse collection of price-reduction tactics intended to stimulate the demand for a specific brand. It is frequently employed when new products are initially introduced to the market and throughout the Product Life Cycle as a temporary stimulus when sales are lagging below expectations. It is a strategy that targets prospective buyers who are generally price sensitive as well as those anticipating price reductions as opportunities to purchase. However, the overuse of short-term price incentives to stimulate sales in specific product or geographic retail markets can create deal-prone buyers who will only purchase in response to discounted prices. Similarly, frequent price changes and aggressively promoted sale prices can create skepticism about the true value or significance of discounts.

Think About It

Most towns seem to have one: that furniture, flooring, or clothing store that advertises a "going-out-of-business" sale several times a year. The strategy must be working to some extent since, ironically, the store never closes up for good.

How can you explain this?

When used appropriately, promotional pricing can be a very effective tool for increasing brand sales in the short run. It also holds the potential to create brand-loyal customers if first-time buyers are favorably impressed by the quality of the product and value they receive from the purchase. There are five general categories of promotional pricing alternatives: markdowns, loss-leader pricing, product bundling, dynamic pricing, and sales promotions.

Shopper walks next to a back to school advertisement in the mall.

Many parents take advantage of the back-to-school sales that fall under the special event pricing category of markdowns. What markdowns do you regularly look for when shopping?

Associated Press

Markdowns, or "sale prices," represent the most familiar form of promotional pricing. They encompass a wide array of promotions that feature products selling below their usual or customary price. Seasonal and holiday sales events are commonly used to promote sales at specific times of the year. These events may be run countercyclically to build sales during traditional off-peak periods (e.g., Christmas in July) or procyclically to build volume and capture market share during natural sales peaks (e.g., discounting snowblowers in December). Special event pricing (e.g., back-to-school sales) is also included in this category.

Loss-leader pricing is used primarily by traditional store retailers. This tactic consists of featuring one or more popular brands for sale at prices below the seller's cost of goods. The expectation is that these featured values will build customer traffic for the store and result in purchasers of additional regular-priced products as well. Convenience stores, for example, often feature fresh-brewed coffee priced below cost to attract customers with the expectation that they will also purchase higher-margin products.

Product bundling is most often used in reference to the sale of complementary products together at a special combined or bundled price. For buyers, the overall cost of purchasing the set or bundle is less when compared to purchasing each product individually. Consider the promotions frequently featured by electronics retailers. Desktop computers are typically bundled with a monitor, software, and a printer/scanner for a price significantly below the cost of the individual components purchased separately.

An advantage to the marketer is that prices can often be reduced on product bundles without adversely impacting consumers' perceptions of brand quality. That is, buyers are likely to view a lower cost on the computer package as representing a "better value" rather than raising questions about the quality of any particular component.

Dynamic pricing is a form of retail promotional pricing that has grown in popularity with Internet retailers. The central element of this technique is that price adjustments are made at the point of sale, specific to the purchase history and behavior of the buyer. In some respects, it resembles the negotiated pricing model that is typical of B2B transactions. Dynamic pricing methodologies combine known customer data with preprogrammed pricing algorithms to create price offers uniquely suited to each specific transaction and buyer.

Airline pricing, for example, may rely on customer characteristics such as preferred dates of travel, prior purchase patterns, travel frequency, and whether the trip is for business or leisure to determine the best offer available to any given prospect. If the inquiry is made online, first-time visitors to the site may receive a more favorable price. If the "cookies" on the customer's computer indicate that they have been to the site on many occasions without purchasing anything, deeper discounts may be in order. Information stored on the prospective buyer's computer may also provide useful data about other sites visited, the user's interests, and general buying tendencies.

Sales promotions, as with the other categories, work to build sales volume by lowering the price paid by the buyer. This set of short-term price incentives, however, requires coordination with a supporting communications plan to be effective. Additionally, it often involves more initiative on the part of the buyer to gain the price reduction. The methods used in this category include rebates, coupons, special financing, trade-in plans, and loyalty programs. These types of promotion are discussed in greater detail in the next chapter.

Think About It

Sales promotions have become an integral part of retail strategy. Visit several stores online. Be sure to include Best Buy, Sears, Amazon, and L.L.Bean. Identify as many types of sales promotions as you can.

Do certain types of sales promotions seem to go with certain types of products?

Does the online use of this pricing tactic differ much from how it is practiced by traditional retailers?

10.5 Understanding the Role of Product Pricing

Aston Martin dealership.

Pricing plays a significant role in consumer perceptions of brand image. Some Aston Martin models retail for over $300,000. What conclusions would you make about the brand from that price?

Bloomberg/Getty Images

Marketers need to recognize the critical roles that pricing decisions play in product management. The price component of the marketing mix impacts the way in which brands compete for sales in three ways, including brand image, flexibility, and demand management.

Brand Image: As discussed at several points throughout this text, effective product positioning is dependent on cultivating a brand image that resonates with the target market. Pricing strategy is a critical part of this process. However, it is a particularly impactful part of the process at the earliest stages of the brand's life cycle. Customers' first impressions are typically lasting impressions, and their perception of a brand is often formed when they first learn the price. If buyers do not see substantial product value at this first encounter, it is unlikely that they will pursue the evaluation of this brand any further.

Flexibility: Price is the most flexible and easily modified of the marketing mix variables. In contrast to product, promotion, and distribution decisions, pricing strategy can be changed quickly without incurring significant direct expenses. This feature provides an important tool for responding to competitive threats and for stimulating demand.

Demand Management: Price adjustments can be used effectively to stimulate near-term sales or slow the rate of sales growth if capacity constraints limit product production in the short run. Price-driven sales promotions can also grow demand by securing new distribution channels for the product and expanding the overall distribution network.

Ch. 10 Conclusion

Pricing is always a pivotal decision for marketing managers. It is a prime determinant of both sales revenue and profitability. It is an essential component of how consumers assess product value. It must be planned relative to the needs and preferences of the target market. And it needs to be coordinated with the other elements of the marketing mix for successful execution of the marketing plan. Elements of pricing strategy and tactics are often used to complement the promotional features of the marketing mix to refine the brand's positioning relative to its competitors and drive product sales. In the next chapter, we'll investigate the potential applications of specific options in the promotions mix.

Ch. 10 Learning Resources

Key Ideas

Critical Thinking Questions

 Sometimes brand mangers find the issues surrounding pricing strategy very simple and straightfoward. At other times, pricing strategy is the most challenging of the marketing mix variables to manage. What market-related circumstances or product-specific issues are likely to have a direct influence on the level of difficulty that managers encounter when setting prices?

 Do buyers understand the economic benefits and gains offered by individual brands the same way that marketing managers see them? Do they perceive the significance of price differentiation between brands the same way? Do they really think about whether higher prices for some brands are justified by product quality and value? Does it depend on the product? Do you think that certain segments of the market are more likely to "get it" while others don't? Why?

 Some pricing strategies seem to be focused on "how much money should we charge above our costs?" Others seem oriented toward pricing in relation to how consumers value the product being sold. Another category of pricing strategies looks like it is oriented to just keeping up with whatever competitors are doing. Is one of these views more consistent with the marketing concept than the others?

 What potential ethical problems might arise from the aggressive application of dynamic pricing?

 Consider three of the largest purchases you have made during the past month. How important was the product's price in your choice of brands for each? Was there a significant difference in the impact of price in one category relative to another? Why?

 What is the relationship between consumers' level of involvement with a purchase decision and their sensitivity to pricing differences between brands?

 Identify several examples from the B2B environment where a company charges premium prices over its competitors' rates. On what basis is it able to be successful with this strategy? Are there service-related features that enhance the value of the product?

 Under what circumstances can paying more for a product make it a less risky purchase for the buyer? Consider both B2C and B2B market examples.

 Identify examples of pricing practices that you find unfair or deceptive. In each instance, identify what you believe to be the seller's motivation in using these techniques. Are they effective? Legal?

 Has the Internet made product pricing more competitive in some industries? Less in others? Provide examples to support your position.

 It has been argued that the availability of independent and objective online sources of comparative product information is improving buyers' ability to make informed decisions about the brands they purchase. Do you agree? Cite examples. Can you identify a product market where the availability of online information has lowered prices?

Key Terms

competition-based pricing

The process of making pricing decisions in response to the prices charged by competitors. Several types of company objectives are consistent with this approach.

cost-based pricing

The reliance on an understanding of production- and marketing-related costs as the key elements in determining a product's initial or standard price.

cost-plus pricing

Setting an initial price by adding a fixed monetary or dollar amount above the product's initial cost. This approach is commonly used throughout the service sector of the economy where time- and labor-related costs are often independent of material costs.

customer-based pricing

Sometimes referred to as demand-driven or value-based pricing. It is a set of price-setting techniques that derive product prices from buyers' perceptions of value rather than the seller's cost. This approach includes price skimming and penetration pricing.

differentiation value

The economic value of whatever differentiates the brand being priced from the best alternative. Differentiation value may have both positive and negative elements.

dynamic pricing

A form of retail promotional pricing, popular with Internet retailers, that takes advantage of the opportunity to adjust prices at the point-of-sale based on specific information about the buyer and purchase situation. It enables sellers to create price offers uniquely suited to each specific transaction and buyer.

Economic Value Estimation (EVE)

A customer-based method that sets prices according to the valuation of the reference value of alternatives and differentiation value of the brand being priced.

loss-leader pricing

Consists of featuring one or more popular brands for sale at prices below the seller's cost of goods. The expectation is that these featured values will build customer traffic for the store and result in purchasers of additional regular-priced products as well.

markdowns

Often referred to as "sale prices," these are the most familiar form of promotional pricing. They encompass a diverse array of promotions that feature products selling below their usual or customary price.

markup pricing

Setting an initial or standard price by adding a fixed percentage increase above the product's initial cost. This is a method favored by many large retailers.

penetration pricing

A pricing technique that consists of establishing relatively low initial prices to attract new customers and build sales volume. After securing customer acceptance and a foothold in the market, prices are subsequently increased to capture higher levels of profitability.

price elasticity of demand (PED)

An economic measure of the responsiveness of the quantity of a good demanded to a change in its price. It is expressed as the percentage change in quantity demanded in response to a 1 percent change in price. Its value can be influenced by many factors, including brand loyalty, the availability of substitute goods (the substitution effect), percentage of income being spent to acquire a product, the perceived necessity of the purchase, and the anticipated duration of the price change.

price skimming

A pricing technique that initially sets new product prices relatively high to maximize per-unit profits. This approach enables the organization to recover development and preliminary marketing costs before the arrival of competing brands drives prices lower. The sustainability of this strategy over time hinges on several factors related to the dynamics of the market including barriers to entry.

pricing objectives

An alternative pricing goal typically set in response to the positioning and the overall brand strategy for the product. The primary goal of any given pricing strategy will typically be focused on achieving one of four major objectives: profit maximization, market share maximization, market skimming, or quality leadership.

product bundling

Selling complementary products together at a special combined or bundled price. For buyers, the overall cost of purchasing the set or bundle is less when compared to purchasing each product individually.

promotional pricing

An array of price-reduction tactics intended to stimulate the demand for specific brand. They are frequently employed when new products are initially introduced to the market and throughout the Product Life Cycle as a temporary stimulus when sales are lagging below expectations. There are five general categories of promotional pricing alternatives: markdowns, loss-leader pricing, product bundling, dynamic pricing, and sales promotions.

reference value

The price of the customer's best alternative relative to the brand being priced.

sales promotions

Short-term incentives intended to build sales volume by lowering the price paid by the buyer. The methods used in this category include rebates, coupons, special financing, trade-in plans, and loyalty programs.

Web Resources

The home page for the Professional Pricing Society. The site includes a number of useful references and white papers for business professionals concerned with making pricing decisions and effective price management.

http://www.pricingsociety.com

An award-winning site dedicated to providing resources to both students and teachers of economics. Marketing managers would find the sections on pricing and elasticity of demand particularly useful.

http://www.welkerswikinomics.wetpaint.com

Site hosted by LeveragePoint software that provides a video demonstration of how value modeling software programs can be used to execute EVE analysis. Though it exclusively features LeveragePoint brand software solutions, the basic principles are applicable to all forms of EVE analysis.

<http://www.leveragepoint.com/solutions/software/eve/>

Part V: Promotion and Distribution Decisions

Part IV of this text examined how the product and price elements of the marketing mix combined to provide an offering of value to a specific target market. Part V investigates the two remaining elements of the marketing mix in detail: promotions and place. Specifically, Chapter 11 explains how the value that is inherent in the good or service offered by an organization is communicated to prospective purchasers. This requires creating customer awareness for the specific brand and conveying images and information that support the intended positioning strategy. Chapter 12 looks at the two central components of the place element within the marketing mix: channel and distribution decisions. Moving goods and services from where they are created to where they are demanded is the critical function met through the place-related decisions made by marketing managers.

Contents:

Chapter 11: Promotions: Integrated Marketing Communication

Chapter 12: Marketing Channels and Distribution Decisions

Chapter 11

Promotions: Integrated Marketing Communication

Blank billboard on a city street

Hemera/Thinkstock

Learning Outcomes

By the end of this chapter, you should:

 Be able to identify the elements of the promotions mix and their basic characteristics.

 Know the essential objectives of marketing communications.

 Be able to compare and contrast the hierarchy-of-effects model and its implications to the Elaboration Likelihood Model.

 Be able to identify the major steps in the development of effective communications programs.

 Know the four general classifications of sales functions and be able to describe the sales process.

 Understand how the effectiveness and efficiency of the sales effort can be improved through sales training and appropriate compensation of the sales force.

Ch. 11 Introduction

Promotions serve a critical function within the marketing process. Their value rests in their ability to inform a selected audience of the benefits of buying one uniquely positioned brand from among the array of competitive offerings available. Consequently, the primary objective of marketing communications is to persuade prospective buyers by shaping their attitudes toward the brand. As we explored in Chapter 5, attitude change can be accomplished by the provision of brand-specific information and images. The path of progress in changing attitudes is mediated by the individual's level of involvement or interest in the product being marketed.

This chapter focuses primarily on the role of promotions in the process of persuasion. The beginning sections of this chapter introduce the elements of the promotions mix and their characteristics. This is followed by an examination of the three fundamental goals of marketing communications and our understanding of the processes that govern and limit the effectiveness of promotions and advertising programs. The central section of the chapter presents a five-part model for designing effective advertising programs with a particular emphasis on product positioning objectives. The concluding sections focus exclusively on personal selling and sales management as essential weapons within the promotions arsenal. A sales process model is developed, and issues related to sales force recruitment, training, and compensation are discussed.

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Most effective advertisements and sales presentations share one important similarity: They tell stories. The experiences of one metro Milwaukee family illustrate the difference that a story can make. The family was faced with the difficult task of finding the right skilled nursing facility for Lois, the 87-year-old family matriarch. They met with representatives of two suburban facilities who made very similar presentations. Each stressed the high quality of skilled nursing care, Medicare certification, recreational therapy programs, nutritious meal plans, pastoral care, and the availability of many special programs and activities. One offered a more comprehensive physical rehabilitation program and the other had a lower staff-to-resident ratio, but they seemed essentially the same. The third facility that they visited was not appreciably different from the other two. The services and facilities were of equally high caliber and the range of opportunities available was comparable. The presentation made to the family, however, was substantially different. Rather than meeting in a conference room, the center's representative escorted the family throughout the complex, explaining how each of the areas and facilities would meet their family member's needs. Women were having their hair and nails and done in the on-site salon. Wheelchair-bound residents were playing a game called balloon ball in a large recreation room. One small group of seniors was in the midst of a book club discussion while another was playing cards. The family and the guide also visited a few of the residents in their rooms.

At each stop along the way, the center's representative related short personal vignettes about some of the residents' interests and activities. She stopped to introduce some of the residents along the route and let them relate their own experiences and opinions about the facilities. She answered all of the family's questions as they arose . . . questions that had not even occurred to them when visiting the other facilities.

The facility's representative was effective because she was able to provide a living illustration of how this nursing home was the caring solution to the challenge the family confronted. Most of all, the family was able to visualize how this facility would meet their loved one's needs. They made their decision that afternoon and felt far better about it than they had thought possible.

11.1 The Promotions Mix

The promotions mix is a term used to refer to "the various communication techniques such as advertising, personal selling, sales promotion, and public relations/product publicity available to a marketer that are combined to achieve specific goals" (American Marketing Association, 2012). In most instances, the goals relate to informing prospective buyers about specific brands and persuading them to buy. The significance of a promotions mix concept rests in understanding that although each of the ingredients has significant potential in its own right, the net impact of each ingredient can be significantly enhanced when used in conjunction with other elements. Integrated Marketing Communications (IMC) is a term sometimes used to refer to the coordination of the promotions mix, in support of a product or service, to maximize the persuasive impact on the intended audience in the most financially efficient manner possible.

Consistent with the IMC concept, all of the elements of the promotions mix should work together and reinforce each other to promote a brand such that the combined persuasive impact of the promotional parts is greater than the sum of the individual ingredients. That is, all of the parts of the marketing communications plan should be both complementary to each other and synergistic in their combined impact. The four promotions options available to marketing managers are introduced in the sections that follow. Each alternative possesses specific strengths and is especially well-suited to specific situations and opportunities. Following this introduction, the balance of the chapter focuses on the two primary elements of the promotions mix: advertising and personal selling.

Advertising

Advertising refers to any paid form of nonpersonal communication between a seller and potential buyers. It is a paid form in the sense that it compensates media outlets to deliver the advertiser's message. Traditional media include television, radio, newspapers, magazines, trade shows, catalogs, and direct mail. These media options have provided one-way communication from the seller to the consumer with very little interaction between the two. However, marketers are increasingly using the Internet and social media to interact with consumers and tailor the content of ads to relevant personal characteristics of the prospective buyer. The significance of these emerging media options to marketing communications is investigated in Chapter 13.

Marketing plans for both consumer and industrial goods have relied on mass media advertising to reach potential buyers for hundreds of years. It gives the advertiser complete control over the content of the message being delivered and can reach a very large audience very cost effectively.

Advertising also offers marketing managers substantial creative flexibility, depending on the specific class of media being considered. Television provides nearly limitless options in the expression of action, color, and sound. Radio is more restricted in its technical capabilities, but it often relies on appeals to the audience's imagination or theater of the mind. Print, electronic, and online media possess specific inherent strengths and weaknesses as well. However, all media have the power to foster a wide range of emotions when used to their greatest potential. Consider the following examples. Each conveys substantially different emotional appeals while relying almost exclusively on a single image or photograph to communicate the intended impression or meaning.

Think About It

Examine the following ads. Can you identify the emotional button that each is trying to press?

Why would the emotion triggered by the advertisement be an effective way to promote the product or message that is featured?

Polar bear holding a Coca-Cola bottle(left); Calvin Klein billboard advertisement for their denim products (right).

Associated Press

Billboard advertisement for the ASPCA

Associated Press

Though advertising offers several advantages over other promotions alternatives, its impact and value may be substantially limited due to the crowded media marketplace. Most consumers are bombarded daily by hundreds of advertisements. Breaking through the clutter to achieve a significant impact on your intended audience can be difficult. Although carefully selected advertising media vehicles can make reaching your audience cost effective, the success of an advertising campaign in influencing your target market is often dependent on the creative impact of your message and execution.

Personal Selling

In contrast to advertising, personal selling is a form of promotion that involves personal interactions between company representatives and prospective customers. More specifically, the seller's direct contact may be with any individual at the buyer's organization who is likely to have a role in the purchasing decision. Personal selling can take place via face-to-face meetings, telephone conversations, videoconferencing, or other interactive media.

Personal selling is a process of persuading others that often relies on a combination of spoken and written communication. It almost always plays a more prominent role in the promotions mix for business-to-business than those selling directly to end consumers. The most common exceptions occur for "big ticket" consumer items such as cars, real estate, and investments. The greatest advantage to be found in personal selling is its interactive nature. Salespeople can refine and reshape their message to prospective buyers based on the feedback they receive during the sales call. Each sales message can be uniquely tailored to the needs of the individual customer, and the buyer's specific questions or objections enable the seller to focus its energies on addressing those issues of greatest concern. This is particularly critical when the product being promoted can be custom designed and the terms of sale are negotiable.

The primary limitation of personal selling relative to other forms of promotion is cost. Recruitment-, training-, and compensation-related expenses make sales calls far more expensive on a per-customer basis than advertising. The impact, however, should also be substantially greater. Whether personal selling is a viable option for a given product is simply a function of the costs of selling relative to the profitability of each sale. Consider how cars have been traditionally sold. They are sufficiently sophisticated and complex to warrant having a trained professional assist prospective buyers. The profit margin realized from the sale of new cars is sufficient to compensate a salesperson for his or her work. We'll discuss personal selling and advertising in more detail in upcoming sections.

How They Sell

The relationship between buyer and seller is so important that it is now an academic study. A researcher watches how the sales representative guides the customer through a sale. What is the salesperson's role in the customers' shopping experience?

Sales Promotions

Sales promotions are short-term price incentives intended to encourage customers to buy a specific brand within a specified time frame. The objective of most sales promotions is to build sales volume in the near term by lowering the price paid by the buyer. Common forms of business-to-consumer sales promotions include discount coupons, rebates, and point-of-purchase savings. Other types of B2C sales promotions are intended to boost sales by providing nonprice incentives. These include contests, sweepstakes, loyalty programs, free product trials, and free product samples.

Smucker's jelly on sale for 2 for $4 on store shelves.

Quantity discounts, like these 2 for $4 promotions on Smucker's products, are intended to build sales volume at a reduced price.

Associated Press

Sales promotions aimed at distribution channel intermediaries (wholesalers and retailers) are also used extensively in business-to-business marketing programs. Usually termed trade promotions, they include different types of manufacturers' efforts to support existing channels of distribution and encourage the development of new ones. These include cash incentives, sales contests, merchandising support, and quantity discounts on purchases made within a fixed interval.

Sales promotions can be very effective in generating short-term sales for a product. They can be particularly effective in markets where brand loyalty is low. Many types of B2C sales promotions can be effective in stimulating customers to try new brands and new products, especially when paired with corresponding B2B incentives to support channel participation. Loyalty programs such as frequent shopper cards and buy-one-get-one-free promotions, in turn, are often used to reinforce brand loyalty.

The primary disadvantage to most forms of sales promotions is the emphasis on price. Discount coupons, for example, are intended to stimulate sales by reducing the buyer's cost to purchase. The satisfaction derived from the purchase is intended to come from the product, not the savings. However, in product markets where discount coupons are frequently used by competing brands, customers come to expect them and may be unwilling to make a purchase without one. The loyalty, purchase satisfaction, and positive reinforcement in this instance have been transferred to the coupon redemption experience rather than a brand. If all competitors engage in competitive couponing, each brand suffers a corresponding loss in per-unit profit margins and no one wins.

In most marketing contexts, sales promotions are subordinate to other elements of the marketing mix rather than operating independently to achieve specific goals. They are most commonly used in support of related pricing and advertising tactics to provide short-term incentives. As illustrated in Chapter 9, consumer-directed sales promotions such as coupons and price dealing are often used in the introductory stage of the Product Life Cycle (PLC) to encourage innovators to try the product and early adopters to accelerate the process of building sales volume. Sales promotions targeting resellers can also be effective during this stage of the PLC by promoting the development of distribution networks.

A distributor's commitment to promote and distribute a new brand is often a direct response to the incentives provided by the manufacturer. The stimulus to buy and resell throughout the channel of distribution is usually a function of pricing and the strategic use of promotions to either push or pull the product through the channel. Chapter 12 provides a detailed examination of the role played by sales promotions in managing and promoting product distribution.

In later stages of the PLC, sales promotions are a tactic used primarily in conjunction with advertising to battle for brand sales in fast-growing product markets. As competitive rivalries heat up in the growth stage, the role of sales promotions is primarily oriented toward building and protecting market share. Similarly, the primary role of sales promotions in the maturity phase of the cycle is to capture market share from competitors in relatively stagnant product markets. As market growth turns negative, brands often rely on sales promotions to reinforce existing levels of sales volume.

Public Relations

Public relations are nonpaid, impersonal promotional communications distributed via the news media or other vehicles outside the direct control of the seller. Publicity is the most common form of public relations used to disseminate information about a company or product, and traditional news media provide the most common medium of communication. The public relations, or PR, activity usually takes the form of feature articles or broadcast stories intended for customers, shareholders, or other stakeholders. However, companies are increasingly reliant on the Internet and nontraditional media to reach their intended audience. Many companies employ public relations firms to assist in the placement of stories in media that will most efficiently and effectively reach their target audience.

The Johnson & Johnson Campaign for Nursing is a multimedia public relations program intended to reinforce the company's image as a leading producer of health care products. The focus of its message is that the company supports nurses as the pivotal players in providing direct, hands-on care for patients. Its website (http://www.campaignfornursing.com), press releases, instructional materials, and scholarship programs emphasize the company's dedication to supporting caregivers rather than promoting the products it sells. This linkage between the company and a commitment to nursing is designed to enhance the target audience's appreciation of Johnson & Johnson as a trusted name that truly cares for its customers.

Public relations has the potential to provide favorable exposure for a company or product without direct payment to the publisher or distributor of the information. Since the information reaches the audience from an independent and trusted news source, it tends to be regarded as more credible than paid advertisements in the minds of receivers. It also has the advantage of being relatively inexpensive to produce.

The primary drawback associated with public relations as a promotional tool is that it is not reliable. The sponsoring firm has little control over independent media's decision to carry the stories. The media outlet may choose to ignore it, use only a portion of it, or release it at a time that is not well suited to the needs of the sponsor. The growing influence of the Internet as a form of nontraditional media, however, has provided a wide array of alternatives. In addition to creating unique, issue-specific websites, companies can collaborate with a vast range of potential partners in both the for-profit and nonprofit sectors to get their message to the intended audience.

Adverse events beyond the immediate control of the firm always have the potential to produce negative publicity for an organization. Financial misconduct on the part of company officials, catastrophic product failures, environmental disasters, and human resource–related failures can all create unwanted news events. In those instances, many companies will rely on public relations firms to assist them in damage control operations and managing the flow of information from inside the firm.

Think About It

Each of the four elements of the promotions mix has certain advantages and disadvantages, depending on your objectives in using them.

Which of the four would be best if your goal were simply to reach as many people as possible with a message for the lowest possible cost?

Which ones would probably be most cost effective if you wanted to target horse owners with an advertisement for cowboy boots? If selling these boots really depended on having an interactive conversation with prospective buyers to explain why they are so special, which option would be best? If you had no money to spend on promoting these amazing new boots?

What if the objective were to sell as many cowboy boots as quickly as possible? What combination of promotions might work best?

The balance of this chapter focuses exclusively on two primary elements of the promotions mix: advertising and personal selling. The first sections examine the rationale and marketing logic that support the development of effective advertising programs. This is based on a five-part process model that depends on the meaningful translation of the brand's target market to a clearly defined target audience. The concluding sections of the chapter focus on personal selling with an emphasis on working with prospective clients to meet their needs as the cornerstone of effective sales programs.

11.2 Advertising Communication Objectives

As noted in Chapter 6, the final outcome of strategic planning at the brand level will always be a positioning strategy. In that sense, positioning will also always be the primary objective for marketing communications. Positioning is a complex construct based on understanding how target consumers' preferences are shaped by their perceptions of product attributes and brand-specific benefits. The execution of the promotions mix plays a critical role in operationalizing this strategy through ad messages, sales presentations, sales promotions, and public relations efforts. That is, the promotions mix for a given brand reflects the marketing manager's plan for how the organization and brand will relate to its customers and competitors.

To be effective, all of the elements of the promotions must be integrated, targeting the same goals. Brand positioning provides the broad strategic objective for the promotions mix. However, the means by which this ultimate goal can be achieved depends on a mix of three specific communication objectives that must be met over the life cycle of the product: creating brand awareness, promoting brand preference, and reinforcing past purchases. Although each of the elements of the promotions mix can make significant contributions toward achieving these goals, our focus for this section of the chapter will be on the role of advertising.

Creating Brand Awareness

Recall from Chapter 9 that a fundamental role of advertising and other forms of promotions in the introduction stage of the Product Life Cycle is to inform prospective customers of the brand's existence. This is true for both the initial stage of wholly new product categories as well as the introduction of a new brand to an established product market.

Chobani Greek Yogurt on a refrigerator shelf.

Even in a seemingly stable market like yogurt, marketers continue to create and reinforce brand awareness. How does the introduction of new brands and varieties play into this process?

Associated Press

The initial objective of advertising aimed at reaching innovators and early adopters with information about the availability of a new, innovative product is typically geared toward informing prospects about its existence. A shift in emphasis to relaying information about brand-specific attributes and benefits will take place once competitors enter the market. When yogurt was first introduced to the United States as a specialty health food in the 1950s, the initial promotional objective was to build product-level awareness, stimulate consumer interest, and create primary demand. The importance of creating brand awareness grew as category sales developed over time and competing brands entered the market.

Once the category was established, brands such as Dannon, Breyers, Colombo, and Yoplait sought to establish unique identities within the competitive market. Even in a seemingly stable market, the process of creating and reinforcing brand awareness continues to evolve. In 2011, the Breyers yogurt brand was discontinued in favor of Yo Crunch. In that same year, the Colombo brand name (the oldest of the U.S. brands) was discontinued in favor of General Mills' exclusive focus on the Yoplait brand (Unilever USA, 2012). New flavors, brands, and varieties (e.g., light yogurt, Chobani Greek Yogurt) also require advertising and other promotions to build initial awareness.

Promoting Brand Preference

Promoting brand-specific preference in competitive markets is not entirely independent of building brand awareness—consumers cannot prefer brands of which they are not aware. The desired outcome in promoting brand preference is to build and reinforce selective demand for a specific brand by promoting favorable attitudes toward the brand. This requires persuasion. Persuasion within the context of marketing is defined as "changes in consumers' beliefs and attitudes caused by promotion communications" (American Marketing Association, 2012).

As discussed extensively in Chapter 5, attitudes are the powerful personal factors that direct which brands consumers will buy. The multi-attribute model of attitude formation defines attitudes toward brands as a composite of beliefs about attributes that the buyer regards as essential to the product, weighted by the importance of those categories of beliefs. In short, attitudes measure how prospective customers evaluate the bundle of benefits provided by competing brands relative to their specific needs. Marketers' understanding of this multi-attribute perspective on persuasion is readily evident in advertising strategies that are used in every area of B2B and B2C marketing. In fact, it is difficult to find ads within competitive product markets that do not rely on the promotion of specific attributes and benefits to create a favorable positioning strategy. Each of the following ads emphasizes a specific attribute or benefit as the basis for persuading readers to buy their brand instead of competitors' brands.

In some instances, advertisers will use comparative advertising to draw explicit and direct contrasts between their brand's unique characteristics and those of competitors. The distinctive feature of comparative ads is that competing products are identified by name. To make comparative ads maximally effective, the point of contrast between brands needs to be on the product features that the target audience regards as most critical to their satisfaction with the purchase. Consequently, comparative ads for food products typically focus on taste. However, better nutrition or greater convenience would be appropriate claims if these attributes represent key considerations for the target market. Similarly, comparative ads for cars should stress economy, performance, or safety in accord with the priorities of the target customer.

Cobb Cycling bicycle seat ad (left); Doritos Locos Tacos ad (right).

These ads highlight what sets their products apart from the competitors. How might a guarantee or novelty shell distinguish these products from others in their category?

Cobb Cycling/Associated Press

Think About It

Select a product category and collect ads from four of the leading brands. Based on these messages, define how they are being positioned relative to each other.

Are any of the companies using a comparative ad strategy?

Reinforcing Brand Preference

In many mature markets, the absence of overall sales growth for the category fuels aggressive competitive rivalry for market share. Consequently, brand managers rely on advertising to defend their position and share against the threat posed by established competitors and occasional new entrants. Prevailing levels of customer satisfaction within the established target market depend on the perceived value of the brand and buyers' perceptions of value relative to competing brands. In this sense, successful positioning represents both the building up and the maintenance of a desired brand identity, as well as successfully defending it against the attacks posed by competitors.

Reinforcing brand preference within one's existing customer base is an essential advertising function. A brand image created and maintained by years of extensive promotions and positive customer experience represents a tremendous investment to create positive brand equity. Consequently, reinforcing brand preference and positioning through ongoing investments in the promotions mix is a financially sound decision. This basic goal can be pursued by marketing managers in several ways.

Reminder advertising is a term sometimes used to identify ads intended to keep already familiar products readily available in the minds of consumers. This effort to promote top-of-mind awareness is intended to trigger the desired brand choice when the buyer is ready to purchase. The emphasis is on reinforcing the familiarity of a trusted brand name rather than providing reasons to buy the product.

Some reminder advertising is linked to specific purchase occasions. Cross brand pen and pencil sets are often promoted as high school graduation gifts. Samsonite brand organizers and briefcases are sometimes featured as gifts for new college graduates. Prestone antifreeze focuses reminder ads near the start of winter, while Contac allergy-relief products place more emphasis on the early spring.

Campbell's soup on sale in a grocery store.

Campbell's annual back-to-school sales aim to lock out competitors by encouraging consumers to stock up on an affordable meal option that fits into their busy schedules.

Associated Press

For more frequently purchased products, advertising messages are sometimes used to remind customers to stock up on their favorite brand. Stock-up sales encourage multiple purchases and build sales volume over specified periods. Sales promotions and price discounts are often used to reinforce the call to buy now. But these types of events also have the potential to protect a brand's core customer base by blocking out competitors for several purchase cycles. Consider Campbell's annual back-to-school sales on a wide range of soups and shelf-stable healthy meal ideas. The changes in daily routines that come with a new school year provide a good opportunity to feature several products. However, encouraging customers to stock up on several months' worth of tomato soup or sloppy joe mix also locks competitors out of these households and provides opportunities to reinforce brand preference through direct experience and satisfaction with the brands. This technique is sometimes referred to as pantry management, since the goal is to directly influence the range of brands and products in the customer's home.

Well-designed advertising programs have the potential to accomplish these three types of objectives: creating brand awareness, promoting brand preference, and reinforcing past purchases. The section that follows investigates how advertising works and the processes that govern the impact of advertising messages. The two alternative types of models considered here are hierarchy-of-effects models and the Elaboration Likelihood Model. Following the presentation of these process models, the final section on this topic delves into the specifics of how to design efficient and effective advertising programs.

