Marketing Management, Millenium Edition

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Custom Edition for University of Phoenix

Excerpts taken from:

A Framework for Marketing Management,
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A Pearson Education Company
Upper Saddle River, New Jersey 07458

Marketing Management Millenium Edition, Tenth Edition,
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This special edition published in cooperation with Pearson Custom Publishing

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

Please visit our web site at www.pearsoncustom.com

ISBN 0–536–63099-2
BA 993095

PEARSON CUSTOM PUBLISHING
75 Arlington Street, Suite 300, Boston, MA 02116
A Pearson Education Company

SECTION ONE

Marketing in the Twenty-First Century

We will address the following questions:

- What are the tasks of marketing?
- What are the major concepts and tools of marketing?
- What orientations do companies exhibit in the marketplace?
- How are companies and marketers responding to the new challenges?

Change is occurring at an accelerating rate; today is not like yesterday, and tomorrow will be different from today. Continuing today's strategy is risky; so is turning to a new strategy. Therefore, tomorrow's successful companies will have to heed three certainties:

- Global forces will continue to affect everyone's business and personal life.
- Technology will continue to advance and amaze us.
- There will be a continuing push toward deregulation of the economic sector.

These three developments—globalization, technological advances, and deregulation—spell endless opportunities. But what is marketing and what does it have to do with these issues?

Marketing deals with identifying and meeting human and social needs. One of the shortest definitions of marketing is "meeting needs profitably." Whether the marketer is Procter & Gamble, which notices that people feel overweight and want tasty but less fatty food and invents Olestra; or CarMax, which notes that people want more certainty when they buy a used automobile and invents a new system for selling used cars; or IKEA, which notices that people want good furniture at a substantially lower price and creates knock-down furniture—all illustrate a drive to turn a private or social need into a profitable business opportunity through marketing.

MARKETING TASKS

A recent book, *Radical Marketing,* praises companies such as Harley-Davidson for succeeding by breaking all of the rules of marketing.[1] Instead of commissioning expensive marketing research, spending huge sums on advertising, and operating large marketing departments, these companies stretch their limited resources, live close to their customers, and create more satisfying solutions to customers' needs. They form buyers clubs, use creative public relations, and focus on delivering quality products to win long-term customer loyalty. It seems that not all marketing must follow the P&G model.

In fact, we can distinguish three stages through which marketing practice might pass:

1. *Entrepreneurial marketing:* Most companies are started by individuals who visualize an opportunity and knock on every door to gain attention. Jim Koch, founder of Boston Beer Company, whose Samuel Adams beer has become a top-selling "craft" beer, started out in 1984 carrying bottles of Samuel Adams from bar to bar to persuade bartenders to carry it. For 10 years, he sold his beer through direct selling and grassroots public relations. Today his business pulls in nearly $200 million, making it the leader in the U.S. craft beer market.[2]
2. *Formulated marketing:* As small companies achieve success, they inevitably move toward more formulated marketing. Boston Beer recently began a $15 million television advertising campaign. The company now employs more that 175 salespeople and has a marketing department that carries on market research, adopting some of the tools used in professionally run marketing companies.
3. *Intrepreneurial marketing:* Many large companies get stuck in formulated marketing, poring over the latest ratings, scanning research reports, trying to fine-tune dealer relations and advertising messages. These companies lack the creativity and passion of the guerrilla marketers in the entrepreneurial stage.[3] Their brand and product managers need to start living with their customers and visualizing new ways to add value to their customers' lives.

The bottom line is that effective marketing can take many forms. Although it is easier to learn the formulated side (which will occupy most of our attention in this book), we will also see how creativity and passion can be used by today's and tomorrow's marketing managers.

The Scope of Marketing

Marketing people are involved in marketing 10 types of entities: goods, services, experiences, events, persons, places, properties, organizations, information, and ideas.

Goods. Physical goods constitute the bulk of most countries' production and marketing effort. The United States produces and markets billions of physical goods, from eggs to steel to hair dryers. In developing nations, goods—particularly food, commodities, clothing, and housing—are the mainstay of the economy.

Services. As economies advance, a growing proportion of their activities are focused on the production of services. The U.S. economy today consists of a 70–30 services-to-goods mix. Services include airlines, hotels, and maintenance and repair people, as well as professionals such as accountants, lawyers, engineers, and doctors. Many market offerings consist of a variable mix of goods and services.

Experiences. By orchestrating several services and goods, one can create, stage, and market experiences. Walt Disney World's Magic Kingdom is an experience; so is the Hard Rock Cafe.

Events. Marketers promote time-based events, such as the Olympics, trade shows, sports events, and artistic performances.

Persons. Celebrity marketing has become a major business. Artists, musicians, CEOs, physicians, high-profile lawyers and financiers, and other professionals draw help from celebrity marketers.[4]

Places. Cities, states, regions, and nations compete to attract tourists, factories, company headquarters, and new residents.[5] Place marketers include economic development specialists, real estate agents, commercial banks, local business associations, and advertising and public relations agencies.

Properties. Properties are intangible rights of ownership of either real property (real estate) or financial property (stocks and bonds). Properties are bought and sold, and this occasions a marketing effort by real estate agents (for real estate) and investment companies and banks (for securities).

Organizations. Organizations actively work to build a strong, favorable image in the mind of their publics. Philips, the Dutch electronics company, advertises with the tag line, "Let's Make Things Better." The Body Shop and Ben & Jerry's also gain attention by promoting social causes. Universities, museums, and performing arts organizations boost their public images to compete more successfully for audiences and funds.

Information. The production, packaging, and distribution of information is one of society's major industries.[6] Among the marketers of information are schools and universities; publishers of encyclopedias, nonfiction books, and specialized magazines; makers of CDs; and Internet Web sites.

Ideas. Every market offering has a basic idea at its core. In essence, products and services are platforms for delivering some idea or benefit to satisfy a core need.

A Broadened View of Marketing Tasks

Marketers are skilled in stimulating demand for their products. However, this is too limited a view of the tasks that marketers perform. Just as production and logistics professionals are responsible for supply management, marketers are responsible for demand management. They may have to manage negative demand (avoidance of a product), no demand (lack of awareness or interest in a product), latent demand (a strong need that cannot be satisfied by existing products), declining demand (lower demand), irregular demand (demand varying by season, day, or hour), full demand (a satisfying level of demand), overfull demand (more demand than can be handled), or unwholesome demand (demand for unhealthy or dangerous products). To meet the organization's objectives, marketing managers seek to influence the level, timing, and composition of these various demand states.

The Decisions That Marketers Make

Marketing managers face a host of decisions in handling marketing tasks. These range from major decisions such as what product features to design into a new product, how many salespeople to hire, or how much to spend on advertising, to minor decisions such as the wording or color for new packaging.

Among the questions that marketers ask (and will be addressed in this text) are: How can we spot and choose the right market segment(s)? How can we differentiate our offering? How should we respond to customers who press for a lower price? How can we compete against lower-cost, lower-price rivals? How far can we go in customizing our offering for each customer? How can we grow our business? How can we build stronger brands? How can we reduce the cost of customer acquisition and keep customers loyal? How can we tell which customers are more important? How can we measure the payback from marketing communications? How can we improve sales-force productivity? How can we manage channel conflict? How can we get other departments to be more customer-oriented?

Marketing Concepts and Tools

Marketing boasts a rich array of concepts and tools to help marketers address the decisions they must make. We will start by defining marketing and then describing its major concepts and tools.

Defining Marketing

We can distinguish between a social and a managerial definition for marketing. According to a social definition, **marketing** is a societal process by which individuals and groups obtain what they need and want through creating, offering, and exchanging products and services of value freely with others.

As a managerial definition, marketing has often been described as "the art of selling products." But Peter Drucker, a leading management theorist, says that "the aim of marketing is to make selling superfluous. The aim of marketing is to know and understand the customer so well that the product or service fits him and sells itself. Ideally, marketing should result in a customer who is ready to buy."[7]

The American Marketing Association offers this managerial definition: **Marketing (management)** is the process of planning and executing the conception, pricing, promotion, and distribution of ideas, goods, and services to create exchanges that satisfy individual and organizational goals.[8]

Coping with exchange processes—part of this definition—calls for a considerable amount of work and skill. We see marketing management as the art and science of applying core marketing concepts to choose target markets and get, keep, and grow customers through creating, delivering, and communicating superior customer value.

Core Marketing Concepts

Marketing can be further understood by defining the core concepts applied by marketing managers.

Target Markets and Segmentation

A marketer can rarely satisfy everyone in a market. Not everyone likes the same soft drink, automobile, college, and movie. Therefore, marketers start with *market segmentation*. They identify and profile distinct groups of buyers who might prefer or require varying products and marketing mixes. Market segments can be identified by examining demographic, psychographic, and behavioral differences among buyers. The firm then decides which segments present the greatest opportunity—those whose needs the firm can meet in a superior fashion.

For each chosen target market, the firm develops a *market offering*. The offering is *positioned* in the minds of the target buyers as delivering some central benefit(s). For example, Volvo develops its cars for the target market of buyers for whom automobile safety is a major concern. Volvo, therefore, positions its car as the safest a customer can buy.

Traditionally, a "market" was a physical place where buyers and sellers gathered to exchange goods. Now marketers view the sellers as the *industry* and the buyers as the *market* (see Figure 1-1). The sellers send goods and services and communications (ads, direct mail, e-mail messages) to the market; in return they receive money and information (attitudes, sales data). The inner loop in the diagram in Figure 1-1 shows

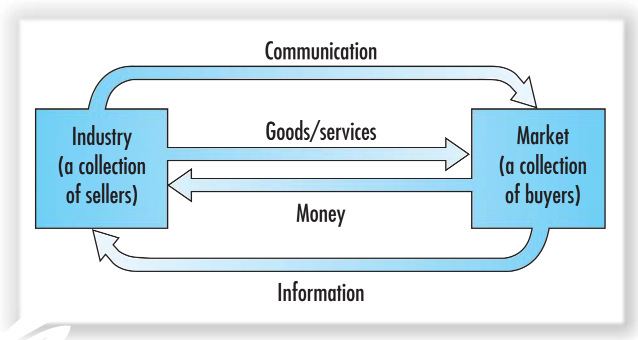

Figure 1-1 A Simple Marketing System

an exchange of money for goods and services; the outer loop shows an exchange of information.

A *global industry* is one in which the strategic positions of competitors in major geographic or national markets are fundamentally affected by their overall global positions. Global firms—both large and small—plan, operate, and coordinate their activities and exchanges on a worldwide basis.

Today we can distinguish between a *marketplace* and a *marketspace.* The marketplace is physical, as when one goes shopping in a store; marketspace is digital, as when one goes shopping on the Internet. E-commerce—business transactions conducted on-line—has many advantages for both consumers and businesses, including convenience, savings, selection, personalization, and information. For example, on-line shopping is so convenient that 30 percent of the orders generated by the Web site of REI, a recreational equipment retailer, is logged from 10 P.M. to 7 A.M., sparing REI the expense of keeping its stores open late or hiring customer service representatives. However, the e-commerce marketspace is also bringing pressure from consumers for lower prices and is threatening intermediaries such as travel agents, stockbrokers, insurance agents, and traditional retailers. To succeed in the on-line marketspace, marketers will need to reorganize and redefine themselves.

The *metamarket,* a concept proposed by Mohan Sawhney, describes a cluster of complementary products and services that are closely related in the minds of consumers but are spread across a diverse set of industries. The automobile metamarket consists of automobile manufacturers, new and used car dealers, financing companies, insurance companies, mechanics, spare parts dealers, service shops, auto magazines, classified auto ads in newspapers, and auto sites on the Internet. Car buyers can get involved in many parts of this metamarket. This has created an opportunity for *metamediaries* to assist buyers to move seamlessly through these groups. One example is Edmund's (www.edmunds.com), a Web site where buyers can find prices for different cars and click to other sites to search for dealers, financing, and accessories. Metamediaries can serve various metamarkets, such as the home ownership market, the parenting and baby care market, and the wedding market.[9]

Marketers and Prospects

Another core concept is the distinction between marketers and prospects. A marketer is someone who is seeking a response (attention, a purchase, a vote, a donation) from another party, called the *prospect.* If two parties are seeking to sell something to each other, both are marketers.

Needs, Wants, and Demands

The successful marketer will try to understand the target market's needs, wants, and demands. *Needs* describe basic human requirements such as food, air, water, clothing, and shelter. People also have strong needs for recreation, education, and entertainment. These needs become wants when they are directed to specific objects that might satisfy the need. An American *needs* food but *wants* a hamburger, French fries, and a soft drink. A person in Mauritius *needs* food but *wants* a mango, rice, lentils, and beans. Clearly, wants are shaped by one's society.

Demands are wants for specific products backed by an ability to pay. Many people want a Mercedes; only a few are able and willing to buy one. Companies must measure not only how many people want their product, but also how many would actually be willing and able to buy it.

However, marketers do not create needs: Needs preexist marketers. Marketers, along with other societal influences, influence wants. Marketers might promote the idea that a Mercedes would satisfy a person's need for social status. They do not, however, create the need for social status.

Product or Offering

People satisfy their needs and wants with products. A *product* is any offering that can satisfy a need or want, such as one of the 10 basic offerings of goods, services, experiences, events, persons, places, properties, organizations, information, and ideas.

A *brand* is an offering from a known source. A brand name such as McDonald's carries many associations in the minds of people: hamburgers, fun, children, fast food, golden arches. These associations make up the brand image. All companies strive to build a strong, favorable brand image.

Value and Satisfaction

In terms of marketing, the product or offering will be successful if it delivers value and satisfaction to the target buyer. The buyer chooses between different offerings on the basis of which is perceived to deliver the most value. We define *value* as a ratio between what the customer *gets* and what he *gives*. The customer gets *benefits* and assumes *costs*, as shown in this equation:

$$\text{Value} = \frac{\text{Benefits}}{\text{Costs}} = \frac{\text{Functional benefits} + \text{emotional benefits}}{\text{Monetary costs} + \text{time costs} + \text{energy costs} + \text{psychic costs}}$$

Based on this equation, the marketer can increase the value of the customer offering by (1) raising benefits, (2) reducing costs, (3) raising benefits and reducing costs, (4) raising benefits by more than the raise in costs, or (5) lowering benefits by less than the reduction in costs. A customer choosing between two value offerings, V_1 and V_2, will examine the ratio V_1/V_2. She will favor V_1 if the ratio is larger than one; she will favor V_2 if the ratio is smaller than one; and she will be indifferent if the ratio equals one.

Exchange and Transactions

Exchange, the core of marketing, involves obtaining a desired product from someone by offering something in return. For exchange potential to exist, five conditions must be satisfied:

1. There are at least two parties.
2. Each party has something that might be of value to the other party.
3. Each party is capable of communication and delivery.

4. Each party is free to accept or reject the exchange offer.
5. Each party believes it is appropriate or desirable to deal with the other party.

Whether exchange actually takes place depends upon whether the two parties can agree on terms that will leave them both better off (or at least not worse off) than before. Exchange is a value-creating process because it normally leaves both parties better off.

Note that exchange is a process rather than an event. Two parties are engaged in exchange if they are negotiating—trying to arrive at mutually agreeable terms. When an agreement is reached, we say that a transaction takes place. A *transaction* involves at least two things of value, agreed-upon conditions, a time of agreement, and a place of agreement. Usually a legal system exists to support and enforce compliance among transactors. However, transactions do not require money as one of the traded values. A barter transaction, for example, involves trading goods or services for other goods or services.

Note also that a transaction differs from a transfer. In a *transfer, A* gives a gift, a subsidy, or a charitable contribution to *B* but receives nothing tangible in return. Transfer behavior can also be understood through the concept of exchange. Typically, the transferer expects something in exchange for his or her gift—for example, gratitude or seeing changed behavior in the recipient. Professional fund-raisers provide benefits to donors, such as thank-you notes. Contemporary marketers have broadened the concept of marketing to include the study of transfer behavior as well as transaction behavior.

Marketing consists of actions undertaken to elicit desired responses from a target audience. To effect successful exchanges, marketers analyze what each party expects from the transaction. Suppose Caterpillar, the world's largest manufacturer of earth-moving equipment, researches the benefits that a typical construction company wants when it buys such equipment. The items shown on the prospect's want list in Figure 1-2 are not equally important and may vary from buyer to buyer. One of Caterpillar's marketing tasks is to discover the relative importance of these different wants to the buyer.

As the marketer, Caterpillar also has a want list. If there is a sufficient match or overlap in the want lists, a basis for a transaction exists. Caterpillar's task is to formulate an offer that motivates the construction company to buy Caterpillar equipment. The construction company might, in turn, make a counteroffer. This process of negotiation leads to mutually acceptable terms or a decision not to transact.

Relationships and Networks

Transaction marketing is part of a larger idea called relationship marketing. *Relationship marketing* aims to build long-term mutually satisfying relations with key parties—customers, suppliers, distributors—in order to earn and retain their long-term preference and business.[10] Effective marketers accomplish this by promising and delivering high-quality products and services at fair prices to the other parties over time. Relationship marketing builds strong economic, technical, and social ties among the parties. It cuts down on transaction costs and time. In the most successful cases, transactions move from being negotiated each time to being a matter of routine.

The ultimate outcome of relationship marketing is the building of a unique company asset called a marketing network. A *marketing network* consists of the company and its supporting *stakeholders* (customers, employees, suppliers, distributors, university scientists, and others) with whom it has built mutually profitable business relationships. Increasingly, competition is not between companies but rather between marketing networks, with the profits going to the company that has the better network.[11]

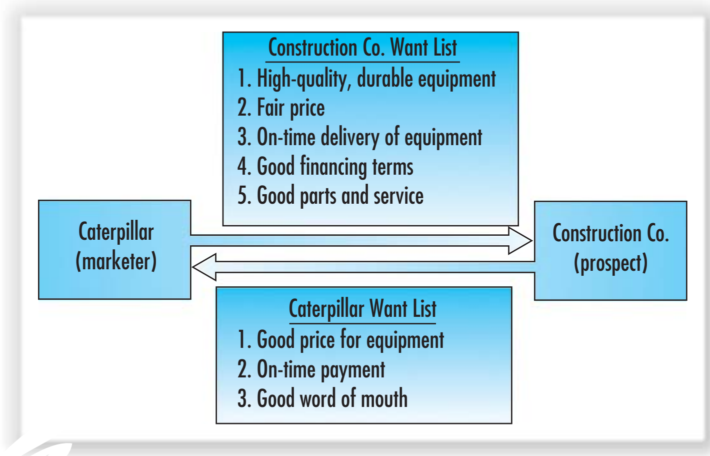

Figure 1-2 Two-Party Exchange Map Showing Want Lists of Both Parties

Marketing Channels

To reach a target market, the marketer uses three kinds of marketing channels. *Communication channels* deliver messages to and receive messages from target buyers. They include newspapers, magazines, radio, television, mail, telephone, billboards, posters, fliers, CDs, audiotapes, and the Internet. Beyond these, communications are conveyed by facial expressions and clothing, the look of retail stores, and many other media. Marketers are increasingly adding *dialogue channels* (e-mail and toll-free numbers) to counterbalance the more normal *monologue channels* (such as ads).

The marketer uses *distribution channels* to display or deliver the physical product or service(s) to the buyer or user. There are physical distribution channels and service distribution channels, which include warehouses, transportation vehicles, and various *trade channels* such as distributors, wholesalers, and retailers. The marketer also uses *selling channels* to effect transactions with potential buyers. Selling channels include not only the distributors and retailers but also the banks and insurance companies that facilitate transactions. Marketers clearly face a design problem in choosing the best mix of communication, distribution, and selling channels for their offerings.

Supply Chain

Whereas marketing channels connect the marketer to the target buyers, the *supply chain* describes a longer channel stretching from raw materials to components to final products that are carried to final buyers. For example, the supply chain for women's purses starts with hides, tanning operations, cutting operations, manufacturing, and the marketing channels that bring products to customers. This supply chain represents a *value delivery system.* Each company captures only a certain percentage of the total value generated by the supply chain. When a company acquires competitors or moves upstream or downstream, its aim is to capture a higher percentage of supply chain value.

Competition

Competition, a critical factor in marketing management, includes all of the actual and potential rival offerings and substitutes that a buyer might consider. Suppose an automobile company is planning to buy steel for its cars. The car manufacturer can buy from U.S. Steel or other U.S. or foreign integrated steel mills; can go to a minimill such as Nucor to buy steel at a cost savings; can buy aluminum for certain parts of the car to lighten the car's weight; or can buy some engineered plastics parts instead of steel.

Clearly U.S. Steel would be thinking too narrowly of competition if it thought only of other integrated steel companies. In fact, U.S. Steel is more likely to be hurt in the long run by substitute products than by its immediate steel company rivals. U.S. Steel also must consider whether to make substitute materials or stick only to those applications in which steel offers superior performance.

We can broaden the picture by distinguishing four levels of competition, based on degree of product substitutability:

1. *Brand competition:* A company sees its competitors as other companies that offer similar products and services to the same customers at similar prices. Volkswagen might see its major competitors as Toyota, Honda, and other manufacturers of medium-price automobiles, rather than Mercedes or Hyundai.
2. *Industry competition:* A company sees its competitors as all companies that make the same product or class of products. Thus, Volkswagen would be competing against all other car manufacturers.
3. *Form competition:* A company sees its competitors as all companies that manufacture products that supply the same service. Volkswagen would see itself competing against manufacturers of all vehicles, such as motorcycles, bicycles, and trucks.
4. *Generic competition:* A company sees its competitors as all companies that compete for the same consumer dollars. Volkswagen would see itself competing with companies that sell major consumer durables, foreign vacations, and new homes.

Marketing Environment

Competition represents only one force in the environment in which all marketers operate. The overall marketing environment consists of the task environment and the broad environment.

The *task environment* includes the immediate actors involved in producing, distributing, and promoting the offering, including the company, suppliers, distributors, dealers, and the target customers. Material suppliers and service suppliers such as marketing research agencies, advertising agencies, Web site designers, banking and insurance companies, and transportation and telecommunications companies are included in the supplier group. Agents, brokers, manufacturer representatives, and others who facilitate finding and selling to customers are included with distributors and dealers.

The *broad environment* consists of six components: *demographic environment, economic environment, natural environment, technological environment, political-legal environment,* and *social-cultural environment.* These environments contain forces that can have a major impact on the actors in the task environment, which is why smart marketers track environmental trends and changes closely.

Marketing Mix

Marketers use numerous tools to elicit the desired responses from their target markets. These tools constitute a marketing mix:[12] **Marketing mix** is the set of marketing tools that the firm uses to pursue its marketing objectives in the target market. As shown in Figure 1-3, McCarthy classified these tools into four broad groups that he called the four Ps of marketing: product, price, place, and promotion.[13]

Marketing-mix decisions must be made to influence the trade channels as well as the final consumers. Typically, the firm can change its price, sales-force size, and advertising expenditures in the short run. However, it can develop new products and modify its distribution channels only in the long run. Thus, the firm typically makes fewer

Figure 1-3 The Four P Components of the Marketing Mix

period-to-period marketing-mix changes in the short run than the number of marketing-mix decision variables might suggest.

Robert Lauterborn suggested that the sellers' four Ps correspond to the customers' four Cs.[14]

Four Ps	Four Cs
Product	Customer solution
Price	Customer cost
Place	Convenience
Promotion	Communication

Winning companies are those that meet customer needs economically and conveniently and with effective communication.

COMPANY ORIENTATIONS TOWARD THE MARKETPLACE

Marketing management is the conscious effort to achieve desired exchange outcomes with target markets. But what philosophy should guide a company's marketing efforts? What relative weights should be given to the often conflicting interests of the organization, customers, and society?

For example, one of Dexter Corporation's most popular products was a profitable grade of paper used in tea bags. Unfortunately, the materials in this paper accounted for 98 percent of Dexter's hazardous wastes. So while Dexter's product was popular with customers, it was also detrimental to the environment. Dexter assigned an employee task force to tackle this problem. The task force succeeded, and the company increased its market share while virtually eliminating hazardous waste.[15]

Clearly, marketing activities should be carried out under a well-thought-out philosophy of efficient, effective, and socially responsible marketing. In fact, there are five competing concepts under which organizations conduct marketing activities: production concept, product concept, selling concept, marketing concept, and societal marketing concept.

The Production Concept

The **production concept,** one of the oldest in business, holds that consumers prefer products that are widely available and inexpensive. Managers of production-oriented businesses concentrate on achieving high production efficiency, low costs, and mass distribution. This orientation makes sense in developing countries, where consumers are more interested in obtaining the product than in its features. It is also used when a company wants to expand the market. Texas Instruments is a leading exponent of this concept. It concentrates on building production volume and upgrading technology in order to bring costs down, leading to lower prices and expansion of the market. This orientation has also been a key strategy of many Japanese companies.

The Product Concept

Other businesses are guided by the **product concept,** which holds that consumers favor those products that offer the most quality, performance, or innovative features. Managers in these organizations focus on making superior products and improving them over time, assuming that buyers can appraise quality and performance.

Product-oriented companies often design their products with little or no customer input, trusting that their engineers can design exceptional products. A General Motors executive said years ago: "How can the public know what kind of car they want until they see what is available?" GM today asks customers what they value in a car and includes marketing people in the very beginning stages of design.

However, the product concept can lead to *marketing myopia.*[16] Railroad management thought that travelers wanted trains rather than transportation and overlooked the growing competition from airlines, buses, trucks, and automobiles. Colleges, department stores, and the post office all assume that they are offering the public the right product and wonder why their sales slip. These organizations too often are looking into a mirror when they should be looking out of the window.

The Selling Concept

The **selling concept,** another common business orientation, holds that consumers and businesses, if left alone, will ordinarily not buy enough of the organization's products. The organization must, therefore, undertake an aggressive selling and promotion effort. This concept assumes that consumers must be coaxed into buying, so the company has a battery of selling and promotion tools to stimulate buying.

The selling concept is practiced most aggressively with unsought goods—goods that buyers normally do not think of buying, such as insurance and funeral plots. The selling concept is also practiced in the nonprofit area by fund-raisers, college admissions offices, and political parties.

Most firms practice the selling concept when they have overcapacity. Their aim is to sell what they make rather than make what the market wants. In modern industrial economies, productive capacity has been built up to a point where most markets are buyer markets (the buyers are dominant) and sellers have to scramble for customers. Prospects are bombarded with sales messages. As a result, the public often identifies marketing with hard selling and advertising. But marketing based on hard selling carries high risks. It assumes that customers who are coaxed into buying a product will like it;

and if they don't, that they won't bad-mouth it or complain to consumer organizations and will forget their disappointment and buy it again. These are indefensible assumptions. In fact, one study showed that dissatisfied customers may bad-mouth the product to 10 or more acquaintances; bad news travels fast, something marketers that use hard selling should bear in mind.[17]

The Marketing Concept

The marketing concept, based on central tenets crystallized in the mid-1950s, challenges the three business orientations we just discussed.[18] The **marketing concept** holds that the key to achieving organizational goals consists of the company being more effective than its competitors in creating, delivering, and communicating customer value to its chosen target markets.

Theodore Levitt of Harvard drew a perceptive contrast between the selling and marketing concepts: "Selling focuses on the needs of the seller; marketing on the needs of the buyer. Selling is preoccupied with the seller's need to convert his product into cash; marketing with the idea of satisfying the needs of the customer by means of the product and the whole cluster of things associated with creating, delivering and finally consuming it."[19]

The marketing concept rests on four pillars: *target market, customer needs, integrated marketing,* and *profitability.* The selling concept takes an inside-out perspective. It starts with the factory, focuses on existing products, and calls for heavy selling and promoting to produce profitable sales. The marketing concept takes an outside-in perspective. It starts with a well-defined market, focuses on customer needs, coordinates activities that affect customers, and produces profits by satisfying customers.

Target Market

Companies do best when they choose their target market(s) carefully and prepare tailored marketing programs. For example, when cosmetics giant Estee Lauder recognized the increased buying power of minority groups, its Prescriptives subsidiary launched an "All Skins" line offering 115 foundation shades for different skin tones. Prescriptives credits All Skins for a 45 percent sales increase since this product line was launched.

Customer Needs

A company can carefully define its target market yet fail to correctly understand the customers' needs. Clearly, understanding customer needs and wants is not always simple. Some customers have needs of which they are not fully conscious; some cannot articulate these needs or use words that require some interpretation. We can distinguish among five types of needs: (1) stated needs, (2) real needs, (3) unstated needs, (4) delight needs, and (5) secret needs.

Responding only to the stated need may shortchange the customer. For example, if a customer enters a hardware store and asks for a sealant to seal glass window panes, she is stating a solution, not a need. If the salesperson suggests that tape would provide a better solution, the customer may appreciate that the salesperson met her need and not her stated solution.

A distinction needs to be drawn between *responsive marketing, anticipative marketing,* and *creative marketing.* A responsive marketer finds a stated need and fills it, while an anticipative marketer looks ahead to the needs that customers may have in the near future. In contrast, a creative marketer discovers and produces solutions that customers did not ask for, but to which they enthusiastically respond. Sony exemplifies a creative marketer because it has introduced many successful new products that customers never asked for or even thought were possible: Walkmans, VCRs, and so on. Sony goes beyond customer-led marketing: It is a *market-driving* firm, not just a market-driven firm. Akio Morita, its founder, proclaimed that he doesn't serve markets; he creates markets.[20]

Why is it supremely important to satisfy the needs of target customers? Because a company's sales come from two groups: new customers and repeat customers. One estimate is that attracting a new customer can cost five times as much as pleasing an existing one.[21] And it might cost 16 times as much to bring the new customer to the same level of profitability as that of the lost customer. *Customer retention* is thus more important than *customer attraction*.

Integrated Marketing

When all of the company's departments work together to serve the customers' interests, the result is *integrated marketing*. Integrated marketing takes place on two levels. First, the various marketing functions—sales force, advertising, customer service, product management, marketing research—must work together. All of these functions must be coordinated from the customer's point of view.

Second, marketing must be embraced by the other departments. According to David Packard of Hewlett-Packard: "Marketing is far too important to be left only to the marketing department!" Marketing is not a department so much as a companywide orientation. Xerox, for example, goes so far as to include in every job description an explanation of how each job affects the customer. Xerox factory managers know that visits to the factory can help sell a potential customer if the factory is clean and efficient. Xerox accountants know that customer attitudes are affected by Xerox's billing accuracy.

To foster teamwork among all departments, the company must carry out internal marketing as well as external marketing. *External marketing* is marketing directed at people outside the company. *Internal marketing* is the task of hiring, training, and motivating able employees who want to serve customers well. In fact, internal marketing must precede external marketing. It makes no sense to promise excellent service before the company's staff is ready to provide it.

Managers who believe the customer is the company's only true "profit center" consider the traditional organization chart—a pyramid with the CEO at the top, management in the middle, and front-line people and customers at the bottom—obsolete. Master marketing companies invert the chart, putting customers at the top. Next in importance are the front-line people who meet, serve, and satisfy the customers; under them are the middle managers, who support the front-line people so they can serve the customers; and at the base is top management, whose job is to hire and support good middle managers.

Profitability

The ultimate purpose of the marketing concept is to help organizations achieve their objectives. In the case of private firms, the major objective is profit; in the case of nonprofit and public organizations, it is surviving and attracting enough funds to perform useful work. Private firms should aim to achieve profits as a consequence of creating superior customer value, by satisfying customer needs better than competitors. For example, Perdue Farms has achieved above-average margins marketing chicken—a commodity if there ever was one! The company has always aimed to control breeding and other factors in order to produce tender-tasting chickens for which discriminating customers will pay more.[22]

How many companies actually practice the marketing concept? Unfortunately, too few. Only a handful of companies stand out as master marketers: Procter & Gamble, Disney, Nordstrom, Wal-Mart, Milliken & Company, McDonald's, Marriott Hotels, American Airlines, and several Japanese (Sony, Toyota, Canon) and European companies (IKEA, Club Med, Nokia, ABB, Marks & Spencer). These companies focus on the customer and are organized to respond effectively to changing customer needs. They all have well-staffed marketing departments, and all of their other departments—manufacturing, finance, research and development, personnel, purchasing—accept the customer as king.

Most companies do not embrace the marketing concept until driven to it by circumstances. Various developments prod them to take the marketing concept to heart, including sales declines, slow growth, changing buying patterns, more competition, and higher expenses. Despite the benefits, firms face three hurdles in converting to a marketing orientation: organized resistance, slow learning, and fast forgetting.

Some company departments (often manufacturing, finance, and research and development) believe a stronger marketing function threatens their power in the organization. Resistance is especially strong in industries in which marketing is being introduced for the first time—for instance, in law offices, colleges, deregulated industries, and government agencies. In spite of the resistance, many companies manage to introduce some marketing thinking into their organization. Over time, marketing emerges as the major function. Ultimately, the customer becomes the controlling function, and with that view, marketing can emerge as the integrative function within the organization.

The Societal Marketing Concept

Some have questioned whether the marketing concept is an appropriate philosophy in an age of environmental deterioration, resource shortages, explosive population growth, world hunger and poverty, and neglected social services. Are companies that successfully satisfy consumer wants necessarily acting in the best, long-run interests of consumers and society? The marketing concept sidesteps the potential conflicts among consumer wants, consumer interests, and long-run societal welfare.

Yet some firms and industries are criticized for satisfying consumer wants at society's expense. Such situations call for a new term that enlarges the marketing concept. We propose calling it the **societal marketing concept,** which holds that the organization's task is to determine the needs, wants, and interests of target markets and to deliver the desired satisfactions more effectively and efficiently than competitors in a way that preserves or enhances the consumer's and the society's well-being.

The societal marketing concept calls upon marketers to build social and ethical considerations into their marketing practices. They must balance and juggle the often conflicting criteria of company profits, consumer want satisfaction, and public interest. Yet a number of companies have achieved notable sales and profit gains by adopting and practicing the societal marketing concept.

Some companies practice a form of the societal marketing concept called *cause-related marketing.* Pringle and Thompson define this as "activity by which a company with an image, product, or service to market builds a relationship or partnership with a 'cause,' or a number of 'causes,' for mutual benefit."[23] They see it as affording an opportunity for companies to enhance their corporate reputation, raise brand awareness, increase customer loyalty, build sales, and increase press coverage. They believe that customers will increasingly look for demonstrations of good corporate citizenship. Smart companies will respond by adding "higher order" image attributes than simply rational and emotional benefits. Critics, however, complain that cause-related marketing might make consumers feel they have fulfilled their philanthropic duties by buying products instead of donating to causes directly.

HOW BUSINESS AND MARKETING ARE CHANGING

We can say with some confidence that "the marketplace isn't what it used to be." It is changing radically as a result of major forces such as technological advances, globalization, and deregulation. These forces have created new behaviors and challenges:

Customers increasingly expect higher quality and service and some customization. They perceive fewer real product differences and show less brand loyalty. They can obtain extensive product information from the Internet and other sources, permitting them to shop more intelligently. They are showing greater price sensitivity in their search for value.

Brand manufacturers are facing intense competition from domestic and foreign brands, which is resulting in rising promotion costs and shrinking profit margins. They are being further buffeted by powerful retailers who command limited shelf space and are putting out their own store brands in competition with national brands.

Store-based retailers are suffering from an oversaturation of retailing. Small retailers are succumbing to the growing power of giant retailers and "category killers." Store-based retailers are facing growing competition from direct-mail firms; newspaper, magazine, and TV direct-to-customer ads; home shopping TV; and the Internet. As a result, they are experiencing shrinking margins. In response, entrepreneurial retailers are building entertainment into stores with coffee bars, lectures, demonstrations, and performances, marketing an "experience" rather than a product assortment.

Company Responses and Adjustments

Given these changes, companies are doing a lot of soul-searching, and many highly respected firms are adjusting in a number of ways. Here are some current trends:

- *Reengineering:* From focusing on functional departments to reorganizing by key processes, each managed by multidiscipline teams.
- *Outsourcing:* From making everything inside the company to buying more products from outside if they can be obtained cheaper and better. *Virtual companies* outsource everything, so they own very few assets and, therefore, earn extraordinary rates of return.
- *E-commerce:* From attracting customers to stores and having salespeople call on offices to making virtually all products available on the Internet. Business-to-business purchasing is growing fast on the Internet, and personal selling can increasingly be conducted electronically.
- *Benchmarking:* From relying on self-improvement to studying world-class performers and adopting best practices.
- *Alliances:* From trying to win alone to forming networks of partner firms.[24]
- *Partner–suppliers:* From using many suppliers to using fewer but more reliable suppliers who work closely in a "partnership" relationship with the company.
- *Market-centered:* From organizing by products to organizing by market segment.
- *Global and local:* From being local to being both global and local.
- *Decentralized:* From being managed from the top to encouraging more initiative and "intrepreneurship" at the local level.

Marketer Responses and Adjustments

As the environment changes and companies adjust, marketers also are rethinking their philosophies, concepts, and tools. Here are the major marketing themes at the start of the new millennium:

- *Relationship marketing:* From focusing on transactions to building long-term, profitable customer relationships. Companies focus on their most profitable customers, products, and channels.

- *Customer lifetime value:* From making a profit on each sale to making profits by managing customer lifetime value. Some companies offer to deliver a constantly needed product on a regular basis at a lower price per unit because they will enjoy the customer's business for a longer period.
- *Customer share:* From a focus on gaining market share to a focus on building customer share. Companies build customer share by offering a larger variety of goods to their existing customers and by training employees in cross-selling and up-selling.
- *Target marketing:* From selling to everyone to trying to be the best firm serving well-defined target markets. Target marketing is being facilitated by the proliferation of special-interest magazines, TV channels, and Internet newsgroups.
- *Individualization:* From selling the same offer in the same way to everyone in the target market to individualizing and customizing messages and offerings.
- *Customer database:* From collecting sales data to building a data warehouse of information about individual customers' purchases, preferences, demographics, and profitability. Companies can "data-mine" their proprietary databases to detect different customer need clusters and make differentiated offerings to each cluster.
- *Integrated marketing communications:* From reliance on one communication tool such as advertising to blending several tools to deliver a consistent brand image to customers at every brand contact.
- *Channels as partners:* From thinking of intermediaries as customers to treating them as partners in delivering value to final customers.
- *Every employee a marketer:* From thinking that marketing is done only by marketing, sales, and customer support personnel to recognizing that every employee must be customer-focused.
- *Model-based decision making:* From making decisions on intuition or slim data to basing decisions on models and facts on how the marketplace works.

These major themes will be examined throughout this book to help marketers and companies sail safely through the rough, but promising, waters ahead. Successful companies will change their marketing as fast as their marketplaces and marketspaces change, so they can build customer satisfaction, value, and retention, the subject of Chapter 2.

EXECUTIVE SUMMARY

All marketers need to be aware of the effect of globalization, technology, and deregulation. Rather than try to satisfy everyone, marketers start with market segmentation and develop a market offering that is positioned in the minds of the target market. To satisfy the target market's needs, wants, and demands, marketers create a product, one of the 10 types of entities (goods, services, experiences, events, persons, places, properties, organizations, information, and ideas). Marketers must search hard for the core need they are trying to satisfy, remembering that their products will be successful only if they deliver value (the ratio of benefits and costs) to customers.

Every marketing exchange requires at least two parties—both with something valued by the other party, both capable of communication and delivery, both free to accept or reject the offer, and both finding it appropriate or desirable to deal with the other. One agreement to exchange constitutes a transaction, part of the larger idea of relationship marketing. Through relationship marketing, organizations aim to build enduring, mutually satisfying bonds with customers and other key parties to earn and retain their long-term business. Reaching out to a target market entails communication channels, distribution channels, and selling channels. The supply chain, which stretches from raw materials to the final products for final buyers, represents a value delivery system. Marketers can capture more of the supply chain value by acquiring competitors or expanding upstream or downstream.

In the marketing environment, marketers face brand, industry, form, and generic competition. The marketing environment can be divided into the task environment (the immediate actors in producing, distributing, and promoting the product offering) and the broad environment (forces in the demographic, economic, natural, technological, political-legal, and social-cultural environment). To succeed, marketers must pay close attention to the trends and developments in these environments and make timely adjustments to their marketing strategies. Within these environments, marketers apply the marketing mix—the set of marketing tools used to pursue marketing objectives in the target market. The marketing mix consists of the four Ps: product, price, place, and promotion.

Companies can adopt one of five orientations toward the marketplace. The production concept assumes that consumers want widely available, affordable products; the product concept assumes that consumers want products with the most quality, performance, or innovative features; the selling concept assumes that customers will not buy enough products without an aggressive selling and promotion effort; the marketing concept assumes the firm must be better than competitors in creating, delivering, and communicating customer value to its chosen target markets; and the societal marketing concept assumes that the firm must satisfy customers more effectively and efficiently than competitors while still preserving the consumer's and the society's well-being. Keeping this concept in mind, smart companies will add "higher order" image attributes to supplement both rational and emotional benefits.

The combination of technology, globalization, and deregulation is influencing customers, brand manufacturers, and store-based retailers in a variety of ways. Responding to the changes and new demands brought on by these forces has caused many companies to make adjustments. In turn, savvy marketers must also alter their marketing activities, tools, and approaches to keep pace with the changes they will face today and tomorrow.

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Winning Markets Through Strategic Planning, Implementation, and Control

We will address the following questions:

- How is strategic planning carried out at the corporate, division, and business-unit levels?
- What are the major steps in planning the marketing process?
- How can a company effectively manage the marketing process?

How do companies compete in a global marketplace? One part of the answer is a commitment to creating and retaining satisfied customers. We can now add a second part: Successful companies know how to adapt to a continuously changing marketplace through strategic planning and careful management of the marketing process.

In most large companies, corporate headquarters is responsible for designing a corporate *strategic plan* to guide the whole enterprise and deciding about resource allocations as well as starting and eliminating particular businesses. Guided by the corporate strategic plan, each division establishes a *division plan* for each business unit within the division; in turn, each business unit develops a *business unit strategic plan.* Finally, the managers of each product line and brand within a business unit develop a *marketing plan* for achieving their objectives.

However, the development of a marketing plan is not the end of the marketing process. High-performance firms must hone their expertise in organizing, implementing, and controlling marketing activities as they follow marketing results closely, diagnose problems, and take corrective action when necessary. In today's fast-paced business world, the ability to effectively manage the marketing process—beginning to end—has become an extremely important competitive advantage.

CORPORATE AND DIVISION STRATEGIC PLANNING

Marketing plays a critical role in corporate strategic planning within successful companies. **Market-oriented strategic planning** is the managerial process of developing and maintaining a viable fit among the organization's objectives, skills, and resources and its changing market opportunities. The aim of strategic planning is to shape the company's businesses and products so that they yield target profits and growth and keep the company healthy despite any unexpected threats that may arise.

Strategic planning calls for action in three key areas. The first area is managing a company's businesses as an investment portfolio. The second area involves assessing each business's strength by considering the market's growth rate and the company's position and fit in that market. And the third area is the development of *strategy,* a game plan for achieving long-term objectives. The complete strategic planning, implementation, and control cycle is shown in Figure 1-4.

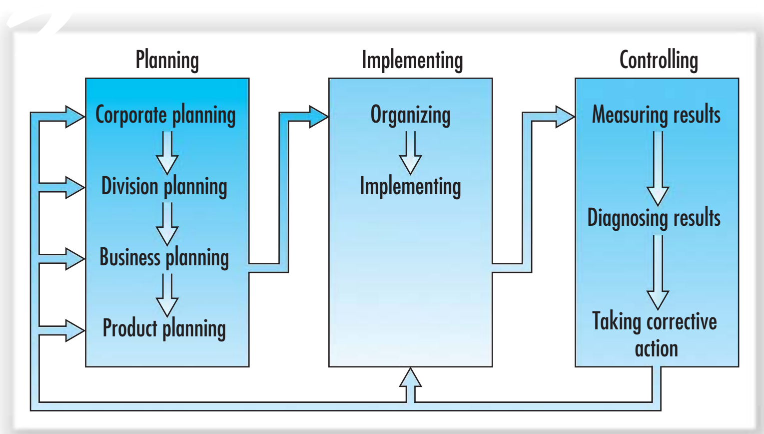
Corporate headquarters starts the strategic planning process by preparing statements of mission, policy, strategy, and goals, establishing the framework within which the divisions and business units will prepare their plans. Some corporations allow their business units a great deal of freedom in setting sales and profit goals and strategies. Others set goals for their business units but let them develop their own strategies. Still others set the goals and get involved heavily in the individual business unit strategies.[1] Regardless of the degree of involvement, all strategic plans are based on the corporate mission.

Defining the Corporate Mission

An organization exists to accomplish something: to make cars, lend money, provide a night's lodging, and so on. Its specific mission or purpose is usually clear when the business starts. Over time, however, the mission may lose its relevance because of changed market conditions or may become unclear as the corporation adds new products and markets.

When management senses that the organization is drifting from its mission, it must renew its search for purpose. According to Peter Drucker, it is time to ask some fundamental questions.[2] *What is our business? Who is the customer? What is of value to the customer? What will our business be? What should our business be?* Successful companies continuously raise these questions and answer them thoughtfully and thoroughly.

Figure 1-4 The Strategic Planning, Implementation, and Control Process



A well-worked-out mission statement provides employees with a shared sense of purpose, direction, and opportunity. It also guides geographically dispersed employees to work independently and yet collectively toward realizing the organization's goals. The mission statement of Motorola, for example, is "to honorably serve the needs of the community by providing products and services of superior quality at a fair price to our customers; to do this so as to earn an adequate profit which is required for the total enterprise to grow; and by so doing provide the opportunity for our employees and shareholders to achieve their reasonable personal objectives."

Good mission statements focus on a limited number of goals, stress the company's major policies and values, and define the company's major *competitive scopes*. These include:

- *Industry scope:* The industry or range of industries in which a company will operate. For example, DuPont operates in the industrial market; Dow operates in the industrial and consumer markets; and 3M will go into almost any industry where it can make money.
- *Products and applications scope:* The range of products and applications that a company will supply. St. Jude Medical aims to "serve physicians worldwide with high-quality products for cardiovascular care."
- *Competence scope:* The range of technological and other core competencies that a company will master and leverage. Japan's NEC has built its core competencies in computing, communications, and components to support production of laptop computers, televisions, and other electronics items.
- *Market-segment scope:* The type of market or customers a company will serve. For example, Porsche makes only expensive cars for the upscale market and licenses its name for high-quality accessories.
- *Vertical scope:* The number of channel levels from raw material to final product and distribution in which a company will participate. At one extreme are companies with a large vertical scope; at the other extreme are firms with low or no vertical integration that may outsource design, manufacture, marketing, and physical distribution.[3]
- *Geographical scope:* The range of regions or countries in which a company will operate. At one extreme are companies that operate in a specific city or state. At the other extreme are multinationals such as Unilever and Caterpillar, which operate in almost every one of the world's countries.

A company must redefine its mission if that mission has lost credibility or no longer defines an optimal course for the company.[4] Kodak redefined itself from a film company to an image company so that it could add digital imaging;[5] Sara Lee redefined itself by outsourcing manufacturing and becoming a marketer of brands. The corporate mission provides direction for the firm's various business units.

Establishing Strategic Business Units

A business can be defined in terms of three dimensions: *customer groups, customer needs,* and *technology*.[6] For example, a company that defines its business as designing incandescent lighting systems for television studios would have television studios as its customer group; lighting as its customer need; and incandescent lighting as its technology.

In line with Levitt's argument that market definitions of a business are superior to product definitions,[7] these three dimensions describe the business in terms of a customer-satisfying process, not a goods-producing process. Thus, Xerox's product definition would be "We make copying equipment," while its market definition would be "We help improve office productivity." Similarly, Missouri-Pacific Railroad's product definition would be "We run a railroad," while its market definition would be "We are a people-and-goods mover."

Large companies normally manage quite different businesses, each requiring its own strategy; General Electric, as one example, has established 49 *strategic business units (SBUs).* An SBU has three characteristics: (1) It is a single business or collection of related businesses that can be planned separately from the rest of the company; (2) it has its own set of competitors; and (3) it has a manager responsible for strategic planning and profit performance who controls most of the factors affecting profit.

Assigning Resources to SBUs

The purpose of identifying the company's strategic business units is to develop separate strategies and assign appropriate funding to the entire business portfolio. Senior managers generally apply analytical tools to classify all of their SBUs according to profit potential. Two of the best-known business portfolio evaluation models are the Boston Consulting Group model and the General Electric model.[8]

The Boston Consulting Group Approach

The Boston Consulting Group (BCG), a leading management consulting firm, developed and popularized the *growth-share matrix* shown in Figure 1-5. The eight circles represent the current sizes and positions of eight business units in a hypothetical company. The dollar-volume size of each business is proportional to the circle's area. Thus, the two largest businesses are 5 and 6. The location of each business unit indicates its market growth rate and relative market share.