11.3 The Marketing Communications Process

Sustained levels of profitability and acceptable rates of return on invested financial resources are two of the primary goals driving brand management decisions. Within this context, expenditures on advertising and promotions can be regarded as investments in future sales. However, there are intermediate communication goals that must be accomplished to build the brand and achieve the desired positioning strategy that ultimately drives product sales and profitability. Throughout its history, the discipline of marketing has developed several models that try to describe how advertising creates positive sales responses within target audiences. This section introduces two alternative perspectives on the process: hierarchy-of-effects models and the Elaboration Likelihood Model.

Hierarchy-of-Effects Models

Figure 11.1: The AIDA hierarchy-of-effects model

AIDA hierarchy flows: awareness, interest, desire, and action.

Adapted from AIDA sales funnel, http://www.mediacontour.com/blog/2012/07/the-marketing-landscape-aida-and-social-media/#more-854

The premise of all hierarchy-of-effects advertising models is that the message must move its audience through a sequence of stages in order to effectively impact behavior.

Hierarchy-of-effects models of communication include several conceptual representations of how advertising elicits responses from an audience. This concept is "based on the premise that advertising moves individuals systematically through a series of psychological stages such as awareness, interest, desire, conviction, and action" (American Marketing Association, 2012). Each step of the hierarchy represents a cognitive stage or mental state that the message recipient must move through before deciding to purchase the advertised brand. Each step represents a response hurdle or threshold that must be overcome for the ad to be effective in persuading a prospect to buy.

Although several models have been proposed, they typically share four common steps, as shown in Figure 11.1: awareness, interest, desire, and action.

Another characteristic that hierarchy-of-effects models share is that the proportion of prospective buyers remaining subject to the influence of the advertisement declines as the audience moves through each of the stages. That is, each successive stage eliminates some percentage of prospects from considering the advertising message any further.

Awareness

The minimum requirement for any advertisement to impact the attitude or behavior of a message recipient is awareness. This represents the first hurdle or prerequisite that an ad must surmount to be effective. If the brand is unfamiliar to the audience, building brand name recognition or awareness may be the primary objective of initial messages within an advertising campaign. This is often accomplished through the presentation of simple messages with high levels of brand name repetition.

Morris-the-Cat being photographed by press people.

Brand must remain the focus of an advertisement. Morris the Cat provides a good example of how brand can become lost when too much emphasis is placed on capturing the consumer's attention.

Bettmann/Corbis

Advertisers have a vast array of techniques at their disposal to gain an audience's attention. The use of attractive stimuli (babies, puppies, fashion models, humor, action, exciting sporting events, etc.) can momentarily secure the attention of many viewers. However, for the ad to create brand awareness, these unconditioned stimuli must be successfully paired in the viewer's mind with the brand being advertised. This principle of classical conditioning was introduced in Chapter 5. The brand itself must be featured as the focal point of the message and not get lost by the impact of the attention-getting devices. This problem plagued early advertisements that featured a finicky cat named Morris. Everyone seemed to recognize and like the persnickety cat that was very particular about the food he ate. They remembered the antics and plot lines for the short Morris-the-Cat vignettes that went into the 30-second television ads. But relatively few people remembered the brand name of the cat food. Morris is still the official spokesman for the brand after more than 40 years on television, and his face is still on the product packaging (Del Monte Foods, 2012). But can you name the brand he represents?

Interest

Simply being aware of the advertisement at a relatively low level of attentiveness can effectively make prospective customers aware of the seller's brand name. However, a deeper level of involvement with the message is required to make the prospect interested in what you have to say. Consequently, once an audience's attention is initially captured, the next objective is to convey information or images that relate to the target audience's product-related wants and needs. In a sense, the goal at this stage is for the advertisement to convince the recipient that what it has to say is worth the audience's time and commitment.

Continuing with the Morris the Cat example, the brand name behind this celebrity feline is 9 Lives cat food. If the use of the world's most finicky, yet adorable, cat is initially successful in capturing the audience's attention, the brand then needs to provide information of interest and direct relevance to the prospective customers. If the target audience is new cat owners, then information on the nutritional needs of cats and corresponding characteristics of 9 Lives Daily Essentials would be appropriate. For the owners of older cats, messages related to the particular benefits of the Long Life or Plus Care lines would be of greater interest.

Desire

Once the target audience has acquired information about the brand, the question remains: Based on the advertisement, do they like it? Well-designed ad messages seldom alienate prospective customers, but most of them fail to create a real desire to purchase the brand. Creating an initial preference for the brand over others in the category is a very lofty goal for an advertising campaign. However, if consumers are unfamiliar with the specific brands within a category, a tentatively positive impression and speculative level of preference may be enough to prompt a trial purchase. If the buyer attends to the message and perceives a close fit between his or her product-related needs and the promises made by the brand being advertised, this is a feasible outcome.

Think About It

Let's consider the odds against advertising. Several formulations of the hierarchy-of-effects model include provision for the statistical likelihood of moving from one stage to the next. Assume that you have 100,000 cat owners in a television audience of 1 million.

What is the likelihood or probability that cat owners would pay attention to your ad? Fifty percent? So now you have 50,000 prospects. What is the likelihood that any one of those 50,000 will have an interest in cat food that specifically promotes the urinary tract health of older cats? Ten percent? So now you have 5,000 prospects. How many of them would cross the threshold from interest to desire to buy this brand after seeing the ad? Five percent? That leaves you with 250 prospects from the initial audience of 1 million viewers. How many of them are likely to follow through and remember to buy the product the next time they're shopping for cat food? If you spent $3.5 million for the 30-second message on television to reach the total audience of 1 million, how good is your return on investment likely to be?

In what ways is this one isolated example likely to underestimate the potential power and value of advertising?

Action

If an advertisement has been successful in moving some members of the target audience through the first three stages of the hierarchy of effects, a significant portion of these prospects is available to purchase the advertised brand. The probability of following through with this intention usually increases with successive exposures to the same or similar messages.

Marketing managers need to be realistic and sometimes skeptical when considering the sales potential that is directly attributable to an advertising message or campaign. To bolster the impact of advertising, sales promotions (e.g., coupons, sweepstakes) are sometimes used to stimulate the desire for a product when the core advertising message is ineffectual or the brand is difficult to differentiate from competitors.

Arriving at this final stage of the model requires that consumers have become aware of the featured brand, grown interested enough to attend to its unique benefits, and developed the desire to buy the brand. The fundamental principle underpinning the hierarchy-of-effects models is that attitudes toward brands are initially shaped and subsequently altered by an advertisement's ability to lead a prospect through this sequence of cognitive steps or hurdles. The model requires that the cognitive activity required to overcome the obstacle posed by each stage be completed before progress to the next level is possible. Ultimately, hierarchy-of-effects models assume that persuasion is contingent on learning and recalling specific information from an advertisement. An alternative model for understanding how advertising communications work to impact buyers' attitudes is the Elaboration Likelihood Model.

Elaboration Likelihood Model

The Elaboration Likelihood Model (ELM), depicted in Figure 11.2, proposes that there are two distinct paths by which an advertisement may persuade a prospective customer: central route and peripheral route (Petty and Cacioppo, 1986). The central route to persuasion closely resembles the hierarchy-of-effects model insofar as it requires the thoughtful evaluation of the message contents. It is sometimes called the high involvement route since it requires the active cognitive participation or message elaboration on the part of the receiver. It is operative when the audience is motivated to pay attention to the advertisement and acquire meaning from it.

Figure 11.2: The Elaboration Likelihood Model

ELM model showing alternative paths to shaping attitudes.

http://mypages.valdosta.edu/mwhatley/7670/activity/attitude.htm4

The Elaboration Likelihood Model of persuasion illustrates alternative paths to shaping attitudes via the central route and peripheral route.

The peripheral route is engaged if the audience responds to the message based on cues in the advertisement other than the relative merits or quality of the arguments or concepts being presented. This would be the case if someone looking at a magazine advertisement for nonprescription pain relievers found the claims made for the brand to be credible based on the photo of a distinguished looking man in a white coat seated in front of a microscope. The image has no direct bearing on the product claims. However, if the illustration of scientific research makes the reader trust the message, this result is due to these cues in the ad rather than the informational content of the message.

Many types of peripheral cues may influence an audience's response to an advertised product. These include the use of attractive and expert spokespeople. The use of cultural celebrities and athletes as either implicit or explicit product endorsers can make the message more impactful. Similarly, babies, puppies, and kittens can also make a positive impression. Pleasant sensory stimuli such as landscapes, fine art, and music can also be used. The number of concepts or arguments presented in an ad, rather than the content of those arguments, can also impact the persuasiveness of an advertising message.

In contrast to the relatively high level of involvement evident in the central route, the peripheral route is engaged when the audience lacks the motivation to actively think about the information content of the message. In some instances, attitude shifts are attributable to the repeated pairing of the brand with a positive sensory or emotional stimulus via classical conditioning.

The persuasive power related to each alternative route is substantially different. Attitudes that are shaped or changed via the central route tend to be more persistent, more resistant to the effects of competing advertising claims, and more directly predictive of actual buying behavior (Petty and Cacioppo, 1986). Attitude shifts that result from peripheral route processing tend to be weaker and less reliable over time, since the changes are based on non-product-related cues within the ad. The lack of involvement or audience motivation associated with the peripheral route also contributes to the relative weakness of these effects.

However, the significance of attitude change facilitated via the peripheral route should not be dismissed. As discussed in Chapter 5, consumers learn a great deal about the brands they buy via classical conditioning. The repeated pairing of favorably viewed stimuli with the advertised brand can make significant contributions to establish the brand's market position independent of the brand's performance attributes and characteristics. The relative significance of peripheral route persuasion to the successful positioning of a brand is also enhanced by consumers' general lack of interest advertisements. Consequently, attitude change strategies that can be effective even when buyer involvement with the message is low are important strategy options.

The value of the ELM of advertising effectiveness lies primarily in its recognition of the two alternate routes to persuasion. It complements the traditional hierarchy-of-effects models insofar as it explicitly recognizes that audiences do not necessarily have to be involved and actively thinking about advertisements for them to be persuasive. It acknowledges that advertising can be effective, even when received passively—the way that most people engage most advertising. The final section on the topic of advertising explores how to translate this understanding of how advertising works into specific guidelines on the design of effective advertising programs.

Think About It

Consider the following advertisements.

Which elements of each ad will be most effective for an audience actively engaged in central route processing of information?

Which features would be more likely to influence people passively responding to the ads via the peripheral route?

Gucci bag advertisement with a model holding a Gucci purse (left); J.C. Penny advertisement for the "Best Price Friday" campaign.

Associated Press

Cadillac advertisement for the "Life. Liberty. And The Pursuit." campaign.

Associated Press

In Depth: Influential Works on Advertising Strategy

Two publications from the 1980s have had an enduring and profound impact on the way marketers think about advertising strategy. Communication and Persuasion: Central and Peripheral Routes to Attitude Change (Petty and Cacioppo, 1986) introduced the Elaboration Likelihood Model. This model addresses the question of how audience involvement impacts advertising effectiveness and was discussed in the previous section on the process of communication.

Positioning: The Battle for Your Mind (Ries and Trout, 1981) popularized the concept of product positioning as a fundamental objective of the marketing process. The essential argument made by the authors is that marketers need to appreciate the limitations of mass media advertising and design messages that can be effective within these constraints. They point to information overload as the biggest challenge confronting brand managers. Consumers are simply overwhelmed by competing mass media advertising messages and overcrowded markets that are populated by too many competing brands. Compounding the effect of these unfavorable factors is that most consumers are simply not motivated to pay much attention to product advertisements.

The authors' solution to effectively promoting a brand within the context of all this noise is to focus on delivering simplified, easily understood messages that capture the vital essence or distinctive meaning of the brand in ways that break through the clutter. This provides the basis for competing for one's place, or position, in the mind of the consumer. These simplified messages or themes provide the platform from which to pursue all three of the primary goals of promotions: inform, persuade, and remind.

Many classic ad campaigns that initially pursued this strategy long ago are still in use today. Wheaties: Breakfast of Champions. Avis: We Try Harder. Seven-Up: The Uncola. BMW: The Ultimate Driving Machine. Visa: It's Everywhere You Want to Be. Maxwell House Coffee: Good to the Last Drop. American Express: Don't Leave Home Without It. Maytag: The Dependability People. Can you think of any others?

11.4 Designing Effective Advertising Programs

Advertising is one of the most common and vital methods by which companies communicate with current and prospective customers. It also represents a tremendous investment for many organizations relative to their size. Consequently, it needs to be designed to be as effective and as efficient as possible. There is a wide array of step-by-step models to assist marketing managers in creating effective advertising programs. The one briefly presented here focuses on the five essential issues that a marketing manager needs to address when developing an advertising program blueprint for a specific brand. Those issues include specifying the target audience, establishing a budget, designing the message, selecting and planning media, and measuring results.

Specify the Target Audience

The deployment of advertising and other promotional resources for a given brand is dependent upon the strategic goals for market segmentation, product differentiation, and positioning. The marketing manager's understanding of the typical target customer's preferences and motivations provides the platform developing an effective advertising program. The first step in the process is to translate this understanding of the target market into a meaningful target audience description.

The target market profile developed through extensive and detailed market research usually provides more information than can be meaningfully used in planning an advertising campaign. The target audience needs to be defined in terms that relate to the selection of both efficient advertising media and effective advertising messages.

The target audience for an advertising campaign is typically defined in terms of market demographics and psychographics. Syndicated media rating and research services such as The Nielsen Company, Simmons Market Research Bureau, and Mediamark Research provide data on several key audience demographics. These include sex, age, household income, marital status, education, employment status, type of residence, and family size. If an advertiser sought to reach a target audience composed of households with annual incomes greater than $70,000 and children under 5 years of age, the information necessary to match a good advertising vehicle to this description is readily available. In addition to relying on syndicated data sources, the media outlets themselves readily provide detailed demographic and psychographic audience profiles to prospective advertisers.

Although psychographic data can be important to the selection of media, they are critical to the development of advertising messages. The benefits that prospective buyers are seeking from the brands they purchase are easily the most central consideration when creating the advertising message. However, other psychographic factors can be used to enhance our understanding of how consumers related to products. These factors include personality traits, social attitudes, shopping habits, and other personal interests. Incorporating this knowledge into the development of messages enables advertisers to make the ad more personally relevant.

Think About It

Go to YouTube.com and select a television advertisement at random. Watch the ad two or three times and pay careful attention to the scene, setting, music, use of imagery, etc.

Based on your analysis, what psychographic considerations went into the development of this message?

Do you think they helped the advertisement communicate more effectively with its intended audience?

Establish a Budget

Advertising budgets should be based primarily on the marketing and communication goals for the brand. However, planners also need to recognize that the funds allocated to advertising need to be treated as an investment against future sales rather than simply a cost of doing business. The level of expenditure should reflect an understanding of the cause-and-effect relationship between advertising expenditures and the consequent impact on brand awareness, positioning, and sales. Ideally, marketing managers would like to know what is being gained from each dollar spent on advertising.

Several types of considerations should be reflected in the process of setting promotional budgets. These include the prevailing intensity of competitive rivalry, growth rates within the product category, and level of brand loyalty within the target audience. Ultimately the question that needs to be answered is how an investment in advertising can improve the brand's position relative to consumer preferences and increase sales.

There are several methods that can be used to facilitate the budget setting process.

The percentage of sales method is commonly used, particularly by small businesses. This simple method only requires the advertiser to assign a fixed percentage of either past or anticipated sales and allocates those funds to advertising. The percentage is often chosen to achieve proportional parity with budgets for rival brands. However, this conservative approach fails to explicitly consider the objectives of the advertising campaign and may stunt market share growth by failing to recognize greater sales potential. A closely related variant of this method is simply to decide on an appropriate amount to allocate toward advertising each unit to be sold and multiplying this figure by the number of units anticipated to sell.

The objective and task method is favored by most large companies. Though it can take many forms, the basic premise is to fit advertising expenditures to overall marketing objectives. And although correct in principle, the practical limitation of this approach is that it requires determining the level of advertising investment required to achieve specific goals. This task increases in difficulty when the firm lacks experience in a given market or is confronting an unusually volatile competitive environment. The level of advertising required to achieve market share targets, for example, will depend in part on how aggressively the brand's closest rivals pursue the same objectives.

The competitive parity method sets spending at an amount proportionate to one's closest competitors. Brand market shares are often used to establish the budget ratios. The logic underpinning this strategy is that if spending for a brand is comparable to that of its competitors, it can defend the status quo within the market. Though unconventional, this type of strategy can be appropriate at times, particularly in latter stages of the Product Life Cycle.

The all available funds method—in which the firm devotes all financial resources not specified for other purposes to advertising—is an aggressive and risky approach to setting promotional budgets. Though not uncommon for startup businesses trying to increase brand awareness, it sacrifices alternative uses of funds (e.g., product development, acquiring new technologies, hiring specialists) and makes the company more vulnerable to unexpected problems. On the other hand, the pursuit of this strategy sometimes reflects market conditions where the anticipated rate of return on advertising expenditures is very high.

Design the Message

Although the creative work of designing advertising messages for large organizations is often assigned to specialists at advertising agencies, marketing managers need to be very involved clients. They must provide the direction to creative specialists by specifying the objectives of the campaign. Working within this role, it is essential to know the answer to two questions: What change is the advertisement intended to make in the minds of the audience and by what route is that change expected to take place?

The question of specific positioning-related goals has been addressed extensively throughout this chapter. The intention of the advertiser is to improve the perceived fit between the needs of the prospective buyer and the benefits or attributes associated with the purchase of the brand. This may include the need to build brand awareness, change perceptions of brand performance, or simply enhance the overall perception of the brand's image. Whether the advertisement is expected to accomplish its goals via the central or peripheral route has a profound bearing on how the message should be designed. In general, the creative design of all advertising messages is based on one of two appeal types: informational appeals and emotional appeals.

Informational advertising appeals relate primarily to the ELM central route to persuade the audience by emphasizing facts and arguments about the brand being sold. The strategy behind the message is to rely on cognitive reasoning and thinking to convince someone to agree with the point that the ad is making. This approach is sometimes referred to as either the rational or logical approach since it relies on the thoughtful consideration of a motivated recipient. The informational appeals that are most commonly used in advertising campaigns stress the specific product features and benefits of greatest direct relevance to the audience. Making the content personally relevant is likely to increase the viewer's involvement with the message being delivered.

An Hollister Co. advertisement.

Bloomberg/Getty Images

Orkin ad showing dangers of fleas, ticks and mosquitoes to household pets (left); Craftsman Halloween ad with brand message, "There's a Craftsman in all of us," above a skeleton made of tools (right).

PR Newswire/Associated Press

Advertisements frequently play on our emotions—the most common being fear, sexual attraction, and humor. Can you tell what emotions these ads play to?

Emotional advertising appeals relate primarily to the ELM peripheral route to persuade the audience by using both words and images to evoke an emotional response. Most often this type of advertising message tries to relate the product and brand being sold to the audience's basic psychological needs. These essential human desires include safety, acceptance, interpersonal interaction, love, happiness, and beauty. Simple messages make a promise to the audience that the featured brand can make their lives better in ways that relate to these needs. In contrast to informational appeals that seek to provide specific rationale to support the purchase of the brand, emotional appeals are not rational. They rely on the perception of positive associations between the advertised brand and other stimuli within the message. Among the emotions most commonly used in these types of ad campaigns are fear, sexual attraction, and humor.

The temptation is to draw a sharp and inviolable distinction between the two routes to persuasion and to assign each of the two types of appeals exclusively to one of these alternatives. However, this would not be accurate. Humor, for example, can be a very effective basis for making a positive brand impression via the central route to persuasion. Conversely, noting the impressive appearance of a list of reasons to buy a given brand may influence a prospect's attitude toward the advertised brand via the peripheral route.

Select and Plan Media

Media alternatives from broadcast, print, and online sources are evaluated according to their capacity to reach an audience efficiently. Managers assess alternative media channels by comparing their associated costs of reaching 1,000 viewers, readers, or listeners. This cost-per-thousand (CPM) ratio is computed by multiplying the advertising cost times 1,000 and dividing by the total audience.

However, not all television programs, magazines, radio broadcasts, and websites have comparable audiences. Consequently, the ability of each option to efficiently reach the target customer for a given brand is dependent on the composition of the audience. Based on the demographic and psychographic profile developed for the brand, each alternative advertising channel or vehicle can be evaluated based on the cost-per-thousand prospects (CPM-P).

In addition to identifying the most efficient media alternatives, media planners need to develop advertising schedules based on reach (R) and frequency (F). Reach is simply the number of different or unique prospects (individuals or households) that is exposed to a given advertisement over a specified interval. The most commonly used time frame is four weeks. Frequency is the average number of times that an average prospect will be exposed to the ad over the same time period. When multiplied (R x F) to provide an assessment of the overall impact from a series of advertisements over a specific period of time, the resulting measure is referred to as gross rating points (GRP). Media planners can define the communication objectives for a given media plan using these three interrelated measures.

Reach targets are set to reflect the ad campaign's goal in terms of the total number or percentage of prospects intended to receive the marketing communication. It is most often expressed as a percentage of the total target audience. If a media plan is designed to reach 25 percent of the total potential target audience for a brand over a four-week period, it has a reach of 25. Reach measures the accumulation of total prospects over time.

Just as reach measures the level of message diffusion within the target audience, frequency illustrates the rate of message repetition. In light of understanding how the central and peripheral routes of the Elaboration Likelihood Model work, it is evident that some types of advertisements require higher levels of repetition than others to be effective. For example, image-based ads intended to shape attitudes via the repeated pairing of stimuli over time (classical conditioning) may require a high number of exposures per prospect to be effective. Messages that require higher levels of repetition per prospect to influence brand attitudes via the peripheral route will require higher average frequency.

In practice, media plans need to identify the desired combination of reach and frequency. Higher reach goals mean that more people will be exposed to the message. Consequently, the scope of the ad's potential impact is expanded. Higher frequency may be a priority if relatively high levels of repetition are required to achieve brand-specific goals. Gross rating points reflect the combined weight of these two considerations. Given a limited budget, however, higher levels of one can be obtained only by sacrificing higher levels of the other.

A channel's ability to efficiently reach the target audience is not the only factor planners must consider when selecting media options. Characteristics that are intrinsic to the nature of the media itself must be taken into account as well. Television, for example, is an excellent option when the combination of sight, sound, and motion is required to convey the essential attributes of product. Local and regional radio stations offer excellent geographic selectivity but cannot illustrate the performance of a sports car in the same way that television can. The Internet offers the potential for direct interaction with customers in ways that cannot be matched by other options. However, it provides limited opportunities to reach some older and poorer segments of consumer markets.

Effects of New Media on Advertising

Digital video recorders enable viewers to quickly and easily skip over commercials as they watch television. Marketing experts assert that entirely new strategies are necessary to reach young people with commercial messages. Which new avenues are marketers taking to promote their product?

Measure Results

For marketing managers, the most significant measurement of advertising effectiveness usually takes place in assessing the results of a whole campaign rather than an individual advertisement. The basic measurement task requires assessing campaign outcomes against original objectives. Consequently, the meaningful assessment of an advertising campaign requires two sets of metrics: precampaign and postcampaign measures of the campaign's objectives.

Two levels or types of measurements are frequently used to evaluate campaign results. Communication tests refer to pre- and postcampaign comparisons on non-sales-related objectives. These could include goals such as increasing brand awareness, improving attitude-related measures, or increasing the level of brand loyalty. Though not directly reflected by product sales, these types of factors are readily subject to direct measurement through the use of consumer ratings.

Sales tests refer to the direct assessment of an advertising campaign's impact on brand sales. They reflect the need to recognize the significance of advertising expenditures as an investment in future sales and profitability. Though it may seem counterintuitive, it can be more difficult to accurately gauge the sales effects of advertising than the communication effects, since sales are influenced by a wide range of factors unrelated to advertising. The behavior of competitors with respect to pricing, product distribution, and all forms of promotion represent potentially confounding influences. Other environmental factors, such as extreme weather or momentous events, can also make it difficult to cleanly interpret the meaning of pre- and postcampaign sales data.

Despite the obstacles associated with measuring the impact of advertising, it is important to remember that the effective and efficient management of advertising is essential to achieving brand objectives. This, in turn, is dependent on reliable information; the relationship between communication and sales tests may help bridge the gap between short-term and long-term brand management issues. As suggested by the hierarchy-of-effects models, achieving the communication goals related to a brand (awareness, interest, desire) are prerequisites to the ultimate goal of action or sales. In some instances, the failure of a campaign to produce short-term sales improvements may mask its value in building the foundation for improvements at a later date. If a campaign is able to build brand awareness and interest in the near-term, it is likely to pay sales dividends at a later date. Consequently, relying on both types of measures will enable marketing managers to make better decisions about the true costs and benefits of advertising.

11.5 Personal Selling and Sales Management

Personal selling spans the promotions and distribution elements of the marketing mix. As part of the promotional program, the message communicated by salespeople must be consistent and integrated with advertising, sales promotions, and public relations. By directly serving the needs of channel intermediaries, the sales force provides a direct product distribution path to customers in many instances. In every instance, the sales force represents a critical, personal link between the buyer and seller.

Although sales positions fall into a wide range, it is useful to distinguish between four general classifications of sales functions: new business development, current account maintenance, sales support, and customer service.

New business development refers to the process of converting prospective buyers into current customers. This is a challenging task in highly competitive markets, but an essential one. Individuals who are particularly effective in bringing new customers to an organization are typically very well compensated. In many businesses, once an initial sale with a new customer is closed, the responsibility for maintaining a productive relationship with a satisfied customer is transferred to people specifically trained in account maintenance.

Customer service representative wearing a phone headset.

Customer service representatives assist customers who are having problems related to recent purchases. They make important contributions to satisfying customers and building brand loyalty.

Stockbyte/Thinkstock

Current account maintenance, sometimes referred to as account management, is directly responsible for maintaining the majority of sales revenue in most business organizations. This sales function is responsible for creating satisfied, loyal customers. In most companies, sales representatives involved in account maintenance have frequent opportunities to introduce new product lines to current customers. A particularly important sales function for this category is trade selling. Trade selling is focused primarily on maintaining the support of distribution channel intermediaries. Rather than selling to final consumer markets, the primary activity for sales representatives working in this area is to provide merchandising and promotional support for current customers. For some firms, this may include gaining the initial sales and product distribution support for new products.

Sales support describes several types of sales-related activities intended to facilitate the selling activities of other sales representatives. Groups in this category include technical specialists such as engineers and scientists who provide special product-related expertise in industrial sales contexts. Another form of sales support is missionary selling. This refers to company representatives who provide product-related information and advise prospective buyers on the merits of the company's brands, but do not make sales. This practice is most familiar in the pharmaceutical sales field.

Customer service includes a vast array of functions related to sales support and service to buyers after the initial sale. Company representatives working in this category primarily assist customers who are experiencing problems or have questions related to a recent purchase. Though not directly involved in sales, their contribution to promoting customer satisfaction makes this an important sales-related function.

The Selling Process

The fundamental advantage that personal selling has over other promotional alternatives is that it is a personal and interactive method of communication. This enables the sales representative to adjust and refine their message as they receive feedback from the prospective buyer. The most potentially effective salespeople are those who are best able to make the adjustments necessary to convincingly satisfy the objections, questions, and concerns raised by the customer. However, skilled sales reps can significantly improve their results by starting with the "right customer."

Beginning with the need to identify the right customer, this section identifies a six-step model of the selling process, as illustrated in Figure 11.3. To be clear, this is not a model about how to be a star salesperson; the focus here is to provide a model illustrating the steps involved in making a sale. Though presented as a step-by-step process, there are instances in which some steps are skipped or the successive order of stages is disrupted.

Figure 11.3: Six-step model of the selling process

Outline of six-step model of the selling process.

Though shown here as a step-by-step progression, the selling process can differ in number and order of stages.

Prospecting

The first step in the process of selling is to identify prospective customers for your goods and services. Prospecting is the set of activities required to identify potential buyers and generate sales leads. From the outset, it is important to recognize that the first priority should be to find customers that represent the potential for long-term relationships. Working from an understanding of the target market, the sales representative may rely on a variety of information sources to acquire the names of potential leads.

The potential sources of information for prospecting include referrals from current customers, suppliers, and other salespeople within the firm. Sales support and customer service representatives within the organization often identify potential prospects for field sales representatives. Other professional, business, and social contacts may also be valuable sources in the search for potential buyers. Impersonal sources used to generate sales leads include lists or directories from trade associations and business groups. Internet searches can also provide a wealth of opportunities to identify prospective customers based on the specific attributes of the target market.

Qualifying the Prospect

Before contacting a potential buyer, sales representatives need to determine if the individual or company truly represents a worthwhile investment of time and effort. Qualifying refers to the process of determining whether a sales lead has the potential to be regarded as a viable prospect. This is a critical determination, since salespeople have limited time to invest in the process of developing new customers. Salespeople must judge the value of the potential buyer relative to several considerations.

Ideally, a sales lead can be initially qualified or rejected by a salesperson prior to a first meeting based on company research. Otherwise-attractive potential customers can often be rejected at this preliminary stage based on two considerations. Customers whose financial situation makes them unable to afford or unlikely to pay for the product being sold are rejected without the need to investigate further. Upon closer inspection, some potential buyers are eliminated from further consideration if they lack the basic productive capacity, infrastructure, or other minimum standards required to make effective use of the product.

Consider a salesperson evaluating a new lead for the sale of high-capacity industrial paint spraying equipment. The company may be initially regarded as a potential customer because it operates a shop that applies custom finishes to earthmoving equipment. However, closer investigation may demonstrate that the type of powder coating being applied is incompatible with the spraying equipment being sold. Alternatively, the custom finishes may be a relatively small part of the company's operations and would not warrant making an expensive investment in a high-capacity system. However, in many instances, the judgments required to qualify a prospect cannot be made without contacting the potential customer.

Initiating Contact

Salespeople are often unable to fully qualify leads prior to making an initial contact; some information required to form a judgment can only be acquired through direct interaction. This preliminary stage of the selling process may include initial introductions, e-mail exchanges, telephone conversations, and face-to-face meetings. The salesperson's goal is to determine as much relevant information about the prospect as possible with as little time investment as possible.

Salespeople will try to determine several things about the prospect's situation at this stage. Does the buyer have a need that our products and services can fill? Do our products suit this customer's unique needs and situation better than competitors' brands? Has the company recently purchased a comparable product from a competitor?

Acquiring as much information as possible about how decisions are made is also of critical importance to the steps that follow. This includes learning who the key decision makers are and who has the authority to approve purchases. Learning more about the culture of the company and its structure may also be useful. In many instances, the amount of effort required to make the initial contact and qualify a prospect can be comparable to the level of work required in the stage which follows: making the sales presentation.

Making the Sales Presentation

The sales presentation usually takes the form of a scheduled meeting where the salesperson attempts to persuade the prospect to become a customer. Though the sales message is often built around the delivery of a prepared presentation, the occasion usually allows for an exchange of information between the parties. The formal, prepared elements of the sales presentation should serve as a platform to illustrate the product's attributes and benefits in light of the seller's understanding of what the buyer needs. The interactive give-and-take exchange between the parties enables both to refine their understanding of the potential fit between the product and buyer's requirements.

There are hundreds if not thousands of books on the art of selling and techniques for making persuasive presentations. However, the demands of each market and each customer interaction are unique. Consequently, developing a set of generic guidelines on the universally best sales tactics would be misleading. Nonetheless, the ability to listen to the concerns of the customer and adapt the content of the presentation to the situation is essential.

In many situations, sales representatives do not anticipate securing a commitment to buy from the prospect during the initial sales presentation. The first face-to-face meeting enables the seller to develop a personal relationship and rapport with the prospect. It can be an occasion to gather additional information about the buyer's needs and expectations. It also provides the opportunity to gauge the prospect's genuine level of interest in the product being sold.

In most situations, buyers will express concerns or raise questions about the specifics of the proposition being presented. These objections provide essential information to sales representatives insofar as they identify points of resistance or obstacles to making the sale. These objections may be expressed verbally or evidenced in the prospect's body language. The ability of the seller to overcome buyers' objections is not simply essential to eventually making the sale. Satisfying concerns raised by the buyer provides him or her with many of the most compelling reasons and persuasive arguments for buying the product.

Closing the Sale

Closing the sale refers to the point at which the salesperson attempts to get a customer to commit to buying a product or service. If the customer is unwilling to make a commitment, the relationship may end at this point unless the seller works to keep the door open to further discussions. If the invitation to close the deal is accepted by the prospect, the occasion marks the starting point for building an ongoing and mutually advantageous relationship.

Salesman and customer looking at a car for sale

The initial interaction with a prospective customer usually determines the likelihood of making a sale.

Flirt/SuperStock

Understanding when to attempt to close is among the salesperson's most difficult challenges. Even highly experienced professionals sometimes wait too long to ask for the order and lose the sale as their customer's enthusiasm or confidence starts to fade. Many sales representatives who are uncertain of the best time to close the deal will use a trial close.

A trial close is a technique used by salespeople to assess the buyer's readiness to make a purchase decision. It often begins by soliciting the buyer's agreement on minor selling points such as dates of delivery or credit terms. If the salesperson gets a positive response to these questions, he or she can be more confident in moving the buyer closer to making a commitment on the final sale. It is a low-risk strategy in the sense that a negative response does not terminate the discussion.

Think About It

Imagine that you're at a big-box electronics store talking to a salesperson about buying a new television set. After you seem to have identified the one you like best, she could simply try to close the sale by asking if you would like to buy it. Do you think that happens very often?

Isn't she more likely to ask if you'd like to take it home yourself or have it delivered? Or which room you think you'll put this set in? If you think this will look great in your living room? Or if you can imagine how much you'll enjoy watching the World Series on this television?

Retail salespeople rely on trial close techniques quite a bit. Why do you suppose they do that?

Maintaining Relationships

The initial sale to a new customer should be seen as a customer satisfaction challenge. Though it certainly represents current, one-time revenue for the firm, this transaction also holds the potential for subsequent sales to a loyal customer if the seller is able to reliably deliver on the promises that closed the initial sale. For this reason, this final stage in the model can be thought of as the starting point for the next sale. In simplest terms, checking back with customers to be certain they are satisfied is a fundamental obligation that companies often relegate to their customer service personnel. In many circumstances, however, it is desirable to have the salesperson who reached the agreement with the buyer maintain personal contact to be sure he or she is satisfied with the product purchased.