The *market growth rate* on the vertical axis indicates the annual growth rate of the market in which the business operates. *Relative market share,* which is measured on the horizontal axis, refers to the SBU's market share relative to that of its largest competitor in the segment. It serves as a measure of the company's strength in the relevant market segment. The growth-share matrix is divided into four cells, each indicating a different type of business:

- *Question marks* are businesses that operate in high-growth markets but have low relative market shares. Most businesses start off as question marks as the company tries to enter a high-growth market in which there is already a market leader. A question mark requires a lot of cash because the company is spending money on plant, equipment, and personnel. The term *question mark* is appropriate because the company has to think hard about whether to keep pouring money into this business.
- *Stars* are market leaders in a high-growth market. A star was once a question mark, but it does not necessarily produce positive cash flow; the company must still spend to keep up with the high market growth and fight off competition.
- *Cash cows* are former stars with the largest relative market share in a slow-growth market. A cash cow produces a lot of cash for the company (due to economies of scale and higher profit margins), paying the company's bills and supporting its other businesses.
- *Dogs* are businesses with weak market shares in low-growth markets; typically, these generate low profits or even losses.

After plotting its various businesses in the growth-share matrix, a company must determine whether the portfolio is healthy. An unbalanced portfolio would have too many

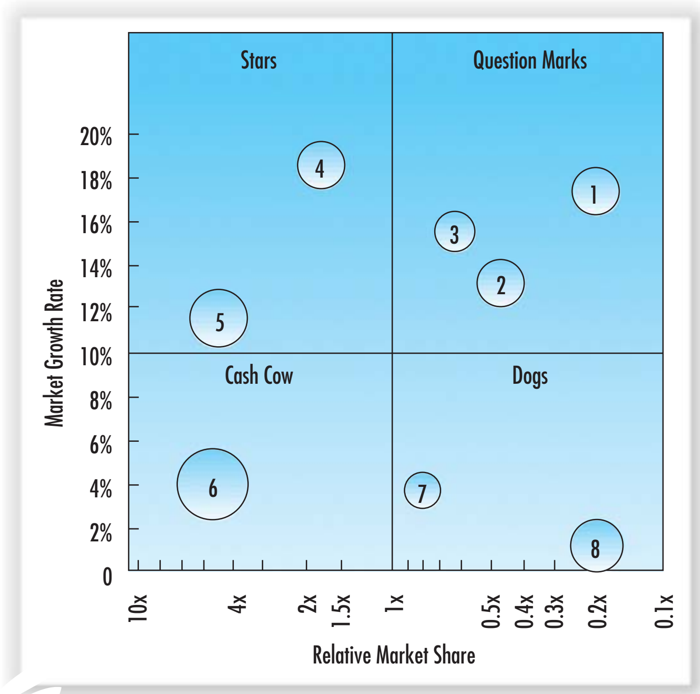


Figure 1-5 The Boston Consulting Group's Growth-Share Matrix

dogs or question marks or too few stars and cash cows. The next task is to determine what objective, strategy, and budget to assign to each SBU. Four strategies can be pursued:

1. *Build:* The objective here is to increase market share, even forgoing short-term earnings to achieve this objective if necessary. Building is appropriate for question marks whose market shares must grow if they are to become stars.
2. *Hold:* The objective in a hold strategy is to preserve market share, an appropriate strategy for strong cash cows if they are to continue yielding a large positive cash flow.
3. *Harvest:* The objective here is to increase short-term cash flow regardless of long-term effect. Harvesting involves a decision to withdraw from a business by implementing a program of continuous cost retrenchment. The hope is to reduce costs faster than any potential drop in sales, thus boosting cash flow. This strategy is appropriate for weak cash cows whose future is dim and from which more cash flow is needed. Harvesting can also be used with question marks and dogs.
4. *Divest:* The objective is to sell or liquidate the business because the resources can be better used elsewhere. This is appropriate for dogs and question marks that are dragging down company profits.

Successful SBUs move through a life cycle, starting as question marks and becoming stars, then cash cows, and finally dogs. Given this life-cycle movement, companies should be aware not only of their SBUs' current positions in the growth-share matrix (as in a snapshot), but also of their moving positions (as in a motion picture). If an SBU's expected future trajectory is not satisfactory, the corporation will need to work out a new strategy to improve the likely trajectory.

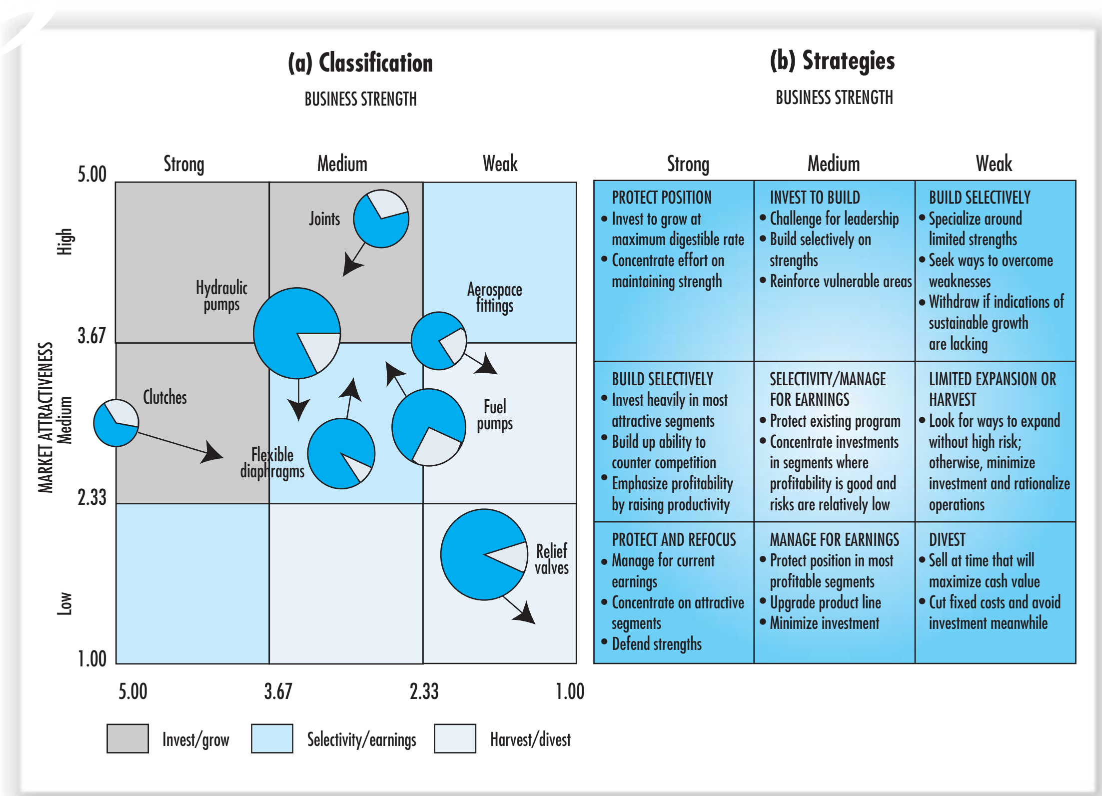
The General Electric Model

An SBU's appropriate objective cannot be determined solely by its position in the growth-share matrix. If additional factors are considered, the growth-share matrix can be seen as a special case of a multifactor portfolio matrix that General Electric (GE) pioneered. In this model, each business is rated in terms of two major dimensions—*market attractiveness* and *business strength*. These two factors make excellent marketing sense for rating a business. Companies are successful to the extent that they enter attractive markets and possess the required business strengths to succeed in those markets. If one of these factors is missing, the business will not produce outstanding results. Neither a strong company operating in an unattractive market nor a weak company operating in an attractive market will do well.

Using these two dimensions, the GE matrix is divided into nine cells, as shown in Figure 1-6. The three cells in the upper-left corner indicate strong SBUs suitable for investment or growth. The diagonal cells stretching from the lower left to the upper right indicate SBUs of medium attractiveness; these should be pursued selectively and managed for earnings. The three cells in the lower-right corner indicate SBUs low in overall attractiveness, which the company may want to harvest or divest.[9]

In addition to identifying each SBU's current position on the matrix, management should also forecast its expected position over the next 3 to 5 years. Making this determination involves analyzing product life cycle, expected competitor strategies,

Figure 1-6 Market-Attractiveness Portfolio Strategies



new technologies, economic events, and so on. Again, the purpose is to see where SBUs are as well as where they appear to be headed.

Critique of Portfolio Models

Both the BCG and GE portfolio models have a number of benefits. They can help managers think more strategically, better understand the economics of their SBUs, improve the quality of their plans, improve communication between SBU and corporate management, identify important issues, eliminate weaker SBUs, and strengthen their investment in more promising SBUs.

However, portfolio models must be used cautiously. They may lead a firm to overemphasize market-share growth and entry into high-growth businesses or to neglect its current businesses. Also, the models' results are sensitive to ratings and weights and can be manipulated to produce a desired location in the matrix. Finally, the models fail to delineate the synergies between two or more businesses, which means that making decisions for one business at a time might be risky. There is a danger of terminating a losing SBU that actually provides an essential core competence needed by several other business units. Overall, though, portfolio models have improved managers' analytical and strategic capabilities and allowed them to make better decisions than they could with mere impressions.[10]

Planning New Businesses, Downsizing Older Businesses

Corporate management often desires higher sales and profits than indicated by the projections for the SBU portfolio. The question then becomes how to grow much faster than the current businesses will permit. One option is to identify opportunities to achieve further growth within the company's current businesses (*intensive growth opportunities*). A second option is to identify opportunities to build or acquire businesses that are related to the company's current businesses (*integrative growth opportunities*). A third option is to identify opportunities to add attractive businesses that are unrelated to the company's current businesses (*diversification growth opportunities*).

- *Intensive growth.* Ansoff has proposed the *product–market expansion grid* as a framework for detecting new intensive growth opportunities.[11] In this grid, the company first considers whether it could gain more market share with its current products in current markets (*market-penetration strategy*) by encouraging current customers to buy more, attracting competitors' customers, or convincing nonusers to start buying its products. Next it considers whether it can find or develop new markets for its current products (*market-development strategy*). Then it considers whether it can develop new products for its current markets (*product-development strategy*). Later it will also review opportunities to develop new products for new markets (*diversification strategy*).
- *Integrative growth.* Often a business's sales and profits can be increased through *backward integration* (acquiring a supplier), *forward integration* (acquiring a distributor), or *horizontal integration* (acquiring a competitor).
- *Diversification growth.* This makes sense when good opportunities exist outside the present businesses. Three types of diversification are possible. The company could seek new products that have technological or marketing synergies with existing product lines, even though the new products themselves may appeal to a different group of customers (*concentric diversification strategy*). Second, the company might search for new products that appeal to its current customers but are technologically unrelated to the current product line (*horizontal diversification strategy*). Finally, the company might seek new businesses that have no relationship to the company's current technology, products, or markets (*conglomerate diversification strategy*).

Of course, companies must not only develop new businesses, but also prune, harvest, or divest tired, old businesses in order to release needed resources and reduce costs. Weak businesses require a disproportionate amount of managerial attention; managers should therefore focus on growth opportunities rather than wasting energy and resources trying to save hemorrhaging businesses.

BUSINESS STRATEGIC PLANNING

Below the corporate level, the strategic-planning process for each business or SBU consists of the eight steps shown in Figure 1-7. We examine each step in the sections that follow.

Business Mission

Each business unit needs to define its specific mission within the broader company mission. Thus, a television studio-lighting-equipment company might define its mission as "The company aims to target major television studios and become their vendor of choice for lighting technologies that represent the most advanced and reliable studio lighting arrangements."

SWOT Analysis

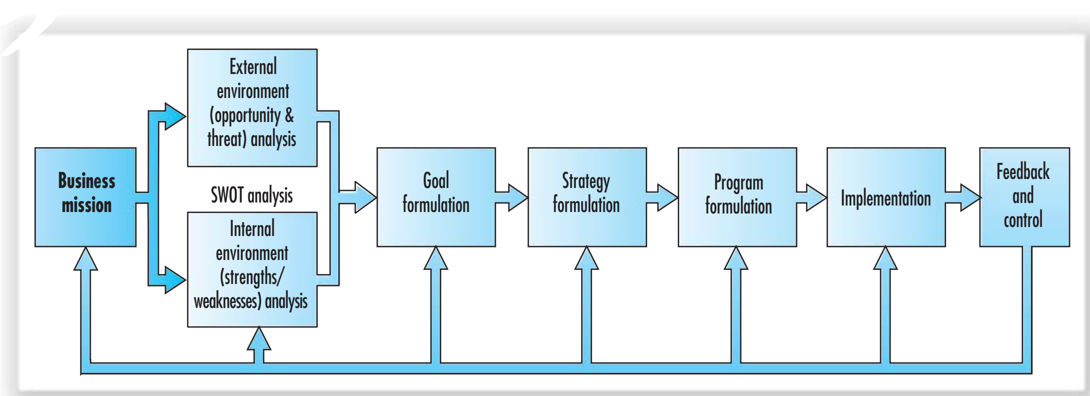
The overall evaluation of a business's strengths, weaknesses, opportunities, and threats is called *SWOT analysis*. SWOT analysis consists of an analysis of the external and internal environments.

External Environment Analysis

In general, a business unit has to monitor key *macroenvironment forces* (demographic-economic, technological, political-legal, and social-cultural) and *microenvironment actors* (customers, competitors, distributors, and suppliers) that affect its ability to earn profits (see Chapter 4 for more detail). Then, for each trend or development, management needs to identify the associated marketing opportunities and threats.

A **marketing opportunity** is an area of buyer need in which a company can perform profitably. Opportunities can be classified according to their *attractiveness* and their *success probability*. The company's success probability depends on whether its busi-

Figure 1-7 The Business Strategic-Planning Process



ness strengths not only match the key success requirements for operating in the target market, but also exceed those of its competitors. Mere competence does not constitute a competitive advantage. The best-performing company will be the one that can generate the greatest customer value and sustain it over time.

An **environmental threat** is a challenge posed by an unfavorable external trend or development that would lead, in the absence of defensive marketing action, to deterioration in sales or profit. Threats should be classified according to *seriousness* and *probability of occurrence*. Minor threats can be ignored; somewhat more serious threats must be carefully monitored; and major threats require the development of contingency plans that spell out changes the company can make if necessary.

Internal Environment Analysis

It is one thing to discern attractive opportunities and another to have the competencies to succeed in these opportunities. Thus, each business needs to periodically evaluate its internal strengths and weaknesses in marketing, financial, manufacturing, and organizational competencies. Clearly, the business does not have to correct all of its weaknesses, nor should it gloat about all of its strengths. The big question is whether the business should limit itself to those opportunities in which it possesses the required strengths or consider better opportunities to acquire or develop certain strengths.

Sometimes a business does poorly because its departments do not work together well as a team. It is therefore critically important to assess interdepartmental working relationships as part of the internal environmental audit. Honeywell, for example, asks each department to annually rate its own strengths and weaknesses and those of the other departments with which it interacts. The notion is that each department is a "supplier" to some departments and a "customer" of other departments. If one department has weaknesses that hurt its "internal customers," Honeywell wants to correct them.

Goal Formulation

Once the company has performed a SWOT analysis of the internal and external environments, it can proceed to develop specific goals for the planning period in a process called *goal formulation*. Managers use the term *goals* to describe objectives that are specific with respect to magnitude and time. Turning objectives into measurable goals facilitates management planning, implementation, and control.

To be effective, goals must (1) be arranged *hierarchically* to guide the businesses in moving from broad to specific objectives for departments and individuals; (2) be stated *quantitatively* whenever possible; (3) be *realistic;* and (4) be *consistent*. Other important trade-offs in setting goals include: balancing short-term profit versus long-term growth; balancing deep penetration of existing markets with development of new markets; balancing profit goals versus nonprofit goals; and balancing high growth versus low risk. Each choice in this set of goal trade-offs calls for a different marketing strategy.

Strategy Formulation

Goals indicate what a business unit wants to achieve; *strategy* describes the game plan for achieving those goals. Every business strategy consists of a marketing strategy plus a compatible technology strategy and sourcing strategy. Although many types of marketing strategies are available, Michael Porter has condensed them into three generic types that provide a good starting point for strategic thinking: overall cost leadership, differentiation, or focus.[12]

- *Overall cost leadership:* Here the business works to achieve the lowest production and distribution costs so that it can price lower than competitors and win more market share. Firms pursuing this strategy must be good at engineering, purchasing, manufacturing, and physical distribution; they need less skill in marketing. Texas Instruments uses this strategy. The problem is that rivals may emerge with still lower costs, hurting a firm that has rested its whole future on cost leadership.

- *Differentiation:* Here the business concentrates on achieving superior performance in an important customer benefit area, such as being the leader in service, quality, style, or technology—but not leading in all of these things. Intel, for instance, differentiates itself through leadership in technology, coming out with new microprocessors at breakneck speed.
- *Focus:* Here the business focuses on one or more narrow market segments, getting to know these segments intimately and pursuing either cost leadership or differentiation within the target segment. Airwalk shoes, for instance, came to fame by focusing on the very narrow extreme-sports segment.

Firms that do not pursue a clear strategy—"middle-of-the-roaders"—do the worst. International Harvester fell upon hard times because it did not stand out as lowest in cost, highest in perceived value, or best in serving some market segment. Middle-of-the-roaders try to be good on all strategic dimensions, but because strategic dimensions require different and often inconsistent ways of organizing the firm, these firms end up being not particularly excellent at anything.

Strategy formulation in the age of the Internet is particularly challenging. The chemical company Solutia, a Monsanto spinoff, copes by creating four different, possible short-term scenarios for each strategy. This allows the firm to act quickly when it sees a scenario unfolding. Sun Microsystems holds a weekly meeting with the firm's top decision makers to brainstorm strategies for handling new threats. By revisiting strategic plans frequently, both companies are able to stay ahead of environmental changes.[13]

Program Formulation

Once the business unit has developed its principal strategies, it must work out detailed supporting programs. Thus, if the business has decided to attain technological leadership, it must plan programs to strengthen its R&D department, gather technological intelligence, develop leading-edge products, train the technical sales force, and develop ads to communicate its technological leadership.

After these marketing programs have been tentatively formulated, the marketing people must estimate their costs. Questions arise: Is participating in a particular trade show worth it? Will a specific sales contest pay for itself? Will hiring another salesperson contribute to the bottom line? Activity-based cost (ABC) accounting should be applied to each marketing program to determine whether it is likely to produce sufficient results to justify the cost.[14]

Implementation

A clear strategy and well-thought-out supporting programs may be useless if the firm fails to implement them carefully. Indeed, strategy is only one of seven elements, according to McKinsey & Company, that the best-managed companies exhibit.[15] In the McKinsey 7-S framework for business success, strategy, structure, and systems are considered the "hardware" of success, and style (how employees think and behave), skills (to carry out the strategy), staff (able people who are properly trained and assigned), and shared values (values that guide employees' actions) are the "software." When these software elements are present, companies are usually more successful at strategy implementation.[16] Implementation is vital to effective management of the marketing process, as discussed later in this chapter.

Feedback and Control

As it implements its strategy, the firm needs to track the results and monitor new developments in the internal and external environments. Some environments are fairly stable from year to year. Other environments evolve slowly in a fairly predictable way. Still other environments change rapidly in significant and unpredictable ways. Nonetheless, the company can count on one thing: The marketplace will change. And when it does, the company will need to review and revise its implementation, programs, strategies, or even objectives.

A company's strategic fit with the environment will inevitably erode because the market environment changes faster than the company's 7-Ss. Thus a company might remain efficient while it loses effectiveness. Peter Drucker pointed out that it is more important to "do the right thing" (effectiveness) than "to do things right" (efficiency). The most successful companies excel at both.

Once an organization fails to respond to a changed environment, it has difficulty recapturing its lost position. This happened to the once-unassailable Motorola when it was slow to respond to the new digital technology used by Nokia and others, and kept rolling out analog phones.[17] Similarly, Barnes & Noble did not immediately recognize the threat posed by Amazon.com's Internet-based book retailing model; then, as a latecomer to e-commerce, it had more of a struggle establishing itself. Clearly, the key to organizational health is the firm's willingness to examine the changing environment and to adopt appropriate new goals and behaviors. High-performance organizations continuously monitor the environment and use flexible strategic planning to maintain a viable fit with the evolving environment.

THE MARKETING PROCESS

Planning at the corporate, division, and business levels is an integral part of planning for the marketing process. To understand that process fully, we must first look at how a company defines its business.

The task of any business is to deliver value to the market at a profit. There are at least two views of the *value-delivery process*.[18] The traditional view is that the firm makes something and then sells it (Figure 1-8). In this view, marketing takes place in the second half of the value-delivery process. The traditional view assumes that the company knows what to make and that the market will buy enough units to produce profits for the company.

Companies that subscribe to this traditional view have the best chance of succeeding in economies marked by goods shortages in which consumers are not fussy about quality, features, or style. But the traditional view of the business process will not work in more competitive economies in which people face abundant choices. The "mass market" is actually splintering into numerous micromarkets, each with its own wants, perceptions, preferences, and buying criteria. The smart competitor therefore must design the offer for well-defined target markets.

The Value-Delivery Sequence

This belief is at the core of the new view of business processes, which places marketing at the beginning of the planning process. Instead of emphasizing making and selling, companies see themselves involved in a three-phase value creation and delivery sequence (Figure 1-8).

The first phase, choosing the value, represents the strategic "homework" that marketing must do before any product exists. The marketing staff must segment the market, select the appropriate market target, and develop the offer's value position-

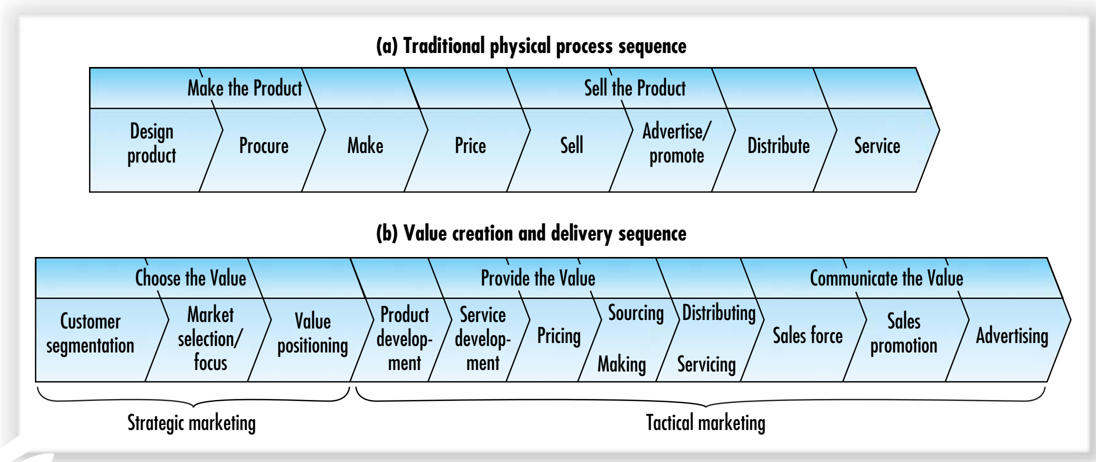


Figure 1-8 Two Views of the Value-Delivery Process

ing. In the second phase, providing the value, marketers detail the product's specifications and services, set a target price, then make and distribute the product. Developing specific product features, prices, and distribution occurs at this stage and is part of *tactical marketing*. The task in the third phase is communicating the value. Here, further tactical marketing occurs in utilizing the sales force, sales promotion, advertising, and other promotional tools to inform the market about the product. Thus, as Figure 1-8 shows, the marketing process actually begins before there is a product and continues while it is being developed and after it becomes available.