The level of customer service that is required to keep customers happy varies substantially with the product being sold. Complex, technical purchases that require expert installation or training may call for extensive interaction between the company's sales staff and the client long after the actual transaction has closed. Support for the sale of simpler products, however, can often be handled through existing customer service channels. In either case, creating opportunities to reinforce a positive relationship with the buyer promotes a sense of confidence in the seller and brand loyalty. This, in turn, generates opportunities for future sales that are advantageous to both parties.

11.6 Organizational Sales Structure

A company's sales force provides a personal connection to current and prospective customers. It is literally the face of the organization. For many firms, the costs associated with creating and maintaining their own full-time sales teams claim a substantial portion of the revenue generated from product sales. For all of these reasons and others, the efficient recruitment, training, and deployment of the sales force is essential to the survival and success of the firm.

The design of the sales organization within any firm reflects the strategic priorities of the company. The primary criterion driving the choice of organizational sales models is the efficient and effective allocation of the sales effort. The three most common options for arranging and coordinating the company's sales force organization are by product, by geographic territory, and by customer type.

A product-driven sales structure is common within firms that manufacture a range of complex products. High-tech and medical equipment companies, for example, are likely to organize salespeople according to the products they sell. This places a primary emphasis on making certain that each salesperson has the requisite technical knowledge and product familiarity to sell effectively. The primary disadvantage associated with this approach is that requiring sales reps to specialize on selling only one product or product type creates redundancy of effort as several salespeople often must serve the same account.

A geographic territory-driven sales structure is a very common design in which each representative is assigned to an exclusive territory. Consequently, each individual is responsible for performing a wider array of sales tasks across a broader spectrum of company products than is typical of product-driven models. However, this also allows for the designation of smaller sales territories and lower travel-related expenses, and it enables salespeople to become better acquainted with their customers. In the interest of promoting equity between sales representatives, territories are usually created to provide either roughly equal sales potential or equivalent workloads.

A customer-driven sales structure organizes the sales force according to industry or customer type. In contrast to the product-driven model, the primary emphasis in this system is that it permits salespeople to become experts in different segments of the markets the company serves. The objective behind this approach is to make each individual sales rep an expert in the unique needs and expectations of one type of buyer. This approach is particularly attractive in markets where buyer preferences and requirements tend to shift substantially over time. However, this design also tends to create the potential for very large sales territories and high travel-related costs if customers are widely dispersed.

Sales Force Recruitment and Training

The successful application of any of these designs is fundamentally dependent on the caliber of the salespeople recruited and trained by the organization. In fact, the survival of many organizations is dependent on the effectiveness of the sales force. Despite these high stakes, there are few generalizations that can be drawn about the personal characteristics or personality traits that make a good salesperson. Instead, the best type of person for a specific sales position will depend on the unique demands of the situation.

Different types of selling require different sets of abilities, skills, and character traits. Some of the most effective people involved in new business development are often persuasive, confident, ambitious, and aggressive. These qualities contribute to their potential for success in converting prospects into customers. However, customer services salespeople need to be emotionally steady, patient, and empathetic. By contrast, sales support staff members need to rely on technical knowledge and product-specific training. An aptitude for learning and innate intelligence are among the traits that will make them most effective in facilitating the selling activities of other sales representatives in the field.

Recruiters need to have a clear sense of the criteria that are most appropriate to use when evaluating applicants for the sales force. Feedback from current buyers can help to identify the selection criteria that directly relate to developing effective customer relations in different contexts. Critically evaluating the traits and qualifications of the most successful salespeople within the firm can also provide useful inputs. After reconciling these sets of information, companies should carefully evaluate the unique requirements of the vacant position to fine-tune their selection criteria.

Best Buy employee working on sales training.

The effective training and ongoing development of the sales staff is essential to the long-run success of the firm.

Getty Images News/Getty Images

The process of recruiting may include building a list of referrals from knowledgeable sources both within and outside the organization. Large firms often rely on professional employment agencies such as the Robert Half Agency and KAS Sales Recruiting to develop and evaluate an initial pool of applicants. Many recruitment firms and human resources departments within large corporations also require applicants to complete written examinations to provide an assessment of job-related personality traits. As with all vacant positions, employers also give due consideration to personal references, employment history, and interview performance as well.

Formal sales training is essential to make sure that all salespeople within the organization are equipped with the product knowledge and sales skills to represent the company effectively. This applies to the veteran salespeople within an organization just as it does to newly hired employees. The expense and time invested in sales training differs substantially between companies and industries. More startup and ongoing training is required for individuals expected to sell complex products that compete in highly dynamic markets. In addition to learning about the company and its products, all salespeople need to understand their competitors and their products if they expect to provide the customer with superior value.

Sales Force Compensation

A key ingredient to attracting outstanding salespeople to work for an organization is the compensation package. Most sales representatives who work in new business development and current account maintenance are compensated under one of three types of plans: straight salary, straight commission, or a combination of salary plus commission.

A straight salary compensation plan provides the salesperson with a reliable, stable source of income that he or she can depend on receiving on a regular schedule. This is most appropriate when the company expects the representative to spend a significant portion of work time on nonselling activities. It also reduces the likelihood of the sales rep intentionally overstocking customers' inventories for the sake of earning more money from sales commissions in the near term.

Straight salary is often favored for situations in which it is difficult to specifically assign product sales to individual sales reps. This would be the case, for example, in missionary selling, where company representatives provide information, advise buyers, and facilitate the sale for others to actually close. This would also apply anytime that multiple salespeople are working with a customer or sales are routinely being made on a referral basis.

The fundamental disadvantage to straight salary plans is that compensation is not directly linked to selling performance. Although year-end bonuses and annual salary increases can be tied back to the individual's overall performance, it is essential that all parties understand how that performance will be measured.

A straight commission compensation plan rewards salespeople exclusively on the basis of either unit or total dollar sales volume. It provides a focused motivation restricted only to sales performance and is most appropriately used when aggressive selling behavior is desired. Positions advertised with this type of compensation package may be more likely to attract high-performing, ambitious sales professionals than other types of plans. Although this approach provides an unambiguous incentive to maximize sales productivity, it can have some undesirable consequences.

Given the straightforward incentive structure, management tends to have relatively little control over the behavior of the salesperson. Acting exclusively on the basis on self- interest, he or she may not be willing to take the time required to convert difficult prospects into customers. Similarly, he or she may neglect making follow-up calls after a sale even when this practice is essential to establishing lasting relationships between the buyer and seller. Some salespeople working on a straight commission basis may also be inclined to focus their efforts on maximizing sales to the current customer base rather than prospecting for new leads.

Combination compensation plans are the result of mixing salary plus commissions. This approach is very attractive to both employers and their sales reps to the extent that it can effectively retain the best characteristics and overcome the worst limitations of the straight salary and straight commission alternatives. Combination plans usually include the payment of bonuses as well for sales performance levels that exceed preestablished goals or quotas. It has been estimated that some form of a combination plan is used in about 68 percent of all sales forces (Spiro, Stanton, and Rich, 2002).

Combination plans provide a stable base income to the employee in recognition of non-selling activities while also rewarding strong sales performances via the payment of sales commissions. Flexibility in designing the mix of incentives from these two streams of income gives management the means to adjust the relative importance of sales and non-selling tasks for the salesperson. That is, increasing the salary component should signal a shift toward supporting more non-selling-related activities for that period. Conversely, increasing commissions should motivate the employee to pursue higher sales objectives.

Ch. 11 Conclusion

Although the elements of the marketing mix are necessarily interrelated in the planning and execution of marketing programs, there is a unique linkage between the promotions mix and product distribution strategy. As discussed in the next chapter, advertising can play a significant role in generating demand at the retail level, thereby creating an incentive to "pull" product through the channels of distribution. Alternatively, aggressive selling and the use of sales promotions aimed at channel intermediaries can effectively "push" a product through channels to the retail product markets.

Ch. 11 Learning Resources

Key Ideas

Critical Thinking Questions

 What role does the promotions mix play in executing the positioning strategy for the brand? How does this differ from B2B markets to B2C markets?

 What does it mean to "integrate marketing communications"? Why is this important to achieving the promotional objectives for the brand?

 What is the relationship between the product differentiation and the promotions mix? Now for the tougher question: How does the promotions mix relate to the market segmentation decisions made for a brand?

 Imagine that a national television news report has identified your company as one that exploits child labor in underdeveloped nations. It isn't true, and you're committed to setting the record straight. Explain the nature of the relationship between publicity and public relations in this situation.

 Due to the ill-advised use of cents-off coupons in the Sunday newspaper every other week for nine months, you've essentially trained customers not to buy your brand unless they have a coupon for it. How can you reverse this situation and undo the damage?

 Coke and Pepsi spend billions of dollars annually advertising their brands. Why? Is it because it's possible that there's still someone out there who hasn't heard of Coca-Cola?

 Assume your best friend sees what you're reading and challenges you with the following statement: "You know, I have never been influenced by an advertising message." Explain how the hierarchy-of-effects models might support that assertion. Explain why the Elaboration Likelihood Model provides reasons to doubt that claim.

 Setting advertising budgets is difficult. The percentage of sales, objective and task, and competitive parity methods can all begin from the same starting point and lead you to very different conclusions. Explain what factors might cause you to get big differences in the results you obtain from applying all three methods in the same situation.

 In discussing how to measure the results from an advertising campaign, two alternative types of tests were introduced: communication tests and sales tests. The clients served by advertising agencies are always eager to see the sales test results. But many people on the agency side of the relationship are more likely to use advertising recall measures to assess the success of a campaign. Under what circumstances would it be more useful to see how many people remembered your ad than to look at the change in your sales over the period in which the advertisement was airing?

 Many popular sales coaches over the past 30 years have taught that good salespeople need to learn to love the word "no." What do you suppose they mean by that?

 Consider the four types of sales functions described in the chapter: new business development, current account maintenance, sales support, and customer service. Based on your assessment of the personality types best suited to performing these roles, which is the most attractive to you? The least? Why?

 Consider the three types of compensation plans discussed in the chapter: straight salary, straight commission, and a combination of the two. Under which of these schemes do you think you would be most productive? Happiest? How does your answer to this question relate to your response to the question above? Is there a conflict? Why?

 The term "prospecting" is used to describe the process of identifying potential customers for your goods and services. Many people think of gold miners and oil well drillers when they hear the term. Why would these be good or poor analogies to describe what sales prospecting is all about?

 It's been said that personal selling is more faithful to the true meaning of the marketing concept than all other forms of promotion. Do you agree? Why?

Key Terms

Click on each key term to see the definition.

advertising

Any paid form of nonpersonal communication between a seller and potential buyers.

all available funds

Allocates all financial resources not specifically allocated to other purposes to the advertising budget.

communication tests

Pre-versus post-campaign comparisons on non-sales-related measures.

comparative advertising

Advertising messages that make explicit contrasts between brands of the same product.

competitive parity

Sets advertising spending at an amount proportionate to that of one's closest competitors.

cost-per-thousand (CPM)

Cost associated with of reaching 1,000 viewers, readers, or listeners.

cost-per-thousand prospects (CPM-P)

Cost associated with of reaching 1,000 prospects for the brand being advertised.

current account maintenance

The process of keeping current buyers satisfied.

customer service

A wide array of functions related to sales support and service to buyers after the initial sale.

Elaboration Likelihood Model (ELM)

A representation of how advertising works via two alternative paths mediated by audience involvement with the message. The central route requires the thoughtful evaluation of the message contents to be persuasive. The peripheral route is potentially effective when the audience is not motivated to process the informational content of the ad.

emotional advertising appeals

Message content that emphasizes words and images to evoke an emotional response.

frequency (F)

The average number of times that an average prospect will be exposed to a given advertisement over a specified interval.

gross rating points (GRP)

Reach times frequency (RxF).

hierarchy-of-effects models

Representations of how advertising messages move an audience through a progressive sequence of psychological stages such as awareness, interest, desire, conviction, and action.

informational advertising

Appeals message content which emphasizes facts and arguments.

Integrated Marketing Communications (IMC)

Coordination of the promotions mix to achieve the communications objectives of the product or service being sold.

missionary selling

Providing product-related information and advice to prospective buyers without any expectation of making a sale.

new business development

The process of converting prospective buyers into current customers.

objective and task

A media budget setting method that works by matching advertising expenditures to the corresponding marketing objectives for the campaign.

pantry management

Providing incentives to consumers to encourage them to stock up on several purchase cycles' worth of a product for the purpose of preventing competitors' brands from selling.

percentages of sales

A budget setting method that allocates fixed percentages of either past or anticipated sales advertising media.

personal selling

Personal interactions between company representatives and prospective customers for the purpose of facilitating current and future sales.

persuasion

Changing a person's attitudes by means of promotional messages.

promotions mix

The communication techniques available to marketers. These include advertising, personal selling, sales promotion, public relations, and publicity.

prospecting

The of activities required to identify potential buyers and generate sales leads.

public relations

Nonpaid, impersonal communications sent out by news media or other vehicles outside the control of the seller.

qualifying

The process of determining if a sales lead has the potential to be a viable sales prospect.

reach (R)

The number of unique prospects that is exposed to a given advertisement over a specified interval.

reminder advertising

Ads intended to keep familiar products readily available in the minds of consumers.

sales support

Sales-related activities intended to facilitate the activities of other salespeople.

sales tests

Pre-versus postcampaign comparisons of brand sales.

trade selling

Sales activities focused on maintaining the support of distribution channel intermediaries.

trial close

A technique used by salespeo­ple to help determine the buyer's readiness to purchase.

Web Resources

The online home for Advertising Age, the leading trade publication for professionals in all phases of advertising. This site provides comprehensive coverage of the industry via both paid and free services. It also provides access to the Advertising Age Datacenter. This feature provides limited free access to a range of advertising-related databases and resources.

http://www.adage.com

A website sponsored by the Advertising Educational Foundation. This site includes free access to examples of award-winning advertisements, excerpts from advertising books published in the business press, case histories, and information about careers.

http://www.aef.com

A website maintained by the trade publication Sales and Marketing Management magazine. The site includes reprints of articles from the print version of the magazine, webcasts, e-newsletters, case studies, white papers, and other resources of direct relevance to professional selling.

http://www.salesandmarketing.com

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Chapter 12

Marketing Channels and Distribution Decisions

Directional sign by a field.

Paul Edmondson/Corbis

Learning Outcomes

By the end of this chapter, you should:

 Be able to identify the channel intermediaries, the functions involved in product distribution systems, and how the sorting process adds value by aligning the product mix with buyers' preferences.

 Recognize the advantages and costs associated with the use of indirect channels of distribution.

 Be able to identify the basic channel structures common to the distribution systems for both consumer and industrial goods.

 Appreciate the significance of market coverage and distribution density objectives in the planning of distribution channels and the application of push and pull strategies to promote the movement of brands through multilevel channels of distribution.

 Recognize the role of vertical marketing systems in channel coordination and control.

 Understand how channel power and conflict impact the nature of relationships between channel intermediaries.

Ch. 12 Introduction

Creating and promoting the right product at the right price is of relatively little value to consumers if they are not able to get their hands on it. The distribution element of the marketing mix focuses on the creation of systems that enable customers to access and purchase products. To be economically justified, the systems must be both effective in facilitating product delivery and financially efficient. Distribution channels provide the paths through which products flow from sellers to ultimate consumers. They can vary substantially in length and complexity. Many conventional channel strategies include several cooperating and interconnected intermediaries such as manufacturers' agents, wholesalers, and retailers. Each channel member receives the item at one price point and sells it to the next level at a higher price until it is sold to the final consumer. However, direct sales from producers to final consumers have become increasingly common in many markets due to the growth of online sales.

Marketing intermediaries within the channels of distribution exist to perform essential functions. The most basic function is simply to bring products from where they are created to where they are demanded. Consequently, the tendency is to think of distribution channels strictly in terms of the physical transportation of goods. However, many other types of nontransportation functions need to be performed to efficiently bridge the gap between buyers and sellers. These include activities ranging from promoting, sorting, order processing, and inventory management to insurance and financing.

This chapter focuses primarily on marketing-related distributions functions. The tasks performed by the different types of intermediaries are developed at the outset. Based on an understanding of the value added by the performance of channel functions, the advantages and costs associated with participating in alternative distribution systems are examined. Issues critical to determining the best channel design for product manufacturers are then considered. The concluding section of this chapter examines channel dynamics. Of specific significance is how the interests of interdependent channel members are coordinated in the midst of power differentials and conflicting objectives between members.

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When teaching marketing principles to college freshmen, I often make analogies to familiar concepts to help students grasp the essentials of the various topics: How building market share in competitive environments is comparable to a middle school football game. Why the development of a marketing plan and marketing mix is like baking and decorating a wedding cake. How market segmentation can be understood by using the characters from a familiar sitcom like Cheers. Why doing market research is like trying to solve a murder mystery. And so forth.

When introducing the topic of distribution systems, I sometimes explain that the basic operation of a distribution channel is comparable to the plumbing in your home. There are product flows that can be directed along various routes to meet customer needs. The kitchen sink, dishwasher, and shower each represent different points of interface with customers. These points of direct contact bring the otherwise hidden channel operations to visible points of product use. The presence of parallel water lines to serve different sites and even the pressure levels within various parts of the system all have counterparts in channels of product distribution. Throughout this short introduction, the emphasis is always on the importance and economic value of a well-designed operational system.

One frigid January evening when I returned from delivering this introductory lecture, I arrived at my apartment to find that a water supply line in the wall had frozen and burst. The resulting leak under pressure ruined a section of drywall, created a short in an electrical outlet that destroyed my television set, and left a terrible odor in the wet carpeting. It was an altogether unpleasant experience made worse over the next three days by the landlord and water utility. However, when I returned to class the following week I did have a couple of additional remarks to make on the plumbing analogy that related to the effects of disruptions in product flow, the significance of system pressure levels, the consequences of stock-outs, and the results of failures in customer service.

12.1 Channels of Distribution

A channel of distribution is "an organized network (system) of agencies and institutions which, in combination, perform all the functions required to link producers with end customers to accomplish the marketing task" (American Marketing Association, 2012). A distribution channel is created to provide the producers of goods and services with the means to move their products from where they are created to where they are demanded. That is, channel systems are typically developed in direct response to the needs and plans of sellers. However, specific systems or distribution channels can only be sustained if they are economically efficient. If the value of services they provide fails to exceed the cost of providing them, they will eventually fail. Similarly, if more cost-efficient alternatives become available, the existing channel will become obsolete.

Traditional channels of product distribution are sustained by the combination and collaboration of intermediary institutions through which products are moved from the seller to the ultimate consumer. Although there is popular skepticism about the need for "middlemen" in some situations, channel intermediaries perform vital economic functions that add value to goods being sold. The economic justification for each channel member lies in its ability to perform economic functions more efficiently and at lower cost than the producer operating independently can.

Distribution

The choice and organization of distribution channels in a fast-moving market is paramount, for it plays a part in the value chain. The costs and client benefits of the product add to the overall cost of the product. What does this mean for the company's customers?

Channel Intermediaries

Peanut butter production line

Harvest and processing are only the beginning of bringing the finalized peanut butter product from its origin to the consumers.

Associated Press

Consider the tasks required to bridge the gaps in time and space that potentially separate school children from peanut butter. After farmers have harvested the peanuts, and the makers of Skippy, Jif, and Peter Pan have processed and packaged the final product, it has to go from the manufacturer's own warehouses to grocery wholesalers across the country. From there, these brands need to reach more than 95,500 grocery stores in the United States alone (United States Census Bureau, 2012).

The challenge confronting these companies is to move the product from its point of origin to where its customers are. It is a formidable challenge to accomplish this task in a cost-effective manner that creates neither shortages nor excessively high levels of inventory at any point in the distribution process. One of the keys to accomplishing product distribution goals is the efficient use of specialists called channel intermediaries.

Channel intermediaries are businesses that specialize in providing services directly related to the process of moving goods from producers to consumers. Sometimes referred to as middlemen, they provide the links connecting buyers and sellers. Distribution channel intermediaries can be classified according to either the type of organization or the functions they perform. The various types of marketing intermediaries are summarized in Table 12.1.

Table 12.1: Marketing intermediaries

Type Definition

Middleman An independent business that operates as a link between producers and ultimate consumers or industrial users. There are two primary levels of middlemen: wholesalers and retailers.

Wholesaler A business operated for the purpose of buying, taking title to, storing, and physically handling goods in large quantities, and subsequently reselling the goods in smaller quantities to retailers or other customers.

Distributor A wholesaler that operates in industrial contexts.

Jobber A wholesaler that buys from manufacturers and sells exclusively to retailers.

Retailers A merchant engaged primarily in selling to ultimate consumers.

Merchant Middleman A channel intermediary that buys goods outright and takes title to them.

Agent A person or organization that represents another for the purpose of negotiating sales but does not take legal title to the goods being sold.

Broker A middleman who acts as a go-between for buyers and sellers but does not serve as a permanent representative for either.

Manufacturer's Agent An agent who operates on a contractual basis to sell the products of multiple producers, often within an exclusive territory for those brands. These sales representatives typically sell related lines of products but not brands that are directly competitive.

Facilitating Agent A firm that assists in the performance of distribution-related tasks other than buying, selling, and transferring title. This category includes banks, transportation companies, legal services, market research firms, and public warehouses.

Source: American Marketing Association, 2012

Channel Functions

Transportation is the most readily evident function performed by the channel of distribution. However, this term refers to more than the physical movement of goods from one place to the next. Within the domain of marketing, transportation specifically refers to all of the intermediate steps involved in the process as well. Each of these intermediate steps adds value to the final delivered product by improving the fit between the preferences of buyers and the final assortment of goods made available to them.

The added value provided by channel intermediaries is evident in the extensive range of marketing functions they perform. The most basic are simply the process of buying and selling. That is, channel intermediaries purchase products for resale to other channel partners and end consumers. However, the value of these transactions is substantially enhanced for the final consumer by other types of functions that shape the characteristics and circumstances of the purchase to better suit the buyer's needs. Primary among these functions are those involved in the sorting process.

Mound of peanuts at peanut facility.

Without channel intermediaries, consumers of peanut butter would have to purchase the raw product directly from growers.

Fotosearch/Getty Images

The sorting process refers to the set of channel activities that align the mix of goods and services created by diverse producers with the variety or assortment demanded by consumers. Specifically, it is the "function performed by intermediaries in order to bridge the discrepancy between the assortment of goods and services generated by the producer and the assortment demanded by the consumer" (American Marketing Association, 2012). On the most basic level, producers create large quantities, and most consumers want smaller amounts. However, the discrepancy between the assortment created by manufacturers and the assortment preferred by consumers extends far beyond the quantities involved.

Consider the peanut butter example we began earlier. In the absence of the sorting process provided by channel intermediaries, consumers would have to travel to where the peanuts are grown; buy in large, standardized quantities; and then produce their own peanut butter. To arrive at the point of being able to choose from among several brands, package sizes, and product varieties on a store shelf, several intermediate activities must take place between the processing facility and the grocery store. The tasks required to bring the product mix into alignment with customer demand include four specific processes: sorting out, accumulation, allocation, and assorting.

Sorting out is the initial phase of the sorting process that breaks down and reorganizes a mixed or heterogeneous product supply into separate collections or inventories that are relatively consistent with respect to kind, size, or quality. This is a step most often observed in the marketing of agricultural products such as peanuts, where produce from the fields needs to be separated by quality or graded prior to further processing.

Accumulation is the process of assembling and pooling relatively small quantities from diverse sources and suppliers to create a larger, homogeneous supply of comparable products. This can take place at several points in the product distribution process. Using the peanut butter example, the finished product is packed in relatively small jars of various sizes. Cases are created by combining a larger quantity (e.g., two dozen) of jars of the same size and variety. Larger cases, crates, and pallet loads of the same item are then created to prepare for shipping. This pooling process has the advantage of creating larger outgoing shipments that can be transported at lower cost.

Allocation is the dimension of the sorting process that breaks down the accumulated homogeneous product supply or product inventory into smaller lots. Wholesalers typically buy at lower per-unit costs by purchasing truckload or carload lots and then break these down for sale to channel customers. In this way, wholesalers are able to realize a profit while performing the task of reallocating products according to market demand.

In contrast to allocation, which breaks inventory into smaller lots, assorting refers to the process of building a collection of products from multiple sources for use in relation to each other. Retailers create assortments at a single location to match their customers' preferences. This assortment includes competing brands within categories (Skippy, Jif, and Peter Pan), as well as items across an expansive range of product types. Retailers are most successful in providing value to their customers when they are able to match the assortment of products to the preferences of their target market.

It is also important to note that both number of channel levels and types of intermediaries in the distribution channel are influenced by the kinds of assortments that buyers require from retailers. This, in turn, directly impacts the availability of opportunities to improve channel efficiency and effectiveness.

The sorting process is an essential marketing and distribution function for most kinds of products. This includes physical goods, services, and electronic or digital goods. Although online sales significantly impact the nature of product distribution, online marketing managers still need to provide for the same channel functions as offline marketers.

The monetary value associated with the services that channel members provide is determined based on end users' perceptions and needs. If the costs associated with the services provided by intermediaries cannot be justified by the value produced, market forces will eliminate the providers from the distribution system. Regardless of changes to the channel length and structure, however, the essential functions provided by the system cannot be eliminated. The next section examines the general advantages associated with participation in a distribution channel and alternative channel structures and designs.

Think About It

It has been a fundamental axiom of product distribution for more than a century that the sorting process performed by distribution channels is essential to marketing manufactured products (Bartels, 1976). Although intermediate channel members can be eliminated and the component activities of the sorting process can be shifted from one channel level to another, none of the constituent processes themselves can be eliminated.

Is this basic principle being violated when online vendors sell music, movies, and software directly to end users?

12.2 Channel Advantages and Disadvantages

Amazon's website.

Online retailers like Amazon facilitate the direct sale and distribution of digital products.

Bloomberg/Getty Images

The rapid development of online sales has tended to shorten the distribution channel for many products. Companies like Amazon.com, 1-800-Flowers.com, and Dell Computer have developed successful online business models that thrive without relying on any resellers between themselves and their final consumers. The physical transport of their products is usually assigned to independent parcel post shippers such as FedEx and UPS. For most companies competing in B2C and B2B markets, however, the assistance provided by other types of channel intermediaries is essential.

Benefits of Channel Arrangements

The decision to participate in an existing distribution system or implement an alternative distribution path involves assessing all options. Marketing managers must be critical and selective to be certain that the channel members chosen add value to the organization's final product in excess of the associated costs. The added value that can be derived from participation in an existing distribution channel includes cost savings, time savings, customer convenience, promotional support, and the facilitation of transactions.

Cost Savings

Participation in cooperative channel arrangements enables producers to save costs through the functional specialization of channel members. If each participant in the distribution channel specializes in performing a specific task as efficiently as possible, the channel members should be able to complete those activities at a lower cost than less specialized and narrowly focused companies. Although this applies to several types of distribution-related activities (e.g., insurance, warehousing), the most critical area of savings from specialization relates to the physical movement of products. Transportation companies should be able to ship at lower rates in most instances than companies that attempt to deliver their goods using their own fleets.

Think About It

Driving along the Interstate Highway System, you will often see delivery trucks for both very large companies (e.g., Anderson Windows) and lots of smaller companies that you've never heard of.

What factors would lead small companies to decide that owning or leasing their own delivery trucks is more cost-effective than contracting with professional shipping or transport companies?

Does the concept of "capacity utilization" mean something different for smaller companies than for large ones?

Time Savings

Relying on professional transport specialists can improve product delivery speeds as well as reduce costs. Time savings are directly related, of course, to saving money in many instances. However, the opportunity to deliver the product to the customer more quickly often pays benefits beyond reduced transport costs. In B2C product markets, the speed of delivery can impact the customer's level of satisfaction. Though holiday-specific purchases are frequently cited when discussing the importance of timely delivery, it is important to get the product into the hands of buyers as quickly as possible on other occasions as well. Consumers' enthusiasm for many purchases typically wanes if they have to wait longer than expected for delivery.

In B2B markets, the timely delivery of products is often essential to the customer's ongoing operations. Essential equipment, replacement parts, manufacturing inventories, and supplies of all kinds need to be delivered in advance of the buyers' requirements. As discussed in previous chapters, B2B buyers are particularly prone to considering all facets of reliability, customer service, timely delivery, and product availability when evaluating alternative vendors.

Customer Convenience

Kroger store in Illinois.

Large retail chains, like Kroger, offer convenience to shoppers by providing a greater variety of products under one roof.

Associated Press

The opportunity to participate in existing distribution channels often provides buyers with greater convenience. Large retail chains such as Walmart, Sears, and Kroger can make the shopping experience much more convenient for customers. The ready availability of a large assortment of products within a single store creates valued convenience for shoppers. In terms of specific channel functions, these businesses perform both the accumulating and assortment functions. Consequently, shoppers need to visit fewer stores and spend less time to find the products they want.

The same principle holds true in B2B markets. Automotive repair shops, for example, prefer to work with parts suppliers that carry a wide assortment or products from multiple manufacturers. Just as with the B2C market, selling into an existing distribution network can create greater levels of convenience for final consumers and, consequently, offer a competitive advantage over brands that do not.

Resellers within the channel also provide a unique form of efficiency by selling to their customers in smaller quantities than the people they buy from. Manufacturers prefer to ship in relatively large quantities. The distribution network progressively breaks the large lots into quantities that customers prefer. Through this allocation process, multiple channel intermediaries are able to refit the order size to match the preferences of their customers while still capturing a portion of the price advantage and cost savings associated with buying in large volume. This consideration often determines the number of levels that is most efficient for a given distribution system.

Think About It

To some extent, virtually every product category can be promoted and sold online without the services of channel intermediaries or middlemen. However, when you consider the online sales potential for any product relative to the total sales for a category, there is a limit. For every category, online sales will be limited to less than 100 percent of total retail sales. Why? What are the barriers?

Why would there be a natural ceiling on how high online retail sales can rise as a percentage of all retail sales?

Do you think that Amazon's Kindle and other e-book brands could ever replace more than 50 percent of printed book sales?

Promotional Support

Manufacturers' participation in an established distribution channel has the potential to promote sales at the reseller level. Since each succeeding level of the distribution network is dependent on reselling the product for their survival, they can be expected to actively promote product sales through personal selling, advertising, and other promotional initiatives. Resellers at all levels of the distribution chain gain nothing by holding inventory. Their profitability depends on selling the goods they have acquired from the previous level of the distribution channel.

Facilitation of Transactions

To facilitate the sale of inventory, many resellers will offer financial incentives or provide financial assistance to enable their customers to purchase. This type of assistance may include extending short-term credit, reducing down payment requirements, providing low-interest loans, or accepting product trade-ins.

Channel intermediaries also facilitate product sales by providing product information and follow-up service after the sale. Since many producers are heavily dependent on resellers' promotion of their brands, manufacturers routinely provide sales training programs, incentive programs, and point-of-sale promotional materials to wholesalers and retailers. In some instances, producers will partner with other channel members by providing company data on customer purchasing behavior to assist them in refining their own marketing efforts.

Costs of Channel Arrangements

Selecting the best path to distribute a product requires a careful comparison of available alternatives. Channel intermediaries are product resellers, and the benefits related to collaborating with them are offset by three important cost-related disadvantages.

Tapping into the services provided by channel intermediaries will result in a direct loss of revenue from sales. Resellers need to be compensated for their efforts, and they typically extract their profits simply by charging their customers more than they paid to purchase the product. Consequently, the producer does not earn as much as he possibly could by selling direct to the end user. However, intermediaries do not profit at all if they do not resell what they have purchased.

In addition to giving up potential revenue from sales, marketers also give up a measure of control over how their brand will be promoted. The potentially adverse impact on brand image can, however, be mitigated through advertising messages that are delivered directly to the intended target market. Nonetheless, at the point of resale, channel partners may opt to sacrifice the integrity of brand positioning for the sake of making a sale. Product benefits may be exaggerated. The brand may be sold for purposes the manufacturer did not intend.

The third channel cost to consider when selecting a distribution strategy is that resellers typically have many products to sell. Even if not directly competitive, the priority and importance assigned to selling one specific brand is necessarily less for resellers of multiple companies' products than it is for that product's manufacturer. Consequently, some brands will not receive the level of attention from salespeople or customer service that others will. This is most often a greater concern for smaller brands than market leaders.

The preceding sections provided a brief overview of the benefits and costs associated with distribution systems in a general sense. However, each alternative channel structure has its own merits and weaknesses that are unique to the customer's situation. The section that follows examines the most common channel systems for distributing products to both B2C and B2B markets. In addition, the general considerations that should be taken into account when selecting a distribution channel are briefly examined.

12.3 Channel Structure

There are four alternative channel structures that are used to distribute consumer goods from the point of manufacture to end user. As illustrated in Figure 12.1, a direct channel moves the product from the point of origin to the final consumer without the use of any intermediary channel partners, or so-called middlemen. Direct systems of product distribution include most online sales as well as orders placed from catalogs. In these simple systems, no other organizations take legal ownership of the product.

Figure 12.1: Common channel structures for consumer goods

Figure showing common direct and indirect channels for consumer goods.

This figure outlines the common direct and indirect channels for consumer goods.

Adapted from http://www.web-books.com/eLibrary/NC/B0/B64/051MB64.html

The three most common forms of indirect channel structures rely on one or more intermediary organizations to span the gap between the producer of the product and the ultimate consumer. The intervening resellers may include agents, wholesalers, and retailers. Unlike agents, most wholesalers and retailers generally purchase the product for resale and take legal ownership of it. Most of the products that you encounter in retail stores such as Best Buy, Target, and Home Depot reach these destinations via indirect channels of distribution.

Employee wrapping cheese in a cheese shop.

Smaller firms, like a regional producer of specialty organic cheeses, often rely on a team of agents to help get their products to wholesale distributors and eventually to a retailer's shelf.

ZUMA Press/Corbis

Channel structures are sometimes characterized by their length and width. Channel length is simply the number of levels required to create a distribution system. Each type of independent intermediary (e.g., agent, wholesaler, retailer) represents a distinct channel level. Channel width, in turn, refers to the number of members or businesses operating at a given level within the distribution system.