Steps in the Marketing Process

The **marketing process** consists of analyzing market opportunities, researching and selecting target markets, designing marketing strategies, planning marketing programs, and organizing, implementing, and controlling the marketing effort. The four steps in the marketing process are:

1. *Analyzing market opportunities.* The marketer's initial task is to identify potential long-run opportunities given the company's market experience and core competencies. To evaluate its various opportunities, assess buyer wants and needs, and gauge market size, the firm needs a marketing research and information system. Next, the firm studies consumer markets or business markets to find out about buying behavior, perceptions, wants, and needs. Smart firms also pay close attention to competitors and look for major segments within each market that they can profitably serve.
2. *Developing marketing strategies.* In this step, the marketer prepares a *positioning* strategy for each new and existing product's progress through the life cycle, makes decisions about product lines and branding, and designs and markets its services.
3. *Planning marketing programs.* To transform marketing strategy into marketing programs, marketing managers must make basic decisions on marketing expenditures, marketing mix, and marketing allocation. The first decision is about the level of marketing expenditures needed to achieve the firm's marketing objectives. The second

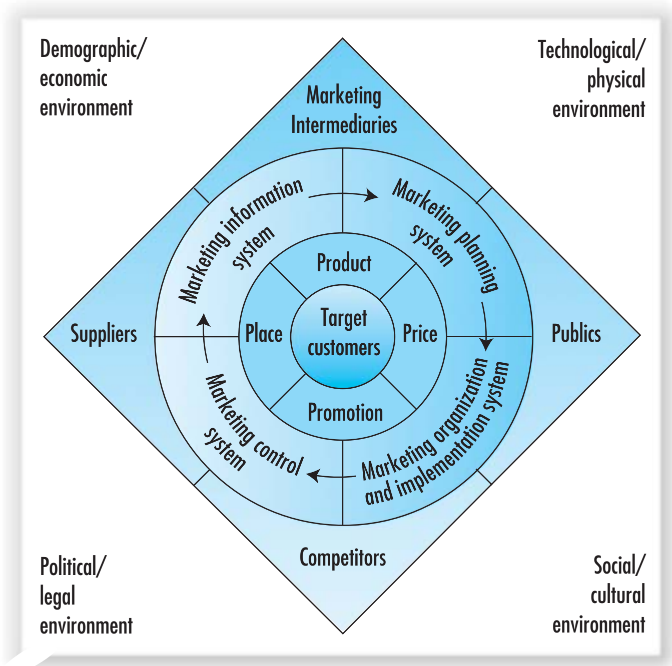


Figure 1-9 Factors Influencing Company Marketing Strategy

decision is how to divide the total marketing budget among the various tools in the marketing mix: *product, price, place,* and *promotion.*[19] And the third decision is how to allocate the marketing budget to the various products, channels, promotion media, and sales areas.

4. *Managing the marketing effort.* In this step (discussed later in this chapter), marketers organize the firm's marketing resources to implement and control the marketing plan. Because of surprises and disappointments as marketing plans are implemented, the company also needs feedback and control.

Figure 1-9 presents a grand summary of the marketing process and the factors that shape the company's marketing strategy.

The Nature and Contents of a Marketing Plan

The *marketing plan* created for each product line or brand is one of the most important outputs of planning for the marketing process. A typical marketing plan has eight sections:

- *Executive summary and table of contents:* This brief summary outlines the plan's main goals and recommendations; it is followed by a table of contents.
- *Current marketing situation:* This section presents relevant background data on sales, costs, profits, the market, competitors, distribution, and the macroenvironment, drawn from a fact book maintained by the product manager.
- *Opportunity and issue analysis:* This section identifies the major opportunities and threats, strengths and weaknesses, and issues facing the product line or brand.
- *Objectives:* This section spells out the financial and marketing objectives to be achieved.

- *Marketing strategy:* This section explains the broad marketing strategy that will be implemented to accomplish the plan's objectives.
- *Action programs:* This section outlines the broad marketing programs for achieving the business objectives. Each marketing strategy element must be elaborated to answer these questions: What will be done? When will it be done? Who will do it? How much will it cost?
- *Projected profit-and-loss statement:* Action plans allow the product manager to build a supporting budget with forecasted sales volume (units and average price), costs (production, physical distribution, and marketing), and projected profit. Once approved, the budget is the basis for developing plans and schedules for material procurement, production scheduling, employee recruitment, and marketing operations.
- *Controls:* This last section outlines the controls for monitoring the plan. Typically, the goals and budget are spelled out for each month or quarter so senior management can review the results each period. Sometimes contingency plans for handling specific adverse developments are included.

No two companies handle marketing planning and marketing plan content exactly the same way. Most marketing plans cover one year and vary in length; some firms take their plans very seriously, while others use them as only a rough guide to action. The most frequently cited shortcomings of marketing plans, according to marketing executives, are lack of realism, insufficient competitive analysis, and a short-run focus.

MANAGING THE MARKETING PROCESS

In addition to updating their marketing plans, companies often need to restructure business and marketing practices in response to major environmental changes such as globalization, deregulation, computer and telecommunications advances, and market fragmentation. Against this dynamic backdrop, the role of marketing in the organization must change as well. Now that the enterprise is fully networked, every functional area can interact directly with customers. This means that marketing no longer has sole ownership of customer interactions; rather, marketing needs to integrate all the customer-facing processes so that customers see a single face and hear a single voice when they interact with the firm. To accomplish this requires careful structuring of the marketing organization.

Organization of the Marketing Department

Modern marketing departments take numerous forms. The marketing department may be organized according to function, geographic area, products, or customer markets. Global organization is another consideration for firms that market goods or services in other countries.

Functional Organization

The most common form of marketing organization consists of functional specialists (such as the sales manager and marketing research manager) who report to a marketing vice president, who coordinates their activities. The main advantage of a functional marketing organization is its administrative simplicity. However, this form loses effectiveness as products and markets increase. First, a functional organization often leads to inadequate planning for specific products and markets because products that are not favored by anyone are neglected. Second, each functional group competes with the other functions for budget and status. Therefore, the marketing vice president constantly has to weigh the claims of competing functional specialists and faces a difficult coordination problem.

Geographic Organization

A company selling in a national market often organizes its sales force (and sometimes other functions, including marketing) along geographic lines. The national sales manager may supervise four regional sales managers, who each supervise six zone managers, who in turn supervise eight district sales managers, who supervise 10 sales people. Several companies are now adding *area market specialists* (regional or local marketing managers) to support the sales efforts in high-volume, distinctive markets. For example, McDonald's now spends about 50 percent of its advertising budget regionally, and Anheuser-Bush has subdivided its regional markets into ethnic and demographic segments, with different ad campaigns for each.

Product- or Brand-Management Organization

Companies that produce a variety of products and brands often establish a product- (or brand-) management organization as another layer of management within the marketing function. A product manager supervises product category managers, who in turn supervise specific product and brand managers. A product-management organization makes sense if the firm's products are quite different, or if the sheer number of products is beyond the ability of a functional marketing organization to handle.

In both consumer and industrial markets, product and brand managers are responsible for product planning and strategy; preparing annual marketing plans and sales forecasts; working with advertising and merchandising agencies to create programs and campaigns; stimulating support among sales reps and distributors; ongoing research into product performance, customer and dealer attitudes, opportunities and threats; and initiating product improvements to meet changing market needs.

The product-management organization allows the product manager to concentrate on developing a cost-effective marketing mix for each product, to react more quickly to marketplace changes, and to watch over smaller brands. On the other hand, it can lead to conflict and frustration when product managers are not given enough authority to carry out their responsibilities effectively. In addition, product managers become experts in their product but rarely achieve functional expertise. And appointing product managers and associate product managers for even minor products can bloat payroll costs. Finally, brand managers normally move up in a few years to another brand or transfer to another company, leading to short-term thinking that plays havoc with long-term brand building.

To counter these disadvantages, some companies have switched from product managers to product teams. For example, Hallmark uses a triangular marketing team consisting of a market manager (the leader), a marketing manager, and a distribution manager; 3M uses a horizontal product team consisting of a team leader and representatives from sales, marketing, laboratory, engineering, accounting, and marketing research.

Another alternative is to introduce *category management,* in which a company focuses on product categories to manage its brands. Kraft has changed from a classic brand-management structure, in which each brand competed for resources and market share, to a category-based structure in which category business directors (or "product integrators") lead cross-functional teams of representatives from marketing, R&D, consumer promotion, and finance. These category teams work with process teams dedicated to each product category and with customer teams dedicated to each major customer.[20] Still, category management is essentially product-driven, which is why Colgate recently moved from brand management (Colgate toothpaste) to category management (toothpaste category) to a new stage called "customer-need management" (mouth care). This last step finally focuses the organization on a basic customer need.[21]

Market-Management Organization

Many companies sell their products to a diverse set of markets; Canon, for instance, sells fax machines to consumer, business, and government markets. When customers fall into different user groups with distinct buying preferences and practices, a market management organization is desirable. A *markets manager* supervises several *market managers* (also called *market-development managers, market specialists,* or *industry specialists*). The market managers draw upon functional services as needed or may even have functional specialists reporting to them.

Market managers are staff (not line) people, with duties similar to those of product managers. This system has many of the same advantages and disadvantages of product management systems. Its strongest advantage is that the marketing activity is organized to meet the needs of distinct customer groups. This is why Xerox converted from geographic selling to selling by industry, as did IBM, which recently reorganized its employees into 14 customer-focused divisions. In fact, several studies have confirmed the value of market-centered organization: Slater and Narver found a substantial positive effect of market orientation on both commodity and noncommodity businesses.[22]

Product-Management/Market-Management Organization

Companies that produce many products that flow into many markets tend to adopt a *matrix organization.* Consider DuPont, a pioneer in developing the matrix structure. Its textile fibers department consists of separate product managers for rayon and other fibers plus separate market managers for menswear and other markets. The product managers plan the sales and profits for their respective fibers, each seeking to expand the use of his or her fiber; the market managers seek to meet their market's needs rather than push a particular fiber. Ultimately, the sales forecasts from the market managers and the product managers should add to the same grand total.

A matrix organization would seem desirable in a multiproduct, multimarket company. However, this system is costly and often creates conflicts as well as questions about authority and responsibility. By the early 1980s, a number of companies had abandoned matrix management. But matrix management has resurfaced and is again flourishing in the form of "business teams" staffed with full-time specialists reporting to one team boss. The major difference is that companies today provide the right context in which a matrix can thrive—an emphasis on flat, lean team organizations focused around business processes that cut horizontally across functions.[23]

Corporate-Divisional Organization

As multiproduct-multimarket companies grow, they often convert their larger product or market groups into separate divisions with their own departments and services. This raises the question of what marketing services and activities should be retained at corporate headquarters. Some corporations leave marketing to each division; some have a small corporate marketing staff; and some prefer to maintain a strong corporate marketing staff.

The potential contribution of a corporate marketing staff varies in different stages of the company's evolution. Most companies begin with weak marketing in their divisions and often establish a corporate staff to bring stronger marketing into the divisions through training and other services. Some members of corporate marketing might be transferred to head divisional marketing departments. As divisions become strong in their marketing, corporate marketing has less to offer them. Some companies then decide corporate marketing has done its job and proceed to eliminate the department.[24]

Global Organization

Companies that market internationally can organize in three ways. Those just going global may start by establishing an *export department* with a sales manager and a few assistants (and limited marketing services). As they go after global business more aggressively, they can create an *international division* with functional specialists (including marketing) and operating units structured geographically, according to product, or as international subsidiaries. Finally, companies that become truly *global organizations* have top corporate management and staff plan worldwide operations, marketing policies, financial flows, and logistical systems. In these organizations, the global operating units report directly to top management, not to the head of an international division.

Building a Companywide Marketing Orientation

Many companies are beginning to realize that their organizations are not really market- and customer-driven—they are product or sales driven. Companies such as Baxter, General Motors, and Shell are working hard to reorganize themselves into true market-driven companies. The task is not easy: it requires changes in job and department definitions, responsibilities, incentives, and relationships.

To create a market- and customer-focused company, the CEO must: convince senior managers of the need to be more customer-focused; appoint a senior marketing officer and marketing task force; get outside help and guidance; change reward measurement and system to encourage actions that build long-term customer satisfaction; hire strong marketing talent; develop strong in-house marketing training programs; install a modern marketing planning system; establish an annual marketing excellence recognition program; consider restructuring as a market-centered organization; and shift from a department focus to a process-outcome focus.

DuPont successfully made the transition from an inward-looking to an outward-looking orientation when it began building a "marketing community" by reorganizing divisions along market lines and holding marketing management training seminars for thousands of managers and employees. The company also established a marketing excellence recognition program and honored employees from around the world who had developed innovative marketing strategies and service improvements.[25] It takes a great deal of planning and patience to get managers to accept customers as the foundation and future of the business—but it can be done, as the DuPont example shows.

Marketing Implementation

Organization is one factor contributing to effective **marketing implementation,** the process that turns marketing plans into action assignments and ensures that such assignments are executed in a manner that accomplishes the plan's stated objectives.[26] This part of the marketing process is critical, because a brilliant strategic marketing plan counts for little if it is not implemented properly. Whereas strategy addresses the *what* and *why* of marketing activities, implementation addresses the *who, where, when,* and *how.* Strategy and implementation are closely related in that one layer of strategy implies certain tactical implementation assignments at a lower level. For example, top management's strategic decision to "harvest" a product must be translated into specific actions and assignments.

Bonoma identified four sets of skills for implementing marketing programs: (1) diagnostic skills (the ability to determine what went wrong); (2) identification of company level (the ability to discern whether problems occurred in the marketing function, the marketing program, or the marketing policy); (3) implementation skills (the ability to budget resources, organize effectively, motivate others); and (4) evaluation skills (the ability to evaluate results).[27] These skills are as vital for nonprofits as they are for businesses, as the Alvin Ailey Dance Theater has discovered.

Like many nonprofit cultural organizations, the company founded by Alvin Ailey in 1958 always seemed to be operating in the red—despite its ability to attract full houses—because of the high costs of mounting a production. But Judith Jameson, the principal dancer who succeeded Ailey as director after his death, has been able to keep the company in the black, thanks largely to her skill at motivating others to carry out marketing efforts. The nonprofit implements its marketing plan through a high-powered board of directors and a group of businesses that want to associate with the Ailey company for their own marketing purposes. For example, Healthsouth Corporation provides free physical therapy to the dancers and benefits from the association when marketing its sports medicine clinics. With an audience that is almost half African American and 43 percent of which is between the ages of 19 and 39, Ailey provides access to an important market for its corporate partners, earning their enthusiastic support.[28]

Evaluating and Controlling the Marketing Process

To deal with the many surprises that occur during the implementation of marketing plans, the marketing department has to monitor and control marketing activities continuously. Table 1.1 lists four types of marketing control needed by companies: annual-plan control, profitability control, efficiency control, and strategic control.

Annual-Plan Control

The purpose of annual-plan control is to ensure that the company achieves the sales, profits, and other goals established in its annual plan. The heart of annual-plan control is the four-step *management by objectives* process in which management (1) sets monthly or quarterly goals; (2) monitors the company's marketplace performance; (3) determines the causes of serious performance deviations; and (4) takes corrective action to close the gaps between goals and performance.

This control model applies to all levels of the organization. Top management sets sales and profit goals for the year that are elaborated into specific goals for each lower level. In turn, each product manager commits to attaining specified levels of sales and costs; each regional district and sales manager and each sales representative also commits to specific goals. Each period, top management reviews and interprets performance results at all levels, using these five tools:

- *Sales analysis. Sales analysis* consists of measuring and evaluating actual sales in relation to goals, using two specific tools. *Sales-variance analysis* measures the relative contribution of different factors to a gap in sales performance. *Microsales analysis* looks at specific products, territories, and other elements that failed to produce expected sales. The point of these analyses is to determine what factors (pricing, lower volume, specific territories, etc.) contributed to a failure to meet sales goals.
- *Market-share analysis.* Company sales do not reveal how well the company is performing relative to competitors. To do this, management needs to track its market share. Overall market share is the company's sales expressed as a percentage

Table 1.1 Types of Marketing Control

Type of Control	Prime Responsibility	Purpose of Control	Approaches
I. Annual-plan control	Top management Middle management	To examine whether the planned results are being achieved	▪ Sales analysis ▪ Market-share analysis ▪ Marketing expense-to-sales analysis ▪ Financial analysis ▪ Market-based scorecard analysis
II. Profitability control	Marketing controller	To examine where the company is making and losing money	Profitability by: ▪ product ▪ territory ▪ customer ▪ segment ▪ trade channel ▪ order size
III. Efficiency control	Line and staff management Marketing controller	To evaluate and improve the spending efficiency and impact of marketing expenditures	Efficiency of: ▪ sales force ▪ advertising ▪ sales promotion ▪ distribution
IV. Strategic control	Top management Marketing auditor	To examine whether the company is pursuing its best opportunities in markets, products, and channels	▪ Marketiing-effectiveness review ▪ Marketing audit ▪ Marketing excellence review ▪ Company ethical and social responsibility review

of total market sales. Served market share is its sales expressed as a percentage of the total sales to its *served market*—all of the buyers who are able and willing to buy the product. Relative market share can be expressed as market share in relation to the largest competitor; a rise in relative market share means a company is gaining on its leading competitor. A useful way to analyze market-share movements is in terms of customer penetration, customer loyalty, customer selectivity, and price selectivity.

➤ *Marketing expense-to-sales analysis*. This is a key ratio because it allows management to be sure that the company is not overspending to achieve sales goals. Minor fluctuations in the expense-to-sales ratio can be ignored, but major fluctuations are cause for concern.

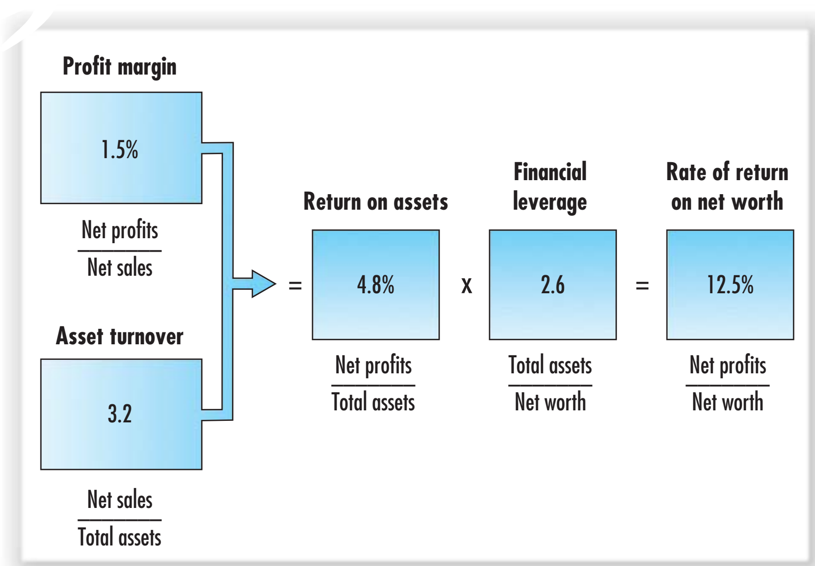
- *Financial analysis.* Management uses financial analysis to identify the factors that affect the company's *rate of return on net worth.*[29] The main factors are shown in Figure 1-10, along with illustrative numbers for a large chain-store retailer. To improve its return on net worth, the company must increase its ratio of net profits to its assets or increase the ratio of its assets to its net worth. The company should analyze the composition of its assets (i.e., cash, accounts receivable, inventory, and plant and equipment) and see if it can improve its asset management.[30]
- *Market-based scorecard analysis.* Companies should also prepare two market-based scorecards that reflect performance and provide possible early warning signals of problems. A *customer-performance scorecard* records how well the company is doing on such customer-based measures as new customers, dissatisfied customers, lost customers, target market awareness, target market preference, relative product quality, and relative service quality. A *stakeholder-performance scorecard* tracks the satisfaction of constituencies who have a critical interest in and impact on the company's performance: employees, suppliers, banks, distributors, retailers, and stockholders.[31]

Profitability Control

Successful companies also measure the profitability of their products, territories, customer groups, segments, trade channels, and order sizes. This information helps management determine whether any products or marketing activities should be expanded, reduced, or eliminated. The first step in marketing-profitability analysis is to identify the functional expenses (such as advertising and delivery) incurred for each activity. Next, the firm measures how much functional expense was associated with selling through each type of channel. Third, the company prepares a profit-and-loss statement for each type of channel.

In general, marketing-profitability analysis indicates the relative profitability of different channels, products, territories, or other marketing entities. However, it does not prove that the best course of action is to drop the unprofitable marketing entities,

Figure 1-10 Financial Model of Return on Net Worth



nor does it capture the likely profit improvement if these marginal marketing entities are dropped. Therefore, the company must examine its alternatives closely before taking corrective action.

Efficiency Control

Suppose a profitability analysis reveals poor profits for certain products, territories, or markets. This is when management must ask whether there are more efficient ways to manage the sales force, advertising, sales promotion, and distribution in connection with these marketing entities. Some companies have established a *marketing controller* position to work on such issues and improve marketing efficiency.

Marketing controllers work out of the controller's office but specialize in the marketing side of the business. At companies such as General Foods, DuPont, and Johnson & Johnson, they perform a sophisticated financial analysis of marketing expenditures and results, analyzing adherence to profit plans, helping prepare brand managers' budgets, measuring the efficiency of promotions, analyzing media production costs, evaluating customer and geographic profitability, and educating marketing personnel on the financial implications of marketing decisions.[32]

Strategic Control

From time to time, companies need to undertake a critical review of overall marketing goals and effectiveness. Each company should periodically reassess its strategic approach to the marketplace with marketing-effectiveness reviews and marketing audits.

- *The marketing-effectiveness review.* Marketing effectiveness is reflected in the degree to which a company or division exhibits the five major attributes of a marketing orientation: *customer philosophy* (serving customers' needs and wants), *integrated marketing organization* (integrating marketing with other key departments), *adequate marketing information* (conducting timely, appropriate marketing research), *strategic orientation* (developing formal marketing plans and strategies), and *operational efficiency* (using marketing resources effectively and flexibly). Unfortunately, most companies and divisions score in the fair-to-good range on measures of marketing effectiveness.[33]
- *The marketing audit.* Companies that discover marketing weaknesses should undertake a **marketing audit,** a comprehensive, systematic, independent, and periodic examination of a company's (or SBU's) marketing environment, objectives, strategies, and activities to identify problem areas and opportunities and recommend a plan of action for improving the company's marketing performance.[34] The marketing audit examines six major marketing components: (1) the macroenvironment and task environment, (2) marketing strategy, (3) marketing organization, (4) marketing systems, (5) marketing productivity, and (6) marketing function (the 4 Ps).

Highly successful companies also perform marketing excellence reviews and ethical-social responsibility reviews to gain an outside-in perspective on their marketing activities.

- *The marketing excellence review.* This best-practices excellence review rates a firm's performance in relation to the best marketing and business practices of high-performing businesses. The resulting profile exposes weaknesses and strengths and highlights where the company might change to become a truly outstanding player in the marketplace.
- *The ethical and social responsibility review.* In addition, companies need to evaluate whether they are truly practicing ethical and socially responsible marketing. Business success and continually satisfying customers and other stakeholders are

intimately tied to adoption and implementation of high standards of business and marketing conduct. The most admired companies abide by a code of serving people's interests, not only their own. Thus, the ethical and social responsibility review allows management to determine how the firm is grappling with ethical issues and exhibiting a "social conscience" in its business dealings.

Effective control of the marketing process ultimately depends on accurate, timely, and complete information about markets, demand, and the marketing environment—the subject of the next chapter.

EXECUTIVE SUMMARY

Market-oriented strategic planning is the managerial process of developing and maintaining a viable fit among the organization's objectives, skills, and resources and its changing market opportunities. The aim of strategic planning is to shape the company's businesses and products to yield the targeted profits and growth. Strategic planning takes place at four levels: corporate, division, business unit, and product.

The corporate strategy establishes the framework within which the divisions and business units prepare their strategic plans. Setting a corporate strategy entails defining the corporate mission; establishing strategic business units (SBUs), assigning resources to each SBU based on its market attractiveness and business strength, and planning new businesses and downsizing older businesses. Strategic planning for SBUs entails defining the business mission, analyzing external opportunities and threats, analyzing internal strengths and weaknesses, formulating goals, formulating strategy, formulating programs, implementing the programs, and gathering feedback and exercising control.

The marketing process consists of four steps: analyzing market opportunities, developing marketing strategies, planning marketing programs, and managing marketing effort. Each product level within a business unit must develop a marketing plan for achieving its goals. The marketing plan is one of the most important outputs of the marketing process. It should contain an executive summary and table of contents, an overview of the marketing situation, an analysis of opportunities and threats, a summary of financial and marketing objectives, an overview of marketing strategy, a description of action programs, a projected profit-and-loss statement, and a summary of the controls for monitoring the plan's progress.

In managing the marketing process, companies can organize the marketing department according to function, geographic area, products, or customer markets. Companies that market in other countries can create an export department, an international division, or a global organization. Marketing implementation is the process that turns marketing plans into action assignments and ensures that such assignments are executed in a manner that accomplishes the plan's stated objectives. To manage the marketing process, companies can apply four types of control: annual-plan control, profitability control, efficiency control, and strategic control.

NOTES

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Gathering Information and Measuring Market Demand

Marketing is becoming more of a battle based on information than one based on sales power.

We examine the following questions:

- What are the components of a modern marketing information system?
- What constitutes good marketing research?
- How can marketing decision support systems help marketing managers make better decisions?
- How can demand be more accurately measured and forecasted?

The marketing environment is changing at an accelerating rate. Given the following changes, the need for real-time market information is greater than at any time in the past:

From local to national to global marketing: As companies expand their geographical market coverage, their managers need more information more quickly.

From buyer needs to buyer wants: As incomes improve, buyers become more selective in their choice of goods. To predict buyers' responses to different features, styles, and other attributes, sellers must turn to marketing research.

From price to nonprice competition: As sellers increase their use of branding, product differentiation, advertising, and sales promotion, they require information on these marketing tools' effectiveness.

Fortunately, the exploding information requirements have given rise to impressive new information technologies: computers, microfilm, cable television, copy machines, fax machines, tape recorders, video recorders, videodisc players, CD-ROM drives, the Internet.[1] Some firms have developed marketing information systems that provide company management with rapid and incredible detail about buyer wants, preferences, and behavior. For example, the Coca-Cola Company knows that we put 3.2 ice cubes in a glass, see 69 of its commercials every year, and prefer cans to pop out of vending machines at a temperature of 35 degrees. Kimberly-Clark, which makes Kleenex, has calculated that the average person blows his or her nose 256 times a year. Hoover learned that we spend about 35 minutes each week vacuuming, sucking up about 8 pounds of dust each year and using 6 bags to do so.[2] Marketers also have extensive information about consumption patterns in other countries. On a per capita basis within Western Europe, for example, the Swiss consume the most chocolate, the Greeks eat the most cheese, the Irish drink the most tea, and the Austrians smoke the most cigarettes.[3]

Nevertheless, many business firms lack information sophistication. Many lack a marketing research department. Others have departments that limit work to routine forecasting, sales analysis, and occasional surveys. In addition, many managers complain about not knowing where critical information is located in the company; getting too much information that they can't use and too little that they really need; getting important information too late; and doubting the information's accuracy. In today's information-based society, companies with superior information enjoy a competitive advantage. The company can choose its markets better, develop better offerings, and execute better marketing planning.

THE COMPONENTS OF A MODERN MARKETING INFORMATION SYSTEM

Every firm must organize a rich flow of information to its marketing managers. Competitive companies study their managers' information needs and design marketing information systems (MIS) to meet these needs.

- A ***marketing information system (MIS)*** consists of people, equipment, and procedures to gather, sort, analyze, evaluate, and distribute needed, timely, and accurate information to marketing decision makers.

To carry out their analysis, planning, implementation, and control responsibilities, marketing managers need information about developments in the marketing environment. The role of the MIS is to assess the manager's information needs, develop the needed information, and distribute that information in a timely fashion. The information is developed through internal company records, marketing intelligence activities, marketing research, and marketing decision support analysis.

I NTERNAL RECORDS SYSTEM

Marketing managers rely on internal reports on orders, sales, prices, costs, inventory levels, receivables, payables, and so on. By analyzing this information, they can spot important opportunities and problems.

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The heart of the internal records system is the *order-to-payment cycle*. Sales representatives, dealers, and customers dispatch orders to the firm. The sales department prepares invoices and transmits copies to various departments. Out-of-stock items are back ordered. Shipped items are accompanied by shipping and billing documents that are sent to various departments.

Today's companies need to perform these steps quickly and accurately. Customers favor those firms that can promise timely delivery. Customers and sales representatives fax or e-mail their orders. Computerized warehouses fulfill these orders quickly. The billing department sends out invoices as quickly as possible. An increasing number of companies are using *electronic data interchange (EDI)* or *intranets* to improve the speed, accuracy, and efficiency of the order-to-payment cycle. Retail giant Wal-Mart tracks the stock levels of its products and its computers send automatic replenishment orders to its vendors.[4]

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Marketing managers need up-to-the-minute reports on current sales. Armed with laptop computers, sales reps can access information about prospects and customers and provide immediate feedback and sales reports. An ad for SalesCTRL, a sales force automation software package, boasts, "Your salesperson in St. Louis knows what Customer Service in Chicago told their customer in Atlanta this morning. Sales managers can monitor everything in their territories and get current sales forecasts anytime."

Sales force automation (SFA) software has come a long way. Earlier versions mainly helped managers track sales and marketing results or acted as glorified datebooks. Recent editions have put even more knowledge at marketers' fingertips, often through internal "push" or Web technology, so they can give prospective customers more information and keep more detailed notes. Here are three companies that are using computer technology to design fast and comprehensive sales reporting systems:

- **A , I .** Before heading out on a call, sales reps at this telecommunications equipment company use their laptop computers to dial into the company's worldwide data network. They can retrieve the latest price lists, engineering and configuration notes, status reports on previous orders, and e-mail from anywhere in the company. And when deals are struck, the laptop computers record each order, double-check the order for errors, and send it electronically to Timeplex headquarters in Woodcliff Lake, New Jersey.[5]
- **A H C** Formerly called Baxter, Alliance supplies hospital purchasing departments with computers so that the hospitals can electronically transmit orders directly to Alliance. The timely arrival of orders enables Alliance to cut inventories, improve customer service, and obtain better terms from suppliers for higher volumes. Alliance has achieved a great advantage over competitors, and its market share has soared.
- **M** In 1996, San Francisco–based Montgomery Security was in a bind. To remain competitive in the financial sector, this Nations Banks subsidiary had to find a way for more than 400 finance, research, and

sales or trading employees to share information about companies whose stock they were considering taking public. Yet all of the departments at Montgomery had different database formats for their records; some even kept files on notepads. The company solved the problem with Sales Enterprise Software from Siebel Systems. It gave Montgomery significant gains in productivity. With a common database format, everyone could share information and keep confidential information secure.[6]

The company's marketing information system should represent a cross between what managers think they need, what managers really need, and what is economically feasible. An *internal MIS committee* can interview a cross-section of marketing managers to discover their information needs. Some useful questions are:

1. What decisions do you regularly make?
2. What information do you need to make these decisions?
3. What information do you regularly get?
4. What special studies do you periodically request?
5. What information would you want that you are not getting now?
6. What information would you want daily? Weekly? Monthly? Yearly?
7. What magazines and trade reports would you like to see on a regular basis?
8. What topics would you like to be kept informed of?
9. What data analysis programs would you want?
10. What are the four most helpful improvements that could be made in the present marketing information system?

MARKETING INTELLIGENCE SYSTEM

Whereas the internal records system supplies *results data*, the marketing intelligence system supplies *happenings data*.

■ A ***marketing intelligence system*** is a set of procedures and sources used by managers to obtain everyday information about developments in the marketing environment.

Marketing managers collect marketing intelligence by reading books, newspapers, and trade publications; talking to customers, suppliers, and distributors; and meeting with other company managers. A company can take several steps to improve the quality of its marketing intelligence.

First, it can train and motivate the sales force to spot and report new developments. Sales representatives are the company's "eyes and ears"; they are positioned to pick up information missed by other means. Yet they are very busy and often fail to pass on significant information. The company must "sell" its sales force on their importance as intelligence gatherers. Sales reps should know which types of information to send to which managers. For instance, the Prentice Hall sales reps who sell this textbook let their editors know what is going on in each discipline, who is doing exciting research, and who plans to write cutting-edge textbooks.

Second, the company can motivate distributors, retailers, and other intermediaries to pass along important intelligence. Consider the following example:[7]

■ **P H C** A major fluid-power-products manufacturer, Parker Hannifin has asked each of its distributors to forward to Parker's marketing research division a copy of all invoices containing sales of its products. Parker analyzes these invoices to learn about end users and shares its findings with the distributors.

Many companies hire specialists to gather marketing intelligence. Retailers often send *mystery shoppers* to their stores to assess how employees treat customers. The city of Dallas recently hired Feedback Plus, a professional-shopper agency, to see how car-pound employees treat citizens picking up their cars. Neiman Marcus employs the same agency to shop at its 26 stores nationwide. "Those stores that consistently score high on the shopping service," says a Neiman Marcus senior VP, "not so coincidentally have the best sales." The stores will tell salespeople that they've "been shopped" and give them copies of the mystery shopper's report. Typical questions on the report are: How long before a sales associate greeted you? Did the sales associate act as if he or she wanted your business? Was the sales associate knowledgeable about products in stock?[8]

Third, companies can learn about competitors by purchasing their products; attending open houses and trade shows; reading competitors' published reports; attending stockholders' meetings; talking to employees, dealers, distributors, suppliers, and freight agents; collecting competitors' ads; and reading the *Wall Street Journal*, the *New York Times*, and trade association papers.

Fourth, the company can set up a *customer advisory panel* made up of representative customers or the company's largest customers or its most outspoken or sophisticated customers. For example, Hitachi Data Systems holds a three-day meeting with its customer panel of 20 members every 9 months. They discuss service issues, new technologies, and customers' strategic requirements. The discussion is free-flowing, and both parties gain: The company gains valuable information about customer needs; and the customers feel more bonded to a company that listens closely to their comments.[9]

Fifth, the company can purchase information from outside suppliers such as the A. C. Nielsen Company and Information Resources, Inc. (see Table 1.2, part D). These research firms gather and store consumer-panel data at a much lower cost than the company could do on its own.

Sixth, some companies have established a *marketing information center* to collect and circulate marketing intelligence. The staff scans the Internet and major publications, abstracts relevant news, and disseminates a news bulletin to marketing managers. It collects and files relevant information and assists managers in evaluating new information.

MARKETING RESEARCH SYSTEM

Marketing managers often commission formal marketing studies of specific problems and opportunities. They may request a market survey, a product-preference test, a sales forecast by region, or an advertising evaluation. We define marketing research as follows:

- ***Marketing research*** is the systematic design, collection, analysis, and reporting of data and findings relevant to a specific marketing situation facing the company.

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A company can obtain marketing research in a number of ways. Most large companies have their own marketing research departments.[10]

- **P & G** P&G assigns marketing researchers to each product operating division to conduct research for existing brands. There are two separate in-house research groups, one in charge of overall company advertising research and the other in charge of market testing. Each group's staff consists of marketing research managers, supporting specialists (survey designers, statisticians, behavioral scientists), and in-house field representatives to conduct and supervise interviewing. Each year, Procter & Gamble calls or visits over 1 million people in connection with about 1,000 research projects.

- **H -P** At HP, marketing research is handled by the Market Research & Information Center (MRIC), located at HP headquarters. The MRIC is a shared resource for all HP divisions worldwide and is divided into three

TABLE 1.2

Secondary-Data Sources

A. Internal Sources

Company profit…loss statements, balance sheets, sales figures, sales-call reports, invoices, inventory records, and prior research reports.

B. Government Publications

- *Statistical Abstract of the United States*
- *County and City Data Book*
- *Industrial Outlook*
- *Marketing Information Guide*
- Other government publications include the *Annual Survey of Manufacturers; Business Statistics; Census of Manufacturers; Census of Population; Census of Retail Trade, Wholesale Trade, and Selected Service Industries; Census of Transportation; Federal Reserve Bulletin; Monthly Labor Review; Survey of Current Business*; and *Vital Statistics Report*.

C. Periodicals and Books

- *Business Periodicals Index*
- *Standard and Poor's Industry*
- *Moody's Manuals*
- *Encyclopedia of Associations*
- Marketing journals include the *Journal of Marketing, Journal of Marketing Research*, and *Journal of Consumer Research*.
- Useful trade magazines include *Advertising Age, Chain Store Age, Progressive Grocer, Sales & Marketing Management*, and *Stores.*
- Useful general business magazines include *Business Week, Fortune, Forbes, The Economist, Inc.*, and *Harvard Business Review.*

D. Commercial Data

- *Nielsen Company*: Data on products and brands sold through retail outlets (Retail Index Services), supermarket scanner data (Scantrack), data on television audiences (Media Research Services), magazine circulation data (Neodata Services, Inc.), and others.
- *MRCA Information Services*: Data on weekly family purchases of consumer products (National Consumer Panel) and data on home food consumption (National Menu Census).
- *Information Resources, Inc.*: Supermarket scanner data (InfoScan) and data on the impact of supermarket promotions (PromotioScan).
- *SAMI/Burke*: Reports on warehouse withdrawals to food stores in selected market areas (SAMI reports) and supermarket scanner data (Samscam).
- *Simmons Market Research Bureau* (MRB Group): Annual reports covering television markets, sporting goods, and proprietary drugs, with demographic data by sex, income, age, and brand preferences (selective markets and media reaching them).
- Other commercial research houses selling data to subscribers include the *Audit Bureau of Circulation; Arbitron, Audits and Surveys; Dun & Bradstreet; National Family Opinion; Standard Rate & Data Service*; and *Starch.*

groups. The Market Information Center provides background information on industries, markets, and competitors using syndicated and other information services. Decision Support Teams provide research consulting services. Regional Satellites in specific locales worldwide support regional HP initiatives.[11]

Small companies can hire the services of a marketing research firm or conduct research in creative and affordable ways, such as:

- *Engaging students or professors to design and carry out projects:* One Boston University MBA project helped American Express develop a successful advertising campaign geared toward young professionals. The cost: $15,000.

- *Using the Internet:* A company can collect considerable information at very little cost by examining competitors' Web sites, monitoring chat rooms, and accessing published data.
- *Checking out rivals:* Many small companies routinely visit their competitors. Tom Coohill, a chef who owns two Atlanta restaurants, gives managers a food allowance to dine out and bring back ideas. Atlanta jeweler Frank Maier Jr., who often visits out-of-town rivals, spotted and copied a dramatic way of lighting displays.[12]

Companies normally budget marketing research at 1 percent to 2 percent of company sales. A large percentage is spent buying the services of outside firms. Marketing research firms fall into three categories:

- *Syndicated-service research firms:* These firms gather consumer and trade information, which they sell for a fee. Examples: Nielsen Media Research, SAMI/Burke.
- *Custom marketing research firms:* These firms are hired to carry out specific projects. They design the study and report the findings.
- *Specialty-line marketing research firms:* These firms provide specialized research services. The best example is the field-service firm, which sells field interviewing services to other firms.

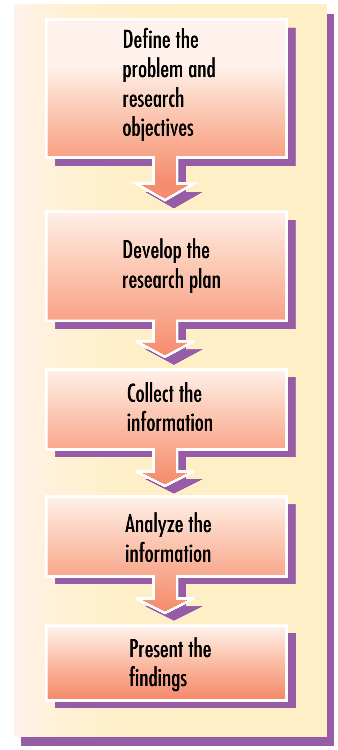

FIGURE 1-11

The Marketing Research Process

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Effective marketing research involves the five steps shown in Figure 1-11. We will illustrate these steps with the following situation:

> *American Airlines is constantly looking for new ways to serve its passengers. One manager came up with the idea of offering phone service. The other managers got excited about this idea. The marketing manager volunteered to do some preliminary research. He contacted a major telecommunications company to find out the cost of providing this service on B747 coast-to-coast flights. The telecommunications company said that the equipment would cost the airline about $1,000 a flight. The airline could break even if it charged $25 a phone call and at least 40 passengers made calls during the flight. The marketing manager then asked the company's marketing research manager to find out how air travelers would respond to this new service.*

Step 1: Define the Problem and Research Objectives

Management must not define a problem too broadly or too narrowly. A marketing manager who tells the marketing researcher, "Find out everything you can about air travelers' needs," will collect a lot of unnecessary information. Similarly, a marketing manager who says, "Find out if enough passengers aboard a B747 flying between the East Coast and West Coast would be willing to pay $25 to make a phone call so that American Airlines would break even on the cost of offering this service," is taking too narrow a view of the problem. To get the information she needs, the marketing researcher could say: "Why does a call have to be priced at $25? Why does American have to break even on the cost of the service? The new service might attract enough new passengers to American so that even if they don't make enough phone calls, American will make money out of attracting new passengers."

In discussing the problem, American's managers discovered another issue. If the new service were successful, how fast could other airlines copy it? Airline marketing competition is replete with examples of new services that were so quickly copied by competitors that no airline gained a competitive advantage. How important is it to be first and how long could the lead be sustained?

The marketing manager and marketing researcher agreed to define the problem as follows: "Will offering an in-flight phone service create enough incremental preference and profit for American Airlines to justify its cost against other possible investments American might make?" They then agreed on the following specific research objectives:

1. What are the main reasons that airline passengers place phone calls while flying?
2. What kinds of passengers would be the most likely to make calls?
3. How many passengers are likely to make calls, given different price levels?
4. How many extra passengers might choose American because of this new service?
5. How much long-term goodwill will this service add to American Airlines' image?
6. How important is phone service relative to improving other factors such as flight schedules, food quality, and baggage handling?

Not all research projects can be this specific. Some research is *exploratory*—its goal is to shed light on the real nature of the problem and to suggest possible solutions or new ideas. Some research is *descriptive*—it seeks to ascertain certain magnitudes, such as how many people would make an in-flight phone call at $25 a call. Some research is *causal*—its purpose is to test a cause-and-effect relationship. For example, would passengers make more calls if the phone were located next to their seat rather than in the aisle near the lavatory?

MARKETING memo

Secondary Sources of Data On-Line

The number of on-line government and business information sources is truly overwhelming. Here is a sample of several that should prove useful when conducting on-line market research, and many offer information for free or a reasonable fee. Note that because the Web is changing at such a rapid rate, the addresses may change.

Associations

- American Marketing Association (www.ama.org/hmpage.htm)
- The American Society of Association Executives (www.asaenet.org)
- CommerceNet—industry association for Internet commerce (www.commerce.net)
- Gale's Encyclopedia of Associations (www.gale.com)

Business Information

- A Business Compass (ABC)—selectively describes and links to key business sites on the Web (www.abcompass.com)
- A Business Researcher's Interests—provides links to business directories, media sites, marketing-related resources, and much more (www.brint.com)
- Bloomberg Personal—timely news and financial services (www.bloomberg.com)
- C/Net—journalistic coverage of high technology, computers, and the Internet (www.cnet.com)
- Company Link—free basic directory data, press releases, stock prices, and SEC data on 45,000 U.S. firms and more information available to subscribers (www.companylink.com)
- EDGAR—public company financial filings (www.sec.gov/edgarhp.htm)
- Hoover's—directory of company information (www.hoovers.com)

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Step 2: Develop the Research Plan

The second stage of marketing research calls for developing the most efficient plan for gathering the needed information. The marketing manager needs to know the cost of the research plan before approving it. Suppose the company estimates that launching the in-flight phone service would yield a long-term profit of $50,000. The manager believes that doing the research would lead to an improved pricing and promotional plan and a long-term profit of $90,000. In this case, the manager should be willing to spend up to $40,000 on this research. If the research would cost more than $40,000, it is not worth doing.[13] Designing a research plan calls for decisions on the *data sources*, *research approaches*, *research instruments*, *sampling plan*, and *contact methods*.

Data Sources. The researcher can gather secondary data, primary data, or both. *Secondary data* are data that were collected for another purpose and already exist somewhere. *Primary data* are data gathered for a specific purpose or for a specific research project.

Researchers usually start their investigation by examining secondary data to see whether their problem can be partly or wholly solved without collecting costly primary data. (Table 1.2 shows the rich variety of secondary-data sources available in the United States.)[14] Secondary data provide a starting point for research and offer the advantages of low cost and ready availability.

The Internet, or more particularly, the World Wide Web, is now the greatest repository of information the world has seen. In an incredibly short span of time, the Web has become a key tool for sales and marketing professionals to access competitive information or conduct demographic, industry, or customer research. See the Marketing Memo "Secondary Sources of Data On-line" for a minidirectory of sites where you can conduct free or at least inexpensive market research.

When the needed data do not exist or are dated, inaccurate, incomplete, or unreliable, the researcher will have to collect primary data. Most marketing research projects involve some primary-data collection. The normal procedure is to interview some people individually or in groups to get a sense of how people feel about the topic in question and then develop a formal research instrument, debug it, and carry it into the field.

When stored and used properly, the data collected in the field can form the backbone of later marketing campaigns. Direct marketers such as record clubs, credit-card companies, and catalog houses have long understood the power of database marketing.

- A ***customer*** or ***prospect database*** is an organized collection of comprehensive data about individual customers, prospects, or suspects that is current, accessible, and actionable for marketing purposes such as lead generation, lead qualification, sale of a product or service, or maintenance of customer relationships.

Some techniques that are becoming increasingly popular are data warehousing and data mining—but they are not without risks. See the Marketing for the Millennium box, "Companies Turn to Data Warehousing and Data Mining: Exercise Care."

Research Approaches. Primary data can be collected in five ways: observation, focus groups, surveys, behavioral data, and experiments.

- *Observational research:* Fresh data can be gathered by observing the relevant actors and settings. The American Airlines researchers might meander around airports, airline offices, and travel agencies to hear how travelers talk about the different carriers. The researchers can fly on American and competitors' planes to observe the quality of in-flight service. This exploratory research might yield some useful hypotheses about how travelers choose air carriers.
- *Focus-group research:* A *focus group* is a gathering of six to ten people who are invited to spend a few hours with a skilled moderator to discuss a product, service, organization, or other marketing entity. The moderator needs to be objective, knowledgeable on the issue, and skilled in group dynamics. Participants are normally paid a small sum for attending. The meeting is typically held in pleasant surroundings and refreshments are served.

  In the American Airlines research, the moderator might start with a broad question, such as "How do you feel about air travel?" Questions then move to how people regard the different airlines, different services, and in-flight telephone service. The moderator encourages free and easy discussion, hoping that the group dynamics will reveal deep feelings and thoughts. At the same time, the moderator "focuses" the discussion. The discussion, recorded through note taking or on audiotape or videotape, is subsequently studied to understand consumer beliefs, attitudes, and behavior.

  Focus-group research is a useful exploratory step. Consumer-goods companies have been using focus groups for many years, and an increasing number of newspapers, law firms, hospitals and public-service organizations are discovering

(continued)

- National Trade Data Bank—free access to over 18,000 market research reports analyzing trends and competition in scores of industries and for hundreds of products (www.stat-usa.gov)
- Public Register's Annual Report Service—allows searches of 3,200 public companies by company name or industry and offers annual reports via e-mail (www.prars.com/index.html)
- Quote.Com—access to a wide range of business wires, companies' directories, and stock quotes (www.quote.com)

Government Information

- Census Bureau (www.census.gov)
- FedWorld—a clearinghouse for over 100 federal government agencies (www.fedworld.gov)
- Thomas—indexes federal government sites (thomas.loc.gov)
- Trade/Exporting/business:Stat-USA (www.stat-usa.gov)
- US Business Advisor (www.business.gov)

International Information

- CIA World Factbook—a comprehensive statistical and demographic directory covering 264 countries around the world (www.odic.gov/cia/publications)
- The Electronic Embassy (www.embassy.org)
- I-Trade—free and fee-based information services for firms wishing to do business internationally (www.i-trade.com)
- The United Nations (www.un.org)

Sources: Based on information from Robert I. Berkman, *Find It Fast: How to Uncover Expert Information on Any Subject in Print or Online* (New York: HarperCollins, 1997); Christine Galea, "Surf City: The Best Places for Business on the Web," *Sales & Marketing Management*, January 1997, pp. 69–73; David Curle, "Out-of-the-Way Sources of Market Research on the Web," *Online*, January–February 1998, pp. 63–68. See also Jan Davis Tudor, "Brewing Up: A Web Approach to Industry Research," *Online*, July–August 1996, p. 12.

MARKETING FOR MILLENNIUM

C D D M :E C

Companies are using data mining, a set of methods that extracts patterns from large masses of data organized in what is called a *data warehouse*. Banks and credit-card companies, telephone companies, catalog marketers, and many other companies have a great deal of information about their customers, including not only their addresses but also their transactions and enhanced data on age, family size, income, and other demographic information. By carefully mining this data, a company could benefit in several ways:

- Knowing which customers may be ready for a product upgrade offer
- Knowing which customers might buy other products of the company
- Knowing which customers would make the best prospects for a special offer
- Knowing which customers have the most lifetime value and giving them more attention and perks
- Knowing which customers might tend to exit and taking steps to prevent this

Some observers believe that a proprietary database can provide a company with a significant competitive advantage. It•s no wonder that at a secret location in Phoenix, security guards watch over American Express•s 500 billion bytes of data on how its customers have used the company•s 35 million green, gold, and platinum charge cards. Amex uses the database to include precisely targeted offers in its monthly mailing of millions of customer bills.

Here are some examples of the uses of database marketing:

- MCI Communications Corporation, the long-distance carrier, sifts through 1 trillion bytes of customer phoning data to craft new discount calling plans for different types of customers.[a]
- Marriott•s Vacation Club International has managed to reduce its volume of mail and yet increase its response rate by developing a model showing which customers in its database are most likely to respond to specific vacation offerings.
- Tesco, the British supermarket chain, notifies different groups, such as wine buyers or cheese buyers, when there will be a special sale of wine or cheese.
- Lands• End can tell which of its 2 million customers should receive special mailings of specific clothing items that would fit their wardrobe needs.