Consider the most likely model for a regional producer of specialty organic cheeses. The relatively small firm may rely on a team of agents rather than its own external sales force to reach an 11-state market. As many as 15 agents acting on behalf of the company may sell through 60 wholesale food distributors to create market access via 860 retailers. In this instance, the length of the company's distribution channel is defined by its three levels. The width is greatest at the retail level where it serves 860 outlets and narrowest at the level closet to the point of production where 15 independent agents represent the seller.

The common channel structure alternatives available in B2B markets are illustrated in Figure 12.2. The direct channel option is used much more widely in B2B than B2C markets. It is especially common for well-known manufacturers and market leaders. It is also favored when the products being distributed are relatively expensive, technologically complex, and built to buyers' specifications. Most industrial products that are sold as a consequence of direct negotiations with the buyers are distributed via direct channels.

Figure 12.2: Common channel structures for industrial goods

Figure showing common direct and indirect channels for industrial goods.

This figure outlines the common direct and indirect channels for industrial goods.

Adapted from http://www.web-books.com/eLibrary/NC/B0/B64/051MB64.html

In indirect B2B channels, resellers that perform the functions usually associated with wholesalers are often called distributors. These intermediaries take title to the product being sold and provide the storage and handling capabilities required to serve its customers. Distributors are most commonly used in the sale of standardized products that have a relatively large number of possible buyers. In contrast to products sold through direct B2B channels, the monetary values associated with each sale tend to be relatively small.

The creation or selection of a channel structure for any given product has profound consequences for almost every facet of the marketing plan. The distribution system must be compatible with the brand's advertising objectives, pricing strategy, sales force allocation plan, and even product design. It will directly impact product-related costs, sales potential, profitability, and customer service. Given the far-reaching implications of this decision, the next section of this chapter is devoted to an examination of the factors that should be considered when choosing a distribution channel design.

12.4 Channel Design Considerations

Choosing one type of channel structure over another is a significant strategic commitment and investment for a firm. It is a decision that imposes substantial consequences on the overall performance of the brand. Whether these are positive or negative depends on the congruence or fit of the channel design with the overall marketing plan for a given brand. The importance of this decision is magnified by the fact that any changes to a distribution channel typically result in significant costs and cannot be quickly implemented.

Selecting the best possible channel design for the distribution of a given product is contingent on several channel-dependent objectives and market-specific characteristics. The most relevant issues to be considered include distribution intensity, promotional support, customer service, and system cost effectiveness.

Distribution Intensity

Of the criteria that can be used to assess the effectiveness of any product distribution system, the most fundamental is product availability. Channels are created to facilitate the selling process and make products readily available for customers who wish to purchase. However, selling a product through every possible outlet is not necessarily efficient or compatible with most brand marketing plans. For a product to achieve its targeted level of availability, a marketing manager must determine the level of market coverage desired.

Market coverage is the percentage or proportion of retail or wholesale outlets carrying a specific brand relative to the total number of outlets that sell comparable products. Marketing managers can pursue different levels of coverage based on the capability of alternative channel designs to reach the target market. There are three alternatives based on different levels of desired market coverage: intensive, selective, or exclusive distribution.

Market coverage in indirect B2C channels is determined by the number of wholesalers and retailers committed to the distribution of the product. Intensive distribution describes the level of market coverage in which a product is sold through all available wholesalers and retailers who sell that product type within in a given market. Achieving this maximum possible level of access to consumer markets is a common strategic goal for manufacturers of low involvement consumer goods. Convenience goods and products often purchased on impulse thrive on being everywhere and anywhere a potential customer may encounter them.

The advantage of this strategic option is that it maximizes the availability of products such as soft drinks and snack foods. This tends to promote brand recognition and reinforce top-of-mind awareness for market leaders. It may be even more critical to brands that are striving to compete against larger, well-established convenience goods. However, retailers are often reluctant to fully support these relatively inexpensive brands or cooperate with the company's marketing programs since every retailer has the same brands and opportunities. Relatively low dollar sales volume and the lack of any exclusivity for the brand within a geographic market limit many retailers' enthusiasm for the product.

Think About It

Bottled water is a convenience good that typically requires intensive distribution in many markets to be successful. Brands like Aquafina (from PepsiCo), Dasani (from Coca-Cola), and Poland Spring (from Nestlé Waters) have the means to secure distribution in most major retail venues. But every once in a while, a new brand emerges and takes its place on the shelf besides these giants.

How can a would-be market challenger in a convenience product category convince the distribution channel intermediaries to stock and distribute its brand?

Exclusive distribution describes a level of market coverage in which a product is distributed through only one retailer within a particular region. It is a viable channel strategy for high involvement specialty goods. It may be a particularly desirable path to follow if the positioning strategy is focused on differentiating the brand on the basis of prestige, status, or exceptionally high quality. Fine jewelry, expensive home furnishings, and designer clothing often rely on exclusive distribution to reach their target markets.

Woman shopping at the clothing section at Target

Selective distribution allows a company to choose what retailers—and therefore what markets—it targets. For example, the clothing brand Merona selectively distributes through Target stores.

Associated Press

One of the primary advantages to pursuing an exclusive distribution goal is control. It enables the marketing manager to match the positioning objective for the brand being sold to the image and attributes of the exclusive retailer within a given market. Although this requires substantial cooperation between the producer and the retailer, it should be a complementary relationship if they share a common target market. The greatest risk posed by this option lies in the lack of diversification. Relying entirely on a single retailer makes the producer dependent on the performance of an exclusive dealer while the retailer, in turn, may sell a wide variety of products.

Selective distribution refers to an intermediate level of market coverage in which a product is distributed through a limited number of intermediaries. It is a strategy often pursued by producers of infrequently purchased goods that typically involve comparison shopping by the buyer. Though a good strategy for a wide range of products, the challenge lies in providing retailers with sufficient support or incentives to carry and support a specific brand when the range of alternatives being stocked is limited.

Relying on this option enables a company to sell through only those retailers that best fit with the brand's objectives. These objectives include the image being conveyed and the market being targeted. Many of the most popular clothing brands sold by retailers such as Target and J.C. Penney fit within this category. As an intermediate compromise between exclusive and intensive distribution options, it can have some of the same strengths and weaknesses associated with each.

Sales Promotions in Channel Strategy

One of the common goals shared by all channel members is making sales, since intermediaries are product resellers. Promotional programs may be initiated and carried out at any level within the channel of distribution. Although manufacturers look to retailers especially to provide merchandising support, the active support of salespeople is essential at all levels within the channel. The relative emphasis and attention that a reseller's sales force provides to any given product is often a direct response to the incentives provided by the manufacturer. Inducements to buy and sell throughout the distribution channel typically focus on pricing strategies and the strategic use of sales promotions to either push or pull the product through the channel.

Marketing organizations selling through indirect channels of distribution work to stimulate sales to the final customer either directly using a pull strategy or indirectly using a push strategy.

The pull strategy consists of using promotional efforts targeting the final consumer of a product to build selective brand demand. The brand is said to be pulled through the channel as a result of consumer response to advertising and sales promotions that drive retail-level demand. The demand at the retail level creates a corresponding pull or demand pressure at the wholesale level to stock and distribute the brand. In this way, advertising and sales promotions are used to build interest among retail prospects to draw the product through the distribution channel.

Channel intermediaries tend to respond quickly to the profit potential associated with high volume sales. Consequently, this strategy builds cooperation within the channel to carry new or emerging brands when the manufacturer can demonstrate high levels of consumer interest. Market leaders have the best opportunity to successfully apply this strategy in the growth stage of the Product Life Cycle since the increase in category sales holds the greatest potential volume growth for them.

The push strategy is a manufacturer-driven strategy that offers incentives to channel intermediaries rather than the end consumer. The objective is to encourage channel members to carry the manufacturer's product by offering trade allowances, quantity-driven price discounts, and other sales promotions. Once a product is pushed from the manufacturer to the wholesaler, for example, the wholesaler needs to find a means to push the product to retailers. Often this requires the wholesaler to share the value of price discounts and other promotional incentives with the retailer. Retailers in turn may need to discount their in-store prices to final consumers to move higher volumes of the product. It is an effective strategy that is fueled by the need at each level of the channel to resell the product to the next.

New and relatively small brands often rely on the push strategy to secure distribution for their products from existing channels and intermediaries. The higher unit margins created by offering sales promotions to channel members help to offset the lower unit volume sales. This form of direct inducement targets resellers' profit motivation as a means to gain access to a distribution network. Once access has been secured, other efforts to build relationships with channel partners and build brand preference with final consumers become possible.

Customer Service

Customer service has many possible meanings, depending on the context. Within the context of distribution channel design, it is most often used in reference to a system's capability to meet the needs of intermediaries so that they are better prepared to meet the needs of final customers. This perspective is readily apparent in B2B selling contexts, where end users depend on the reliable delivery of parts, supplies, and finished goods to operate their own businesses.

Alternate configurations of distribution channels have the potential to deliver different levels of customer service. Direct channels, without any intermediaries, are often favored in B2B markets where customer service is a critical factor in the way customers evaluate alternative vendors. The reliance on very short channels eliminates many ordering errors and service lags due to poor communication with intermediaries. In this way it enables manufacturers to be more directly responsive to the immediate needs of customers. However, not relying on intermediary specialists to perform some tasks at lower costs will inevitably increase the costs directly attributable to delivering higher levels of dependable customer service.

System Cost Effectiveness

The cost associated with each alternative distribution channel is an important consideration in selecting the best design for a specific situation. Since this choice represents a critical investment by the firm, it is reasonable that the evaluation of all related costs should be a primary consideration. The total cost concept is a principle in the evaluation of physical distribution systems that requires marketing managers to explicitly consider all the costs related to each alternative design for distributing goods to customers. The primary costs to consider include the physical transportation of the product, warehousing, order processing, and distribution-related packaging.

The total cost concept also recognizes that minimizing costs and achieving the customer service objectives for a product represent conflicting goals. Any effort to truly minimize all channel-specific costs would result in slow delivery times, higher rates of damaged merchandise, and lost sales due to insufficient levels of inventory throughout the system. Over time, lost sales from dissatisfied customers at all levels of the channel would probably threaten the manufacturer's existence.

The concept of explicitly recognizing the total costs associated with the company's choice of distribution models must take into account that forgoing some marginal sales opportunities can lower total system costs. Consequently, the best design for any given situation will be one that strikes a balance between the need to contain costs and the need to preserve important sales opportunities and high levels of customer satisfaction.

For many companies, the critical factor will be deciding on the number of intersections, or points of direct interface, between target market customers and the channel of distribution. As this number increases, inventory, warehousing, and order processing costs increase, but the general level of customer service increases as well. Limiting sales to one point of interface would reduce inventory and handling costs. However, it would inevitably reduce convenience and availability to customers.

The considerations addressed in this section relate to identifying the best possible channel design for any given situation. The concluding sections of this chapter focus on how to make the preferred channel model operate efficiently and effectively.

12.5 Channel Coordination and Control

The efficiency and effectiveness of direct channel structures are exclusively dependent on their intentional management by the manufacturer since there are no intermediaries. However, getting the best possible performance from indirect channel structures requires coordination and cooperation among the channel partners. Beginning in the 1990s, manufacturers developed vertical marketing systems as a strategy to improve channel performance.

Vertical Marketing Systems

Vertical marketing systems (VMS) are distribution channel systems "consisting of horizontally coordinated and vertically aligned establishments that are professionally managed and centrally coordinated to achieve optimum operating economies and maximum market impact" (American Marketing Association, 2012). Horizontal coordination refers specifically to cooperative agreements reached by organizations at the same channel level (e.g., grocery wholesalers). Vertically aligned establishments are those that span or cross over channel levels (e.g., agents, wholesalers, and retailers).

Both horizontal and vertical coordination arrangements result in a higher degree of interdependence between firms. Dependence on each other, in turn, promotes cooperation. Under these arrangements, channel partners are less able to independently make changes to the way that products are distributed. Although there are many highly specialized variations, the three basic types of vertical marketing systems are corporate, contractual, and administered.

Corporate VMS

Starbucks coffee sign logo.

Starbucks is an example of a supplier operating retail outlets in B2C markets.

agefotostock/SuperStock

Under a corporate VMS structure, one organization owns either all channel members in the distribution chain or the firms operating at an adjoining level. The most common model is for producers to own and operate a wholly private distribution system. In some instances, this is the consequence of a forward integration strategy in which wholesale and retail functions are created or acquired by a manufacturer. Though less common, a backward integration strategy is an alternative that enables intermediaries to acquire control of distribution partners that precede them in the channel. A wholesaler, for example, may acquire a manufacturer to ensure continued supply of scarce products. The motivation to acquire channel partners may include the acquisition of physical facilities such as warehouses or securing control over other resources such as a highly trained sales force or prized contractual linkages to suppliers of raw materials.

The primary strength associated with corporate VMS structures is that they provide direct control over the sales, distribution, and customer service activities within the channel. This may be critical to the success of custom-designed products in B2B markets where accurate and reliable communications between channel levels is essential to customer satisfaction. For complex products based on proprietary technologies, this design also facilitates the protection of closely held company information.

Though more common in B2B markets, there are many examples of suppliers operating retail outlets in B2C markets. The Starbucks Corporation, for example, began as a retail cafe in the early 1970s to sell specialty coffee in Seattle, Washington. Within a year the company moved from buying its raw coffee beans from outside suppliers to sourcing and purchasing directly from growers. The company now operates more than 17,000 stores in 55 countries while continuing to purchase its raw coffee beans directly from growers throughout the world (Starbucks Corporation, 2012).

Contractual VMS

Contractual VMS is a distribution system that coordinates the production and distribution of products through legal contracts that specify the rights and responsibilities of channel participants. These agreements set both goals and limits for the activities that each intermediary is permitted to perform. By formally agreeing to explicitly defined terms of performance, the system is able to realize greater economies of scale and more efficient operations through improved coordination and execution of essential functions.

Subway restaurant with patrons eating outside

Franchise models, like the one used by Subway, allow the central organization to control most of its members' daily operations.

Associated Press

The contractual VMS format includes several types of arrangements among channel partners. Wholesaler-sponsored contractual VMS channels are initiated when a wholesaler organizes and manages independent retailers to operate under a common brand. Ben Franklin craft stores and Western Auto automotive parts stores are organized in this way. A retailer-sponsored contractual VMS channel also organizes retail sellers, but the organization is managed at the retail level rather than the wholesale level.

Franchise systems are a special instance of contractual VMS where a central organization at one level controls almost all of the operations of its members. Many fast-food restaurant chains such as McDonald's, Subway, and KFC are organized according to the franchise system. However this type of channel structure is compatible with a wide variety of categories, including tax preparers, employment services, travel agencies, convenience stores, and car rental companies.

Consumer Cooperatives: The Other Contractual VMS

REI store

ZUMA Press/Corbis

The contractual VMS is often thought of as a relatively recent and innovative form of business organization designed to concentrate the buying power and channel power of its member retailers. However, consumer cooperatives began more than 150 years ago as retail consumers banded together to pool their collective purchasing power and meaningfully assert their influence in the marketplace. They have survived over the years because the root concept is so fundamental and universally appealing: private individuals working together to form an independent business entity to serve the collective needs of the membership.

Recreational Equipment Incorporated (REI) has been a trusted retailer of outdoor gear since 1938 and is now the nation's largest consumer cooperative. What began as a group of 23 mountain climbing buddies now boasts more than 3.5 million active members and more than 110 retail stores nationwide. In addition to leveraging its purchasing power for the benefit of its members, the company provides shoppers with the knowledge and confidence to explore and discover new adventures through frequent educational clinics and expert advice from REI staff members. The focus of the organization is to provide a pleasant and convenient shopping experience for its members. However, it is not only the members who benefit. REI has remained on FORTUNE magazine's list of the "100 Best Companies to Work For" since the list was first published in 1998.

REI differs from many for-profit organizations in its deep commitment to its customers' shared values and personal well-being. The organization's stated purpose is to inspire, educate, and outfit people for outdoor adventure and stewardship. At its core is a commitment to getting people outside and leading healthy active lives, caring for the planet by protecting shared natural spaces, and engaging others in making a difference. Members share this commitment and, in return for their loyalty to REI, receive an annual dividend. In 2008, through a 10 percent dividend on purchases, REI returned $94 million to members, retaining $30.2 million in net income to reinvest in the company while supporting the great outdoors with $4.3 million in community grants. While REI realizes that the company must be successful and profitable, its leadership also defines success by the value added to the lives of members, their communities, and society overall (Recreational Equipment Incorporated, 2012).

Administered VMS

Administered VMS is a product distribution model in which a single dominant channel member or channel captain coordinates the distribution-related decisions of the intermediaries. In most cases, this leadership role is not formally recognized by written agreements. It tends to occur when the market power of one channel member is sufficient to compel the voluntary cooperation of others. For manufacturers, this market power is most often a consequence of dominant market share within a product category (e.g., Kraft Foods). For retailers, it typically stems from operating a very large number of stores and maintaining high levels of market coverage in the regions it serves (e.g., Walmart).

At the retail level of distribution, channel leaders typically try to create merchandising plans and policies that they wish to enforce on all channel members. Nabisco, for example, might propose a shelf-space organization and allocation plan to its retailers to organize cookie and cracker in-store displays. Not surprisingly, the merchandising suggestions promoted by channel captains are usually of greatest direct benefit to themselves. The channel leaders' ability to secure the voluntary cooperation of other channel members relies primarily on their level of channel power. The means by which companies exercise their influence or power throughout the channel of distribution are discussed in the following section.

12.6 Channel Dynamics: Power and Conflict

Every distribution channel design or systematic arrangement of intermediaries encounters problems when its individual members pursue divergent strategies in the quest to achieve profitability and build market share. The potential for unproductive conflict within the channel is increased due to power differentials between participants and the inherent short-term inflexibility of channel designs. This section examines how the dynamics of channel power and conflict impact product marketing and the efficient operation of indirect distribution channels.

Channel Power

Channel power is defined as "the ability of a particular channel member to control or influence the decision making and behavior of another channel member, or one channel member's potential for influence with another channel member" (American Marketing Association, 2012). In distribution systems composed of multiple intermediaries, each adds value to the product being delivered to final consumers, but they all differ in their ability to exert pressure on others' decisions. Among the most common examples are demands for more favorable prices from sellers and pressuring others to take over the performance of some channel functions (e.g., customer service requirements).

Channel intermediaries' power to influence brand managers' decisions often arises from one or two sources. If a large proportion of a producer's total sales volume is handled by one channel, the manufacturer's dependence on the performance of those resellers gives them leverage. In other instances, a producer's poorly differentiated product will empower resellers to readily wield the threat of brand switching or shifting a large percentage of their sales efforts to competitive brands.

In each situation, the channel power that accrues to the intermediaries enables them to bargain with producers for volume-based discounts, lower list prices, and higher levels of merchandising support. In short, any terms of sale subject to negotiation represent opportunities to exert channel power against other channel members. Terms of delivery, for example, are often the subject of negotiation, since reducing the time between placing an order and making delivery enables the buyer to carry lower levels of inventory and reduce its related carrying costs.

Heinz tomato ketchup bottles on store shelf

High levels of brand loyalty among consumers have created significant channel power for Heinz Ketchup.

Associated Press

Channel power can reside with manufacturers, wholesalers, or retailers. All that is required for power to grow is an imbalance in the relative dependence of one channel partner on another. When producers are able to create high levels of selective demand for the brands they sell, they are capable of exerting product power. In these instances, other channel members recognize the need to carry the popular brand or risk losing sales. In the grocery industry, brands like Peter Pan peanut butter, Maxwell House coffee, Heinz ketchup, and Cheerios cereal have product power.

Middle power results from the ability of a single wholesaler to serve a large number of relatively small retailers. By sorting, accumulating, and allocating products from a wide variety of manufacturers, the wholesaler holds a degree of power over small retailers by virtue of their dependence. The efficiencies created by the wholesaler in creating assortment and the switching costs associated with finding other means to acquire the needed products give the wholesaler substantial bargaining power over its immediate customers.

Front power resides with large retailers who can bargain for special considerations from either manufacturers or wholesalers based on their relative size. When the market coverage established by a retail group accounts for a substantial percentage of a product's total sales within a region, others in the channel grow in their relative dependence on them.

Channel Conflict

Competition between channel partners to capture the greatest share of profitability from the final sale of distributed goods will inevitably create tension. Channel conflict is a general term used to refer to any form of discord or dispute between two or more channel participants (see Figure 12.3). However, it is most likely to occur when manufacturers disintermediate or go around existing channel partners by selling products directly to consumers or through new parallel channels of distribution. Other forms of channel conflict may arise between partners whenever there is a lack of consensus on the overall goals and operational norms for the distribution channel. The systematic study of how the division of channel power shapes the nature of conflict between intermediaries was first formalized by Stern and Reve (1980).

Figure 12.3: Potential sources of channel conflict

Figure showing how a manufacturer can side-step existing channel partners and sell directly to the consumer.

Channel conflict can occur when manufacturers side-step existing channel partners and sell directly to the consumer.

http://www.growthpath.ca/specialized\_expertise

In many instances, channel conflict is both inevitable and essential to the health of the distribution channel. Finding rational resolutions to disputes between channel members often creates more efficient operations. In fact, the solution to disagreements is often the primary means by which channels adapt to changing market conditions and shifts in the distribution of channel power. In most instances, the challenge for managers is to recognize and respond to the potential for channel conflicts before combatants' positions become entrenched and lasting damage is done.

Consider the potential problems that might arise if a producer decides to create a separate, parallel distribution channel to reach the final consumer. This is often the case when traditional channels are suddenly faced with online competition from a manufacturer's direct sales initiatives on the Internet. The existing channel recognizes this as a threat to sales volume and profitability. However, the motivation for the company is to grow sales, not damage relationships with the existing channel intermediaries. If handled badly, the direct consequence could be a loss of sales if channel partners are alienated and reduce their support for the product.

In the situation above, the effective resolution of the impending conflict needs to be in place even before rumors of the development of the direct sales online site reach channel intermediaries. The manufacturer needs to create both push and pull strategy options that will substantially reduce the damage inflicted on the traditional channel and establish a complementary relationship between the two, if possible. Sales incentives to middlemen could include a number of trade promotions that will improve the profit margin on each unit sold. Quantity discounts tied to sales volume and cash payments or allowances to induce retailers to prominently stock the product on their shelves could be effective. Promotional allowances could be paid to stimulate advertising and in-store merchandising. Ideally, some post-sale customer service functions could be shifted from the retailer directly to the manufacturer as a consequence of providing customers with access to the website.

Ch. 12 Conclusion

The design of distribution channels and administration of channel functions have tremendous consequences for marketers. They represent long-term investments in future sales and need to be carefully managed. Decisions related to channel structure, distribution intensity, customer service, and the effective use of promotional strategy and sales promotions should all be derived from the comprehensive marketing plan for the brand. In the next chapter, we will examine the special challenges that confront marketing managers when executing these decisions within the context of international markets.

Ch. 12 Learning Resources

Key Ideas

Critical Thinking Questions

 How can a distribution channel system be a source of competitive advantage? How can the choice of one system create higher market shares for a manufacturer than another?

 What specific factors need to be considered in selecting one channel system over another?

 Imagine that a new company is planning to manufacture and sell aftermarket windshield wipers for cars and lights in Buffalo, New York. What factors should they consider when deciding on their channel strategy?

 What kinds of costs and consequences would the company described above face if it abandoned its chosen channel of distribution after five years in favor of a completely different arrangement?

 How would you go about estimating the profit consequences of one channel system relative to an alternative while you're still in the planning stages?

 How might you determine whether a push or a pull strategy would be more effective in creating incremental sales for a brand? Can you imagine a circumstance in which you would rely on a push strategy in one channel system and a pull strategy in the other?

 In some parts of the world, you are likely to encounter people who regard channel intermediaries or middlemen as profiteers who exploit producers and consumers. How would you respond to them?

 Channel conflict between manufacturers and distributors is not uncommon. Sometimes it is caused by a conflict of interest between the two. What are the most likely reasons for this situation to arise?

 Imagine a situation where the manufacturer of medical record-keeping software is having a problem with its exclusive distributor in the United States. After several months of falling sales and discord between the partners, this disagreement comes to the attention of the business media. The producer's public relations officer goes on the record to quell rumors by dismissing the problem as simply poor performance by the distributor rather than any deficiencies in the product. What are the likely outcomes from this statement? What might the PR person have been attempting to accomplish?

 A century ago, the stability of distribution linkages depended on the good faith cooperation of the parties involved and agreements sealed by handshakes rather than written contracts. One advantage to this arrangement is that any of those involved could pursue alternative channel partners at their discretion. Why is it more important in today's business environment to have legally binding commitments that limit the flexibility of all parties?

 How do direct sales marketing channels in consumer markets differ from those in business-to-business markets? Be thorough in considering differences in products, selling strategy, pricing, and customer purchasing characteristics.

 Based on your familiarity with a product of your choice, create a diagram or flowchart that illustrates a likely channel of distribution for your favorite brand. Once that is complete, provide a list of what the customer at one intermediate level of the channel wants from the process. This could include issues related to transportation, delivery scheduling, inventory management, and warehousing requirements. How important are reliable availability, speed of delivery, lot size, product variety, convenience, and customer service?

 Under what circumstances is it advantageous for a business to use more than one marketing channel?

 Imagine a small manufacturer of specialty baking ingredients. After reviewing its annual sales performance, the management team realizes that it is near the point of exhausting its sales potential from its reliance on a sole distribution channel. What issues need to be considered and what steps need to be taken before beginning work on the development of an alternative channel? If the second channel poses a limited direct threat to sales from the first, how should the development of this alternative channel be presented to the original distribution partners?

 Consider the situation in the previous question. It is almost certain that the total sales volume will be substantially larger in different marketing channels. How can we be relatively certain of this without knowing more information? Identify the primary reasons that drive differences in the sales levels of alternate channels.

 It is common to see situations where the prices charged between channel intermediaries are lower in one channel system than another, even if the retail prices charged in both are identical. Why? Even if one of the alternatives is a direct marketing channel, the retail price is likely to be the same between the two levels. Why?

 Still comparing alternative channels, explain how one marketing channel with higher distribution-related sales expenses can be more profitable than the other.

 Dell Computer established its position in the industry as a successful pioneer in direct sales. What considerations would prompt the company to branch out to create alternative indirect marketing channels, including sales through Walmart?

 Mixed channel arrangements are said to exist when some target customers are accessed via more than one channel of distribution for the same brand. Under what circumstances would this be an intentional strategy? Identify three companies that rely on mixed channel product distribution systems.

 How might the intentional use of multiple channels impact the growth strategy of a business? Give an example.

 Does selling a product online always help businesses serve customers at a lower cost? Does it help or hurt customer service?

 Does a VMS have the potential to improve customer service and enhance the value of products for the final consumer?

Key Terms

Click on each key term to see the definition.

accumulation

The process of assembling and pooling relatively small quantities from various suppliers to create a larger, more homogeneous supply of similar products.

administered VMS

A distribution system in which a single dominant channel member coordinates the distribution-related decisions of the intermediaries in the absence of formal written agreements.

agent

A person or company that represents others for the purpose of negotiating sales but does not take title to the product being sold. An agent that does not have a permanent relationship with the company he or she represents is a broker.

allocation

The phase of the sorting process that breaks down the accumulated product supply into smaller lots.

assorting

The process of creating a collection or assortment of products from multiple sources for use in relation to each other.

backward integration strategy

A strategy by which intermediaries acquire control of distribution partners that precede them in the channel to expand control over the supply and price of a product.

broker

A middleman who acts as a go-between for buyers and sellers but does not serve as a permanent representative for either.

channel captain

The dominant channel member with an administered VMS.

channel conflict

Any form of discord or dispute between two or more channel participants. Occurs most often when manufacturers disintermediate or go around existing channel partners by selling products direct to consumers or other parallel channels of distribution.

channel intermediaries

Organizations that specialize in services directly related to the process of moving goods from producers to consumers. Sometimes referred to as middlemen.

channel length

The number of levels used to create a distribution system.

channel of distribution

An interlinked system of institutions that work together to perform the functions necessary to move products from where they are created to where they are demanded.

channel power

The capacity of channel members to influence the behavior of other channel members.

channel width

The number of channel members operating at a given level within a distribution system.

contractual VMS

A distribution system that coordinates the creation and distribution of products through legal contracts specifying the rights and obligations of channel participants.

corporate VMS

A channel structure in which one organization owns either all channel members in the distribution chain or the firms operating at an adjoining level of distribution.

direct channel

A distribution path that moves the product from the producer to the final consumer without reliance on any intermediary channel members.

distributor

In indirect B2B channels a reseller that performs the tasks associated with wholesalers in B2C markets.

exclusive distribution

The level of market coverage in which a product is distributed through only one retailer within a particular region.

facilitating agent

A company that performs tasks related to the physical distribution of a product other than buying, selling, and transferring title. This category includes banks, transportation companies, legal services, market research firms, and public warehouses.

forward integration strategy

A strategy in which wholesale and retail functions are created or acquired by a manufacturer to provide more direct control over the distribution of products.

front power

Channel power exercised by a relatively large retailer.

indirect channel

A distribution path that relies on one or more intermediary organizations to move the product from the producer to the final consumer.

intensive distribution

The level of market coverage in which a product is sold through all suitable wholesalers and retailers.

jobber

A wholesaler that buys from manufacturers and sells exclusively to retailers.

manufacturer's agent

An agent who works on a contractual basis to sell the products of multiple producers.

market coverage

The proportion of retail or wholesale intermediaries selling a specific brand relative to the total number of these outlets that sell comparable products.

merchant middleman

Any channel intermediary who buys goods and takes legal title to them.

middle power

Channel power in the possession of a wholesaler.

middleman

An independent business that provides connections between buyers and sellers. Wholesalers and retailers are the primary types of middlemen.

product power

Channel power residing with the product's manufacturer.

pull strategy

Using promotional efforts to build selective brand demand at the consumer level. The brand is drawn through the channel as a consequence of consumer response to advertising and sales promotions.

push strategy

Using financial incentives to encourage channel members to carry and promote a product for resale to subsequent levels of the channel.

retailer

A channel member that sells to the final consumer.

selective distribution

An intermediate level of market coverage in which a product is distributed through a limited number of wholesalers and retailers.

sorting out

The initial phase of the sorting process that reorganizes a mixed product supply into discrete inventories that are relatively consistent with respect to kind, size, or quality.

sorting process

Channel activities that create a mix of goods and services from diverse producers to match the preferences of consumers.

total cost concept

The principle that requires managers to explicitly consider all the costs related to each alternative design for distributing goods to customers. These costs include transportation, warehousing, order processing, and distribution-related packaging. However, the concept also recognizes that minimizing these costs may be at odds with achieving high levels of customer service.

transportation

A broad term that encompasses the physical movement of products from one place to another and all of the intermediate steps involved in the process as well.

vertical marketing systems (VMS)

Coordinated channel systems made up of horizontally and vertically aligned participants, managed to optimize operating economies and market impact.

wholesaler

A channel participant that buys and subsequently resells goods in smaller quantities to retailers or other customers. Often referred to as distributors in B2B markets. Wholesalers who buy from producers and sell only to retailers are called jobbers.

Web Resources

This website provides a comprehensive directory of logistics resources on the Internet. It includes recent articles on a diverse range of topics related to the physical distribution of products. This includes supply chain management, transportation systems, and warehousing.

http://www.logisticsworld.com

Home of the Transportation Research Board of the National Academies. This nonprofit organization has a mission to promote practical innovation in transportation through research. The site provides free access to more than 50,000 papers, abstracts, articles, and reports on topics related to all phases of transportation research.

http://www.trb.org

This site provides access to an online text entitled The Geography of Transport Systems. Formally known as Transport Geography on the Web, this is the site of a project that has been in development on the Internet for more than a decade. It is an excellent reference for the study of how geographical considerations impact the design and operation of transportation systems.

<http://www.people.hofstra.edu/geotrans/index.html>

Part VI: Managing Marketing in the New Economy

Parts IV and V of this text examined how the elements of the marketing mix combined to create, communicate, and distribute products of value to specific target markets. This concluding section extends this theme to examine how the process of marketing management itself has been impacted by significant changes in the global economic environment. Chapter 13 investigates the implications of how the development of a new economy has reshaped our understanding of several core marketing constructs. The rapid international expansion of the Internet and corresponding growth of e-commerce has produced profound changes in the way products are created, sold, and distributed on a global basis. Chapter 14 extends the study of this subject matter and concludes the text by exploring the process of marketing management within an international context. Critical topics of interest within this chapter include market selection and alternative market entry strategies.

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Chapter 13: Marketing Challenges in the New Economy

Chapter 14: Managing Marketing in the Global Economy

Chapter 13

Marketing Challenges in the New Economy

Montage of people using digital products.

Associated Press

Learning Outcomes

By the end of this chapter, you should:

 Be able to identify how B2B and B2C marketing practices have changed in the new economy and recognize the implications of channel disintermediation.

 Understand how mass customization has enabled consumers to participate in the process of creating products in the new economy and the significance of service-dominant logic as an emerging marketing paradigm.

 Be able to identify the primary factors driving the phenomenon of globalization and evaluate the consequences of international economic integration.

 Understand the significance of a company's Web presence as both a promotional tool and an e-commerce vehicle.

Ch. 13 Introduction

The global economy has experienced remarkable growth since the 1990s as a direct consequence of advances in computer technology. For many companies, productivity and profitability have grown at accelerating rates as faster microprocessors, the expansion of fiber-optic networks, and the growth of wireless technologies have fueled the emergence of the Internet as a significant force in B2C and B2B commercial markets. These technologies, when combined with the lowering of trade barriers and the emergence of international agencies to promote free trade, have contributed to the rapid expansion of truly global product markets and growing globalization.

This chapter examines how the traditional processes and practices of marketing management are being fundamentally challenged by forces that will continue to reshape and refine the world economic system throughout this century. Although the most visible and powerful of the factors driving this transformation may be the Internet, the focus of the chapter is on what this global information network has made possible rather than on the technology itself. The beginning sections of this chapter introduce the concept of channel disintermediation. This term refers to the elimination of middlemen primarily as a consequence of pursuing e-commerce alternatives. This is followed by an examination of how conceptions of products and services are being substantially altered in the new millennium. Of particular note is how technology has produced new opportunities for marketers to personalize and customize products to suit buyers' preferences. The concluding sections focus exclusively on the subject of globalization. Although there are a wide range of social, political, and economic views about the relative merits of international trade, there is little disagreement that the consequences for marketers are profound.