These benefits don•t come without heavy cost, not only in collecting the original customer data but also in maintaining it and mining it. Yet when it works, it yields more than it costs. A 1996 study by DWI estimated that the average return on investment for a data warehouse over the course of three years is more than 400 percent. The data has to be in good condition, and the discovered relationships must be valid. Mistakes are always possible: British Columbia Telecom wanted to invite 100 of its best customers to a Vancouver Grizzlies basketball game and selected customers who were heavy 900-number users. The invitations were already at the printer when the marketing staff discovered that heavy 900-number users included sex-line enthusiasts. They quickly added other criteria to mine for a new list of guests.

[a]John Verity, •A Trillion-Byte Weapon,Ž *Business Week,* July 31, 1995, pp. 80…81.

Sources: Peter R. Peacock, •Data Mining in Marketing: Part 1,Ž *Marketing Management*, Winter l998, pp. 9…18, and •Data Mining in Marketing: Part 2,Ž *Marketing Management*, Spring l998, pp. 15…25; Ginger Conlon, •What the !@#!*?!! Is a Data Warehouse?Ž *Sales & Marketing Management*, April 1997, pp. 41…48; Skip Press, •Fool•s Gold? As Companies Rush to Mine Data, They May Dig Up Real Gems„or False Trends,Ž *Sales & Marketing Management*, April 1997, pp. 58, 60, 62.

their value. However, researchers must avoid generalizing the reported feelings of the focus-group participants to the whole market, because the sample size is too small and the sample is not drawn randomly.[15]

With the development of the World Wide Web, many companies are now conducting on-line focus groups:[16]

Janice Gjersten of WPStudio, an on-line entertainment company, found that on-line focus-group respondents could be much more honest than those in her traditional in-person focus groups. Gjersten contacted Cyber Dialogue, which provided focus-group respondents drawn from its 10,000-person database. The focus group was held in a chat room that Gjersten "looked in on" from her office computer. Gjersten could interrupt the moderator at any time with flash e-mails unseen by the respondents. Although the on-line focus group lacked voice and body cues, Gjersten says she will never conduct a traditional focus group again. Not only were respondents more honest, but the cost for the on-line group was one third that of a traditional focus group, and a full report came to her in one day, compared to four weeks.

- *Survey research:* Surveys are best suited for descriptive research. Companies undertake surveys to learn about people's knowledge, beliefs, preferences, and satisfaction, and to measure these magnitudes in the general population. American Airlines researchers might want to survey how many people know American, have flown it, prefer it, and would like telephone availability.
- *Behavioral data:* Customers leave traces of their purchasing behavior in store scanning data, catalog purchase records, and customer databases. Much can be learned by analyzing this data. Customers' actual purchases reflect revealed preferences and often are more reliable than statements they offer to market researchers. People often report preferences for popular brands, and yet the data show them actually buying other brands. For example, grocery shopping data show that high-income people do not necessarily buy the more expensive brands, contrary to what they might state in interviews; and many low-income people buy some expensive brands. Clearly American Airlines can learn many useful things about its passengers by analyzing ticket purchase records.
- *Experimental research:* The most scientifically valid research is experimental research. The purpose of experimental research is to capture cause-and-effect relationships by eliminating competing explanations of the observed findings. To the extent that the design and execution of the experiment eliminate alternative hypotheses that might explain the results, the research and marketing managers can have confidence in the conclusions. It calls for selecting matched groups of subjects, subjecting them to different treatments, controlling extraneous variables, and checking whether observed response differences are statistically significant. To the extent that extraneous factors are eliminated or controlled, the observed effects can be related to the variations in the treatments.

American Airlines might introduce in-flight phone service on one of its regular flights from New York to Los Angeles at a price of $25 a phone call. On the same flight the following day, it announces the availability of this service at $15 a phone call. If the plane carried the same number and type of passengers on each flight, and the day of the week made no difference, any significant difference in the number of calls made could be related to the price charged. The experimental design could be elaborated further by trying other prices, replicating the same prices on a number of flights, and including other air routes in the experiment.

TABLE 1.3

Types of Questions

A. Closed-end Questions

Name	Description	Example
Dichotomous	A question with two possible answers.	In arranging this trip, did you personally phone American? Yes No
Multiple choice	A question with three or more answers.	With whom are you traveling on this flight? ☐ No one ☐ Spouse ☐ Spouse and children ☐ Children only ☐ Business associates/friends/relatives ☐ An organized tour group
Likert scale	A statement with which the respondent shows the amount of agreement/disagreement.	Small airlines generally give better service than large ones. Strongly disagree 1__ / Disagree 2__ / Neither agree nor disagree 3__ / Agree 4__ / Strongly agree 5__
Semantic differential	A scale connecting two bipolar words. The respondent selects the point that represents his or her opinion.	American Airlines Large __ __ __ __ __ __ __ Small Experienced __ __ __ __ __ __ __ Inexperienced Modern __ __ __ __ __ __ __ Old-fashioned
Importance scale	A scale that rates the importance of some attribute.	Airline food service to me is Extremely important 1___ / Very important 2___ / Somewhat important 3___ / Not very important 4___ / Not at all important 5___
Rating scale	A scale that rates some attribute from •poorŽ to •excellent.Ž	American•s food service is Excellent 1___ / Very Good 2___ / Good 3___ / Fair 4___ / Poor 5___
Intention-to-buy scale	A scale that describes the respondent•s intention to buy.	If an in-flight telephone were available on a long flight, I would Definitely buy 1___ / Probably buy 2___ / Not sure 3___ / Probably not buy 4___ / Definitely not buy 5___

(continued)

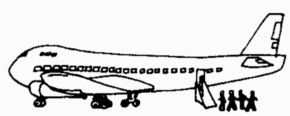
Research Instruments. Marketing researchers have a choice of two main research instruments in collecting primary data: questionnaires and mechanical devices.

- *Questionnaires:* A questionnaire consists of a set of questions presented to respondents for their answers. Because of its flexibility, the questionnaire is by far the most common instrument used to collect primary data. Questionnaires need to be carefully developed, tested, and debugged before they are administered on a large scale.

  In preparing a questionnaire, the professional marketing researcher carefully chooses the questions and their form, wording, and sequence. The form of the question asked can influence the response. Marketing researchers distinguish between closed-end and open-end questions. *Closed-end questions* prespecify all the possible answers. *Open-end questions* allow respondents to answer in their own words. Closed-end questions provide answers that are easier to interpret and tabulate. Open-end questions often reveal more because they do not constrain respondents' answers. Open-end questions are especially useful in exploratory research, where the researcher is looking for insight into how people think rather than in measuring how many people think a certain way. Table 1.3 provides examples of both types of questions.

TABLE 1.3 *(continued)*

Types of Questions

B. Open-end Questions		
Name	**Description**	**Example**
Completely unstructured	A question that respondents can answer in an almost unlimited number of ways.	What is your opinion of American Airlines?
Word association	Words are presented, one at a time, and respondents mention the first word that comes to mind.	What is the first word that comes to your mind when you hear the following? Airline ___________________________ American ___________________________ Travel ___________________________
Sentence completion	An incomplete sentence is presented and respondents complete the sentence.	When I choose an airline, the most important consideration in my decision is ________________________________
Story completion	An incomplete story is presented, and respondents are asked to complete it.	•I flew American a few days ago. I noticed that the exterior and interior of the plane had very bright colors. This aroused in me the following thoughts and feelings . . Now complete the story.Ž
Picture	A picture of two characters is presented, with one making a statement. Respondents are asked to identify with the other and fill in the empty balloon.	
Thematic Apperception Test (TAT)	A picture is presented and respondents are asked to make up a story about what they think is happening or may happen in the picture.	

Finally, the questionnaire designer should exercise care in the wording and sequencing of questions. The questionnaire should use simple, direct, unbiased wording and should be pretested with a sample of respondents before it is used. The lead question should attempt to create interest. Difficult or personal questions should be asked toward the end so that respondents do not become defensive early. Finally, the questions should flow in a logical order.

- *Mechanical Instruments:* Mechanical devices are occasionally used in marketing research. Galvanometers measure the interest or emotions aroused by exposure to a specific ad or picture. The tachistoscope flashes an ad to a subject with an exposure interval that may range from less than one hundredth of a second to several seconds. After each exposure, the respondent describes everything he or she recalls. Eye cameras study respondents' eye movements to see where their eyes land first, how long they linger on a given item, and so on. An audiometer is attached to television sets in participating homes to record when the set is on and to which channel it is tuned.[17]

Sampling Plan. After deciding on the research approach and instruments, the marketing researcher must design a sampling plan. This plan calls for three decisions:

1. *Sampling unit*: *Who is to be surveyed*? The marketing researcher must define the target population that will be sampled. In the American Airlines survey, should the sampling unit be business travelers, vacation travelers, or both? Should travelers under age 21 be interviewed? Should both husbands and wives be interviewed? Once the sampling unit is determined, a sampling

frame must be developed so that everyone in the target population has an equal or known chance of being sampled.

2. *Sample size*: *How many people should be surveyed?* Large samples give more reliable results than small samples. However, it is not necessary to sample the entire target population or even a substantial portion to achieve reliable results. Samples of less than 1 percent of a population can often provide good reliability, given a credible sampling procedure.
3. *Sampling procedure*: *How should the respondents be chosen?* To obtain a representative sample, a probability sample of the population should be drawn. *Probability sampling* allows the calculation of confidence limits for sampling error. Thus one could conclude after the sample is taken that "the interval 5 to 7 trips per year has 95 chances in 100 of containing the true number of trips taken annually by air travelers in the Southwest." Three types of probability sampling are described in Table 4.3, part A. When the cost or time involved in probability sampling is too high, marketing researchers will take nonprobability samples. Table 4.3, part B, describes three types of *nonprobability sampling*. Some marketing researchers feel that nonprobability samples are very useful in many circumstances, even though they do not allow sampling error to be measured.

Contact Methods. Once the sampling plan has been determined, the marketing researcher must decide how the subject should be contacted: mail, telephone, personal, or on-line interviews.

The *mail questionnaire* is the best way to reach people who would not give personal interviews or whose responses might be biased or distorted by the interviewers. Mail questionnaires require simple and clearly worded questions. Unfortunately, the response rate is usually low or slow. *Telephone interviewing* is the best method for gathering information quickly; the interviewer is also able to clarify questions if respondents do not understand them. The response rate is typically higher than in the case of mailed questionnaires. The main drawback is that the interviews have to be short and not too personal. Telephone interviewing is getting more difficult because of answering machines and people becoming suspicious of telemarketing.

Personal interviewing is the most versatile method. The interviewer can ask more questions and record additional observations about the respondent, such as dress and body language. Personal interviewing is the most expensive method and requires more administrative planning and supervision than the other three. It is also subject to interviewer bias or distortion. Personal interviewing takes two forms. In *arranged interviews*, respondents are contacted for an appointment. Often a small payment or incentive is offered. *Intercept interviews* involve stopping people at a shopping mall or busy street corner and requesting an interview. Intercept interviews have the draw-

TABLE 1.4

Probability and Nonprobability Samples

A. Probability Sample	
Simple random sample	Every member of the population has an equal chance of selection.
Stratified random sample	The population is divided into mutually exclusive groups (such as age groups), and random samples are drawn from each group.
Cluster (area) sample	The population is divided into mutually exclusive groups (such as city blocks), and the researcher draws a sample of the groups to interview.
B. Nonprobability Sample	
Convenience sample	The researcher selects the most accessible population members.
Judgment sample	The researcher selects population members who are good prospects for accurate information.
Quota sample	The researcher finds and interviews a prescribed number of people in each of several categories.

back of being nonprobability samples, and the interviews must not require too much time.

There is increased use of *on-line interviewing*. A company can include a questionnaire at its Web page and offer an incentive to answer the questionnaire. Or it can place a banner on some frequently visited site inviting people to answer some questions and possibly win a prize. Or the company can enter a target chat room and seek volunteers for a survey. In collecting data on-line, however, the company must recognize the data's limitations. The company cannot assume that the data are representative of a target population, because the respondents are self-selected. People in the target market who do not use the Internet or who don't want to answer a questionnaire can bias the results. Still the information can be useful for exploratory research in suggesting hypotheses that might be investigated in a more scientific subsequent survey.

Many companies are now using automated telephone surveys to solicit market research information. MetroHealth Systems in Cleveland used to have a dismal return rate of 50 percent on its paper patient-satisfaction surveys. Then the company teamed up with Sprint Healthcare systems of Overland Park, Kansas, to deliver an interactive phone survey. Under the pilot project, patients who left the hospital received a phone card with a toll-free number. When they dialed, a recording asked them several questions about their hospital experience. Results that once took months to sort now came back in a few days, and more patients completed the survey.[18]

And how do you provide incentives for customers to answer your automated survey? One popular approach is to use prepaid phone cards as an incentive. A survey is programmed into an interactive call system that not only administers the survey but also sorts the results virtually any way the client wants them. Then the client distributes the calling cards to its selected market segment. When the call users place their free calls, a voice prompt asks them if they would like to gain additional minutes by taking a short survey. NBC, Coca-Cola, and Amoco are some of the companies that have used prepaid phone cards to survey their customers.[19]

Step 3: Collect the Information

The data collection phase of marketing research is generally the most expensive and the most prone to error. In the case of surveys, four major problems arise. Some respondents will not be at home and must be recontacted or replaced. Other respondents will refuse to cooperate. Still others will give biased or dishonest answers. Finally, some interviewers will be biased or dishonest.

Yet data collection methods are rapidly improving thanks to computers and telecommunications. Some research firms interview from a centralized location. Professional interviewers sit in booths and draw telephone numbers at random. When the phone is answered, the interviewer reads a set of questions from a monitor and types the respondents' answers into a computer. This procedure eliminates editing and coding, reduces errors, saves time, and produces all the required statistics. Other research firms have set up interactive terminals in shopping centers. Persons willing to be interviewed sit at a terminal, read the questions from the monitor, and type in their answers. Most respondents enjoy this form of "robot" interviewing.[20]

Several recent technical advances have permitted marketers to research the sales impact of ads and sales promotion. Information Resources, Inc. recruits a panel of supermarkets equipped with scanners and electronic cash registers. Scanners read the universal product code on each product purchased, recording the brand, size, and price for inventory and ordering purposes. Meanwhile, the firm has recruited a panel of these stores' customers who have agreed to charge their purchases with a special Shopper's Hotline ID card, which holds information about household characteristics, lifestyle, and income. These same customers have also agreed to let their television-viewing habits be monitored by a black box. All consumer panelists receive their programs through cable television, and Information Resources controls the advertising messages being sent to their houses. The firm can then capture through store purchases which ads led to more purchasing and by which customers.[21]

Step 4: Analyze the Information

The next-to-last step in the marketing research process is to extract findings from the collected data. The researcher tabulates the data and develops frequency distributions. Averages and measures of dispersion are computed for the major variables. The researcher will also apply some advanced statistical techniques and decision models in the hope of discovering additional findings. (Techniques and models are described later.)

Step 5: Present the Findings

As the last step, the researcher presents the findings to the relevant parties. The researcher should present major findings that are relevant to the major marketing decisions facing management.

The main survey findings for the American Airlines case show that:

1. The chief reasons for using in-flight phone service are emergencies, urgent business deals, and mix-ups in flight times. Making phone calls to pass the time would be rare. Most of the calls would be made by businesspeople on expense accounts.
2. About 20 passengers out of every 200 would make in-flight phone calls at a price of $25 a call; about 40 would make calls at $15. Thus a charge of $15 would produce more revenue (40 × $15 = $600) than $25 (20 × $25 = $500). Still, this is far below the in-flight break-even cost of $1,000.
3. The promotion of in-flight phone service would win American about two extra passengers on each flight. The net revenue from these two extra passengers would be about $400, and the airline would be able to break even.
4. Offering in-flight service would strengthen the public's image of American Airlines as an innovative and progressive airline. American would break even and gain some new passengers and customer goodwill.

TABLE 1.5

The Seven Characteristics of Good Marketing Research

1. *Scientific method:*	Effective marketing research uses the principles of the scientific method: careful observation, formulation of hypotheses, prediction, and testing.
2. *Research creativity:*	At its best, marketing research develops innovative ways to solve a problem: a clothing company catering to teenagers gave several young men video cameras, then used the videos for focus groups held in restaurants and other places teens frequent.
3. *Multiple methods:*	Good marketing researchers shy away from overreliance on any one method. They also recognize the value of using two or three methods to increase confidence in the results.
4. *Interdependence of models and data:*	Good marketing researchers recognize that data are interpreted from underlying models that guide the type of information sought.
5. *Value and cost of information:*	Good marketing researchers show concern for estimating the value of information against its cost. Costs are typically easy to determine, but the value of research is harder to quantify. It depends on the reliability and validity of the findings and management•s willingness to accept and act on those findings.
6. *Healthy skepticism:*	Good marketing researchers show a healthy skepticism toward glib assumptions made by managers about how a market works. They are alert to the problems caused by •marketing myths.Ž
7. *Ethical marketing:*	Good marketing research benefits both the sponsoring company and its customers. The misuse of marketing research can harm or annoy consumers. Increasing resentment at what consumers regard as an invasion of their privacy or a sales pitch has become a major problem for the research industry.

MARKETING INSIGHT

M C C M

Kevin Clancy and Robert Shulman charge that too many companies build their marketing plans on •marketing myths.Ž Webster•s dictionary defines a myth as •an ill-founded belief held uncritically, especially by an interested group.Ž Clancy and Shulman list the following myths that have led marketing managers down the wrong path:

1. *A brand's best prospects are the heavy buyers in the category*. Although most companies pursue heavy buyers, these people may not be the best target of marketing efforts. Many heavy users are highly committed to specific competitors, and those who are not are often willing to switch products when a competitor offers them a better deal.
2. *The more appealing a new product is, the more likely it will be a success*. This philosophy can lead the company to give away too much to the customer and result in lower profitability.
3. *The effectiveness of advertising is revealed by how memorable and persuasive it is*. Actually, the best ads, when measured by recall and persuasion scores, are not necessarily the most effective ads. A much better predictor of an ad•s effectiveness is the buyer•s attitude toward the advertising„specifically, whether the buyer feels he or she received useful information and whether the buyer liked the advertising.
4. *A company is wise to spend the major portion of its research budget on focus groups and qualitative research*. Focus groups and qualitative research are useful but the major part of the research budget should be spent on quantitative research and surveys.

Some marketers will undoubtedly present counterexamples where these •mythsŽ have actually yielded positive results. Nevertheless, the authors deserve credit for forcing marketers to rethink their basic assumptions.

Source: Kevin J. Clancy and Robert S. Shulman, *The Marketing Revolution: A Radical Manifesto for Dominating the Marketplace* (New York: HarperBusiness, 1991).

Of course, these findings could suffer from a variety of errors, and management may want to study the issues further. (See Table 1.5 and the Marketing Insight box, "Marketing Researchers Challenge Conventional Marketing Wisdom."). But American could now have more confidence in launching the telephone service.

O E COMING BA IE O HE E OF MA KE ING E EA CH

In spite of the rapid growth of marketing research, many companies still fail to use it sufficiently or correctly, for several reasons:

- *A narrow conception of marketing research:* Many managers see marketing research as a fact-finding operation. They expect the researcher to design a questionnaire, choose a sample, conduct interviews, and report results, often without a careful definition of the problem or of the decision alternatives facing management. When fact-finding fails to be useful, management's idea of the limited usefulness of marketing research is reinforced.
- *Uneven caliber of marketing researchers:* Some managers view marketing research as little more than a clerical activity and reward it as such. Less competent marketing researchers are hired, and their weak training and deficient creativity lead to unimpressive results. The disappointing results reinforce management's prejudice against marketing research. Management continues to pay low salaries to its market researchers, thus perpetuating the basic problem.
- *Late and occasionally erroneous findings by marketing research:* Managers want quick results that are accurate and conclusive. Yet good marketing research takes time and money. Managers are disappointed when marketing research costs too much or takes too much time. They also point to well-known cases where the marketing research predicted the wrong result, as when Coca-Cola introduced the New Coke.
- *Personality and presentational differences:* Differences between the styles of line managers and marketing researchers often get in the way of productive relationships. To a manager who wants concreteness, simplicity, and certainty, a

marketing researcher's report may seem abstract, complicated, and tentative. Yet in the more progressive companies, marketing researchers are increasingly being included as members of the product management team, and their influence on marketing strategy is growing.

MARKETING DECISION SUPPORT SYSTEM

A growing number of organizations are using a marketing decision support system to help their marketing managers make better decisions. Little defines an MDSS as follows:

- A ***marketing decision support system (MDSS)*** is a coordinated collection of data, systems, tools, and techniques with supporting software and hardware by which an organization gathers and interprets relevant information from business and environment and turns it into a basis for marketing action.[22]

Table 1.6 describes the major statistical tools, models, and optimization routines that comprise a modern MDSS. Lilien and Rangaswamy recently published *Marketing Engineering: Computer-Assisted Marketing Analysis and Planning,* which provides a package of widely used modeling software tools.[23]

The April 13, 1998, issue of *Marketing News* lists over 100 current marketing and sales software programs that assist in designing marketing research studies, segmenting markets, setting prices and advertising budgets, analyzing media, and planning sales force activity. Here are examples of decision models that have been used by marketing managers:

BRANDAID: A flexible marketing-mix model focused on consumer packaged goods whose elements are a manufacturer, competitors, retailers, consumers, and the general environment. The model contains submodels for advertising, pricing, and competition. The model is calibrated with a creative blending of judgment, historical analysis, tracking, field experimentation, and adaptive control.[24]

CALLPLAN: A model to help salespeople determine the number of calls to make per period to each prospect and current client. The model takes into account travel time as well as selling time. The model was tested at United Airlines with an experimental group that managed to increase its sales over a matched control group by 8 percentage points.[25]

DETAILER: A model to help salespeople determine which customers to call on and which products to represent on each call. This model was largely developed for pharmaceutical detail people calling on physicians where they could represent no more than three products on a call. In two applications, the model yielded strong profit improvements.[26]

GEOLINE: A model for designing sales and service territories that satisfies three principles: the territories equalize sales workloads; each territory consists of adjacent areas; and the territories are compact. Several successful applications were reported.[27]

MEDIAC: A model to help an advertiser buy media for a year. The media planning model includes market-segment delineation, sales potential estimation, diminishing marginal returns, forgetting, timing issues, and competitor media schedules.[28]

Some models now claim to duplicate the way expert marketers normally make their decisions. Some recent expert system models include:

PROMOTER evaluates sales promotions by determining baseline sales (what sales would have been without promotion) and measuring the increase over baseline associated with the promotion.[29]

ADCAD recommends the type of ad (humorous, slice of life, and so on) to use given the marketing goals, product characteristics, target market, and competitive situation.[30]

TABLE 1.6

Quantitative Tools Used in Marketing Decision Support Systems

Statistical Tools	
1. *Multiple regression:*	A statistical technique for estimating a •best fittingŽ equation showing how the value of a dependent variable varies with changing values in a number of independent variables. *Example*: A company can estimate how unit sales are influenced by changes in the level of company advertising expenditures, sales force size, and price.
2. *Discriminant analysis:*	A statistical technique for classifying an object or persons into two or more categories. *Example*: A large retail chain store can determine the variables that discriminate between successful and unsuccessful store locations.[a]
3. *Factor analysis:*	A statistical technique used to determine the few underlying dimensions of a larger set of intercorrelated variables. *Example*: A broadcast network can reduce a large set of TV programs down to a small set of basic program types.[b]
4. *Cluster analysis:*	A statistical technique for separating objects into a specified number of mutually exclusive groups such that the groups are relatively homogeneous. *Example*: A marketing researcher might want to classify a set of cities into four distinct groups.
5. *Conjoint analysis:*	A statistical technique whereby respondents• ranked preferences for different offers are decomposed to determine the person•s inferred utility function for each attribute and the relative importance of each attribute. *Example:* An airline can determine the total utility delivered by different combinations of passenger services.
6. *Multidimensional scaling:*	A variety of techniques for producing perceptual maps of competitive products or brands. Objects are represented as points in a multidimensional space of attributes where their distance from one another is a measure of dissimilarity. *Example*: A computer manufacturer wants to see where his brand is positioned in relation to competitive brands.
Models	
1. *Markov-process model:*	This model shows the probability of moving from a current state to any future state. *Example*: A branded packaged-goods manufacturer can determine the period-to-period switching and staying rates for her brand and, if the probabilities are stable, the brand•s ultimate brand share.
2. *Queuing model:*	This model shows the waiting times and queue lengths that can be expected in any system, given the arrival and service times and the number of service channels. *Example*: A supermarket can use the model to predict queue lengths at different times of the day given the number of service channels and service speed.
3. *New-product pretest models:*	This model involves estimating functional relations between buyer states of awareness, trial, and repurchase based on consumer preferences and actions in a pretest situation of the marketing offer and campaign. Among the well-known models are ASSESSOR, COMP, DEMON, NEWS, and SPRINTER.[c]
4. *Sales-response models:*	This is a set of models that estimate functional relations between one or more marketing variables„such as sales force size, advertising expenditure, sales-promotion expenditure, and so forth„ and the resulting demand level.
Optimization Routines	
1. *Differential calculus:*	This technique allows finding the maximum or minimum value along a well-behaved function.