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Workers working on an air conditioning unit on a building.

Channel disintermediation has impacted every industry to some degree over the past 25 years.

Associated Press

Badger Service & Supply is a regional wholesale distributor of heating, ventilation, and air conditioning (HVAC) equipment headquartered in rural Wisconsin. The firm sells a complete line of leading-edge products to licensed contractors, including replacement components and supplies. Operating as a stocking distributor, the company has a substantial investment in inventory, carrying more than 10,000 products and parts. It employs two technical sales representatives to help local contractors with service-related issues, a warranty administrator to handle warranty claims, five outside salespeople, and seven inside sales representatives. It provides training programs for its customers and initiates regional promotional efforts to support the products it sells. A small staff of engineers helps support the company's larger customers with their application/design needs.

Recently, Badger has struggled to maintain sales revenue and profitability as large numbers of customers have turned to online suppliers to meet their HVAC product needs. Despite having reliably served its customers for more than 60 years, the company may soon go out of business. In many respects, Badger is a victim of the new economy.

At one time, wholesale distributors and other channel intermediaries were regarded as immune from the direct impact of Internet-based competition by virtue of both the value-added functions they provided and their geographic proximity to channel end users. The protective wall that being closer to the customer once provided is being rapidly eroded, however, as foreign competitors have pursued e-commerce strategies to shorten distribution channels or eliminate independent intermediaries altogether. Over time, buyers' shifting perceptions of value have led to the commoditization of products and an increasing emphasis on price as the primary basis for competition rather than service.

The challenges that threaten this firm's continued existence and the limited strategic alternatives available to them illustrate some of the radical shifts in competitive dynamics that have emerged in the new economy. Badger's response to the havoc produced by these forces has relied heavily on revisions to the firm's pricing policies. However, chronic price dealing and other defensive pricing strategies over the past five years have accelerated the decline in profitability rather than curtailing it (Frickenstein and Finch, 2006).

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The Internet and e-commerce have created important new capabilities and opportunities for both consumers and producers. For consumers, the new economy has provided access to a wider range of goods and services from around the world. They enjoy greater direct influence on the character of the products being created and even take an active role in the design of some of them. Information technology has enabled them to obtain and share an ever-growing database of reviews and recommendations about what to buy and what to avoid.

Companies have leveraged the power of the Internet to extend the geographic reach and size of their markets. Being directly connected to their customers has provided opportunities to reduce costs, improve customer service, and acquire a better understanding of their target markets. Clearly, this new economy has had a profound impact on both businesses and their customers.

13.1 The New Economy

The term new economy originated in the popular press when Time magazine ran a cover story in May 1983 heralding a fundamental sea change or transformation of the U.S. economy from one based on manufacturing and heavy industry to one based on new and emerging technologies.

Despite its popularity over the past 30 years, there is not a generally accepted definition for the term new economy. Within the discipline of marketing, the primary focus has been on the impact of information technology and the Internet on the domestic and global economy. This broadly defined term incorporates both emerging information-driven industries (e.g., biotechnology) and technology-driven changes in the way businesses operate (e.g., e-commerce). The term is also used occasionally to highlight distinctions between the telecommunications infrastructure that supports electronic commerce (e.g., Internet service providers) and the industrial infrastructure that supports the "old" manufacturing- based elements of the economy.

Think About It

Sometimes people get carried away when contemplating the impact of new ideas and ways of doing things. It has been argued that the inescapable consequence of the new economy will be that all forms of traditional industrial production will be relocated from traditional industrial economies to less developed nations with lower labor costs. As a consequence, only high-value information services and high-technology occupations will remain in so-called first-world nations. In turn, the prosperity of these societies will become entirely dependent on the success of the new economy. Does this seem likely to you?

What natural and economic obstacles exist to prevent this outcome? What factors or events might lead people to worry about this possibility?

E-commerce refers to the purchase or sale of products over an electronic medium such as the Internet or other computer facilitated exchange network. To effectively promote the direct sale of products via the Internet, supporting technologies such as electronic funds transfer, online order processing, and inventory management software are frequently employed. In some instances, these technologies may displace some intermediaries from the distribution channel since their functions are being shifted to producers. In this circumstance, e-commerce acts as the primary driving force behind a process referred to as channel disintermediation.

Channel Disintermediation

Channel disintermediation, as illustrated in Figure 13.1, refers to bypassing or eliminating one or more intermediaries from the supply chain or channel of distribution. Within the context of the new economy, this most often refers to "cutting out the middleman" by purchasing directly from a manufacturer's or reseller's website. The opening vignette about Badger Service & Supply illustrates this phenomenon clearly. Many of that company's customers were able to obtain both the products and services they required by going online rather than working with a regional supplier. Although e-commerce alternatives often offer lower prices on many products, the cost savings can sometimes temporarily obscure offsetting losses in customer service and the value of a knowledgeable, full-service sales staff.

Figure 13.1: Channel disintermediation in the supply chain

Visual of channel disintermediation, which involves removing one or more parts of a supply chain or channel of distribution.

Channel disintermediation in the supply chain involves removing one or more parts of a supply chain or channel of distribution.

Potential Benefits

In many instances, however, the elimination of channel intermediaries can have several significant benefits for both buyers and sellers. Product purchasers often gain greater convenience, faster delivery, and lower prices. Sellers have the opportunity to respond to their end users directly. This may allow them to capture a portion of the profits that would otherwise have to be shared with channel partners and often reduces the complexity and costs associated with maintaining high levels of customer service and satisfaction.

The diffusion of information via the Internet has fueled the progressive expansion of channel disintermediation over the past several decades. As product- and supplier-related information has become widely available online, price competition has intensified in many markets. And as buyers become more knowledgeable about products and prices, they sometimes instigate the process of disintermediation by initiating direct contact with preferred sellers. In many instances, both parties are responding to positive cost-related incentives since bypassing distributors, wholesalers, and retailers allows buyers to pay less and enables sellers to earn more.

Potential Drawbacks

Although the opportunity to sell directly via the Internet is appealing to many sellers, it has several potentially negative consequences. An organization's traditional channel partners will be directly harmed as a result of any migration toward direct sales. Cutting out wholesalers, retailers, agents, and distributors from some portion of the firm's sales will necessarily create channel conflict. These intermediaries may, in turn, provide less sales support for those products and shift their backing to competitive brands.

Other negative outcomes associated with moving away from traditional channel relationships to e-commerce can result from failing to fully understand the supporting infrastructure required to compete online and serve customers directly. If channel intermediaries had previously performed the tasks associated with creating the desired product assortments for buyers, companies new to direct Internet sales may be overwhelmed by the demands that arise from having to fill a much larger volume of orders for much smaller product quantities. The order fulfillment and shipping capacity of firms that rely on traditional channel arrangements is simply not compatible with the demands of completing a large number of small transactions since these firms have previously relied on intermediaries to perform the sorting process. This deficiency is critical when competing in an online environment where customers expect fast and accurate billing and shipping.

As stated in the previous chapter, the functions performed by channel intermediaries can be shifted from one channel to another, but they cannot be eliminated. The relatively high costs associated with processing and shipping large numbers of small orders sometimes leads firms to recognize that the damaging effects and unanticipated increased costs associated with disintermediation outweigh the benefits. When this results in the restoration or reintroduction of an intermediary between buyers and sellers, the process is referred to as reintermediation.

Although disintermediation can result in the complete elimination of channel intermediaries, many of these specialists survive because their services add value to the process of meeting buyers' needs across a wide range of product markets. Warehousing, inventory management, storage, and shipping are valued services that are difficult to cost-effectively replace with in-house or company-owned substitutes. Consequently, it is not surprising to see reintermediation occur as online sellers restore relationships with previous channel partners or add new types of intermediaries.

New Costs in the New Economy

Google search engine page with search results displayed on a computer monitor

The primary objective of search engine optimization is to make your site easier for prospective customers to find.

All Canada Photos/SuperStock

In addition to performing traditional functions (e.g., holding inventory in warehouses), online merchants face new types of costs in the new economy. Both the presale and postsale tasks associated with online sales differ substantially from traditional business models. Developing effective websites, maintaining current product information, automating order processing, and performing search engine optimization are all specialties that a company may opt to acquire from established providers rather than developing on an in-house basis.

Search engine optimization (SEO) is a term used to describe the process of improving the features of a website so that search engines can find the pages easily and index them. The goal of SEO is to have a company's webpage ranked as high on the search results list as possible. The design features used to promote the rank or visibility of a website include the choice of keywords used in the site's text paragraphs and the placement of those words on the page. In general, higher ranked pages are visited more frequently by prospective buyers. For companies that choose to limit their product's availability to the Internet, competing effectively for customers' attention in this crowded virtual space requires an effective and diligent search engine optimization program.

The Fate of Industrial Distributors in the New Economy

Although almost any good can conceivably be marketed and sold online without the assistance of intermediaries, certain types of B2B products are more easily and efficiently moved from seller to buyer with the help of industrial distributors. Distributors remain vital channel intermediaries to the extent that they add essential value to the supply chain. Traditional industrial distributors play four primary value-adding roles that will determine their long-term viability in the new economy:

 An aggregator of demand buffering manufacturers from orders too small and too logistically complex for them to handle.

 A consolidator of multiple, often competing suppliers that offer customers one-stop shopping for complementary products and accessories.

 A deployment point, putting each manufacturer's inventory closer to consumption for faster customer delivery.

 A local contact point for billing, technical product and application information, and other customer services (Girard, 1999).

Both product type and complexity are major factors in determining the relative contribution of distributors in the new economy. Consider product components and machine parts such as fasteners and belts. Even in the new economy, distributors are relied upon as primary sources due to the many sizes and product variations within these categories. Buyers often rely on the expertise and product knowledge of distributors to identify the right parts and components. The same is true of components that are critical to the manufacturing process, such as pressure gauges and monitoring meters. Ready availability and fast delivery are essential when considering sources for mission-critical products.

Refined chemicals and basic metals are often handled through distributors or brokers who buy in large quantities from producers and resell in smaller quantities. A metal distributor, for example, can purchase from many very large producers such as U.S. Steel and provide metals in quantities and dimensions specifically matched to the production requirements of smaller firms. In situations of this sort, it would be unrealistic for any steel manufacturer to sell products directly to each end user.

In contrast, highly standardized products with uniform capabilities and capacities are more easily sold direct from the manufacturer to the final customer. Electric motors, generators, and standard electronic components are products that are well suited to e-commerce business models.

Just as the new economy has promoted and facilitated substantial changes in the way that products are distributed, the Internet and developments in information technology in general have changed the character of the products themselves. The section that follows will investigate how technology has enabled marketers to personalize and customize products to suit buyers' preferences. It will also examine how the marketing paradigm as a whole may be shifting from a product-based perspective to a new conceptualization focused on the customer's direct involvement in the design and production of goods and services.

13.2 Emerging Product and Service Concepts

Smartphone with applications.

Mass customization is an essential element of the business model for smartphones. Customers have the ability to personalize their phones with applications that allow access to e-mail or social networking accounts.

Imagebroker/Thinkstock

The characteristics of e-commerce and the new economy have challenged many traditional conceptions about products, branding, and the role of the customer in the process of creating unique goods and services. Two of the most provocative concepts are mass customization and the service-dominant logic paradigm. Mass customization is a natural extension of the marketing concept that has only been made feasible on a broad scale in the age of the new economy. It refers to a company's capability to create substantial quantities of unique products, designed to each customer's specifications, at a relatively low cost. The service-dominant logic paradigm goes one step further, explicitly recognizing that consumers play an essential role in the actual production process.

Mass Customization

Mass customization refers to a company's ability to efficiently produce large volumes of products designed to customers' specifications. To be competitive, this often requires the unit cost of production to approximate the unit cost of comparable standardized, mass-produced goods. The capabilities needed to sell competitively priced tailor-made products is almost always a direct consequence of applying high-tech enhancements to the processes of promoting, designing, creating, and distributing such products.

In Chapter 1 we introduced Michael Porter's three generic marketing strategies: product differentiation, cost leadership, and market focus. Product differentiation strategy emphasizes distinguishing your brand from competitors' brands based on the benefits that buyers value most. Cost leadership strategy enables a firm with lower costs of production to attract price-sensitive customers by selling at relatively lower prices than competitors. Market focus strategy is not a distinctly different strategy from the other two, but it describes the scope over which the firm will implement either cost leadership or differentiation strategies. Implicit in choosing from among the three generic strategies is the assumption that effectively differentiating your brand requires investments in creating customer value that make your brand incompatible with cost leadership. Mass customization directly challenges the validity of this assumption by employing technology to facilitate the production of customized products on a large scale at costs equivalent to conventional mass-produced goods.

In the traditional manufacturing economies of the twentieth century, mass-production technologies and methods provided the means to produce large volumes of finished goods at relatively low prices. The drive to realize the rewards derived from economies of scale in production pushed producers to focus on building high sales volumes for standardized products. In fact, the efficiency of the production line model requires the standardization of both the manufacturing processes and the products produced to achieve the lowest possible per-unit costs. Responding to consumer demand for customized or unique alternatives necessarily raised the associated costs significantly. Within this old economy paradigm, the term mass customization is an oxymoron.

The new economy introduced the technological means to make mass customization and the personalization of products possible with relatively little or no increases in unit cost. The ability to custom-design and create unique products for a large base of customers at relatively low costs hinges on the power of computers, the Internet, and other digital technologies. Mass customization has application across a wide range of industries in both B2C and B2B product markets. It is evident in both traditional and e-commerce companies alike.

The iTunes online music store

Apple's iTunes online music store is among the best known and most successful examples of mass customization.

Associated Press

Among the best known examples of mass customization is the Apple iTunes store. As with many other digital services, it is sometimes difficult to precisely define what iTunes is. From a strictly programming perspective, it is a media program that enables users to download, play, save, and organize digital music and video files. As an e-commerce site, it is an online retail store where customers can purchase and download music, music videos, television shows, games, audiobooks, and podcasts. In the case of buying music, this utility enables consumers to purchase only the specific songs that they want rather than pre-assembled collections or albums of music. In effect, buyers are able to create their own mix CDs and compilations according to their unique preferences.

Digital content providers of all kinds routinely provide customized products for their online customers. Software providers such as Microsoft provide a limited range of customization options for their most popular Microsoft Office products to suit the needs of different types of customers. However, smaller firms such as Comtech Solutions have built their business model on their capacity to create customized software solutions that are unique to each customer's needs.

A personalized Yahoo homepage.

A personalized home page can promote loyalty and strengthen relationships with regular users of a site.

Associated Press

Although the range of customized digital goods being sold online is growing each day, the presence of customizable services on the Web is growing quickly as well. Insurance companies such as Progressive use short questionnaires and menu-driven customization options to generate rate quotes for auto, home, and life insurance. Similar capabilities also exist for e-commerce sites selling financial, legal, and educational services.

E-commerce provides the means for tangible products to be customized for buyers as well. Floral arrangements can be custom designed and dispatched for delivery with a personal note from the sender from thousands of miles away. Everything from preferred tobacco blends and custom-designed wines to coffee mugs, books, and t-shirts can be easily personalized by placing an order online. In fact, even the Internet portals that enable buyers to find sellers can be readily customized to suit each individual's preferences. The Yahoo.com portal screen, for example, can be modified by the user to show the local weather, hometown sports, preferred news categories, and even the individual's personal stock portfolio.

The overall capacity for mass customization within any organization rests primarily on two cost considerations: product production and product distribution. Mass customization flourishes in markets where achieving economies of scale no longer depends on the creation of large volumes of standardized products. Independent of the Internet, the application of technology has reduced both production and distribution costs for many types of goods and services in the new economy era. Computers have made it less expensive to fabricate and deliver everything from houses and bicycles to books and shoes.

Growing opportunities for mass customization and the personalization of goods and services requires marketing managers to think differently about the sources of competitive advantage in many markets. The service-dominant logic of marketing in the current era provides a new perspective on the customer's role in shaping the behavior of companies in the marketplace.

Think About It

How has mass customization changed the value and the role of established brands in B2C markets? B2B markets?

Will branding take on lesser or greater importance to successfully introducing and managing products in an online environment? Why?

Service-Dominant Logic

In the midst of the development of the new economy paradigm, a new perspective on marketing management itself has begun to emerge. "In the new economy, the gap between consumers and producers blurs. As mass production is replaced by mass customization, producers must create products that reflect the requirements and tastes of individual consumers. In the new economy, consumers become involved in the actual production process" (Tapscott, 1997).

The growing impact of customer participation in the design of the products they buy is evident in a variety of tangible and digital goods and services sold over the Web. E-commerce merchants such as Dell.com allow consumers to design their own computers on their website. Procter & Gamble's Reflect.com website enables women to create their own personal line of makeup, skin care, and hair care products. Chipshot.com allows buyers to custom order golf equipment. Even Ford and GM have options for customers to order custom cars. Each of these examples is consistent with the emergence of a service-dominant logic of marketing management.

The service-dominant logic view is a radically different way to consider the purpose of marketing management. Traditional, goods-centered views of the marketing function recognize that value is embedded in the production of tangible output. Though buyer preferences drive the marketing process, customers are viewed as passive recipients of the product being produced. Service-dominant logic is a service-centered view where "value is defined by and co-created in concert with the consumer" (Vargo and Lusch, 2004). Consequently, serving the customer's desire for custom-designed products displaces the emphasis on simply marketing standardized goods and services. Within this context, the concept of service also reflects the company's role as the collaborator in product design rather than simply the maker of goods.

The customer can be either a conscious or unaware collaborator in this process. Ordering custom trout lures from Ken's Custom Tackle (http://www.kenscustomtackle.com), for example, requires the buyer's deliberate involvement in specifying the product design. However, customers may also provide Web vendors with valuable information on their shopping habits without knowingly contributing to a database. With each visit to a company website, for example, they leave a trail indicating how they navigated to reach the site, how they interacted on the company's Web pages, and which links they clicked on.

Personalizing the Buying Experience at Amazon.com

Amazon.com has been an innovator in developing the ability to personalize the buyer's shopping experience. By tracking each customer's purchases, it is able to identify groups of shoppers who share similar preferences. This enables Amazon to use other consumers' buying patterns and product evaluations to create lists of recommended purchases that similar customers are likely to have an interest in. The fact that these anonymous referrals are drawn from the feedback and buying behavior of fellow customers adds credibility to the recommendations. Should this be surprising?

Take, for example, the results of a recent Nielsen survey:

"Despite an ever-expanding array of advertising platforms and sources, consumers around the world still place their highest levels of trust in other consumers, according to a recent global Nielsen Internet survey. Conducted twice a year among 26,486 internet users in 47 markets from Europe, Asia Pacific, the Americas and the Middle East, Nielsen most recently surveyed consumers on their attitudes toward thirteen types of advertising—from conventional newspaper and television ads to branded web sites and consumer-generated content. The Nielsen survey found that overall, consumers trust other consumers above all else! 78% of respondents said they trusted—either completely or somewhat— the recommendation of other consumers" (Nielsen, 2007).

More data from the survey are available in Figure 13.2.

Figure 13.2: Consumers trust other consumers most

Results of a survey to determine how much consumer trust different forms of advertisement.

Nielsen 2007

The range of communication vehicles available to consumers in the new economy is truly astounding. Groups of consumers with common interests can congregate via Facebook, MySpace, LinkedIn, Google+ or just plain blogs. Collaborative product evaluation and recommendations can be found from Angie's List to Craigslist and from Digg.com to eBay. Information can be disseminated via e-mail, Twitter, YouTube, or any number of social media outlets.

Now, consider how much more powerful this conclusion is when you recognize that product value in this new economy is co-created by companies together with their customers (Prahalad and Ramaswamy, 2004). If the value of a purchase is embedded in user-driven products, and consumers are the most trusted source of product-related information, is it reasonable to conclude that consumers are truly the sovereigns of this new economy?

The relevance of this service-dominant logic to the practice of marketing management lies in understanding the consequences of customers shaping product and service specifications. As co-creators of value, the buyers' involvement in the process of designing products shifts the competitive focus from how to make good products to creating a service-driven organization that effectively captures buyers' contributions to the process of creating goods. Consequently, intangibles such as specialized knowledge of customers, online connectivity with markets, and customer relationship marketing take on greater importance. Learning how to best capture the information required to serve the needs of the customer then becomes the focal point of the firm with this service-dominant logic.

For many types of digital products and services, distribution costs in the new economy are so low and independent of distance from the buyer. Consequently, the relevant market area for many online sellers is geographically limitless. Inventories are virtually limitless as well and without cost. Expanding geographic markets, however, also creates a much wider diversity of potential competitors. The next section of this chapter addresses the growth of international trade and the growing interdependence of global cultures in the new economy.

13.3 Globalization in the Marketing Context

Within the broad context of economics, the term globalization refers to the process by which world economies have become increasingly interrelated, integrated, and interdependent in recent decades. Advances in information technology and the reduction of trade barriers such as tariffs and quotas have greatly facilitated more efficient international trade. With respect to its significance for marketing management, globalization refers simply to "the practice of global branding and localized marketing adaptation" (Lascu, 2008). Central to brand management on a global level are decisions about whether to standardize the essential character of products across multiple international markets or adapt them locally to suit local preferences. The term is also used to refer to an organization's efforts to expand its operations to new countries and markets.

Most companies are directly or indirectly impacted by the phenomenon of globalization. Consider the case presented at the opening of this chapter. Badger Service and Supply thrived in the backwoods of rural Wisconsin for more than 60 years by serving the needs of the customers within its geographic market. In fact, its nearest major competitor was located more than 100 miles away. However, the Internet changes many things. In this case, it brought competitors from throughout the world to the desktops of Badger Service and Supply's customers. There really is no place to hide in the new economy. Whether compelled by competitive necessity, interactions with suppliers, or the expectations of customers, most companies will have to respond to the effects of globalization. Failing to do so will result in losing business to competitors or failing to take advantage of new market opportunities.

Forces Fueling Globalization

Workers in a clothing factory in Bangkok, Thailand

Outsourcing production to less developed nations may have both positive and negative effects on the local economy and culture.

Associated Press

A number of forces or drivers within the business environment have contributed to the accelerating pace of international trade and globalization of markets. The World Trade Organization has emerged as an effective global agency for regulating international trade, promoting trade agreements, and resolving disputes between nations. Economic cooperation between nations has created several trade blocs throughout the world where regional trade barriers are reduced among the participating countries. These include the European Union (EU), Association of Southeast Asian Nations (ASEAN), and Central American Integration System (CAIS). Regional economic integration and cooperation has also facilitated international trade agreements such as MERCOSUR in South America and NAFTA in North America.

Several other forces have also contributed to the growth of globalization in recent years. For some nations, the pace of economic growth fueled by the specialization of production and corresponding comparative advantage has outgrown domestic demand. The aggregate output from the electronics industry in Japan and clothing production in Thailand, for example, far exceed the level of domestic market demand. The search for new markets and profits drives international sales and usually creates opportunities for multinational agreements or combinations with new business partners outside the producer's home market.

Many of the factors that promote greater globalization are specific to individual nations or regions. Improvements in the transportation infrastructure within and between some countries have enabled the mass migration of people and goods across national boundaries. Improved telecommunications capabilities have also contributed to the greater mobility of people and products. Over the past few decades, the economic systems of several nations have transitioned from closed, government-directed schemes to truly open economies. This process is readily evident in many Eastern European nations, China, and Vietnam. However, information technology and the Internet have had a pervasive and profound impact on international trade throughout the world.

In many ways, the Internet and the growth of e-commerce have emerged as the great equalizers of the new economy. In addition to providing both the smallest and largest companies with worldwide exposure, the direct costs associated with creating an outstanding Web presence are roughly comparable for each.

Think About It

Globalization has had far-reaching consequences on the lives of billions of people around the globe. However, there is no clear consensus as to whether these changes have created a net benefit or a net loss. Consider the list of globalization pros and cons in Table 13.1.

Which side of this argument is more persuasive or compelling for you? Why?

Are there considerations that you feel should be added to this list?

Table 13.1: Globalists versus anti-globalists

Advocates argue that globalization . . . Critics argue that globalization . . .

accelerates economic growth and promotes higher standards of living, better health, and longer lives. imposes poverty and financial hardships in the name of market capitalism and greed.

can lift millions of people out of poverty. creates record profits for multinational corporations while the worldwide income gap between the rich and poor continues to grow.

benefits consumers by providing a greater variety of goods at lower prices. results in U.S. jobs being shipped overseas to low-wage nations.

increases employment and promotes better working conditions. promotes poor working conditions and abuses of workers.

promotes environmental responsibility by providing the wealth required to make positive changes. exploits local governments and the environment for the sake of financial gain.

can provide the means to promote economic freedom and protect human rights. supports trade in human bondage and slavery.

fosters democratic reforms. reduces the sovereignty of nations by making national laws subordinate to international trade agreements.

 threatens the health and economies of agricultural communities.

Table adapted from Batterson and Weidenbaum (2001).

The New Global Economy

Jar of Marmite on a table with toast.

Marmite is nearly as popular with children in the United Kingdom as peanut butter is with most U.S. kids.

agefotostock/SuperStock

Several attendant advantages of the new economy technologies have application on a global scale. As we have already seen, e-commerce has the potential to streamline the product distribution process by means of channel disintermediation and Web-based customer service. The nature of what is being sold can be reshaped as marketers respond to customer preferences through the mass customization and personalization of the products being sold. In addition, the Internet provides a powerful engine that gives both marketers and customers global reach, 24-hour access, and the instantaneous delivery of digital products on a worldwide basis.

As e-commerce and the Internet have promoted the globalization of consumer and product markets, there have been several profound second-order effects. As consumer preferences and cultural values are shared via mass media, buyer preferences have converged with respect to many types of products. This is readily evident in markets for fashion, entertainment, and music. This convergence has created opportunities to reduce costs by standardizing some marketing activities and products.

In some cases, however, the convergence of buyer preferences has also created new opportunities by increasing product-specific demand to a point where it becomes financially viable for companies to serve geographically diverse markets. Small pockets of consumers with converging preferences, dispersed across the globe, can be aggregated into substantial market segments. Given the declining costs of mass customization discussed in the preceding section, this requisite minimum level of demand is also generally declining over time.

Consider the case of Marmite (http://www.marmite.com), a sticky brown food product sold in the United Kingdom that is most commonly spread on toast or used in sandwiches. Many British children are raised on this product in the same way that many U.S. kids are raised on peanut better. Consequently, it is a much beloved and sentimental product that is greatly missed by many British expatriates living abroad. Given the broad dispersion of former UK residents around the world, there are relatively few local markets where the demand is sufficient to warrant stocking the products in traditional stores. However, this geographical diffusion of buyers poses no obstacles to online vendors. Companies like Expat Direct (http://www.expatdirect-uk.com) can create virtual food shops to meet the needs of buyers from around the globe.

Think About It

The KOF Index of Globalization measures and ranks 181 nations according to several globalization-related criteria. These include global connectivity, economic integration and interdependence, and technological infrastructure. The most current data can be downloaded from http://globalization.kof.ethz.ch/. But before you go there, consider the following:

Which countries do you expect to see in the top 10? Where do you expect to find the United States?

After you've looked at the list, identify the rankings that surprised you the most.

The new economy facilitates many good things and represents many important opportunities for marketers in the 21st century. Although our focus to this point has been primarily on e-commerce, there are many goods and services that cannot be sold directly via the Internet due to the nature of the product itself. In these cases, the Internet may play an important role for many companies as a source of product and brand promotion.

13.4 Website Image and Information

As both a communications and distribution channel, the Internet offers immediate global access to a company's products. Even small, locally based companies can create an online presence that rivals their largest competitors. The brand and company image conveyed online is a function of the information presented. Companies that appear to have substantial depth and width of product inventory, for example, may be relying on outside suppliers to fulfill customer orders without ever coming into direct contact with the products. Many of the traditional cost-related barriers to building sales volume and market share on an international basis are drastically diminished by the efficiencies of e-commerce.

A customer signing papers to rent a car at an Enterprise Rent-A-Car location.

Enterprise Rent-A-Car competes internationally by focusing its resources and marketing efforts in the most popular business travel destinations.

Associated Press

The cost savings linked to e-commerce marketing are most readily evident in the direct sale of products in digital formats such as software, games, movies, and e-books. However, the brick-and-mortar retail presence of fast-food restaurants or rental car agencies, for example, cannot be wholly replaced by websites. Nonetheless, most marketers of this kind are eager to establish a global Web presence for their brands for promotional reasons rather than to facilitate direct e-commerce transactions.

The most critical and essential reason for most companies to establish a positive Web presence is that the Internet has become a primary source of product information for many prospective customers. Their reliance on company-sponsored websites, product evaluation sites, and social networks for product information continues to grow each year. Even for products that cannot be purchased online, the Internet has become a principal destination for consumers seeking information. Increasingly, people expect to easily find the information they want in a user-friendly format on the Internet. Companies that fail to meet this expectation will certainly suffer as a consequence.

The international exposure provided by a corporate website can also provide product information and marketing communications to an audience in advance of the company's introduction to their geographic region. In an age when so many people travel internationally, such sites can also familiarize prospective customers with the nature of the goods and services being sold as well as how to find specific retail locations in a given city.

Consider the Web presence of the Enterprise car rental company (http://www.enterprise.com). Many of the customers who rent vehicles at international airports are originating their travels where this brand is not available. However, the company's marketing strategy centers on creating product availability in many of the top business travel destinations. Consequently, clicking on a link at the bottom of the page will take the user to informational websites for the United States, Canada, United Kingdom, Ireland, or Germany that can be customized by the user according to both country and language.

Think About It

Each time customers visit a company website, they leave an information trail that often includes information about how they got to the site, how they navigated through the site, and which links they clicked on.

How can this kind of information be combined with other data to gain insights on buyer behavior?

Are there any ethical problems with tracking people in this way without their knowledge?

What are appropriate and inappropriate uses for this type of information?

Social Media Marketing

One of the distinctive features of the new economy is the rise of social media. Social media has been defined more than 50 different ways by various Internet sources (Social Media Guide, 2012). Broadly defined, social media refers to all forms of electronic media through which users create and exchange content over the Internet via technologies that promote personal engagement and sharing information about their lives. The details being shared often include biographical data, personal photos, and professional information.

Social media technologies include a wide range of platforms including Internet forums, blogs, wikis, podcasts, and various forms of content-sharing communities. However, for marketing managers, social networking sites such as Facebook, MySpace, and LinkedIn are of particular interest. These kinds of sites help create and maintain meaningful online social relationships via posted profiles, e-mail, instant messages, and other forms of contact. In addition, it has been estimated that 70 percent of social media users engage in online shopping (Nielsen, 2011).

Although marketing to social networking sites can be accomplished in different ways, the basic goal is to gain the approval or implicit endorsement of users for the brand being promoted. On Facebook, for example, the objective is to have users "like" the brand on their personal page in much the same way that one can identify human friends. In this way, a user who "likes" the brand or company effectively endorses it and in turn advertises this personal approval to his or her network of contacts. The marketing tasks required to secure this approval may include mass media advertising, e-mail messages, tweets, and other forms of electronic promotion.

From a marketing perspective, social media provides an opportunity for companies to build awareness for their brands and direct traffic to company-sponsored websites. As an extension of traditional media and communications programs, social media marketing enables businesses to reach out to existing and potential customers. In contrast to traditional forms of promotion, the social dimension of these alternative media is particularly attractive due to their potential for spreading messages via social networks. By promoting the spread of messages to the initial recipient's personal network of contacts, social media marketing has the potential to propagate and exponentially disseminate a message from a single point of contact throughout a vast interconnected audience. In this way, social media marketing has the potential to accomplish two specific types of marketing objectives: building awareness and establishing trust.

Building brand awareness is a fundamental goal for many promotional activities, and social media marketing has the potential to make a positive contribution within this context. One advantage for marketers that comes with reaching prospective buyers via social networking sites, however, is that the impact stemming from one positive response can potentially spread to hundreds or thousands of members within that community. Given that Facebook averages more than 500 million daily active users and each user averages more than 120 contacts within his or her personal friend community (Facebook, 2012), the potential for positive impressions to reach a wide audience is substantial. However, bad reviews or poor product feedback can reach thousands of potential customers just as quickly.

Social media also has the potential to promote the establishment of trust by connecting with members of socially defined communities in a more personal and individualized way. The resulting endorsements and referrals provided by the members of one's online community tend to have greater credibility with prospective users than company-sponsored messages such as those delivered by traditional mass media. In turn, users who receive recommendations from friends are more likely to trust, and therefore spend time on, related commercial sites. However, a less obvious consideration for marketing managers is consumers' concerns about advertisers infringing on their electronic privacy. As the analytical tools for tracking and profiling prospective buyers online have grown in sophistication, consumers' concern for their online privacy has also grown (Bandyopadhyay, 2009).

The payoff from successful social media marketing has the potential to be enormous since so many prospective buyers are actively involved with social networking sites on a daily basis. However, the risks associated with the rapid dispersion of negative information and adverse opinions are equally high. To date, there is insufficient evidence to definitively evaluate the power of social media marketing on influencing buyer behavior. Recent research has found that less than 1 percent of commercial website visits come directly from a social media sites. However, 18 percent of site visitors report being influenced by social media to visit a website (VentureBeat, 2011). As with all forms of advertising and promotion, the effectiveness of social media marketing will necessarily vary widely across companies, industries, markets, and execution strategies.

Think About It

In a May 2012 public opinion poll sponsored by the Associated Press and CNBC, one-half of Americans surveyed said they believe that Facebook is simply a passing fad (CNBC, 2012; Fox News, 2012). This skepticism was reflected in the initial public stock offering (IPO) for Facebook several days later, which fell far short of analysts' expectations (Wall Street Journal, 2012). Underlying some of the skepticism about Facebook is uncertainty within the marketing community that social media can be an effective and reliable marketing tool in many applications. Critics argue that it shifts attention from brands to customers. Consequently, consumer opinion becomes the currency of social media rather than product information. Others argue that providing many non-company-controlled sources for product information creates confusion and dilutes brand identity.

What do you think? Is social media a passing fad? If not, how can marketers use this medium creatively and effectively to promote their products?

How does it differ from traditional advertising in consumers' perceptions of it and in its effectiveness?

Ch. 13 Conclusion

By definition, marketing management is an adaptive process. One of its primary functions is to assist the organization in adapting to changing environmental conditions. The new economy has facilitated enormous change in the behavior of consumers and competitors alike. Just as prospective customers are looking for opportunities to buy an increasingly diverse array of products online, businesses need to be critically evaluating the role of e-commerce as they develop their strategic plans.

E-commerce has been instrumental in promoting the collaboration of buyers and sellers in co-creating product value. This stands in stark contrast to the old economy where consumers were passive recipients of the products created exclusively by manufacturers. However, the technological changes driving this new economy have also enabled consumers to interact with each other in remarkable ways to share information about products and producers.

All of these dynamic shifts are occurring on an international basis. The Internet readily facilitates the global dissemination of information to buyers and sellers, changes the character of products, and promotes the globalization of markets. In an integrated world marketplace, consumers have 24/7 access to an astounding array of product choices and information. The response required of marketing managers in the new global economy is the subject of the closing chapter of this book.

Ch. 13 Learning Resources

Key Ideas

Critical Thinking Questions

 How does e-commerce change the ways that companies compete? List all of the different ways that you can think of and provide an example for each.

 How has technology in general and the Internet specifically changed traditional product and service markets? In what ways has the development and growth of e-commerce changed buyers' expectations about sellers?

 Do ideas about product value change when consumers decide to look for brands online rather than in stores?

 Are online prices usually lower than in-store prices? Why? For what types of products is this least and most likely to be true?

 Mass customization sometimes enables buyers to take a direct role in designing the products they buy. When might this arrangement be a bad idea? For what types of goods is this likely to work best?

 Is disintermediation generally a net positive or net negative for an economic system? Do you think that disintermediation is an irreversible trend?

 What can wholesalers and distributors do to make themselves so indispensible to the supply chain that they are not at risk of being eliminated from the channel of distribution?

 Competing effectively in an online environment requires excellent website development and maintenance. How should a company decide whether to do this work in-house or hire outside professionals? Aside from technical skills and knowledge, what attributes would you want to see in the people working on your company website?

 What new ethical issues and challenges have surfaced that are specific to e-commerce and the use of the Internet as a direct sales medium? Are the issues different for B2B versus B2C markets?

 Do you think that online companies find it less difficult or more difficult to escape the consequences of unethical and illegal business practices? Why?

 What is the nature of the relationship between social media and e-commerce? Identify three companies that successfully leveraged the reach of social media to improve brand awareness or sales performance. Why is it difficult to create this type of linkage for many traditional companies?

 Many companies rely on strategic alliances with other firms to succeed in highly competitive markets. How might e-commerce and the Internet change the nature of these alliances? Does information technology make it more or less difficult to establish connections between organizations?

 How does globalization contribute to the diffusion of ideas and new product concepts? What are the benefits and risks associated with relying on the Internet to build a worldwide audience and market for a new product or service?

 The subject of outsourcing production from the developed nations to underdeveloped nations has been a controversial one for decades. What is at the heart of the controversy over this issue: the loss of jobs, lower wages, or the exploitation of workers? What are the most persuasive arguments on each side of this debate?

 What is your understanding of the term globalization? How does this economic and cultural phenomenon impact your life?

 What factors make some countries more global than others? Is it primarily a matter of culture, economics, or government policies? Why do some people worry that economic globalization diminishes the independence and sovereignty of nations?

 Since the Internet and e-commerce tools tend to level the playing field between large and small competitors, why do large multinational corporations dominate international business?

Key Terms

Click on each key term to see the definition.

channel disintermediation

Eliminating one or more intermediaries from the channel of distribution that connects producers to ultimate consumers. Within the context of the new economy, this may occur when online sales result in bypassing agents, distributors, wholesalers, or retailers.

e-commerce

The sale of products over an electronic medium such as the Internet. It is often used in reference to all of the supporting technology required to facilitate direct Internet sales to customers, such as electronic funds transfer, online order processing, and inventory management software.

globalization

The process by which global economies and markets have become increasingly interrelated and interdependent in recent decades. Within the narrow context of marketing management, the term refers to the practice of global branding and adapting the marketing mix to suit local cultures and preferences.

mass customization

The ability to produce large volumes of products designed to customers' specifications at costs that are comparable to standardized, mass-produced goods.

new economy

A phrase used to refer to the impact of information technologies since the mid-1980s on traditional economic systems. Within business contexts, it is currently used in reference to the effect of information technology and the Internet on both the domestic and global economy.

reintermediation

The restoration of a previously displaced intermediary between buyers and sellers.

search engine optimization (SEO)

The process of revising and improving a company's website so that search engines will find and rank the pages higher on the results list from keyword searches.

service-dominant logic

An emerging view or marketing paradigm that recognizes that product value is defined by and co-created in concert with the consumer. This is in contrast to the prevailing view of customers as passive recipients of mass-produced goods and services.

social media

Electronic means of communication through which users exchange information about their lives. The details being shared include biographical information, personal photos, and details about professional pursuits.

Web Resources

This is an interesting site that provides access to a range of studies and research publications on the effectiveness of various Internet marketing techniques and strategies. The site also provides an option to subscribe to a free monthly newsletter that summarizes current trends and research in search engine optimization research and related areas of study.

http://www.marketingexperiments.com

This is the portal to access a range of free services from Google that enable marketers to measure site traffic, sales, and conversions. It can also provide information about how visitors use a given site and the route they took to arrive there. Content analytics can identify which parts of a website are performing well, and social analytics can track the effectiveness of social media programs.

http://www.google.com/analytics

This is a site created by the Levin Institute of the State University of New York. It provides an extensive collection of resources on many of the controversies surrounding globalization. Topic areas include trade agreements, environmental policy, economic development, technology, and immigration.

<http://www.globalization101.org>

Chapter 14

Managing Marketing in the Global Economy

Countries' flags in the shape of a sphere

iStockphoto/Thinkstock

Learning Outcomes

By the end of this chapter, you should:

 Be able to identify the factors that motivate domestic companies to pursue international marketing opportunities.

 Understand how economic and cultural criteria are used to evaluate prospective target market countries.

 Be able to identify the five classes of alternative market entry strategies and know the advantages and disadvantages associated with each.

 Know the basis for deciding whether a company should adapt its products and marketing program to local markets or promote a standardized marketing plan.

 Understand how country of origin effects impact prospective buyers' perceptions of product quality.

Ch. 14 Introduction

Willie Sutton robbed more than 100 banks in the United States from the late 1920s to the early 1950s. When apprehended for the final time, he was asked by reporters why he robbed so many banks. Willie is alleged to have replied: "Because that's where the money is."

The rationale for placing special emphasis on global markets at the close of this book is essentially the same. Without regard to where your company was founded, there are probably more potential customers outside your national boundaries than within. That's where the money is. Global marketing needs to be a primary concern for both B2B and B2C competitors because foreign markets represent opportunities for growth. Of equal importance, the potential for foreign competitors to enter home markets represents a constant threat within an integrated global economy. As technology continues to make international trade increasingly easy and efficient for companies of all sizes, both the threats and opportunities posed by international marketing will continue to grow.

This chapter focuses primarily on how marketing managers can identify and capitalize on international marketing opportunities. The beginning sections introduce the competitive dynamics associated with global competition as well as the risks and rewards associated with the pursuit of foreign markets. This is followed by an examination of the economic and cultural considerations that should shape decisions about which geographic markets to enter. A critical assessment of alternative market entry strategies examines the pros and cons of different routes to penetrating foreign product markets. The concluding sections of the chapter focus on two pivotal topics. The first examines the question of whether products for export should be sold as the same standardized version available in the domestic market or whether the features and image of the brand should be adapted to suit local tastes and preferences. The final topic of the chapter, country of origin effects, is an assessment of how consumers' perceptions of a brand are influenced by their understanding of where the product originates.

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The history of international marketing is riddled with colossal mistakes and blunders made by otherwise well-managed companies trying to find export markets for some of America's most familiar brands. The following list chronicles several of the more notorious gaffes made when attempting to translate English advertising themes into foreign languages.

When Parker Pen launched a new ballpoint pen advertisement in Mexico, its ads were supposed to read, "It won't leak in your pocket and embarrass you." Instead, the company thought that the verb "embarazar" (to impregnate) meant to embarrass, so the resulting ad copy read: "It won't leak in your pocket and make you pregnant."

When Coors Brewing Company tried to translate its slogan "Turn it loose" for Spanish-speaking markets, it was read as "Suffer from diarrhea."

When Braniff International Airways (no longer in business) attempted to translate the slogan "Fly in leather" (a reference to the upholstery of its seats), it came out in Spanish as "Fly naked."

When Pepsi introduced its brand to China, it translated its U.S. slogan "Pepsi Brings You Back to Life" too literally. The slogan as translated into Chinese meant, "Pepsi Brings Your Ancestors Back from the Grave. "

Chicken tycoon Frank Perdue's line, "It takes a tough man to make a tender chicken," was poorly translated into Spanish, where it meant: "It takes a sexually stimulated man to make a chicken affectionate" (Henderson, 2012).

Sadly, there are dozens of these types of examples to choose from. They are routinely and widely cited by everyone from motivational speakers to serious marketing scholars. In fact, there is a plethora of websites devoted to these marketing missteps. If you are interested in reading more, you can find several of these sites listed in the references sections at the end of the chapter.

14.1 Global Marketing and International Competition

Global marketing refers to a "marketing strategy that consciously addresses global customers, markets, and competition in formulating a business strategy" (American Marketing Association, 2012). In most contexts, it can be used interchangeably with the term international marketing to describe the coordinated and integrated execution of marketing management processes, tactics, and strategies in more than one country. It has alternatively been described as "the application of marketing orientation and marketing capabilities to international business" (Muhlbacher, Helmuth, and Dahringer, 2006). Underlying both terms and definitions is the understanding that global markets represent an opportunity for growth and market development that requires companies to extend and leverage their marketing skills, product-based competencies, and brand-specific advantages to adapt to consumer preferences in different parts of the world.

Among the marketing manager's strategic contributions to supporting international business operations is the identification of attractive geographic markets and the determination of which market entry strategy will be most advantageous. The development of marketing programs for specific products and regions is contingent on these decisions. Options include introducing standardized products and existing brands to new markets and adapting elements of the company's product portfolio to suit the unique needs and expectations of local customers in each new country.

Incentives and Rewards of Foreign Sales

Human nature and traditional marketing strategy make both people and companies feel most secure when operating in familiar surroundings. The instinctive and natural tendency for most businesses is to restrict their operations to markets that they more fully understand. In fact, this bias is consistent with the logic of the marketing concept. In all likelihood, firms will be best able to satisfy the needs of customers by focusing their efforts on markets that they understand best, and those markets are inevitably the ones closest to them. Most companies are better equipped to compete in domestic markets simply because they have a clearer understanding of customers who are most like themselves.

The pursuit of sales outside an organization's national boundaries is inherently more expensive and more risky in many ways. Marketing managers need to cope with unfamiliar laws and languages, foreign currency exchange rates, political uncertainty, and unfamiliar customs. From a marketer's perspective, the lack of familiarity with customer needs, product preferences, and expectations should pose the greatest concern. Products and brands may need to be realigned or redesigned to compete effectively against a different array of competing brands. The cost of failure in new markets is often substantial and may be particularly high if it damages the integrity of the brand or company for future ventures.

Based on all of these considerations, it may seem safer for most companies to remain within their national borders. For some firms, it is. However, there are risks that are uniquely associated with failing to pursue international opportunities. First and foremost must be the recognition that opportunities for improved profitability and sales growth inevitably require firms to consider the potential that lies outside their own national boundaries. And it is equally important to note that the pursuit of such opportunities is a selective pursuit. That is, the role of marketing managers is to provide their firms with the best possible chance for success by selectively identifying the regions, countries, and localities that represent the best possible new markets for their firm's products.

Billboard advertisement for Marlboro cigarettes in China.

How do you think a marketing manager prepared placement for this billboard advertisement for Jeep SUV in China?

AFP/Getty Images

In addition to these obvious considerations, there are strategic advantages to the developent of foreign market opportunities that may be more situation-specific and less readily apparent. In some instances, the additional sales volume created through foreign sales enables firms to realize lower unit costs due to economies of scale in manufacturing and improved marketing-related costs. This is essential for firms pursuing a global cost leadership strategy as discussed in Chapter 1. In addition to building international sales volume, the reduced labor costs associated with the outsourcing of production to either a single or multiple sites worldwide can also effectively drive down unit costs.

Other strategic considerations that support the pursuit of international markets relate to the natural dynamics of competitive markets. Every firm in a global economy is fundamentally at risk of losing substantial portions of its total sales to foreign competitors. By pursuing a more globally diversified sales portfolio, companies can reduce their dependence on home markets. Similarly, the growing internationalization of customers' operations, particularly in B2B markets, requires firms to follow. In many instances, this means extending the firm's global market presence to foregn countries where primary customers will need the same goods and services required in domestic markets. This relationship of mutual dependence is evident in many service-related sectors.

The ACE Insurance Group was formed in 1985 to serve domestic business customers by providing excess liability and officers coverage. "Since then, ACE has evolved from a monoline excess insurer owned by its policyholders to a global publicly traded insurance company and one of the world's leading providers of commercial property and casualty insurance" (About ACE, 2012). Through acquisitions and internal development, the organization grew to keep pace with the needs and geographic dispersion of its customer base. The rapid growth in international trade at the close of the twentieth century fueled the rapid development of the organization. By 2010, the ACE Group had grown into a global leader in business insurance and reinsurance with offices in more than 50 countries. The company's business model has been fairly simple. It goes where its customers lead it.

Think About It

Every so often you might hear a motivational speaker or sales trainer still talk about the Wizard of Oz principle of marketing. The question posed from the front of the room would be: "Where did Dorothy find true happiness?" The answer, of course, is right in her own backyard. Many traditional perspectives on marketing strategy emphasize the priority of serving your local and regional markets first. After all, if you can't be the best in your own backyard, what hope do you have of being a successful international competitor? But is this old sales bromide still valid in a global marketplace?

Why shouldn't your first priority always be local?

Buying from foreign suppliers may offer domestic firms many advantages as well. Companies may be able to purchase goods from international sources at lower prices than are available in domestic markets. This, in turn, enables them sell to their home market at competitive prices while realizing higher per-unit margins. Alternatively, foreign markets may offer goods and services that are unavailable in domestic markets. This is particularly attractive to resellers as it allows them to obtain more products for their shelves. For manufacturers, foreign purchases may be the most efficient means to acquire scarce materials such as rare earth metals and technologically advanced components for fabricating electronic goods.

Buying products from foreign markets poses few potential threats relative to the risks that companies must typically incur to sell in foreign markets. The risks encountered in selling products abroad are in some ways to analogous to those associated with the commercialization of new products in domestic markets. However, the marketing manager's unfamiliarity with the culture and business climate of foreign markets makes the challenge of selling abroad substantially greater. As a consequence, the resource commitment required to succeed in a foreign sales venture is often greater than anticipated, and the negative consequences of failure may be greater than they appear at the outset.

Risks Related to Foreign Sales

Shoppers at a Gap clothing store in China.

Shoppers at a Gap clothing store in China find styles and sizes selected to match their preferences and expectations.

Imaginechina/Associated Press

Although the incentives that motivate companies to develop markets outside of their home nation are substantial, the decision to pursue these opportunities exposes companies to great risks as well. Failed foreign ventures can result in both financial losses and damage to the image and prestige of the company and its brands. Perhaps surprisingly, the reasons for most international failures are very similar to the root causes for many domestic marketing failures.

Entering a new international market poses many of the same challenges that confront marketing managers entering a new geographic market within the borders of their home country. At the heart of the issue is that buyers' tastes and preferences differ from one locale to the next. Whether it's a new restaurant or a women's clothing store, what customers want is substantially different in Boston and Santa Fe. Any firm that fails to understand its customers' preferences will ultimately fail, and that principle applies internationally as well.

Think About It

Consider the culture and demographics of Boston, Massachusetts, and Santa Fe, New Mexico. If you were trying to transplant a successful professional women's clothing store from the East Coast to the Southwest, what are the most relevant differences?

How would these impact the range of styles and sizes stocked for each market?

How would the differences in climate affect merchandising and operations?

Now think about tranferring your store's concept to Singapore. How substantial are the adjustments required to make this jump?

What additional types of factors would you have to consider?

Moving across international borders to establish business operations in a new country can certainly pose obstacles that relate to understanding unfamiliar customers and cultures. However, there is a wide array of other risk factors that are also related to entering new markets. Country risk is a term used to refer to the potential financial loss associated with investing resources in a foreign country. It is a broadly defined concept that relates to the relative stability and potential volatility of the nation's business climate as a function of economic and political forces.

One of the most widely watched country risk indicators is the biannual Euromoney Country Risk Ratings survey. The methodology used to calculate these ratings creates a weighted country risk score for each of 185 countries based on political, economic, and structural factors. Economic variables include GDP, unemployment, currency stability, government debt, and monetary and fiscal policy. Measures related to political risk include corruption, political stability, transparency, and the regulatory and policy environment. Assessments of risks related to structural elements of the economy include consumer demographics, industrial relations, and technological infrastructure. To determine risk ratings, each of these three broad categories of factors is equally weighted for each country.

In addition to these considerations, differences in the legal environment from one nation to the next may also pose a threat to the company's global development goals. Local, regional, and national laws and regulations governing business operations are specific to the geographic market and sometimes to each industry.

The impact of business regulations and legal restrictions within each market necessarily increases the cost of doing business. New ventures in unfamiliar markets can be unsuccessful if marketing managers fail to understand and operate within these constraints. However, the failure to fully appreciate the true costs associated with these foreign requirements and restrictions can also result in the financial failure of the enterprise. Consequently, it is critical that marketing managers with responsibilities in international markets comply with all relevant commercial laws and do their best to anticipate future changes.

14.2 Market Selection

Once a company has recognized the incentives for pursuing international markets, the next step is to identify which target market country or countries represent the best fit relative to the products and organizational strengths of the firm. In one sense the task should be simple. Marketing managers need to identify places where there are a substantial number of prospective buyers. On the other hand, the world is a big place, and all of the conventional traits and variables used to segment markets and qualify prospects in domestic markets will not apply in all countries. Integrating culture-specific factors and national economic considerations to analyze foreign market opportunities poses unique challenges. For these reasons, many companies start slowly and cautiously when contemplating their initial international venture.

Marketing managers often begin by considering each country as a discrete and independent market. In light of the growing influence of free-trade zones, trading blocs, and the impact of globalization in general, this is not always a productive assumption. However, the sovereignty of nations, unique cultural identities, and the availability of secondary data on a nation-by-nation basis supports this view for the purpose of making an initial assessment of market potential. The sections that follow examine two general classes of criteria used to make decisions on which markets to enter: economic and cultural criteria.

Economic Criteria

To identify attractive potential country markets, managers require information that will enable them to evaluate the respective costs, benefits, and risks of each option. A first step is often to evaluate the relative economic strength of alternative target market countries. Chapter 4 introduced the Market Potential Index for assessing the general level of economic growth in emerging global markets. Based on eight macroenvironmental dimensions of market potential, this multifactor approach can provide a valuable starting point for investigating the overall economic health and buying power of a given country. It is important to note, however, that the value of some economic criteria to the selection of target market countries is specifically a function of the product being sold. For example, macro-level data indicating that a nation has very low gross domestic product per capita may be a positive indicator when evaluating the potential sales of low-priced, low-quality goods.

In most situations, the determination of the sales potential for a specific brand requires economic information more closely related to product-specific market demand than can be gleaned from indicators such as GDP and per capita income. To accurately assess a brand's sales potential in a given country, metrics related to existing levels of demand within specific product markets are essential. The selection of the most appropriate measures relies heavily on the judgment and experience of the marketing manager. Managers often include factors such as current sales volume within the product market, growth trends, and the size of the intended target market. Information on the number of competitors, their size, and the industry concentration ratio is also commonly gathered.

The range of variables of potential interest is extensive and principally dependent on the nature of the product and market under consideration. Fortunately, the task of assembling the economic information required to make decisions on alternative markets has grown progressively easier in recent years. Globalization and the development of efficient information processing technologies have spurred the creation of several commercially available databases that provide current product-specific information for marketing planners. Among the largest of these providers are Euromonitor International and MarketLine.

Euromonitor International produces a powerful and expansive source for international market information called the Global Market Information Database (GMID). GMID contains over a million demographic, economic, and marketing statistics for 205 countries worldwide. The database also contains 6-year historic market size data for more than 330 consumer products in 52 countries, plus 5-year forecasts. This includes specific information on market size, market forecasts, consumer lifestyles, companies, and brands. For the United Kingdom, Germany, United States, and France, it provides full-text market research reports for specific products and industries as well.

MarketLine produces a comparable database that provides information and data on companies, products, and countries worldwide. It also includes information, research, and news analysis services that are unique to MarketLine. Additionally, it can provide clients with custom-designed statistical models and forecasts on a product-by-country basis. These analytical reports can be supplemented with an analysis of available market- specific intelligence gleaned from both publicly available and private sources.

Databases such as Euromonitor's and MarketLine's often provide sufficient information to make a preliminary assessment of the market potential and competitive intensity of target market countries. However, the value of these databases extends beyond the collection and reporting of economic measures. They also provide valuable insights into the social and cultural influences on the relative attractiveness of alternative markets.

Cultural Criteria

The term "culture" has many meanings in many contexts. Within the context of international business, it refers to the "continuously evolving totality of learned and shared meanings, rituals, norms, and traditions among the members of a society" (Lascu, 2008). When evaluating potential target market nations, there are many dimensions of culture that may impact their attractiveness. These factors include language, religion, and social values. The impact of cultural differences often depends on the product being sold. The significance of colors, accepted protocols for gift-giving, business etiquette, food-related traditions, and gender roles, for example, can all influence prospective buyers' attitudes toward the brand being marketed.

Global Business: Attitudes and Values

Attitudes and values play a vital role in cross-cultural business transactions. These cultural elements of international business are among the most difficult to learn. What steps must a businessperson take in order to ensure a positive and successful transaction?

Cultural influences are important considerations when assessing market opportunities in foreign countries. Just as with economic indicators, however, these types of considerations can work in different ways. In some instances, companies wish to identify countries with cultures very similar to their own in order to minimize the impact of cultural differences. Although seeking out nations with similar cultural backgrounds may be a wise strategy for companies just getting started with international marketing, it limits the range of choices. In many circumstances, marketers recognize that the greatest market potential exists in countries with very dissimilar cultures.

Man frying traditional poori at a food stall, New Delhi, India

Manufacturers of microwave ovens initially found it very difficult to adapt their product technology to the culinary traditions of India.

Exotica/SuperStock

Consider the international market for microwave ovens. In countries where these kitchen appliances have already gained acceptance, the upside market potential for new entrants is limited by the market power of entrenched competitors. Greater potential may exist in countries where the technology has not been readily adopted. India, the second most populous country in the world, has been slow to adopt microwave ovens due to the nature of Indian cuisine. Many traditional Indian dishes such as dosas and paranthas must be slow cooked from the bottom up, and most Indian diners prefer these dishes to be browned. Consequently, Whirlpool's technical innovations and adaptations in the late 1990s to make its microwaves compatible with Indian preferences created an enormous market opportunity.

Significant cultural differences between nations can stem from a vast array of potential sources and affect strategy in many ways. Where the marketer's exclusive focus is on exporting to a foreign market, the most significant differences will be those that relate to target customers. When a company is considering building a factory or opening a retail store, the primary concern will be how cultural differences impact the firm's relationship with employees.

Basic information on the cultural composition of nations around the globe can be obtained easily from many published sources. One surprising source of excellent information is the U.S. Central Intelligence Agency. The CIA's World Factbook provides reliable information on the ethnic roots, languages, religions, age distribution, birth/death rates, and educational attainment of the residents of 267 world entities. It also provides comprehensive overviews of each entity's history, government, geography, communications, and transportation infrastructure.

Although there are numerous sources of public information available to assist marketing managers in improving their understanding of local and national cultures, in many instances it is both desirable and necessary to visit the foreign locations being considered before making any final decisions.

Think About It

If you were responsible for deciding whether your company should invest in opening a small chain of retail stores in Hanoi, Vietnam, could you make the final decision without ever visiting the country?

Would your answer be the same if you were evaluating Toronto, Canada, as a market instead? Portland, Oregon? Why?

The Hofstede Cultural Dimensions Framework

People from different cultures can behave quite differently in similar situations. Many of these differences can be traced to the cultural values and attitudes that differentiate the groups. These differences, in turn, are often reflected in the behavior of consumers from different countries. Geert Hofstede's pioneering study of more than 110,000 people in 40 nations (the Hofstede Cultural Dimensions Framework) identified four specific cultural dimensions that can differentiate between country-based cultural groups (Hofstede, 1983).

Power distance refers to the extent to which the less powerful members of a culture accept that social and economic power is distributed unequally. In countries with high scores on this dimension, this condition is implicitly endorsed both by followers and leaders. In the United States, power distance index values are typically low (40). Americans tend to be fairly egalitarian and democratic in their views toward the distribution of power and routinely regard our superiors at work as colleagues as much as supervisors. It isn't uncommon to address those with higher ranks or titles by their first name. This is in sharp contrast to many Middle Eastern countries, for example, where the power distance is much higher (80).

Individualism versus collectivism refers to the degree to which people in a country prefer to act independent of others rather than as members of a larger group. Societies that score high on individualism exhibit a greater sense of self-sufficiency and expect to look after themselves and their immediate family. In collectivist societies, the self-worth of an individual is rooted more in the social system than in individual achievement, and the well-being of society at large is of greater importance. Those from collectivist societies also tend be more fully integrated into tightly knit groups and large extended families. Loyalty to one's groups is a highly valued virtue in these countries. Latin American, Asian, and Middle Eastern countries tend to score higher on the collectivist dimension than the United States and many European countries.

Masculinity versus femininity refers to whether a national culture tends to value assertiveness or nurturing more highly. Masculine societies also place greater value on ambition, material success, and power. Feminine societies place a greater value on charity, caring for the unfortunate, and preserving the natural environment. Countries with notably high scores favoring the masculine traits include Germany, Australia, Canada, Great Britain, and the United States.

Patrons sitting outside a restaurant in Little Venice in Greece

Richard Cummins/Corbis

Uncertainty avoidance is a reflection of the society's tolerance for risk and ambiguity. Cultures with high scores on this dimension value security and invest heavily in cultural systems that will promote order and stability within the society. People from cultures with high uncertainty avoidance might be expected to have difficulty dealing with unfamiliar problems and unstructured situations. The distribution of scores on this dimension does not conform to an easily discerned pattern. Singapore and Jamaica place a very low priority on avoiding uncertainty. Greece and Portugal anchor the opposite extreme of this scale.

Table 14.1 provides the index values for each of these four dimensions for 66 countries. Provide several examples of how marketing managers for familiar brands might use this information when evaluating the best market opportunities for international expansion.

Table 14.1: Hofstede's cultural dimensions index values

Country Power Distance Individuality Masculinity Uncertainty

Argentina 49 46 56 86

Australia 36 90 61 51

Austria 11 55 79 70

Belgium 65 75 54 94

Brazil 69 38 49 76

Chile 63 23 28 86

China 80 20 66 40

Colombia 67 13 64 80

Costa Rica 35 15 21 86

Czech Republic 57 58 57 74

Denmark 18 74 16 23

Ecuador 78 8 63 67

Egypt 80 38 52 68

El Salvador 66 19 40 94

Ethiopia 64 27 41 52

Finland 33 63 26 59

France 68 71 43 86

Germany 35 67 66 65

Ghana 77 20 46 54

Greece 60 35 57 112

Guatemala 95 6 37 101

Hong Kong 68 25 57 29

Hungary 46 55 88 82

India 77 48 56 40

Indonesia 78 14 46 48

Iran 58 41 43 59

Iraq 80 38 52 68

Ireland 28 70 68 35

Israel 13 54 47 81

Italy 50 76 70 75

Jamaica 45 39 68 13

Japan 54 46 95 92

Kenya 64 27 41 52

Kuwait 80 38 52 68

Lebanon 80 38 52 68

Libya 80 38 52 68

Malaysia 104 26 50 36

Mexico 81 30 69 82

Netherlands 38 80 14 53

New Zealand 22 79 58 49

Nigeria 77 20 46 54

Norway 31 69 8 50

Pakistan 55 14 50 70

Panama 95 11 44 86

Peru 64 16 42 87

Philippines 94 32 64 44

Poland 68 60 64 93

Portugal 63 27 31 104

Saudi Arabia 80 38 52 68

Sierra Leone 77 20 46 54

Singapore 74 20 48 8

South Africa 49 65 63 49

South Korea 60 18 39 85

Spain 57 51 42 86

Sweden 31 71 5 29

Switzerland 34 68 70 58

Taiwan 58 17 45 69

Tanzania 64 27 41 52

Thailand 64 20 34 64

Turkey 66 37 45 85

United Arab Emirates 80 38 52 68

United Kingdom 35 89 66 35

United States 40 91 62 46

Uruguay 61 36 38 100

Venezuela 81 12 73 76

Zambia 64 27 41 52

Adapted from http://www.clearlycultural.com/geert-hofstede-cultural-dimensions/

Hofstede, G. (1983, Fall). The cultural relativity of organizational practices and theories. Journal of International Business Studies, 75–89.

The process of analyzing countries as potential markets must be custom-tailored to the specific needs and expectations of the company seeking these opportunities. Although the consideration of economic and cultural criteria will inevitably be a part of the process, acquiring all of the data required to make reliable judgments may necessitate gathering primary data in foreign settings as well. The final decision on market entry will require the evaluation of costs and benefits within the context of risks that can often be difficult to accurately gauge. As with domestic ventures, companies are seeking to capitalize on attractive market opportunities that pose little risk while enabling the firm to leverage its distinct competitive advantages.

Once the preferred country or region is identified, the next task for marketing managers is to determine the best way in which to enter this unfamiliar market. The following section examines five alternative strategies for market entry. Each form represents trade-offs between direct managerial control, net profit potential, risk of financial loss, and the level of financial commitment required.

14.3 Market Entry Strategies

Once a company has identified the foreign markets it wants to enter, it needs to determine the best strategy for doing so. These strategies include indirect exporting, direct exporting, licensing, joint ventures, and direct investment. The best option depends on the unique circumstances posed by each situation. An overview of some of these options is available in Table 14.2.

Table 14.2: Market entry strategies

Direct and Indirect Exporting

Advantages Disadvantages

Minimizes risk and investment Higher transport costs than manufacturing abroad

Maximizes flexibility Vulnerable to trade barriers

Good way to learn about global marketing Limited learning about country characteristics

Creates production scale economies at home Loss of production economies

 Higher unit cost to consumer

Licensing and Franchising

Advantages Disadvantages

Relatively easy access to global markets Limited direct participation in markets

Profitability with little investment Lack of control over marketing programs

Circumvent tariffs and import quotas Sacrifices long term returns

 May create future competitors

Joint Ventures

Advantages Disadvantages

Benefits from partner's knowledge of home markets Significant investment required

Reduces direct exposure to political uncertainty High costs of coordination and control

An opportunity to learn about new markets Requires sharing of financial rewards

Sometimes the only way to gain entry to a country May turn partner into future competitor

Foreign Direct Investment

Advantages Disadvantages

Can improve domestic sales in new markets Investing in foreign countries is more expensive than exporting

Allows foreign firms to avoid paying import tariffs Risky due to political volatility in host country

Many governments offer tax incentives to attract Political shifts could lead to seizure of a direct investment firm's property and assets

Reduces risks from volatile currency exchange rates Cultural differences within consumer markets may be insurmountable

Markets may prefer locally produced products Cultural differences within business environment may be insurmountable

Developing local expertise enables firms to better understand tastes and preferences of new markets Company or brand identity may be blurred by direct association with a foreign country

In general, the preference for one strategic option over others is determined by the profit potential of the new market, level of financial investment required, and an appraisal of risk. Ventures that pose relatively high levels of uncertainty typically discourage companies from making large resource commitments until a successful future has been secured. It is typical for companies to be financially conservative when they first begin selling into foreign markets. Among the least risky options for any firm's first international project is indirect exporting.

Indirect Exporting

Indirect exporting is simply a description of "sales to export intermediaries who in turn sell to overseas customers. The indirect exporter has no direct contact with overseas customers" (American Marketing Association, 2012). This approach to entering foreign markets relies on the use of independent export agents and trading companies within one's home country to identify potential customers and negotiate sales. These intermediaries are typically compensated for successful sales transactions on a straight-commission basis. Relatively few intermediaries actually buy the manufacturer's products and then resell them abroad.

A container ship carrying different products overseas

What are the advantages of indirect exporting?

Steve Vidler/SuperStock

The initial reliance on independent export agents and trading companies to gain a foothold in foreign markets offers several advantages to domestic producers. The primary advantage is that indirect exporting requires little financial commitment. Rather than investing company resources into the development of an internal operations group for export sales, the company can rely on the experience, expertise, and efficiency of firms that specialize in foreign sales. Financial risk is also reduced substantially since the payment to these agents is usually contingent on the sale of products. International marketing intermediaries with proven track records offer the seller an established presence in foreign markets, important contacts with prospective buyers, and expertise in the unique requirements of operating in foreign markets. Consequently, they also reduce the risks associated with making mistakes that will adversely impact the future potential of the product or brands in emerging markets.

Direct Exporting

Direct exporting refers to "the type of exporting in which firms enter foreign markets directly and do their own export marketing. The firm itself undertakes the complete export marketing task, which is extensive" (American Marketing Association, 2012). These export marketing tasks include the identification of attractive foreign markets, managing the elements of marketing mix, and arranging for international shipping. Companies will sometimes decide to use foreign agents or distributors to represent them within those markets, particularly in the early stages of a product's introduction.

In many instances, direct exporting is a next step for companies that have enjoyed initial international success through indirect exporting. As confidence in both markets and internal company capabilities grows, many firms transition into this role of handling their own product exports. The investment of time, talent, and financial resources required to make this conversion is substantial. However, these higher levels of risk also provide the firm with greater potential returns. Just as we saw with channel disintermediation in the previous chapter, assuming the functions previously performed by marketing intermediaries provides the seller with a larger share of the total profit from sales.