(continued)

TABLE 1.6 *(cont.)*

Quantitative Tools Used in Marketing Decision Support Systems

2. *Mathematical programming:*	This technique allows finding the values that would optimize some objective function that is subject to a set of constraints.
3. *Statistical decision theory:*	This technique allows determining the course of action that produces the maximum expected value.
4. *Game theory:*	This technique allows determining the course of action that will minimize the decision maker•s maximum loss in the face of the uncertain behavior of one or more competitors.
5. *Heuristics:*	This involves using a set of rules of thumb that shorten the time or work required to find a reasonably good solution in a complex system.

[a] S. Sands, •Store Site Selection by Discriminant Analysis,Ž *Journal of the Market Research Society*, 1981, pp. 40…51.
[b] V. R. Rao, •Taxonomy of Television Programs Based on Viewing Behavior,Ž *Journal of Marketing Research*, August 1975, pp. 355…58.
[c] See Kevin J. Clancy, Robert Shulman, and Marianne Wolf, *Simulated Test Marketing* (New York: Lexington Books, 1994).

COVERSTORY examines a mass of syndicated sales data and writes an English-language memo reporting the highlights.[31]

The first decade of the twenty-first century will undoubtedly usher in further software programs and decision models.

A N OVERVIEW OF FORECASTING AND DEMAND MEASUREMENT

One major reason for undertaking marketing research is to identify market opportunities. Once the research is complete, the company must measure and forecast the size, growth, and profit potential of each market opportunity. Sales forecasts are used by finance to raise the needed cash for investment and operations; by the manufacturing department to establish capacity and output levels; by purchasing to acquire the right amount of supplies; and by human resources to hire the needed number of workers. Marketing is responsible for preparing the sales forecasts. If its forecast is far off the mark, the company will be saddled with excess inventory or have inadequate inventory.

Sales forecasts are based on estimates of demand. Managers need to define what they mean by market demand.

HE MEA E OF MA KE DEMAND

Companies can prepare as many as 90 different types of demand estimates (see Figure 1-12. Demand can be measured for six different *product levels*, five different *space levels*, and three different *time levels*.

Each demand measure serves a specific purpose. A company might forecast short-run demand for a particular product for the purpose of ordering raw materials, planning production, and borrowing cash. It might forecast regional demand for its major product line to decide whether to set up regional distribution.

HICH MA KE O MEA E?

Marketers talk about potential markets, available markets, served markets, and penetrated markets. Let us start with the definition of market:

- A ***market*** is the set of all actual and potential buyers of a market offer.

The size of a market hinges on the number of buyers who might exist for a particular market offer. The *potential market* is the set of consumers who profess a sufficient level of interest in a market offer.

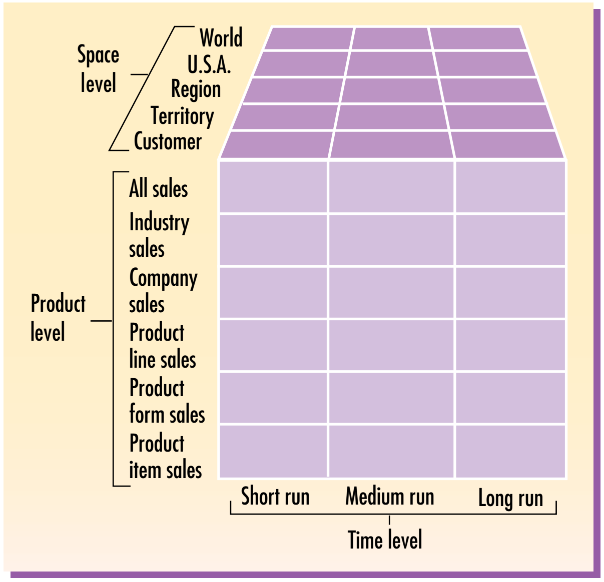


FIGURE 1-12

Ninety Types of Demand Measurement (6 × 5 × 3)

Consumer interest is not enough to define a market. Potential consumers must have enough income and must have access to the product offer. The *available market* is the set of consumers who have interest, income, and access to a particular offer.

For some market offers, the company or government may restrict sales to certain groups. For example, a particular state might ban motorcycle sales to anyone under 21 years of age. The eligible adults constitute the *qualified available market*—the set of consumers who have interest, income, access, and qualifications for the particular market offer.

A company can go after the whole available market or concentrate on certain segments. The *target market* (also called the *served market*) is the part of the qualified available market the company decides to pursue. The company, for example, might decide to concentrate its marketing and distribution effort on the East Coast.

The company will end up selling to a certain number of buyers in its target market. The *penetrated market* is the set of consumers who are buying the company's product.

These market definitions are a useful tool for market planning. If the company is not satisfied with its current sales, it can take a number of actions. It can try to attract a larger percentage of buyers from its target market. It can lower the qualifications of potential buyers. It can expand its available market by opening distribution elsewhere or lowering its price. Ultimately, the company can try to expand the potential market by advertising the product to less interested consumers or ones not previously targeted.

Some retailers have been successful at retargeting their market with new ad campaigns. Consider the case of Target Stores.

- Facing stiff competition from top retailers Wal-Mart and Kmart, Target Stores decided to reach more affluent shoppers and woo them away from department stores. The midwestern discount retailer ran an unusual advertising campaign in some unusual spots: the Sunday magazines of the *New York Times*, the *Los Angeles Times*, and the *San Francisco Examiner*. One ad showed a woman riding a vacuum cleaner through the night sky. The ad simply said "Fashion and Housewares" with the Target logo in the lower right-hand corner. With the look of department store ads, these hip spots have now gained Target Stores a reputation as the "upstairs" mass retailer. It's the place where folks who normally shop in a department store wouldn't feel they were slumming by purchasing clothing along with staples like housewares, both at good prices.[32]

A OCAB LA FO DEMAND MEA EMEN

The major concepts in demand measurement are *market demand* and *company demand*. Within each, we distinguish among a demand function, a sales forecast, and a potential.

Market Demand

As we've seen, the marketer's first step in evaluating marketing opportunities is to estimate total market demand.

- ***Market demand*** for a product is the total volume that would be bought by a defined customer group in a defined geographical area in a defined time period in a defined marketing environment under a defined marketing program.

Market demand is not a fixed number but rather a function of the stated conditions. For this reason, it can be called the *market demand function*. The dependence of total market demand on underlying conditions is illustrated in Figure 1-13. The horizontal axis shows different possible levels of industry marketing expenditure in a given time period. The vertical axis shows the resulting demand level. The curve represents the estimated market demand associated with varying levels of industry marketing expenditure. Some base sales (called the *market minimum,* labeled Q_1 in the figure) would take place without any demand-stimulating expenditures. Higher levels of industry marketing expenditures would yield higher levels of demand, first at an increasing rate, then at a decreasing rate. Marketing expenditures beyond a certain level would not stimulate much further demand, thus suggesting an upper limit to market demand called the *market potential* (labeled Q_2 in the figure).

The distance between the market minimum and the market potential shows the overall *marketing sensitivity of demand*. We can think of two extreme types of markets, the expansible and the nonexpansible. An *expansible* market, such as the market for racquetball playing, is very much affected in its total size by the level of industry marketing expenditures. In terms of Figure 1-13(a), the distance between Q_1 and Q_2 is relatively large. A *nonexpansible* market—for example, the market for opera—is not much affected by the level of marketing expenditures; the distance between Q_1 and Q_2 is relatively small. Organizations selling in a nonexpansible market must accept the market's size (the level of *primary demand* for the product class) and direct their efforts to winning a larger market share for their product (the level of *selective demand* for the company's product).

It is important to emphasize that the market demand function is *not* a picture of market demand over time. Rather, the curve shows alternative current forecasts of market demand associated with alternative possible levels of industry marketing effort in the current period.

Market Forecast

Only one level of industry marketing expenditure will actually occur. The market demand corresponding to this level is called the *market forecast*.

Market Potential

The market forecast shows expected market demand, not maximum market demand. For the latter, we have to visualize the level of market demand resulting from a "very high" level of industry marketing expenditure, where further increases in marketing effort would have little effect in stimulating further demand.

- ***Market potential*** is the limit approached by market demand as industry marketing expenditures approach infinity for a given marketing environment.

The phrase "for a given market environment" is crucial. Consider the market potential for automobiles in a period of recession versus a period of prosperity. The market potential is higher during prosperity. The dependence of market potential on the environment is illustrated in Figure 1-13(b). Market analysts distinguish between the position of the market demand function and movement along it. Companies cannot do

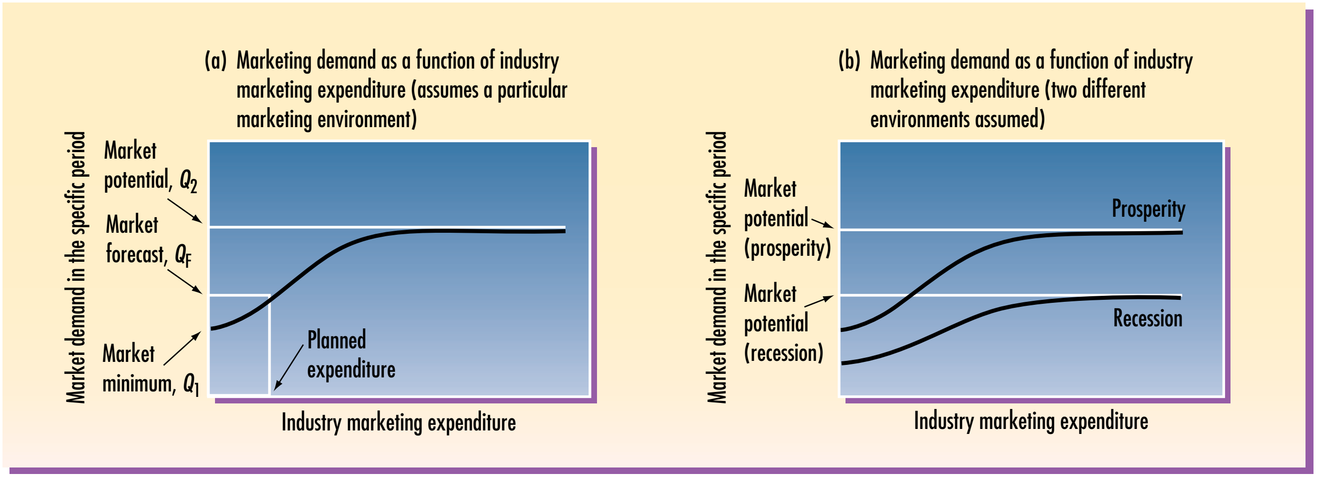


FIGURE 1-13

Market Demand Functions

anything about the position of the market demand function, which is determined by the marketing environment. However, companies influence their particular location on the function when they decide how much to spend on marketing.

Company Demand

We are now ready to define company demand.

- ***Company demand*** is the company's estimated share of market demand at alternative levels of company marketing effort in a given time period.

The company's share of market demand depends on how its products, services, prices, communications, and so on are perceived relative to the competitors'. If other things are equal, the company's market share would depend on the size and effectiveness of its market expenditures relative to competitors. Marketing model builders have developed *sales-response functions* to measure how a company's sales are affected by its marketing expenditure level, marketing mix, and marketing effectiveness.[33]

Company Sales Forecast

Once marketers have estimated company demand, their next task is to choose a level of marketing effort. The chosen level will produce an expected level of sales.

- The ***company sales forecast*** is the expected level of company sales based on a chosen marketing plan and an assumed marketing environment.

The company sales forecast is represented graphically with company sales on the vertical axis and company marketing effort on the horizontal axis, as in Figure 1-13. Too often the sequential relationship between the company forecast and the company marketing plan is confused. One frequently hears that the company should develop its marketing plan on the basis of its sales forecast. This forecast-to-plan sequence is valid if "forecast" means an estimate of national economic activity or if company demand is nonexpansible. The sequence is not valid, however, where market demand is expansible or where "forecast" means an estimate of company sales. The company sales forecast does not establish a basis for deciding what to spend on marketing. On the contrary, the sales forecast is the *result* of an assumed marketing expenditure plan.

Two other concepts are worth mentioning in relation to the company sales forecast.

- A ***sales quota*** is the sales goal set for a product line, company division, or sales representative. It is primarily a managerial device for defining and stimulating sales effort.

Management sets sales quotas on the basis of the company sales forecast and the psychology of stimulating its achievement. Generally, sales quotas are set slightly higher than estimated sales to stretch the sales force's effort.

- A ***sales budget*** is a conservative estimate of the expected volume of sales and is used primarily for making current purchasing, production, and cash-flow decisions.

The sales budget considers the sales forecast and the need to avoid excessive risk. Sales budgets are generally set slightly lower than the sales forecast.

Company Sales Potential

Company sales potential is the sales limit approached by company demand as company marketing effort increases relative to competitors. The absolute limit of company demand is, of course, the market potential. The two would be equal if the company achieved 100 percent of the market. In most cases, company sales potential is less than market potential, even when company marketing expenditures increase considerably relative to competitors'. The reason is that each competitor has a hard core of loyal buyers who are not very responsive to other companies' efforts to woo them.

E IMA ING C EN DEMAND

We are now ready to examine practical methods for estimating current market demand. Marketing executives want to estimate total market potential, area market potential, and total industry sales and market shares.

Total Market Potential

Total market potential is the maximum amount of sales that might be available to all the firms in an industry during a given period under a given level of industry marketing effort and given environmental conditions. A common way to estimate total market potential is as follows: Estimate the potential number of buyers times the average quantity purchased by a buyer times the price.

If 100 million people buy books each year, and the average book buyer buys three books a year, and the average price of a book is $10, then the total market potential for books is $3 billion (100 million × 3 × $10). The most difficult component to estimate is the number of buyers in the specific product or market. One can always start with the total population in the nation, say 261 million people. The next step is to eliminate groups that obviously would not buy the product. Let us assume that illiterate people and children under 12 do not buy books, and they constitute 20 percent of the population. This means that only 80 percent of the population, or approximately 209 million people, would be in the *suspect pool*. We might do further research and find that people of low income and low education do not read books, and they constitute over 30 percent of the suspect pool. Eliminating them, we arrive at a *prospect pool* of approximately 146.3 million book buyers. We would use this number of potential buyers to calculate total market potential.

A variation on this method is the *chain-ratio method*. It involves multiplying a base number by several adjusting percentages. Suppose a brewery is interested in estimating the market potential for a new light beer. An estimate can be made by the following calculation:[34]

Demand for the new light beer = Population × personal discretionary income per capita × average percentage of discretionary income spent on food × average percentage of amount spent on food that is spent on beverages × average percentage of amount spent on beverages that is spent on alcoholic beverages × average percentage of amount spent on alcoholic beverages that is spent on beer × expected percentage of amount spent on beer that will be spent on light beer

Area Market Potential

Companies face the problem of selecting the best territories and allocating their marketing budget optimally among these territories. Therefore, they need to estimate the market potential of different cities, states, and nations. Two major methods of assessing area market potential are available: the market-buildup method, which is used primarily by business marketers, and the multiple-factor index method, which is used primarily by consumer marketers.

Market-Buildup Method. The *market-buildup method* calls for identifying all the potential buyers in each market and estimating their potential purchases. This method produces accurate results if we have a list of all potential buyers *and* a good estimate of what each will buy. Unfortunately, this information is not always easy to gather.

Consider a machine-tool company that wants to estimate the area market potential for its wood lathe in the Boston area. Its first step is to identify all potential buyers of wood lathe in the area. The buyers consist primarily of manufacturing establishments that have to shape or ream wood as part of their operation, so the company could compile a list from a directory of all manufacturing establishments in the Boston area. Then it could estimate the number of lathes each industry might purchase based on the number of lathes per thousand employees or per $1 million of sales in that industry.

An efficient method of estimating area market potentials makes use of the *Standard Industrial Classification (SIC) System* developed by the U.S. Bureau of the Census. The SIC classifies all manufacturing into 20 major industry groups, each with a two-digit code. Thus number 25 is furniture and fixtures, and number 35 is machinery except electrical. Each major industry group is further subdivided into about 150 industry groups designated by a three-digit code (number 251 is household furniture, and number 252 is office furniture). Each industry is further subdivided into approximately 450 product categories designated by a four-digit code (number 2521 is wood office furniture, and number 2522 is metal office furniture). For each four-digit SIC number, the Census of Manufacturers provides the number of establishments subclassified by location, number of employees, annual sales, and net worth. The SIC System is currently being changed over to the new North American Industry Classification System (NAICS), which was developed by the United States, Canada, and Mexico to provide statistics that are comparable across the three countries. It includes 350 new industries, and it uses 20 instead of the SIC's 10 broad sectors of the economy, changes reflecting how the economy has changed. Industries are identified by a six-digit rather than a four-digit code, with the last digit changing depending on the country. The first information based on the new system will be published in early 1999 in the new Economic Census data.[35]

To use the SIC, the lathe manufacturer must first determine the four-digit SIC codes that represent products whose manufacturers are likely to require lathe machines. For example, lathes will be used by manufacturers in SIC number 2511 (wood household furniture), number 2521 (wood office furniture), and so on. To get a full picture of all four-digit SIC industries that might use lathes, the company can use three methods: (1) It can determine past customers' SIC codes; (2) it can go through the SIC manual and check off all the four-digit industries that, in its judgment, would have an interest in lathes; (3) it can mail questionnaires to a wide range of companies inquiring about their interest in wood lathes.

The company's next task is to determine an appropriate base for estimating the number of lathes that will be used in each industry. Suppose customer industry sales are the most appropriate base. For example, in SIC number 2511, ten lathes may be used for every $1 million worth of sales. Once the company estimates the rate of lathe ownership relative to the customer industry's sales, it can compute the market potential.

Table 1.7 shows a hypothetical computation for the Boston area involving two SIC codes. In number 2511 (wood household furniture), there are six establishments with annual sales of $1 million and two establishments with annual sales of $5 million. It is estimated that 10 lathes can be sold in this SIC code for every $1 million in customer sales. The six establishments with annual sales of $1 million account for $6 million in sales, which is a potential of 60 lathes (6×10). Altogether, it appears that the Boston area has a market potential for 200 lathes.

The company can use the same method to estimate the market potential for other

TABLE 1.7

Market-Buildup Method Using SIC Codes

SIC	(a) Annual Sales in Millions of $	(b) Number of Establish-ments	(c) Potential Number of Lathe Sales per $1 Million Customer Sales	Market Potential (a × b × c)
2511	1	6	10	60
	5	2	10	100
2521	1	3	5	15
	5	1	5	25
			30	200

areas in the country. Suppose the market potentials for all the markets add up to 2,000 lathes. This means that the Boston market contains 10 percent of the total market potential, which might warrant the company's allocating 10 percent of its marketing expenditures to the Boston market. In practice, SIC information is not enough. The lathe manufacturer also needs additional information about each market, such as the extent of market saturation, the number of competitors, the market growth rate, and the average age of existing equipment.

If the company decides to sell lathes in Boston, it must know how to identify the best-prospect companies. In the old days, sales reps called on companies door to door; this was called *bird-dogging* or *smokestacking*. Cold calls are far too costly today. The company should get a list of Boston companies and qualify them by direct mail or telemarketing to identify the best prospects. The lathe manufacturer can access *Dun's Market Identifiers*, which lists 27 key facts for over 9,300,000 business locations in the United States and Canada.

Multiple-Factor Index Method. Like business marketers, consumer companies also have to estimate area market potentials. But the customers of consumer companies are too numerous to be listed. Thus the method most commonly used in consumer markets is a straightforward index method. A drug manufacturer, for example, might assume that the market potential for drugs is directly related to population size. If the state of Virginia has 2.28 percent of the U.S. population, the company might assume that Virginia will be a market for 2.28 percent of total drugs sold.

A single factor, however, is rarely a complete indicator of sales opportunity. Regional drug sales are also influenced by per capita income and the number of physicians per 10,000 people. Thus it makes sense to develop a *multiple-factor index* with each factor assigned a specific weight.

The numbers are the weights attached to each variable. For example, suppose Virginia has 2.00 percent of the U.S. disposable personal income, 1.96 percent of U.S. retail sales, and 2.28 percent of U.S. population, and the respective weights are 0.5, 0.3, and 0.2. The buying-power index for Virginia would be

$$0.5(2.00) + 0.3(1.96) + 0.2(2.28) = 2.04$$

Thus 2.04 percent of the nation's drug sales might be expected to take place in Virginia.

The weights used in the buying-power index are somewhat arbitrary. Other weights can be assigned if appropriate. Furthermore, a manufacturer would want to adjust the market potential for additional factors, such as competitors' presence in that market, local promotional costs, seasonal factors, and local market idiosyncrasies.

Many companies compute other area indexes as a guide to allocating marketing resources. Suppose the drug company is reviewing the six cities listed in Table 1.8. The first two columns show its percentage of U.S. brand and category sales in these six cities. Column 3 shows the *brand development index (BDI)*, which is the index of brand sales to category sales. Seattle, for example, has a BDI of 114 because the brand

TABLE 1.8

Calculating the Brand Development Index (BDI)

Territory	(a) Percent of U.S. Brand Sales	(b) Percent of U.S. Category Sales	BDI (a ÷ b) × 100
Seattle	3.09	2.71	114
Portland	6.74	10.41	65
Boston	3.49	3.85	91
Toledo	.97	.81	120
Chicago	1.13	.81	140
Baltimore	3.12	3.00	104

is relatively more developed than the category in Seattle. Portland has a BDI of 65, which means that the brand in Portland is relatively underdeveloped. Normally, the lower the BDI, the higher the market opportunity, in that there is room to grow the brand. However, other marketers would argue the opposite, that marketing funds should go into the brand's strongest markets—where it might be easy to capture more brand share.[36]

After the company decides on the city-by-city allocation of its budget, it can refine each city allocation down to census tracts or zip+4 code centers. *Census tracts* are small, locally defined statistical areas in metropolitan areas and some other counties. They generally have stable boundaries and a population of about 4,000. *zip+4 code centers* (which were designed by the U.S. Post Office) are a little larger than neighborhoods. Data on population size, median family income, and other characteristics are available for these geographical units. Marketers have found these data extremely useful for identifying high-potential retail areas within large cities or for buying mailing lists to use in direct-mail campaigns.

Industry Sales and Market Shares

Besides estimating total potential and area potential, a company needs to know the actual industry sales taking place in its market. This means identifying its competitors and estimating their sales.

The industry's trade association will often collect and publish total industry sales, although it usually does not list individual company sales separately. Using this information, each company can evaluate its performance against the whole industry. Suppose a company's sales are increasing 5 percent a year, and industry sales are increasing 10 percent. This company is actually losing its relative standing in the industry.

Another way to estimate sales is to buy reports from a marketing research firm that audits total sales and brand sales. For example, Nielsen Media Research audits retail sales in various product categories in supermarkets and drugstores and sells this information to interested companies. These audits can give a company valuable information about its total product-category sales as well as brand sales. It can compare its performance to the total industry and/or any particular competitor to see whether it is gaining or losing share.

Business-goods marketers typically have a harder time estimating industry sales and market shares than consumer-goods manufacturers do. Business marketers have no Nielsens to rely on. Distributors typically will not supply information about how much of competitors' products they are selling. Business-goods marketers therefore operate with less knowledge of their market-share results.

ESTIMATING FUTURE DEMAND

We are now ready to examine methods of estimating future demand. Very few products or services lend themselves to easy forecasting. Those that do generally involve a product whose absolute level or trend is fairly constant and where competition is nonexistent (public utilities) or stable (pure oligopolies). In most markets, total demand and company demand are not stable. Good forecasting becomes a key factor in company success. The more unstable the demand, the more critical is forecast accuracy, and the more elaborate is forecasting procedure.

Companies commonly use a three-stage procedure to prepare a sales forecast. They prepare a macroeconomic forecast first, followed by an industry forecast, followed by a company sales forecast. The macroeconomic forecast calls for projecting inflation, unemployment, interest rates, consumer spending, business investment, government expenditures, net exports, and other variables. The end result is a forecast of gross national product, which is then used, along with other environmental indicators, to forecast industry sales. The company derives its sales forecast by assuming that it will win a certain market share.