Direct exporting can be implemented using several different approaches. Some companies invest in the creation of an in-house export department. This unit gathers together all the expertise and services required to facilitate foreign sales for all divisions of the company. An alternative approach is to create the pool of requisite talent in foreign sales branches within each target market country. Oftentimes enjoying substantial autonomy, these sales branches may be authorized to manage multiple marketing functions such as in-country distribution, warehousing, customer service, and promotion, as well as the sales process.

The nature of the product being sold, the potential value of a new sales region, and the complexity of markets being served necessarily determine the extent of the company's investment in developing an in-country market presence. Simpler and less expensive forms of direct exporting are often sufficient. Assigning and dispatching traveling sales representatives dedicated to export sales may be adequate to serve the company's and prospective buyers' needs in foreign markets. Depending on the circumstances, simply sending home-based representatives to foreign venues occasionally to create customers and build sales can also be effective.

Think About It

Imagine that you are applying to be a sales representative for a manufacturer of high-end imaging equipment for the health care industry. The position will require you to be the company's sole representative in a region comprising seven nations in Southeast Asia. This firm has no sales offices or branches in any of these countries.

What would this lead you to believe about the company's commitment to serving the region? Are you sure?

Does it suggest that the primary product you may be asked to sell is at a particular point in the Product Life Cycle? Is this product likely to be a significant part of the company's product portfolio? What factors contribute to your conclusion?

What skills, knowledge, and personal traits would be essential for succeeding in this type of situation?

Licensing

Companies that wish to take the next step beyond indirect exporting, but are not yet prepared to undertake the expense and risk associated with direct exporting, may consider licensing as an alternative. Licensing is "a relatively low risk linkage that allows a manufacturer to enter new markets. It is an arrangement in which a licensee in a new market is given the right to use a process, trademark, patent, or other proprietary item for a fee or royalty" (American Marketing Association, 2012). Often recognized as an efficient tool for participating in foreign markets without large capital investments, this type of arrangement also offers additional advantages.

In many cases, the licensor is paid both an upfront fee and a royalty or commission on each product sold. This limits the downside financial risk to the owner of the intellectual property being leased. It also enables companies to bypass import restrictions and barriers erected by some nations against foreign market entrants since the actual producer is within the country's borders.

The same features that limit the risk associated with this strategy, however, also limit the upside financial potential. This is particularly true if local laws prohibit foreign ownership. This enables the licensee to charge an additional premium based on its favored status within a nation and its exclusive access to markets. However, even greater concerns may exist with respect to the protection of intellectual property.

Once the legal right to use a protected process, trademark, patent, or other proprietary item is extended to a foreign firm, the potential for abuse exists. Trade secrets may be used inappropriately, disclosed, or sold to competitors. Brand equity can be damaged if brand names, images, or trademarks are attached to poor quality goods. Even in instances where the product quality is adequate, the promotion and sale of branded goods at artificially low prices can adversely impact brand identity in global markets.

Although licensing agreements are very specific with respect to the permissible uses of intellectual property in foreign markets, abuses can occur due to the owner's lack of direct control over how the property is utilized. This can be a particular problem when operating in countries where the protection of intellectual property rights is either not explicitly recognized or remains a low priority. The problem can be compounded by a licensing agreement if the licensor discovers at the end of the contract period that the company has created a direct competitor through this process.

A Pizza Hut restaurant that sells 100% vegetarian products in India.

This Pizza Hut franchise in India features 100 percent vegetarian products.

Associated Press

One particular problem that is closely associated with the failure of licensing agreements to adequately protect the intellectual property of licensors is the development of gray markets. Gray markets are composed of branded products that have been diverted from authorized channels of distribution. Whether confined to foreign markets or smuggled into the home country of the licensor, these goods provide direct competition for the goods distributed through the authorized channels at significantly higher prices. This, in turn, damages relationships with legitimate distributors, dilutes brand equity, and steals profits from investors.

Gray markets for electronic goods pose a particularly challenging problem in the new economy. When Apple rolled out its latest iPhone in 2008, retail stores throughout China and Thailand took customers' orders for the product even though it was not scheduled to be sold in those markets. Gray market copies of the device were soon available, and access codes were unlocked so that buyers could use the phone with local mobile service providers. The Anti-Gray Market Alliance estimates the global gray market for information technology products alone to be over $40 billion annually (Zinzaro, 2012).

Franchising is a specific form of licesning. It is a "contractual system of distributing goods and services whereby one party (the franchisor) grants to another party (the franchisee) the right to distribute or sell certain goods or services; the franchisee agrees to operate the business according to a marketing plan substantially prescribed by the franchisor; and the franchisee operates the business substantially under a trademark or trade name owned by the franchisor" (American Marketing Association, 2012). Franchising is, in some ways, a more complete form of licensing insofar as the franchisor provides an established brand concept and operating systems. Fast-food restaurants have employed this model successfully in both domestic and international markets.

Joint Venture

An alternative market entry strategy that requires significant commitment and participation from both a domestic and foreign partner in an international enterprise is joint venturing. Specifically, a joint venture is simply any "form of participation in foreign markets by means of alliance with a local partner" (American Marketing Association, 2012). The objective is to link two companies with complementary strengths relative to the needs of the market they plan to serve. The various legal forms of joint ventures range from informal working agreements to formal equity-sharing arrangements.

Working relationships and partnerships between foreign investors and local investors in a joint venture enable each to contribute unique strengths. In many instances a joint venture may be necessary for economic or political reasons. Although a prospective investor in a foreign market may recognize an opportunity, it may lack the essential knowledge of the local culture, customs, connections, and legal restrictions. In some cases, the foreign government might require joint ownership as a condition for entry. The foreign firm, in turn, may lack the financial or marketing resources required to capitalize on the venture independently.

Joint ventures can have substantial disadvantages. Problems most frequently tend to occur when partners cannot reach agreement on marketing or financial policies. These disagreements can be particularly contentious when the two parties have competing concepts about the marketing mix in relationship to local markets. The partner with superior product knowledge is most often the one who lacks direct experience with the local culture and its preferences. This can quickly become evident in conflicts over advertising concepts, product pricing, and distribution decisions.

Foreign Direct Investment

Foreign direct investment (FDI) is a term used to describe a market entry strategy where a domestic firm expands its operations to a foreign nation either by constructing new operational facilities from the ground up or through the acquisition of existing businesses and operations in the country of interest. In many ways, this approach represents the greatest risk to domestic companies exploring foreign markets, since it typically requires the greatest commitment of both financial and marketing resources. Consistent with these risks, however, this approach also holds the greatest potential rewards, since the profitability from successful operations does not need to be shared with as many intermediaries as are involved with alternative entry strategies.

If local political and economic considerations are favorable, FDI offers companies several distinct advantages. In many markets, direct investment in manufacturing facilities in foreign countries provides access to cheaper labor and raw materials. Over time, it also tends to improve relations with the governments of the target market country insofar as it creates employment opportunities. Successful involvement in the local economy is also likely to improve relationships with customers, suppliers, and channel intermediaries. In contrast to producing goods elsewhere, this strategy can also work to reduce the costs associated with shipping goods into the country. This was a primary consideration in both Honda's and Toyota's decisions to build auto assembly plants in the United States and Canada.

Ultimately, however, all of these advantages associated with direct foreign investment as a market entry strategy are rooted in enabling the company to retain full control of its manufacturing and marketing policies. The primary disadvantage of FDI is that the cost of maintaining this control is full exposure to the risks associated with the investment. Substantial losses from direct investment in foreign markets can stem from a variety of sources including shifts in the political climate, economic instability, currency devaluation, and market-specific declines.

The market entry options described in this section reflect the organization's response to the profit potential associated with new market opportunities, the financial investment required, and an assessment of risk. Once the best alternative has been selected, marketing managers need to determine how the brand is going to compete in this new market. An essential element of this decision is whether to adapt the product and its marketing mix to uniquely fit the prevailing conditions and preferences in the new market or promote an existing, standardized product and marketing mix.

14.4 Adaptation Versus Standardization

Adaptation is a term used to describe the process of modifying a firm's existing marketing mix and strategy to suit the unique preferences and conditions encountered when entering a new foreign market. Most often it is used in reference to adjusting the marketing program to improve its fit with elements of the country's culture that directly impact the acceptance of the brand or product. By contrast, the concept of standardization refers to "the process of extending and effectively applying domestic target-market-dictated product standards—tangible and/or intangible attributes—to markets in foreign environments" (Medina and Duffy, 1998).

The question of whether the most appropriate marketing strategy for entering a foreign country is to adapt the marketing mix to suit local cultural preferences or simply promote a standardized marketing mix is somewhat misleading. It suggests that there are simply two alternatives when the reality is that these options represent endpoints on a continuum. As illustrated in Figure 14.1, the question is truly more about the appropriate degree of adaptation to suit the preferences of geographically defined target markets. It is, essentially, about market segmentation. Should international marketing plans for a given brand treat the globe as one mass market or recognize that each cultural group and nation are potentially separate segments of the product market? As discussed in Chapter 6, there are truly no mass markets and there are no discernible contexts outside of e-commerce in which some degree of adaptation to a foreign market will be not required. Most marketing mixes and products require some degree of adaptation to fine-tune their fit to new markets. If nothing else, the language on labels, advertising messages, and the channels of distribution will need to be adapted to reach local markets.

Figure 14.1: Continuum of adaptation versus standardization

Figure showing the continuum of adaptation and standardization.

In most instances, the question of adaptation versus standardization is applied to the product- and promotions-related elements of the marketing mix. Although globalization has fostered the international sharing and convergence of some cultural phenomena, consumers in different countries still differ from each other in very significant ways. This is evident from the data presented in Table 14.1 on Hofstede's four cultural dimensions. However, there are also many less profound differences between cultures that may drive the need to position brands differently in different markets. Consider one of the world's most iconic brands, Coca-Cola. Despite its well-publicized commitment to a secret formula, the levels of sweetness and carbonation differ from one country the next to suit the specific tastes of those consumers. Despite having global reach and tremendous brand equity, the product still needs to be tailored to meet the preferences of the market.

A San Tribesman drinking a can of Coca-Cola

Coca-Cola has successfully penetrated the market all over the world. How has its adaption to specific target markets helped or hindered their product?

FransLanting/Corbis

Unfortunately, there are few universal principles to guide managers in making choices on product adaptation versus standardization. However, newer brands being introduced to emerging markets are likely to be more readily adaptable to their new environments. Part of this stems from the absence of long product histories that set brand impressions and positioning strategies in conceptual cement. Additionally, many recently created brands are developed from the outset with the expectation that they will be global brands. This is particularly evident in the creation of online enterprises such as Amazon, Facebook, Google, and eBay.

In some circumstances, older established brands can leverage existing perceptions of product quality or prestige as a means to enter new markets. High-end products in particular appeal to audiences with greater than average global awareness. Consequently, the introduction of an existing brand to these buyers' home countries can be facilitated by the lack of adaptation. Though far less costly than a Rolex watch or Cartier necklace, Starbucks has shown through its global development strategy how premium pricing and the development of brand awareness among travelers can facilitate the development of a relatively standardized global brand.

In addition to considering revisions to the product's tangible features, marketing managers also need to evaluate variations in branding, packaging, pricing, and promotional strategy. Communication adaptation is the term sometimes used to refer to the process of transforming marketing communications to fit alternative international markets. As illustrated in the opening vignette, adapting existing promotional themes and slogans to suit new markets can be problematic. The general challenge given to marketing managers is sometimes stated as a mandate to think globally but act locally. The advertisements shown here illustrate how the same core message was translated into multiple cultural contexts by Nike.

Nike billboard in London, England of England soccer star Wayne Rooney (left); Nike billboard in Shanghai, China with a Chinese athlete (center); Nike billboard in Munich, Germany with soccer star, Franck Ribery (right).

Nike adapts its advertising to suit its target market. What similarities do you see in these English, Chinese and German ads? What differences do you see?

Associated Press (left)/Imaginechina,Corbis (center)/Associated Press (right)

Think About It

Select a product and brand with which you are very familiar. Now consider the information that was presented earlier on Hofstede's four primary dimensions of national culture. Given the data, identify three nations that would probably require few adaptations of that brand prior to market entry. Now identify three other countries that seem very different on these measures of culture. Specify the types of product-related changes you would need to make to adapt the product to suit these consumers.

What additional information would you want to collect about consumers in these nations prior to revising your marketing mix?

It may seem from the preceeding discussion that marketing managers should have a predisposed bias in favor of adaptation over standardization. After all, it clearly seems to be more consistent with the fundamental tenets of marketing and the marketing concept. However, global standardized brands permit standardized marketing strategies that generate significant scale economies and cost savings in all phases of the marketing mix. The strategic value and the range of alternative strategies supported by these types of scale economies were discussed in Chapter 1. This, however, is not the sole argument in favor of standardization.

Standardized brands can also provide greater added value for consumers throughout the world to the extent that the promotion of a distinct and widely recognized global identity ensures a consistent and satisfying experience for buyers across markets. Research has demonstrated that the acceptance of global brands does not necessarily invalidate or diminish the impact of cultural differences in shaping buyer behavior. Instead, consumers tend to reinterpret global brands according to their own cultural backgrounds. In this way, the experience of multinational brands becomes specific to the local culture even to the extent that buyers' perceptions may differ substantially from those communicated by the company (Ghantous, 2008). In this way, a consumer in Bolivia and another in Slovakia might each recognize the same Pepsi brand but have unique interpretations of its meaning consistent with their own cultural background and norms.

As suggested, the image conveyed by a brand name to new markets can be shaped by forces beyond the direct control of the marketing manager. In many instances, buyers' impressions of a product are colored by their attitudes toward the country where the product is made. This phenomenon, known as country of origin effects, can work to the advantage or disadvantage of companies introducing new products to foreign markets.

14.5 Country of Origin Effects

Country of origin effects is a term used to refer to the way that buyers' opinions of a product's quality are impacted by their perceptions of the country where the product was produced. These perceptions are usually based on mental images, associations, and attitudes that buyers have learned over time. A positive effect is often observed in how consumers respond to their own country's products, although the effect may be reversed in some developing nations where product quality is held in low regard by its own citizens.

The relative magnitude of the impact of country of origin effects tends to be positively related to price and consumers' general level of involvement with the type of product. Prospective buyers are more likely to have a keen interest in where competing brands of laptop computers, jeans, and cars are produced, but much less concern for the point of origin for household cleaners, energy drinks, and office supplies.

Statue of lion with a beer at the entrance of a Lowenbrau Beer hall in Germany.

The distinctively German-sounding Löwenbräu brand name identifies the product's country of origin for consumers.

Steve Vidler/SuperStock

Marketing managers need to be aware of the positive and negative contributions that country of origin effects can make to the image and positioning strategy for their brands. When propsective buyers in target market nations hold a highly favorable view of the brand's home country, there are several ways to promote the connection. Simply including prominent labels and tags to indicate where the product was made is an obvious, but effective strategy. Identifying the country of origin, however, can also be accomplished through branding. Toyota sounds Japanese. Ferrari sounds Italian. Campofrio sounds Spanish. Löwenbräu sounds German. Husqvarna sounds Swedish. In some instances, the country of origin can be identified very directly through brand names such as British Airways, Royal Dutch Shell, and Canada Dry Ginger Ale.

There are also numerous examples of how product-specific characteristics can be linked to the country of origin. These impressions may extend to all brands within a category such as the great taste of Colombian coffee or the contemporary high-fashion styles associated with Italian clothing. In other situations, country of origin perceptions can envelope an entire country's products. German-made goods are perceived as well-engineered and produced with high precision. Japanese products are known for their excellence in the application of electronic technology.

In general, country of origin effects tend to remain stable over time, and the critical factor to their impact is more often the country of manufacture rather than the location of the firm's headquarters (Johansson, 2009). When the country of origin image is a positive one, elements of the marketing mix should be used to accentuate customers' awareness of this linkage. When the national identity of the home country has a negative connotation, brands should be selected to mask the country of origin or even suggest a more favorable alternative source. For example, Häagen-Dazs ice cream, like many French-sounding perfumes and German-sounding beers, was actually created in the United States.

Ch. 14 Conclusion

In the final analysis, the principles governing effective and efficient marketing management remain fully applicable to the development of international markets. All of the fundamental principles and applications developed in the preceding chapters of the text are both appropriate and essential to competing successfully in a global marketplace. If anything, the need to put the customer at the center of marketing planning and strategy is magnified when confronting unfamiliar cultures and customs. Although the failures and blunders cited in the opening vignette are extreme examples of a breakdown in communications, the lesson to be learned is a vital one. Understanding and effectively communicating with your target market remains the most critical aspect of marketing, whether the consumers are in your backyard or halfway around the world.

Ch. 14 Learning Resources

Key Ideas

Critical Thinking Questions

 What does it mean to be a truly international company? What characteristics distinguish an international company from a multinational corporation? Can the size of a firm limit its potential to compete internationally? How?

 Lists of the world's most popular and powerful brands are published by various sources. Before you look up the lists online, identify the brands you would expect to see near the top. Why did you select those names? What percentage of the brands on these lists is likely to be from American corporations?

 Will the future growth of free-trade zones, trading blocs, and economic unions between sovereign nations make the tasks of competing globally simpler or more complex?

 Traditionally, governments have been able to exert direct influence on the importation of foreign products by managing tax rates, tariffs, and other potential barriers to entry. As the impacts of globalization grow, will sovereign national governments continue to play this role? What can competitors do to prevent a firm from entering a particular market?

 The chapter refers to various indices and ratings systems to evaluate the attractiveness of alternative target market countries. If you were to create a new index specifically for rating the attractiveness of alternative national markets for light-duty truck sales, what economic and cultural variables would you include? What if the product were office furniture? Energy drinks?

 The chapter discusses five alternative market entry strategies. What factors would you consider for selecting the best way to sell light-duty trucks in the Sub-Saharan African country of Nigeria? Office furniture? Energy drinks?

 Consider the choices related to adaptation versus standardization. Speculate on the types of changes that would be required to enter the Nigerian market. Which elements of the marketing mix could remain relatively standardized? For which of the three products would the required level of adaptation be the greatest?

 How do the distribution channels for global brands differ from strictly domestic channels? What types of problems might you encounter in a global system that do not exist within the boundaries of your home market?

 The Hofstede Cultural Dimensions Framework provides an interesting way to analyze the cultural differences between countries. Using the data provided in the chapter, develop a brief analysis illustrating how three nations of your choice differ from the United States. What are the marketing-related implications of these differences for both B2B and B2C markets?

 Country of origin effects can work for and against the successful introduction of a new product. If you were helping to launch the international introduction of an American brand of power tools, where would country of origin effects be likely to work in your favor? Against you? Consider the same question using other countries of origin. What does this tell you about the role of this phenomenon in global branding? Would it matter more or less if the tools were for use by professional builders or do-it-yourself homeowners in these foreign markets? Why?

 Domestic firms can organize their international marketing efforts in several different ways. Smaller firms tend to rely on individual brand managers to take responsibility for initial efforts to pursue foreign sales. Over time, export departments or divisions take over these responsibilities when the level of activity and sales warrant the commitment to hiring specialists. What unique skills or insights are companies likely to lose as they make this transition? How can this loss be avoided?

 Rapidly developing economies attract lots of interest from prospective market entrants. Beyond the potential to sell into these opportunities, these dynamic markets also have a substantial impact on the global economy. Explain why.

 Each of the market entry strategies discussed represents trade-offs between financial commitment, control, risk, profit potential, and market complexity. In general, compare industrialized markets like the United States to fast-growing emerging economies like the United Arab Emirates, Chile, and Malaysia. How do they differ with respect to the types of trade-offs required? Which types of entry strategies might be best suited to each for a manufacturer of solar panels?

 Select three popular and familiar brands. Go to their websites and examine all of the references to international activities. What differences do you observe in the orientation or philosophy between the companies? Does the nature of the product being sold seem to impact the relative importance attached to foreign sales?

Key Terms

Click on each key term to see the definition.

adaptation

The process of modifying a firm's marketing programs and products to suit the preferences of new markets.

communication adaptation

The process of changing the promotions and communications mix to fit new international markets.

country of origin effects

The impact that buyers' opinions of a product's home country have on their perception of the product's quality.

country risk

The potential for financial loss from investing in a foreign country, particularly when losses are due to unanticipated political instability or economic volatility.

direct exporting

The process of exporting products to foreign markets characterized by companies selling directly and doing their own export marketing.

Euromoney Country Risk Ratings

A systematic, biannual assessment of country risk factors for 185 countries. Ratings reflect a composite appraisal or scoring of economic, political, and social structural measures.

foreign direct investment (FDI)

A market entry and development strategy that involves a domestic firm expanding its operations to a foreign nation either by building or acquiring new facilities in the country of interest.

franchising

A contractual system similar to licensing whereby the franchisor grants the franchisee the right to distribute or sell certain goods or services.

global marketing

A coordinated and integrated marketing strategy that intentionally seeks to reach customers in foreign markets. Can be used interchangeably with the term international marketing to describe the marketing management processes required to sell products in more than one country.

gray markets

Marketing schemes designed to circumvent authorized channels of distribution to sell branded goods at prices lower than those intended by the manufacturer.

Hofstede Cultural Dimensions Framework

A systematic approach to understanding differences between national cultures based on four dimensions of cultural values: power, collectivism, masculinity, and uncertainty avoidance.

indirect exporting

The process of selling products to exporters, who in turn sell to foreign customers. Indirect exporters have no direct contact with foreign customers.

individualism versus collectivism

Alternative ends of the scale that measures the extent to which people in a culture tend to act independent of others versus acting in concert with a larger group.

joint venture

A foreign market entry strategy that requires either working agreements or formal equity-sharing arrangements between a local partner and a company seeking market access.

licensing

An arrangement in which the legal permission to use a process, trademark, patent, or other proprietary item is granted to a foreign producer in exchange for a fee or royalty payment.

masculinity versus femininity

Opposite ends of the spectrum that describes a range of values from highly assertive to highly nurturing. Those societies closer to the masculine end of the scale place greater value on ambition, material success, and power. Feminine societies place a greater value on charity, caring for the unfortunate, and preserving the natural environment.

power distance

The extent to which the less powerful members within a culture acknowledge and accept the unequal allocation of social and economic power.

standardization

The process of extending an established, standard marketing mix to foreign markets rather than adapting elements of the program to suit the local culture.

uncertainty avoidance

A reflection of how a culture responds to risk and ambiguity. Societies with high uncertainty avoidance would have greater difficulty coping with unfamiliar and unstructured problems.

Web Resources

This website provides an extensive set of examples of cross-cultural marketing blunders. In addition to mistakes related to advertising, it includes many examples of how the failure to understand the traditions and customs of other cultures has created problems for businesspeople working in foreign markets.

http://www.kwintessential.co.uk/cultural-services/articles/crosscultural-marketing.html

This website provides access to the article "Lost in Translation," by Randall Frost. It discusses the challenges involved in translating clever English language slogans and advertising themes into foreign languages.

http://www.brandchannel.com/features\_effect.asp?pf\_id=340

This website is an entertaining list of Peter Wise's Top 20 mistakes in international marketing and advertising translation.

http://ezinearticles.com/?International-Marketing-and-Advertising-Translation—-The-Top-20-Blunders,-Mistakes-and-Failures&id=3999831

This website is a list of 10 unusual examples from international marketing that illustrate how promotional messages in one language can be badly misinterpreted in another language when the translation is poorly executed.

http://marketinghackz.com/10-product-and-campaign-blunders-to-learn-from/

This website provides access to business consultant Deborah Swallow's list of cross-cultural marketing mistakes. However, her site also includes a wide array of useful information on several serious topics related to intercultural communication within a business context.

http://www.deborahswallow.com/2009/08/20/cross-cultural-marketing-blunders/

This website is a good source of information about global capital markets. It includes news, commentary, and articles on all facets of international finance arranged by topic and region.

http://www.euromoney.com

This website is a premier site for access to international market research. It provides current databases and research reports organized by industry, company, and consumer across more than 200 countries.

http://www.euromonitor.com

This website provides a comprehensive collection of company, financial, product, and consumer information extending across every major country, market, and industry. It also publishes news items and summaries from business publications around the world.

http://www.marketlineinfo.com

This website includes information on the history, people, government, economy, geography, communications, transportation, military, and transnational issues for 267 global entities. The site also provides geographic maps of the major world regions and a political map of the world.

<https://www.cia.gov/library/publications/the-world-factbook/index.html>

Glossary

accessible To be effective target markets, segments must be able to be effectively reached and served through existing marketing channels.

accumulation The process of assembling and pooling relatively small quantities from various suppliers to create a larger, more homogeneous supply of similar products.

adaptation The process of modifying a firm’s marketing programs and products to suit the preferences of new markets.

added value Refers to the addition of product features and benefits that exceed the typical buyer’s expectations.

administered VMS A distribution system in which a single dominant channel member coordinates the distribution-related decisions of the intermediaries in the absence of formal written agreements.

advertising Any paid form of nonpersonal communication between a seller and potential buyers.

agent A person or company that represents others for the purpose of negotiating sales but does not take title to the product being sold. An agent that does not have a permanent relationship with the company he or she represents is a broker.

all available funds Allocates all financial resources not specifically allocated to other purposes to the advertising budget.

allocation The phase of the sorting process that breaks down the accumulated product supply into smaller lots.

Ansoff Product/Market Opportunity Matrix A model to assist in the process of identifying new growth strategy options. It recognizes new product- and market-related opportunities as originating from one of four alternative strategies: market penetration, market development, product development strategy, and diversification.

aspirational audience The portion of a market that hopes to someday be able to afford the purchase of high-status brands.

aspirational brands Brands that status seekers would like to own for the purpose of demonstrating their wealth or high social status but cannot afford to buy.

assorting The process of creating a collection or assortment of products from multiple sources for use in relation to each other.

attitude The feeling of liking or disliking something. It is a relatively stable and enduring emotional response that directs our behavior toward the object of the attitude.

augmented product Features and benefits that provide added value to products even though they may not be the primary drivers or core benefits in the purchase decision.

available market Those buyers who possess both the interest and means to purchase a specific product under current market conditions.

backward integration strategy A strategy by which intermediaries acquire control of distribution partners that precede them in the channel to expand control over the supply and price of a product.

barriers to market entry Also known as barriers to competition, these are factors that reduce the level of competitive rivalry within a market. Barriers in any given context may include economic, legal, technological, cultural, and psychological features. Product differentiation, branding, advertising, patents, entry restrictions, tariffs, and quotas may all function as effective barriers to competition.

basic product The tangible features that constitute the product being purchased.

BCG Growth-Share Matrix A decision making aid that displays strategic business units on a two-by-two graph defined by forecasted market growth rate and relative market share.

behavioral learning A form of passive learning that takes place in response to external stimuli and events.

behavioral segmentation Dividing markets based on how consumers relate to the product being marketed in different circumstances. Common behavioral variables include purchase occasion, product usage rates, brand loyalty status, attitude toward the product, and benefits sought from purchase of the product.

benchmarking The procedures for evaluating an organization’s processes and performance against the best standards within the same or different industries. Statistical tools are used extensively to objectively measure performance.

brand A name, term, design, symbol, or any other feature that identifies one seller’s good or service as distinct from those of other sellers.

brand associations The positive and negative impressions that consumers link to the outcomes related to buying and using a specific brand. They are reflections of the perceived brand image.

brand awareness A general measure of consumers’ knowledge of the existence of a brand; the first preliminary step in the purchase decision process that ultimately leads to a sale.

brand equity The value of a brand based on consumer attitudes about positive brand attributes and the favorable consequences of brand use. It is a multifaceted construct defined by five underlying classes of assets: brand loyalty, brand awareness, perceived quality, brand associations, and other proprietary assets.

brand extensions New products or services introduced under the same brand name as existing goods in an effort to capitalize on the positive image or values associated with the existing brand name.

brand image The perception of a brand in the minds of current and prospective buyers; a composite of what the brand means to buyers in terms of their attitudes and expectations. Sometimes referred to as brand identity or brand personality.

brand loyalty The reliable tendency of consumers to consistently purchase the same brand within a given product class.

brand usage gap The difference between potential sales to the target market and the current level of brand usage by customers within the targeted segment of the market.

broker A middleman who acts as a go-between for buyers and sellers but does not serve as a permanent representative for either.

business-to-business (B2B) Sales and related transactions between businesses (e.g., manufacturer-to-wholesaler or wholesaler-to-retailer sales).

business-to-consumer (B2C) Sales and related transactions between business and consumers (e.g., retailer-to-consumer sales).

buyers Professional purchasing specialists who identify suppliers, arrange terms of sale, and carry out the contractual procedures required to facilitate the sale of the product.

buying center A cross-functional decision making unit composed of all the people who participate in or influence the decision making process.

buy phases Stages that organizations follow when making purchasing decisions.

bypass attack This strategy involves avoiding the target competitor’s position entirely. It often requires the introduction of substantially new products, new technologies, or significantly different business models. The objective is to change the nature of the market itself.

capital goods Long-lasting industrial installations and equipment used in the production or management of finished products.

cash cow An SBU with a large market share in a mature, slow-growing industry.

causal research Studies that investigate cause-and-effect relationships between marketing variables.

causal study An analysis in which historical time series data (e.g., sales) are combined with other time series data (e.g., advertising expenditures) related to the variable being forecasted (e.g., future sales).

channel captain The dominant channel member with an administered VMS.

channel conflict Any form of discord or dispute between two or more channel participants. Occurs most often when manufacturers disintermediate or go around existing channel partners by selling products direct to consumers or other parallel channels of distribution.

channel disintermediation Eliminating one or more intermediaries from the channel of distribution that connects producers to ultimate consumers. Within the context of the new economy, this may occur when online sales result in bypassing agents, distributors, wholesalers, or retailers.

channel intermediaries Organizations that specialize in services directly related to the process of moving goods from producers to consumers. Sometimes referred to as middlemen.

channel length The number of levels used to create a distribution system.

channel of distribution An interlinked system of institutions that work together to perform the functions necessary to move products from where they are created to where they are demanded.

channel power The capacity of channel members to influence the behavior of other channel members.

channel width The number of channel members operating at a given level within a distribution system.

classical conditioning A form of behavioral learning in which a previously known stimulus that elicits a positive response is repeatedly paired with another, neutral stimulus. When a subject experiences this paired association of stimuli several times, he passively learns to associate the previously neutral stimulus with the pre-existing positive feelings associated with the initial positive stimulus.

cognitive dissonance Feelings of dissatisfaction or insecurity that a buyer feels about the purchase they have made.

cognitive learning An active learning process based on information processing.

communication adaptation The process of changing the promotions and communications mix to fit new international markets.

communication tests Pre- versus post-campaign comparisons on non-sales-related measures.

comparative advertising Advertising messages that make explicit contrasts between brands of the same product.

competition-based pricing The process of making pricing decisions in response to the prices charged by competitors. Several types of company objectives are consistent with this approach.

competitive parity Sets advertising spending at an amount proportionate to that of one’s closest competitors.

confirmatory analysis Investigations seeking validation or confirmation for a specific new product or service proposal.

consideration set The specific brand alternatives being actively considered by the decision maker from among the evoked set.

conspicuous consumption Buying and displaying expensive brands as a way to convey a high status image.

consumer confidence An assessment of how optimistic consumers feel about the future state of the economy and their personal financial situation. It is generally regarded as a leading economic indicator.

continuous quality improvement (CQI) A system or set or processes intended to improve the quality of goods and services provided to consumers.

contractual VMS A distribution system that coordinates the creation and distribution of products through legal contracts specifying the rights and obligations of channel participants.

convenience goods Consumer products that are typically consumed and purchased frequently.

core benefit The primary or essential value that the customer derives from the product being purchased (e.g., transportation).

core competencies Specific activities or skill sets at which a firm excels.

corporate mission statement A formal, written statement that defines the purpose and scope of the organization.

corporate VMS A channel structure in which one organization owns either all channel members in the distribution chain or the firms operating at an adjoining level of distribution.

cost leadership strategy Leveraging lower overall costs of production to enable the firm to attract price-sensitive customers by selling at prices that are relatively lower than competitors’ prices.

cost-based pricing The reliance on an understanding of production- and marketing-related costs as the key elements in determining a product’s initial or standard price.

cost-per-thousand (CPM) Cost associated with of reaching 1,000 viewers, readers, or listeners.

cost-per-thousand prospects (CPM-P) Cost associated with of reaching 1,000 prospects for the brand being advertised.

cost-plus pricing Setting an initial price by adding a fixed monetary or dollar amount above the product’s initial cost. This approach is commonly used throughout the service sector of the economy where time- and labor-related costs are often independent of material costs.

country of origin effects The impact that buyers’ opinions of a product’s home country have on their perception of the product’s quality.

country risk The potential for financial loss from investing in a foreign country, particularly when losses are due to unanticipated political instability or economic volatility.

current account maintenance The process of keeping current buyers satisfied.

customer churning This term can describe the loss of customers over time for any reason. It is often used specifically to refer to tactics intended to maximize profitability from an initial sale without the intention to build a long-term relationship or customer loyalty.

customer databases Organized collections of qualitative and quantitative customer-related information that have been compiled for the purpose of improving marketing performance.

customer lifetime value (CLV) A methodology for evaluating the future, long-term profitability of a customer from projections of future cash flows and customer-specific forecasts of profitability.

customer profitability analysis (CPA) A methodology for analyzing the profitability of a company’s current customers from the analysis of internal accounting data.

customer relationship management (CRM) A systematic strategy that addresses both the initial acquisition and the retention of customers. It requires the coordination and integration of all business activities and processes to provide superior value to customers. It also emphasizes the role of marketing in communicating with consumers to build long-term relationships and maintain customer loyalty.

customer retention A term that can refer to both the activities that a company uses to reduce the loss of customers and the rate at which an organization is successful at keeping its customers.

customer satisfaction A buyer’s subjective, experience-based assessment of whether a product meets his or her expectations.

customer selectivity The ability of an organization to recognize that not all customers are equally profitable and the capacity to profitably use this knowledge to manage resources to reach the most profitable segments.

customer service A wide array of functions related to sales support and service to buyers after the initial sale.

customer-based pricing Sometimes referred to as demand-driven or value-based pricing. It is a set of price-setting techniques that derive product prices from buyers’ perceptions of value rather than the seller’s cost. This approach includes price skimming and penetration pricing.

customized marketing The most extreme level of market segmentation that treats each prospective buyer as a separate segment. Customized marketing is also known as micromarketing.

cyclical component The element in a time series study that incorporates any regular wavelike pattern in the sequences of values.

database marketing A general term used to describe any systematic approach to the collection, processing, and use of consumer and company data.

deciders The individual team member or members who make the final purchase decision.

Delphi method A qualitative forecasting method that relies on the interaction of multiple expert sources to develop forecasts through group consensus.

demographic segmentation Dividing markets by using identifiable social characteristics of individuals and groups that have been shown to effectively differentiate between buyers with different brand preferences. These variables include income, age, sex, ethnicity, education, occupation, home ownership, religion, social class, and family status.

descriptive research Studies using methodologies that describe the level or metrics associated with market-related variables. The final product of descriptive research is a snapshot of the relevant market based on the characteristics selected for study.

determinant attributes Brand features that are used by consumers to discriminate between brands in the multi-attribute purchase decision process.

differential advantage The unique product attributes or benefits that provide buyers with significant and substantial reasons to prefer one brand over another.

differentiation value The economic value of whatever differentiates the brand being priced from the best alternative. Differentiation value may have both positive and negative elements.

direct channel A distribution path that moves the product from the producer to the final consumer without reliance on any intermediary channel members.

direct exporting The process of exporting products to foreign markets characterized by companies selling directly and doing their own export marketing.

discretionary income The spendable portion of disposable income available to households after deducting the cost of necessities such as shelter.

disposable income The amount of money that households have available to spend after accounting for income taxes.

distributor In indirect B2B channels a reseller that performs the tasks associated with wholesalers in B2C markets.

diversification growth strategy A component of the Ansoff matrix that involves increasing sales by introducing new products into new markets.

dogs SBUs with little profitability or little opportunity for sales growth.

dynamic pricing A form of retail promotional pricing, popular with Internet retailers, that takes advantage of the opportunity to adjust prices at the point-of-sale based on specific information about the buyer and purchase situation. It enables sellers to create price offers uniquely suited to each specific transaction and buyer.

e-commerce The sale of products over an electronic medium such as the Internet. It is often used in reference to all of the supporting technology required to facilitate direct Internet sales to customers, such as electronic funds transfer, online order processing, and inventory management software.

Economic Value Estimation (EVE) A customer-based method that sets prices according to the valuation of the reference value of alternatives and differentiation value of the brand being priced.

Elaboration Likelihood Model (ELM) A representation of how advertising works via two alternative paths mediated by audience involvement with the message. The central route requires the thoughtful evaluation of the message contents to be persuasive. The peripheral route is potentially effective when the audience is not motivated to process the informational content of the ad.

emergency goods Consumer products that are sought in response to sudden, unexpected events.

emotional advertising appeals Message content that emphasizes words and images to evoke an emotional response.

encirclement attack This strategy involves surrounding or enveloping target competitors, often by producing a range of brands that are similar to the target product. The objective in this instance is for each new brand to steal away a small portion of the target competitor’s market share. It is sometimes described as laying siege to a competitor.

environmental scanning The process of systematically assessing how elements of the external environment will impact a business or market.

Euromoney Country Risk Ratings A systematic, biannual assessment of country risk factors for 185 countries. Ratings reflect a composite appraisal or scoring of economic, political, and social structural measures.

evaluation of alternatives This stage in the high involvement purchasing process entails the evaluation of alternative brands in accord with the processes defined by the multi-attribute model.

evoked set Total number of brands that the buyer knows about in the product category he or she is evaluating.

exclusive distribution The level of market coverage in which a product is distributed through only one retailer within a particular region.

expectations The customer’s subjective feelings, anticipating the bundle of benefits that a product will deliver.

expert opinion A subjective approach to forecasting that relies exclusively on the judgment of individuals who possess specialized knowledge of buyers, competitors, and products.

expert panel methods A qualitative forecasting method that relies on the opinions and judgment of many professionals. Unlike the Delphi method, however, expert panels are assembled and brought together to directly share and compare views.

exploratory analysis Open investigations undertaken without any prior assumptions about the validity or feasibility of the proposal under consideration.

exploratory research Studies that collect information about a problem under investigation in a loosely organized, unstructured, and informal manner. They are often used as preliminary research to help define the underlying market-related problem more clearly and specifically.

exponential smoothing A process for weighting the observations in time series data to place greater emphasis on the most recent observations.

external search This relates to the acquisition of new information from sources outside ourselves such as advertising, Internet searches, and discussions with friends.

facilitating agent A company that performs tasks related to the physical distribution of a product other than buying, selling, and transferring title. This category includes banks, transportation companies, legal services, market research firms, and public warehouses.

financial strength A measure of the firm’s depth of financial resources relative to its needs.

flank attack A strategy designed to exert pressure against competitive brands without engaging in a head-on confrontation. It typically involves launching new marketing programs that target segments that are not deemed essential or central to the success of the target brand. This may include introducing a new brand to meet the needs of a particular market niche.

foreign direct investment (FDI) A market entry and development strategy that involves a domestic firm expanding its operations to a foreign nation either by building or acquiring new facilities in the country of interest.

forward integration strategy A strategy in which wholesale and retail functions are created or acquired by a manufacturer to provide more direct control over the distribution of products.

franchising A contractual system similar to licensing whereby the franchisor grants the franchisee the right to distribute or sell certain goods or services.

frequency (F) The average number of times that an average prospect will be exposed to a given advertisement over a specified interval.

front power Channel power exercised by a relatively large retailer.

frontal attack This refers to a direct head-on assault against one or more close competitors, typically requiring the commitment of substantial resources.

gap analysis A variety of comparisons that examine the difference between actual performance and potential performance on measures of interest to marketing managers.

gatekeepers People within the organization who control the flow of relevant purchase- and product-related information.

general need description and product specification The stage where the problem that was initially identified is translated into a general need description.

generic competitors All kinds of products that the customer may regard as serving the same basic need on a particular usage occasion. This final tier of competition reflects extraordinary rather than ordinary buying circumstances.

generic strategy A general level of strategy applied to the pursuit of market opportunities. The three basic types of generic marketing strategy are product differentiation, cost leadership, and market focus.

geographic segmentation Dividing markets with an emphasis on the importance of understanding where prospective buyers live and how this impacts their brand preferences.

globalization The process by which global economies and markets have become increasingly interrelated and interdependent in recent decades. Within the narrow context of marketing management, the term refers to the practice of global branding and adapting the marketing mix to suit local cultures and preferences.

global marketing A coordinated and integrated marketing strategy that intentionally seeks to reach customers in foreign markets. Can be used interchangeably with the term international marketing to describe the marketing management processes required to sell products in more than one country.

gray markets Marketing schemes designed to circumvent authorized channels of distribution to sell branded goods at prices lower than those intended by the manufacturer.

gross rating points (GRP) Reach times frequency (RxF).

guerilla attack This differs from conventional marketing programs that are aimed at confronting competing brands with sustained initiatives. This kind of attack is launched at irregular and unpredictable intervals, often using unconventional means intended to wear down the target through a long series of minor attacks.

hedonic products Brands geared primarily toward satisfying the drive for experiential pleasures.

heterogeneous Composed of individuals with dissimilar product-related wants and needs.

hierarchy-of-effects models Representations of how advertising messages move an audience through a progressive sequence of psychological stages such as awareness, interest, desire, conviction, and action.

Hofstede Cultural Dimensions Framework A systematic approach to understanding differences between national cultures based on four dimensions of cultural values: power, collectivism, masculinity, and uncertainty avoidance.

homogeneous Composed of individuals with very similar product-related wants and needs.

inbound logistics All of the processes involved in bringing raw materials and unfinished goods into the company for conversion into final products.

indirect channel A distribution path that relies on one or more intermediary organizations to move the product from the producer to the final consumer.

indirect exporting The process of selling products to exporters, who in turn sell to foreign customers. Indirect exporters have no direct contact with foreign customers.

individualism versus collectivism Alternative ends of the scale that measures the extent to which people in a culture tend to act independent of others versus acting in concert with a larger group.

Industry Concentration Ratio Identifies the aggregate market share for the 4, 8, and 25 largest firms in most product markets. High four-firm concentration ratios indicate that a relatively few companies within an industry control a large portion of the market.

influencers Individuals who attempt to affect the outcome of the process, often through the expression of their expert opinion. They may offer suggestions on the functional or technical specification of product requirements.

information search The second stage in the five-step purchase decision process model; occurs when consumers seek information to help them better understand and solve the problem.

informational advertising Appeals message content which emphasizes facts and arguments.

innovative capacity An organization’s ability to develop and market new products or services.

Integrated Marketing Communications (IMC) Coordination of the promotions mix to achieve the communications objectives of the product or service being sold.

intensive distribution The level of market coverage in which a product is sold through all suitable wholesalers and retailers.

internal search Seeking relevant product information from a scan of one’s own memory.

involvement The perceived relevance or importance of a product to our wants and needs.

irregular component The element of a time series study that is caused by short-term, unanticipated, and non-recurring factors that impact the observed values in the data set.

jobber A wholesaler that buys from manufacturers and sells exclusively to retailers.

joint venture A foreign market entry strategy that requires either working agreements or formal equity-sharing arrangements between a local partner and a company seeking market access.

jury of executive opinion The top executives within a company serve as an expert panel to consider long-range trends that may impact the organization.

label Any information attached to a product for the purpose of naming it and describing its use, its dangers, its ingredients, its manufacturer, etc.

leading economic indicator A statistical measure that points to positive or negative changes in the national economy ahead of the actual changes.

learning A term used to describe the process by which people acquire new knowledge and preferences.

licensing An arrangement in which the legal permission to use a process, trademark, patent, or other proprietary item is granted to a foreign producer in exchange for a fee or royalty payment.

longitudinal studies These studies require the collection of repeated observations of the same variables over extended periods of time. They are also referred to as correlational studies when they are looking for statistical relationships between two or more marketing variables.

long-range forecasting Making predictions for periods greater than one year into the future.

loss-leader pricing Consists of featuring one or more popular brands for sale at prices below the seller’s cost of goods. The expectation is that these featured values will build customer traffic for the store and result in purchasers of additional regular-priced products as well.

loyal customers Buyers whose purchase history demonstrates a commitment to one brand through a series of repeated purchases over time. Customer loyalty is typically rooted in sustaining high levels of customer satisfaction.

macro-environmental forces Uncontrollable external variables that impact all firms within an industry (e.g., prevailing economic conditions, cultural trends).

making the transaction or ordering process routine Efforts to standardize the process for subsequent routine orders and future product reorders.

manufacturer’s agent An agent who works on a contractual basis to sell the products of multiple producers.

markdowns Often referred to as "sale prices," these are the most familiar form of promotional pricing. They encompass a diverse array of promotions that feature products selling below their usual or customary price.

market All the individuals, groups, and organizations that want or need a product and have the resources required to purchase.

market challenger A strong and well positioned second-tier brand that lacks the dominance held by the market leader. It is regarded as a challenger insofar as it is engaged in an aggressive strategy to gain market share. Challengers may pursue one of five attack options including frontal attacks, flank attacks, encirclement attacks, guerilla attacks, and bypass attacks.

market coverage The proportion of retail or wholesale intermediaries selling a specific brand relative to the total number of these outlets that sell comparable products.

market demand The total volume or amount of a specific product purchased by consumers over the complete range of prices at which it is sold.

market development strategy A component of the Ansoff matrix that involves increasing sales by introducing existing products into new markets.

market dominance The strength of a brand relative to its nearest competitors. Often measured by brand market share or relative market share.

market focus strategy A strategy option defined by the scope over which the firm will implement either cost leadership or differentiation strategies.

market follower A financially secure firm that does not occupy the most dominant position and is content to maintain its market share rank. Typically follows a conservative strategy and often follows the example set by market leaders.

market leader A brand that is dominant within its market. It holds the position of market share and relative market share leadership.

market leadership A company that holds the highest market share in a given product market.

market mapping The process of identifying the additional marketing mix activities, investments, and financial consequences associated with actively targeting a new segment-specific opportunity.

market methods Qualitative sales forecasting techniques that rely on tapping the opinion of current customers and prospective buyers.

marketnicher A brand that concentrates its resources and marketing efforts on relatively small target markets. This is directly comparable to the generic focus strategy.

market penetration index The ratio of current market demand to potential demand level.

market penetration strategy A component of the Ansoff matrix that involves increasing sales of existing products to current markets.

market potential A measure of the maximum total possible sales of a given product over a fixed interval of time.

Market Potential Index A multi-factor index of market potential for emerging global markets created by the Michigan State University Center for International Business and Economic Research.

market research The systematic gathering, recording, and analyzing of data with respect to a particular market, where market refers to a specific customer group in a specific geographic area.

market segmentation The process and strategy by which the total market for a product is divided into smaller parts or segments of customers that have similar wants and needs with respect to a specific product.

market segments Clusters of prospective and current customers who are similar to each other in ways that lead them to respond to a firm’s marketing mix similarly.

market test An experimental market introduction, conducted on a limited basis, within a carefully selected sample of the intended target market. The primary goal of the test is to enable marketing managers to project the sales and profit consequences of a full-scale market launch.

market-centered specialization Concentrating on the specific needs and preferences of a particular segment of consumers across multiple product categories.

marketing and sales The fourth element of the value chain, which includes product pricing and promotion activities (e.g., advertising, personal selling, and sales promotion).

marketing capability Ability of competitors to competently market new products or services.

marketing concept A customer-oriented philosophy of business management which stresses that the objectives of the organization can best be met through the analysis and satisfaction of customers’ wants and needs.

marketing management A set of processes for creating, communicating, and delivering value to customers and for managing customer relationships in ways that benefit the organization and its stakeholders.

marketing mix Tools available to the marketing manager to influence the target market to purchase one brand over another. Often referred to as the 4 Ps.

marketing objectives Growth and profitability goals for the firm expressed in quantitative and qualitative terms.

marketing orientation An emphasis on satisfying customer wants and needs as the basis for making business decisions. This is in contrast to a product orientation, which develops goods and services based on the company’s resources and skills rather than customer preferences.

marketing plan A document composed of an analysis of the current marketing situation, marketing objectives, marketing strategy, marketing mix plans, and financial projections.

marketing research process A multistep procedure designed to answer three research questions: What should we be investigating? How should we design the study? What will the results reveal?

marketing strategy A statement of how a brand or product line will coordinate the marketing mix to achieve its objectives.

markup pricing Setting an initial or standard price by adding a fixed percentage increase above the product’s initial cost. This is a method favored by many large retailers.

masculinity versus femininity Opposite ends of the spectrum that describes a range of values from highly assertive to highly nurturing. Those societies closer to the masculine end of the scale place greater value on ambition, material success, and power. Feminine societies place a greater value on charity, caring for the unfortunate, and preserving the natural environment.

mass customization The ability to produce large volumes of products designed to customers’ specifications at costs that are comparable to standardized, mass-produced goods.

mass marketing The level of market segmentation that does not discriminate or differentiate between prospective groups or segments of buyers. Mass marketing is also known as undifferentiated marketing.

matching The process of aligning the strengths of the firm with new opportunities while pursuing ways to mitigate potential threats and company-specific weaknesses.

materials Industrial goods including both basic raw materials and manufactured materials.

measurable Effective target segments must be identifiable by marketing metrics for which data are readily available. This could include measures of sales potential, market size, purchasing power, and customer profiles.

medium-range forecasting Making annual forecasts or predictions.

merchant middleman Any channel intermediary who buys goods and takes legal title to them.

micro-environmental forces Uncontrollable external variables that selectively and discretely influence each firm uniquely and independently (e.g., behavior of a company’s suppliers and customers).

microsegment A term used to describe a small, limited, precisely identified division of a market. It refers to a targeted sub-segment or component of a larger defined segment.

middleman An independent business that provides connections between buyers and sellers. Wholesalers and retailers are the primary types of middlemen.

middle power Channel power in the possession of a wholesaler.

missionary selling Providing product-related information and advice to prospective buyers without any expectation of making a sale.

modified rebuy A B2B purchase decision that involves limited decision making and problem solving.

monetary value A term used in industrial product sales to indicate either cost savings or revenue improvements resulting from the purchase of a product.

motivation The internal state or processes that drive people to engage in goal-oriented behavior. Within the context of marketing, an internal drive to purchase products or services that consumers believe will fulfill conscious and unconscious wants and needs.

multi-attribute models Conceptual and mathematical models that specify consumer attitudes toward brands as a composite of beliefs about product attributes, weighted by the importance of those categories of beliefs.

multidimensional scaling (MDS) A set of related statistical techniques that enables researchers to visualize information in ways that help identify patterns of similarities or dissimilarities in data. MDS can display information about two or more product attributes on a perceptual map to evaluate the perceived distances between competing brands.

multiple segment specialization Targeting several segments with either a solitary brand or multiple brands.

multivariate regression analysis The most common technique used to carry out causal time series analyses. This statistical forecasting tool identifies relationships between sales (the dependent variable) and one or more influencing factors (independent variables).

naive forecasting The prediction that sales for the next period will be the same as sales for the previous period.

new business development The process of converting prospective buyers into current customers.

new economy A phrase used to refer to the impact of information technologies since the mid-1980s on traditional economic systems. Within business contexts, it is currently used in reference to the effect of information technology and the Internet on both the domestic and global economy.

new product development process A conceptual model describing the cultivation of an idea from its initial beginnings to its introduction to the market as a new product. The development of new products in this model is described in six sequential stages: idea generation, screening, concept development and testing, business analysis, market testing, and commercialization.

new task buying The most complex of the three buy classes. A new task purchase requires greater effort in gathering information and evaluating alternatives because the company has not previously made a similar decision.

niche marketing The level of market segmentation where an organization creates narrowly focused marketing plans for very small segments. Niche marketing is also known as concentrated marketing.

North American Industry Classification System (NAICS) A coding system created by Mexico, Canada, and the United States to classify businesses by the type of activity in which they are primarily engaged. It is frequently used to analyze and segment business-to-business markets.

objective and task A media budget setting method that works by matching advertising expenditures to the corresponding marketing objectives for the campaign.

operating and business supplies Short-lived goods used to support the routine operations of the firm.

operating capacity A firm’s manufacturing or service-producing potential within existing product and service lines.

operations All of the activities that transform the inputs delivered by the inbound logistics systems into final products.

organizational markets B2B buyer markets composed primarily of manufacturers, wholesalers, retailers, and government agencies.

outbound logistics The activities involved in shipping out and distributing final products (e.g., warehousing and transportation).

package The container used to protect, promote, transport, and/or identify a product.

packaging The process by which packages are created.

packaging for distribution Activities involved in designing and creation of containers for a product during its transportation from the manufacturer, through the channels of distribution, to the point of retail sale or purchase.

packaging for final customers Activities involved in the design and creation of containers that the final buyer receives at the time of purchase. Packaging at this retail level can contribute to the value offered by a product in four distinct ways: maintaining product integrity, promoting of the brand image, enhancing the convenience associated with using the product, and providing valuable information to the buyer.

pantry management Providing incentives to consumers to encourage them to stock up on several purchase cycles’ worth of a product for the purpose of preventing competitors’ brands from selling.

Pareto principle A common rule of thumb that states that 80 percent of your profits or sales will come from 20 percent of your clients.

parts Finished industrial goods that enter the manufacturing process for other products without any further change in their basic form.

penetration pricing A pricing technique that consists of establishing relatively low initial prices to attract new customers and build sales volume. After securing customer acceptance and a foothold in the market, prices are subsequently increased to capture higher levels of profitability.

perceived quality The consumer’s subjective opinion of of a brand’s or product’s capability to meet his or her expectations and product-specific needs.

percentages of sales A budget setting method that allocates fixed percentages of either past or anticipated sales advertising media.

performance review The buyer’s systematic, periodical reviews of the efficiency and effectiveness of current suppliers.

performance value A subjective assessment of how well a product does what the buyer expects it to do.

personal selling Personal interactions between company representatives and prospective customers for the purpose of facilitating current and future sales.

persuasion Changing a person’s attitudes by means of promotional messages.

PESTEL analysis An environmental scanning approach that examines six classes of external environmental factors: political, economic, social, technological, environmental, and legal.

place One of four variables in the marketing mix; relates primarily to distribution and location decisions.

Porter’s Five Forces Model A framework for industry analysis that identifies the five factors that determine the level of competitive intensity within a product market. Those factors include the threat of new competitors, the intensity of competitive rivalry, the threat of substitute products, and the bargaining power of both customers and suppliers.

positioning process A four-step model used to identify the best positioning strategy for a brand. Steps include identifying the competitive set, determining target market perceptions and determinant attributes, analyzing competitors, and determining the attributes required to meet positioning objectives.

post-purchase evaluation The final stage of the purchase decision process where consumers respond with satisfaction or remorse to the choice they have made.

power distance The extent to which the less powerful members within a culture acknowledge and accept the unequal allocation of social and economic power.

price elasticity of demand (PED) An economic measure of the responsiveness of the quantity of a good demanded to a change in its price. It is expressed as the percentage change in quantity demanded in response to a 1 percent change in price. Its value can be influenced by many factors, including brand loyalty, the availability of substitute goods (the substitution effect), percentage of income being spent to acquire a product, the perceived necessity of the purchase, and the anticipated duration of the price change.

price premium The additional monetary value that a customer will spend for a specific branded product above and beyond the retail price associated with generic or unbranded competitors.

price skimming A pricing technique that initially sets new product prices relatively high to maximize per-unit profits. This approach enables the organization to recover development and preliminary marketing costs before the arrival of competing brands drives prices lower. The sustainability of this strategy over time hinges on several factors related to the dynamics of the market including barriers to entry.

price–quality correlation The tendency for buyers to associate better product quality with higher prices.

pricing One of four variables in the marketing mix; relates to both economic and psychological dimensions of price setting.

pricing objectives An alternative pricing goal typically set in response to the positioning and the overall brand strategy for the product. The primary goal of any given pricing strategy will typically be focused on achieving one of four major objectives: profit maximization, market share maximization, market skimming, or quality leadership.

primary data Information that is gathered specifically in response to a particular research question.

problem recognition (consumer buying) First stage in the five-step purchase decision process model; occurs when a consumer becomes aware of a need that must be met and recognizes that a particular product or service is required.

problem recognition (organizational buying) The process is initiated when a problem or need is recognized.

product One of four variables in the marketing mix, related to both the tangible and intangible dimensions of ideas, goods, services, or some combination of the three. Bundles of benefits created specifically to meet the needs of specific target markets for of satisfying organizational objectives.

product bundling Selling complementary products together at a special combined or bundled price. For buyers, the overall cost of purchasing the set or bundle is less when compared to purchasing each product individually.

product class competitors Brands that provide similar bundles of benefits and functions but lie outside the immediate competitive set.

product development strategy A component of the Ansoff matrix that involves increasing sales by introducing new products into current markets.

product differentiation strategy Distinguishing your product from competitors’ products in a way that makes prospective buyers prefer your brand. The basis of differentiation can be tangible or intangible attributes of the product.

product differentiation The process of meaningfully distinguishing one product or brand from another in a way that renders it more appealing to a given target market.

Product Diffusion Curve (PDC) A model illustrating how the acceptance of new products spreads through five adopter segments or categories within a market: innovators, early adopters, early majority, late majority, and laggards.

product form competitors Brands of products or services within the same product category. This is the narrowest definition of competition, and the brands sold in this class are often referred to as direct competitors.

Product Life Cycle (PLC) A conceptual model that describes the four stages that a product typically passes through from its origins until its exit from the market: introduction, growth, maturity, and decline.

product line A group of products that are related to each other by virtue of sharing a common target market. Lines can also be defined as sets of products that share similar uses, technologies, distribution channels, or other relevant features.

product mix The complete collection or set of products offered for sale by an organization, inclusive of all product lines.

product positioning The strategy and tactics involved in creating and shaping the brand’s image in the mind of prospective buyers. Product positioning is also referred to as brand positioning.

product positioning The way that consumers view competitive brands or types of products. The term is also commonly used to describe the strategy or strategic plan that is developed to achieve the intended position in the market relative to competing brands.

product power Channel power residing with the product’s manufacturer.

product quality The buyer’s perception of the sum of the benefits he or she receives from the product.

product supply system An orientation to delivering products to the market that emphasizes manufacturing and distribution with less regard for consumer product preferences. This product-focused approach to marketing can be simply defined as selling what you can make rather than making what you can sell.

product usage gap The difference between total market potential and current product usage by all customers within a given market.

product-centered specialization Selling across several segments within a single product market.

promotion One of four variables in the marketing mix; relates to the firm’s overall communications program.

promotional pricing An array of price-reduction tactics intended to stimulate the demand for specific brand. They are frequently employed when new products are initially introduced to the market and throughout the Product Life Cycle as a temporary stimulus when sales are lagging below expectations. There are five general categories of promotional pricing alternatives: markdowns, loss-leader pricing, product bundling, dynamic pricing, and sales promotions.

promotions mix The communication techniques available to marketers. These include advertising, personal selling, sales promotion, public relations, and publicity.

proposal solicitation The stage in the purchase process where buyers invite qualified and approved suppliers to submit proposals.

proprietary assets Tangible or intangible items that contribute positive economic value to a brand. This includes legally protected intellectual property such as patents, trademarks, and copyrights.

prospecting The of activities required to identify potential buyers and generate sales leads.

psychographic segmentation Dividing markets based on the psychological and lifestyle attributes of buyers such as personality, values, and attitudes.

psychological pricing A class of price-setting tactics that are based on understanding how products create intrinsic satisfaction for the buyer.

public relations Nonpaid, impersonal communications sent out by news media or other vehicles outside the control of the seller.

pull strategy Using promotional efforts to build selective brand demand at the consumer level. The brand is drawn through the channel as a consequence of consumer response to advertising and sales promotions.

purchase decision process five-stage model An illustration of the steps involved in high involvement decision making.

purchase decision The fourth stage of the purchase decision process, where consumers choose between the contending brands.

push strategy Using financial incentives to encourage channel members to carry and promote a product for resale to subsequent levels of the channel.

qualifying The process of determining if a sales lead has the potential to be a viable sales prospect.

qualifying market segments The process of evaluating the market potential for each alternative segment and estimating the cost-benefit trade-offs associated with pursuing each segment as a target market.

qualitative forecasting techniques Using the judgment and expert opinion of knowledgeable professionals to generate forecasts.

quantitative forecasting methods Using the analysis of historical data to predict future sales.

question mark (problem child) An SBU that holds a relatively small market share in a high-growth market.

reach (R) The number of unique prospects that is exposed to a given advertisement over a specified interval.

reference price The approximate price or price level that buyers expect to pay for a given product.

reference value The price of the customer’s best alternative relative to the brand being priced.

reintermediation The restoration of a previously displaced intermediary between buyers and sellers.

relative market share The ratio of one SBU’s market share to the market share of its largest competitor.

reminder advertising Ads intended to keep familiar products readily available in the minds of consumers.

retailer A channel member that sells to the final consumer.

sales force composite A two-part qualitative forecasting technique. The organization’s sales force serves as the expert panel. Additionally, however, each salesperson prepares forecasts for his or her own territory. Prior to when the expert sales panel comes together, the forecasts are consolidated and distributed for later discussion by the group.

sales forecasting A specialized subfield within the domain of market research that provides predictions about markets, customers, and competitors. Almost all forms of marketing-related forecasts relate either directly or indirectly to predicting future sales.

sales potential The portion of the market potential that a firm can reasonably expect to reach. An estimate of the size of the brand’s target market.

sales promotions Short-term incentives intended to build sales volume by lowering the price paid by the buyer. The methods used in this category include rebates, coupons, special financing, trade-in plans, and loyalty programs.

sales support Sales-related activities intended to facilitate the activities of other salespeople.

sales tests Pre- versus postcampaign comparisons of brand sales.

sampling plan Dimensions of the research design used to select subjects from the research population of interest.

search engine optimization (SEO) The process of revising and improving a company’s website so that search engines will find and rank the pages higher on the results list from keyword searches.

seasonal component The element of a time series study that accounts for regular, recurring patterns of variability at specific times of the year.

secondary benefits Features that enhance the primary value provided by the product (e.g., cruise control, GPS navigation system).

secondary data Information that has been collected prior to a study for unrelated purposes.

segment marketing The level of market segmentation that differentiates between customer groups within a product market by executing separate marketing plans for individual brands. Segment marketing is also known as differentiated marketing.

selective distribution An intermediate level of market coverage in which a product is distributed through a limited number of wholesalers and retailers.

sensitivity analysis A collection of analytical techniques that tests target variables (e.g., profitability) to assess how sensitive or responsive they are to changes in other variables (e.g., prices).

service An intangible product that does not result in the ownership of material goods that can be stored or inventoried. The benefits derived from consumption of a service are uniquely dependent on the knowledge, talents, and abilities of the service provider. Services possess four characteristics that have direct implications for how they should be marketed: intangibility, perishability, inseparability, and variability.

service value chainThe fifth element of the value chain, this comprises the actions undertaken by the organization to satisfy customers’ needs after the initial product sale has been completed (e.g., repair services and customer support).

service-dominant logic An emerging view or marketing paradigm that recognizes that product value is defined by and co-created in concert with the consumer. This is in contrast to the prevailing view of customers as passive recipients of mass-produced goods and services.

share penetration index The ratio of the brand’s current sales to its potential sales.

shopping goods Consumer products purchased and consumed less frequently than convenience goods. These are more expensive purchases, and buyers are willing to invest more time comparison shopping across brands and between retailers to locate the best values. These products are usually higher involvement purchases than convenience goods, but less involving than specialty goods.

short-range forecasting Making predictions less than one year into the future.

simple linear regression analysis A statistical forecasting tool that identifies relationships between sales (the dependent variable) and one correlated factor (independent variable).

simulation A qualitative forecasting procedure that begins by providing a panel of experts with several written, conceptual scenarios of the future based on clearly defined assumptions. Participants interact to reach consensus on which scenario and set of assumptions represent the most likely depiction of future events.

single-segment concentration strategies Focusing marketing resources on serving one segment exclusively.

social class A division or group within a society that shares a similar social and economic status.

social media Electronic means of communication through which users exchange information about their lives. The details being shared include biographical information, personal photos, and details about professional pursuits.

sorting out The initial phase of the sorting process that reorganizes a mixed product supply into discrete inventories that are relatively consistent with respect to kind, size, or quality.

sorting process Channel activities that create a mix of goods and services from diverse producers to match the preferences of consumers.

specialty goods Consumer products that are relatively expensive and infrequently purchased. Consumers are deliberate and selective when making these very high involvement decisions.

standardization The process of extending an established, standard marketing mix to foreign markets rather than adapting elements of the program to suit the local culture.

stars SBUs that exhibit relatively high market share in high-growth markets.

straight rebuy A habitual purchase decision typical of the low involvement purchases made by B2C buyers.

strategic business unit (SBU) Any product or service line within a company that is small enough to be flexible in its response to external market forces and big enough to exercise direct control over the internal decision factors affecting its performance.

strategy A long-term plan of action designed to achieve specific objectives.

subcultures Groups of people who are differentiated from the broader culture in which they live by shared beliefs and characteristics that identify the groups as distinct from the whole.

substantial To serve as effective target markets, segments must be sufficiently large and profitable enough to pursue.

supplier selection The evaluation and selection of the winning supplier, usually based on the results of a supplier evaluation model.

supplier/source search The processes used by buyers to identify potential suppliers.

switching costs Obstacles to a buyer’s change of brands, products, or suppliers.

SWOT analysis A strategic planning technique used to investigate how internal, company-specific factors and external environment impact the feasibility of new marketing ventures. SWOT is an acronym for strengths, weaknesses, opportunities, and threats.

tactics The short-term means required to execute strategy and achieve specific objectives.

target market A group of potential buyers that the firm seeks to satisfy with its marketing mix. It is the segment of the market at which the firm directs its product and marketing efforts.

time series A set of quantitative observations collected at successive points in time over a specified period or interval.

time series study An analysis in which historical time series data are used exclusively to predict future values of the same variable.

top-of-mind awareness A measure indicating which brand is first recalled when customers are prompted by the name of the product category.

total cost concept The principle that requires managers to explicitly consider all the costs related to each alternative design for distributing goods to customers. These costs include transportation, warehousing, order processing, and distribution-related packaging. However, the concept also recognizes that minimizing these costs may be at odds with achieving high levels of customer service.

total customer satisfaction (TCS) A management philosophy based on the principles of TQM. The focus of TCS is the creation of processes for achieving the highest possible levels of customer satisfaction.

total product A conceptualization of products as consisting of four levels, each of which contributes to the value that customers receive from their purchase. These levels are the core benefit, secondary benefits, basic product, and augmented product.

total quality management (TQM) A comprehensive management philosophy centered on creating processes for continuous improvement of product quality.

trade selling Sales activities focused on maintaining the support of distribution channel intermediaries.

transportation A broad term that encompasses the physical movement of products from one place to another and all of the intermediate steps involved in the process as well.

trend component The element in a time series study that accounts for the gradual shifting of the time series data over a long period of time.

trial close A technique used by salespeople to help determine the buyer’s readiness to purchase.

uncertainty avoidance A reflection of how a culture responds to risk and ambiguity. Societies with high uncertainty avoidance would have greater difficulty coping with unfamiliar and unstructured problems.

users People within the firm who will be end users of the product being purchased.

value The total package or bundle of benefits that a customer receives from the purchase and use of a product relative to the perceived costs of buying it.

value chain analysis A systematic approach to understanding the sequence or chain of business activities that converts inputs into outputs of greater value. The end goal of this analysis is to identify opportunities to enhance the competitive position of the firm.

value delivery system In contrast to the product supply system, the means of providing value to the market is rooted in first understanding the needs of consumers. This consumer-focused approach to marketing emphasizes customer satisfaction as its primary goal.

value drivers The benefits most valued by the target; tangible or intangible characteristics that enhance the value of a product or service.

value propositions Overt commitments or promises made by the seller to provide the buyer with a specific level of value or bundle of product benefits.

vertical marketing systems (VMS) Coordinated channel systems made up of horizontally and vertically aligned participants, managed to optimize operating economies and market impact.

wholesaler A channel participant that buys and subsequently resells goods in smaller quantities to retailers or other customers. Often referred to as distributors in B2B markets. Wholesalers who buy from producers and sell only to retailers are called jobbers.

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