How do firms develop their forecasts? Firms may do it internally or buy forecasts from outside sources such as:

- *Marketing research firms*, which develop a forecast by interviewing customers, distributors, and other knowledgeable parties.
- *Specialized forecasting firms*, which produce long-range forecasts of particular macroenvironmental components, such as population, natural resources, and technology. Some examples are Data Resources, Wharton Econometric, and Chase Econometric.
- *Futurist research firms*, which produce speculative scenarios. Some examples are the Hudson Institute, the Futures Group, and the Institute for the Future.

All forecasts are built on one of three information bases: what people say, what people do, or what people have done. The first basis—what people say—involves surveying the opinions of buyers or those close to them, such as salespeople or outside experts. It encompasses three methods: surveys of buyer's intentions, composites of sales force opinions, and expert opinion. Building a forecast on what people do involves another method, putting the product into a test market to measure buyer response. The final basis—what people have done—involves analyzing records of past buying behavior or using time-series analysis or statistical demand analysis.

Survey of Buyers' Intentions

Forecasting is the art of anticipating what buyers are likely to do under a given set of conditions. Because buyer behavior is so important, buyers should be surveyed.

In regard to major consumer durables (for example, major appliances), several research organizations conduct periodic surveys of consumer buying intentions. These organizations ask questions like the following:

Do you intend to buy an automobile within the next six months?					
0.00	0.20	0.40	0.60	0.80	1.00
No chance	Slight possibility	Fair possibility	Good possibility	High probability	Certain

This is called a *purchase probability scale*. The various surveys also inquire into consumer's present and future personal finances and their expectations about the economy. The various bits of information are then combined into a consumer sentiment measure (Survey Research Center of the University of Michigan) or a consumer confidence measure (Sindlinger and Company). Consumer durable-goods producers subscribe to these indexes in the hope of anticipating major shifts in consumer buying intentions so that they can adjust their production and marketing plans accordingly.

Some surveys measuring purchase probability are geared toward getting feedback on specific new products before they are released in the marketplace:

- **A POLL** Cincinnati-based AcuPOLL is one of the nation's biggest screeners of new products. In 1997 it sifted through more than 25,000 new items,

> picking 400 of the most innovative to test on 100 nationally representative primary grocery store shoppers. The consumers see a photo and brief description and are asked (1) whether they would buy the product and (2) whether they think it is new and different. Products deemed both unique and "buys" are dubbed "pure gold." Products that are just unique but not desired by consumers are dubbed "fool's gold." AcuPOLL's pure gold list in 1997 included "Hair-off Mittens" to remove hair from women's legs easily, Uncle Ben's Calcium Plus rice, and Shout Wipes stain treater towelettes. Fool's gold products included Juiced OJ (PLUS) Caffeine, a potent cocktail of caffeine-laced orange juice; Lumident ChewBrush, a toothbrush that can be chewed like gum; and Back to Basics, a "microbrewed" beer shampoo that starts with malted barley so you can put a "head" on your head.[37]

For business buying, various agencies carry out buyer-intention surveys regarding plant, equipment, and materials. The better-known agencies are McGraw-Hill Research and Opinion Research Corporation. Their estimates tend to fall within a 10 percent error band of the actual outcomes. Buyer-intention surveys are particularly useful in estimating demand for industrial products, consumer durables, product purchases where advanced planning is required, and new products. The value of a buyer-intention survey increases to the extent that the cost of reaching buyers is small, the buyers are few, they have clear intentions, they implement their intentions, and they willingly disclose their intentions.

Composite of Sales Force Opinions

Where buyer interviewing is impractical, the company may ask its sales representatives to estimate their future sales. Each sales representative estimates how much each current and prospective customer will buy of each of the company's products.

Few companies use their sales force's estimates without making some adjustments. Sales representatives might be pessimistic or optimistic, or they might go from one extreme to another because of a recent setback or success. Furthermore, they are often unaware of larger economic developments and do not know how their company's marketing plans will influence future sales in their territory. They might deliberately underestimate demand so that the company will set a low sales quota. Or they might lack the time to prepare careful estimates or might not consider the effort worthwhile.

To encourage better estimating, the company could supply certain aids or incentives to the sales force. For example, sales reps might receive a record of their past forecasts compared with their actual sales and also a description of company assumptions on the business outlook, competitor behavior, and marketing plans.

Involving the sales force in forecasting brings a number of benefits. Sales reps might have better insight into developing trends than any other single group. After participating in the forecasting process, sales reps might have greater confidence in their sales quotas and more incentive to achieve them.[38] Also, a "grassroots" forecasting procedure provides very detailed estimates broken down by product, territory, customer, and sales reps.

Expert Opinion

Companies can also obtain forecasts from experts, including dealers, distributors, suppliers, marketing consultants, and trade associations. Large appliance companies survey dealers periodically for their forecasts of short-term demand, as do car companies. Dealer estimates are subject to the same strengths and weaknesses as sales force estimates. Many companies buy economic and industry forecasts from well-known economic-forecasting firms. These specialists are able to prepare better economic forecasts than the company because they have more data available and more forecasting expertise.

Occasionally companies will invite a group of experts to prepare a forecast. The experts exchange views and produce a group estimate (*group-discussion methods*). Or the experts supply their estimates individually, and an analyst combines them into a single estimate (*pooling of individual estimates*). Alternatively, the experts supply individual estimates and assumptions that are reviewed by the company, then revised. Further rounds of estimating and refining follow (*Delphi method*).[39]

Past-Sales Analysis

Sales forecasts can be developed on the basis of past sales. *Time-series analysis* consists of breaking down past time series into four components (trend, cycle, seasonal, and erratic) and projecting these components into the future. *Exponential smoothing* consists of projecting the next period's sales by combining an average of past sales and the most recent sales, giving more weight to the latter. *Statistical demand analysis* consists of measuring the impact level of each of a set of causal factors (e.g., income, marketing expenditures, price) on the sales level. Finally, *econometric analysis* consists of building sets of equations that describe a system and proceeding to fit the parameters statistically.

Market-Test Method

Where buyers do not plan their purchases carefully or experts are not available or reliable, a direct market test is desirable. A direct market test is especially desirable in forecasting new-product sales or established product sales in a new distribution channel or territory.

SUMMARY

1. Three developments make the need for marketing information greater now than at any time in the past: the rise of global marketing, the new emphasis on buyers' wants, and the trend toward nonprice competition.

2. To carry out their analysis, planning, implementation, and control responsibilities, marketing managers need a *marketing information system (MIS)*. The MIS's role is to assess the managers' information needs, develop the needed information, and distribute that information in a timely manner.

3. An MIS has four components: (a) an internal records system, which includes information on the order-to-payment cycle and sales reporting systems; (b) a marketing intelligence system, a set of procedures and sources used by managers to obtain everyday information about pertinent developments in the marketing environment; (c) a marketing research system that allows for the systematic design, collection, analysis, and reporting of data and findings relevant to a specific marketing situation; and (d) a computerized marketing decision support system that helps managers interpret relevant information and turn it into a basis for marketing action.

4. Companies can conduct their own marketing research or hire other companies to do it for them. Good marketing research is characterized by the scientific method, creativity, multiple research methods, accurate model building, cost–benefit analysis, healthy skepticism, and an ethical focus.

5. The process consists of defining the problem and research objective, developing the research plan, collecting the information, analyzing the information, and presenting the findings to management. In conducting research, firms must decide whether to collect their own data or use data that already exist. They must also decide which research approach (observational, focus-group, survey, behavioral data, or experimental) and which research instrument (questionnaire or mechanical instruments) to use. In addition, they must decide on a sampling plan and contact methods.

6. One major reason for undertaking marketing research is to discover market opportunities. Once the research is complete, the company must carefully evaluate its opportunities and decide which markets to enter. Once in the market, it must prepare sales forecasts based on estimates of demand.

7. There are two types of demand: market demand and company demand. To estimate current demand, companies attempt to determine total market potential, area market potential, industry sales, and market share. To estimate future demand, companies survey buyers' intentions, solicit their sales force's input, gather expert opinions, or engage in market testing. Mathematical models, advanced statistical techniques, and computerized data collection procedures are essential to all types of demand and sales forecasting.

CONCEPTS

1. Each of the following questions appears on a paper questionnaire that respondents fill out and return to a research firm. Rephrase or reformat each question so that the respondent is more likely to provide the research firm with the information it needs.

- **a.** Which brand do you like best?
- **b.** Can you tell me how many children you have, whether they are girls or boys, and how old they are?
- **c.** How much say do you have regarding the charities that your church contributes to?
- **d.** With what frequency have you experienced this phenomenon of late?
- **e.** Are auto manufacturers making satisfactory progress in controlling auto emissions?

2. Levi Strauss's marketing team has determined that the men who buy Levi's jeans fall into five categories:

- Utilitarian jeans customer: *The Levi loyalist who wears jeans for work and play*
- Trendy casual: *High-fashion customers who come to life at night*
- Price shopper: *Buys on the basis of price at department stores and discount stores*
- Mainstream traditionalist: *Over 45 years old and shops in a department store accompanied by his wife*
- Classic independent: *Independent buyer, shops alone in specialty stores, and wants clothes that make him "look right" (the target in this case)*

The marketing team wants to develop a product for the "classic independent" segment. Should the Levi name be used on the new product? Can this product be marketed successfully through Levi's current channels of distribution? What kinds of formal market research should the company conduct to help it make a sound decision on whether to pursue this segment and how?

3. Suggest creative ways to help companies research the following issues:

- **a.** A liquor company needs to estimate liquor consumption in a legally dry town.
- **b.** A magazine distribution house wants to know how many people read a specific magazine in doctors' offices.
- **c.** A men's hair tonic producer wants to know at least four alternative ways to research how men use its products.

4. A children's toy manufacturer is developing its sales forecast for next year. The company's forecaster has estimated sales for six different environment/strategy combinations (see Table 1.9).

TABLE 1.9

Sales Forecasts

	High Marketing Budget	Medium Marketing Budget	Low Marketing Budget
Recession	15	12	10
Normal	20	16	14

The forecaster believes that there is an 0.20 probability of recession and an 0.80 probability of normal times. He also believes the probabilities of a high, medium, and low company market budget are 0.30, 0.50, and 0.20, respectively. How might the forecaster arrive at a single-point sales forecast? What assumptions are being made?

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SECTION TWO

Scanning the Marketing Environment

We focus on two questions:

- What are the key methods for tracking and identifying opportunities in the macroenvironment?
- What are the key demographic, economic, natural, technological, political, and cultural developments?

Today you have to run faster to stay in the same place.

Successful companies take an outside-inside view of their business. They recognize that the marketing environment is constantly spinning new opportunities and threats and understand the importance of continuously monitoring and adapting to that environment. One company that has continually reinvented one of its brands to keep up with the changing marketing environment is Mattel with its Barbie doll:[1]

- **M** Mattel's genius is in keeping its Barbie doll both timeless and trendy. Since Barbie's creation in 1959, the doll has filled a fundamental need that all girls share: to play a grown-up. Yet Barbie has changed as girls' dreams have changed. Her aspirations have evolved from jobs like "stewardess," "fashion model," and "nurse," to "astronaut," "rock singer," and "presidential candidate." Mattel introduces new Barbie dolls every year in order to keep up with the latest definitions of achievement, glamour, romance, adventure, and nurturing. Barbie also reflects America's diverse population. Mattel has produced African American Barbie dolls since 1968—the time of the civil rights movement—and the company has introduced Hispanic and Asian dolls as well. In recent years, Mattel has introduced the Crystal Barbie doll (a gorgeous glamour doll), Puerto Rican Barbie (part of its "dolls of the world" collection), Great Shape Barbie (to tie into the fitness craze), Flight Time Barbie (a pilot), and Troll and *Baywatch* Barbies (to tie into kids' fads and TV shows). Industry analysts estimate that two Barbie dolls are sold every second and that the average American girl owns eight versions of Barbie. Every year since 1993, sales of the perky plastic doll have exceeded $1 billion.

Many companies fail to see change as opportunity. They ignore or resist changes until it is too late. Their strategies, structures, systems, and organizational culture grow increasingly obsolete and dysfunctional. Corporations as mighty as General Motors, IBM, and Sears have passed through difficult times because they ignored macroenvironmental changes too long.

The major responsibility for identifying significant marketplace changes falls to the company's marketers. More than any other group in the company, they must be the trend trackers and opportunity seekers. Although every manager in an organization needs to observe the outside environment, marketers have two advantages: They have disciplined methods—marketing intelligence and marketing research—for collecting information about the marketing environment. They also spend more time with customers and more time watching competitors.

We examine the firm's *external environment* —the macroenvironment forces that affect it, its consumer markets, its business markets, and its competitors.

ANALYZING NEEDS AND TRENDS IN THE MACROENVIRONMENT

Successful companies recognize and respond profitably to unmet needs and trends. Companies could make a fortune if they could solve any of these problems: a cure for cancer, chemical cures for mental diseases, desalinization of seawater, nonfattening tasty nutritious food, practical electric cars, and affordable housing.

Enterprising individuals and companies manage to create new solutions to unmet needs. Club Mediterranee emerged to meet the needs of single people for exotic vacations; the Walkman and CD Man were created for active people who wanted to listen to music; Nautilus was created for men and women who wanted to tone their bodies; Federal Express was created to meet the need for next-day mail delivery.

Many opportunities are found by identifying *trends*.

- A ***trend*** is a direction or sequence of events that have some momentum and durability.

One major trend is the increasing participation of women in the workforce, which has spawned the child day-care business, increased consumption of microwavable foods, and office-oriented women's clothing.

- **K** More and more workplaces and child-care centers are installing monitoring setups such as the "I See You" equipment from Simplex Knowledge in White Plains, New York. Not created to monitor child-care providers, the system allows parents to see their children at different points throughout the day. Via still photos taken by a camera in the child-care center and posted on a secure Web site on the Internet, working parents who long to spend more time with their young ones get reassuring glimpses throughout the day.[2]

- Although shopping malls are in decline, there's been a boom in niche malls that cater to the needs of working women. Shops at Somerset Square in Glastonbury, Connecticut, is one such open-air shopping center. It features a customized retail mix of specialty shops, targeted promotions, and phone-in shopping, in which shoppers phone ahead with sizes and color preferences while store employees perform a "wardrobing" service. Many of the stores also informally extend hours for working women who find time to shop only before or after work.[3]

We can draw distinctions among fads, trends, and megatrends. A *fad* is "unpredictable, short-lived, and without social, economic, and political significance."[4] A company can cash in on a fad such as Pet Rocks or Cabbage Patch dolls, but this is more a matter of luck and good timing than anything else.

Trends are more predictable and durable. A trend reveals the shape of the future. According to futurist Faith Popcorn, a trend has longevity, is observable across several market areas and consumer activities, and is consistent with other significant indicators occurring or emerging at the same time.[5] (See the Marketing Insight "Faith Popcorn Points to 16 Trends in the Economy.")

John Naisbitt, another futurist, prefers to talk about *megatrends*, which are "large social, economic, political and technological changes [that] are slow to form, and once in place, they influence us for some time—between seven and ten years, or longer."[6] Naisbitt and his staff spot megatrends by counting the number of times hard-news items on different topics appear in major newspapers. The 10 megatrends Naisbitt has identified are:

1. The booming global economy
2. A renaissance in the arts
3. The emergence of free-market socialism
4. Global lifestyles and cultural nationalism
5. The privatization of the welfare state
6. The rise of the Pacific Rim
7. The decade of women in leadership
8. The age of biology
9. The religious revival of the new millennium
10. The triumph of the individual

Trends and megatrends merit marketers' close attention. A new product or marketing program is likely to be more successful if it is in line with strong trends rather than opposed to them. But detecting a new market opportunity does not guarantee its success, even if it is technically feasible. For example, today some companies have created portable "electronic books" in which different book disks can be inserted for reading. But there may not be a sufficient number of people interested in reading a book on a computer screen or willing to pay the required price. This is why market research is necessary to determine an opportunity's profit potential.

MARKETING INSIGHT

F P P 16 E

Famous trend-watcher Faith Popcorn runs BrainReserve, a marketing consulting firm that monitors cultural trends and advises companies such as AT&T, Black & Decker, Hoffman-LaRoche, Nissan, Rubbermaid, and many more. Popcorn and her associates have identified 16 major cultural trends affecting the U.S. economy. How many of these trends have you noticed in your own life?

1. *Anchoring:* The tendency to use ancient practices as anchors or support for modern lifestyles. This trend explains the widespread popularity of aromatherapy, meditation, yoga, and Eastern religions.
2. *Being alive:* The desire to lead longer and more enjoyable lives. Vegetarianism, low-tech medicine, meditation, and other life extenders and enhancers are part of this trend. Marketers can capitalize on the trend by designing healthier products and services.
3. *Cashing out:* The desire for a simpler, less hectic lifestyle, as when an executive suddenly quits a high-profile career, escapes the hassles of big-city life, and turns up in Vermont running a bed-and-breakfast. The trend is marked by a nostalgic return to small-town values.
4. *Clanning:* The growing need to join up with and belong to groups in order to confront a more chaotic world. Marketers are responding with products, services, and programs that help make consumers feel a part of something; for example, Harley-Davidson•s Harley Owners Group (HOG).
5. *Cocooning:* The impulse to stay inside when the going outside gets too tough and scary. People are turning their homes into nests: redecorating, watching TV and rental movies, ordering from catalogs, and using answering machines to filter out the outside world. Socialized cocoons gather inside for conversation or a •salon.Ž Wandering cocoons are people who hole up in their cars with take-out foods and their car phones.
6. *Down-aging:* The tendency for older people to act and feel younger than their age. They spend more on youthful clothes and hair coloring, and they engage in more playful behavior, such as buying adult toys, attending adult camps, or signing up for adventure vacations.
7. *Egonomics:* The wish to individualize oneself through possessions and experience. Egonomics gives marketers an opportunity to succeed by offering customized goods, services, and experiences.
8. *Fantasy adventure:* The need to find emotional escapes to offset daily routines. People following this trend seek safari vacations or eat exotic foods. For marketers, this is an opportunity to create fantasy products and services. The trend will certainly feed the growth of virtual reality throughout the first decade of the new millennium.
9. *Female think:* The recognition that men and women act and think differently. A strong indicator of female think is the popularity of books such as *Men Are from Mars, Women Are from Venus*. Because relationships are powerful motivators for women, for example, Saturn Car Company has created strong relationships with its customers, many of whom are women.

(continued)

IDENTIFYING AND RESPONDING TO THE MAJOR MACROENVIRONMENT FORCES

Companies and their suppliers, marketing intermediaries, customers, competitors, and publics all operate in a macroenvironment of forces and trends that shape opportunities and pose threats. These forces represent “noncontrollables,” which the company must monitor and respond to. In the economic arena, companies and consumers are increasingly affected by global forces. These include:

- The substantial speedup of international transportation, communication, and financial transactions, leading to the rapid growth of world trade and investment, especially tripolar trade (North America, Western Europe, Far East).
- The rising economic power of several Asian countries in world markets.
- The rise of trade blocs such as the European Union and the NAFTA signatories.
- The severe debt problems of a number of countries, along with the increasing fragility of the international financial system.
- The increasing use of barter and countertrade to support international transactions.
- The move toward market economies in formerly socialist countries along with rapid privatization of publicly owned companies.
- The rapid dissemination of global lifestyles.

(continued)

10. *Icon toppling:* The idea that •if it•s big, it•s bad.Ž Marketers are responding by finding ways to think, act, and look smaller. An example is Miller•s Plank Road Brewery beer, which has the look and feel of today•s popular microbrewery beverages.

11. *Mancipation:* The emancipation of men from stereotypical male roles. Men are no longer required to be macho, distant, and strong. This trend is revealed in ads featuring men as nurturing dads and concerned husbands.

12. *99 lives:* The attempt to relieve time pressures by doing many things at once. People become adept at •multitasking,Ž doing many tasks at once, such as talking on a portable phone while surfing the Internet. Marketers can cash in on the 99 lives trend by creating cluster marketing enterprises„all-in-one service stops.

13. *Pleasure revenge:* The proud and public pursuit of pleasure as a rebellion against self-control and deprivation. Fed up with the health kick of the early 1990s, people are consuming more red meat, fats, and sugars and turning away from health-food alternatives.

14. *S.O.S. (save our society):* The desire to make society more socially responsible with respect to education, ethics, and the environment. The best response for marketers is to urge their own companies to practice more socially responsible marketing.

15. *Small indulgences:* A penchant to indulge in small-scale splurges to obtain an occasional emotional lift. A consumer might eat healthy all week, and then splurge on a pint of superpremium Häagen-Dazs ice cream on the weekend, or might brown bag it for lunch but buy an expensive Starbucks latte and pastries for breakfast.

16. *The vigilant consumer:* Intolerance for shoddy products and poor service. Vigilant consumers want companies to be more aware and responsive, so they act up, boycott, write letters, and buy •green products.Ž

Source: This summary is drawn from various pages of Faith Popcorn•s *The Popcorn Report* (New York: HarperBusiness, 1992) and Faith Popcorn and Lys Marigold, *Clicking* (New York: HarperCollins, 1996)

- The gradual opening of major new markets, namely China, India, eastern Europe, the Arab countries, and Latin America.
- The increasing tendency of multinationals to transcend their locational and national characteristics and become transnational firms.
- The increasing number of cross-border corporate strategic alliances—for example, MCI and British Telecom, and Texas Instruments and Hitachi.
- The increasing ethnic and religious conflicts in certain countries and regions.
- The growth of global brands in autos, food, clothing, electronics, and so on.

- **C -P** Colgate-Palmolive test-marketed Total, its antibacterial plaque-fighting toothpaste, in six countries: the Philippines, Australia, Colombia, Greece, Portugal, and the United Kingdom. The team in charge of the global launch was a veritable corporate United Nations of operations, logistics, and marketing strategists. Their efforts paid off handsomely: Total was soon a $150 million brand worldwide, selling in 75 countries, with virtually identical packaging, positioning, and advertising (Figure 2-1).[7]

Within the rapidly changing global picture, the firm must monitor six major forces: demographic, economic, natural, technological, political-legal, and social-cultural. Although these forces will be described separately, marketers must pay attention to their causal interactions, because these set the stage for new opportunities as well as threats. For example, explosive population growth (demographic) leads to more resource depletion and pollution (natural environment), which leads consumers to call for more laws (political-legal). The restrictions stimulate new technological solutions and products (technology), which if they are affordable (economic forces) may actually change attitudes and behavior (social-cultural).

DEMOG APHIC EN I ONMEN

The first macroenvironmental force that marketers monitor is population because people make up markets. Marketers are keenly interested in the size and growth rate of population in different cities, regions, and nations; age distribution and ethnic mix; educational levels; household patterns; and regional characteristics and movements.

Worldwide Population Growth

The world population is showing "explosive" growth. It totaled 5.4 billion in 1991 and is growing at 1.7 percent per year. At this rate, the world's population will reach 6.2 billion by the year 2000.[8]

The world population explosion has been a source of major concern, for two reasons. The first is the fact that certain resources needed to support this much human life (fuel, foods, and minerals) are limited and may run out at some point. First published in 1972, *The Limits to Growth* presented an impressive array of evidence that unchecked population growth and consumption would eventually result in insufficient food supply, depletion of key minerals, overcrowding, pollution, and an overall deterioration in the quality of life.[9] One of the study's strong recommendations is the worldwide social marketing of family planning.[10]

The second cause for concern is that population growth is highest in countries and communities that can least afford it. The less developed regions of the world currently account for 76 percent of the world population and are growing at 2 percent per year, whereas the population in the more developed countries is growing at only 0.6 percent per year. In the developing countries, the death rate has been falling as a result of modern medicine, but the birthrate has remained fairly stable. Feeding, clothing, and educating their children while also providing a rising standard of living is nearly impossible in these countries.

The explosive world population growth has major implications for business. A growing population does not mean growing markets unless these markets have sufficient purchasing power. Nonetheless, companies that carefully analyze their markets can find major opportunities. For example, to curb its skyrocketing population, the Chinese government has passed regulations limiting families to one child per family. Toy marketers, in particular, are paying attention to one consequence of these regulations: These children are spoiled and fussed over as never before. Known in China as "little emperors," Chinese children are being showered with everything from candy to computers as a result of what's known as the "six pocket syndrome." As many as six adults—parents, grandparents, great-grandparents, and aunts and uncles—may be indulging the whims of each child. This trend has encouraged such companies as Japan's Bandai Company (famous for its Mighty Morphin' Power Rangers), Denmark's Lego Group, and Mattel to enter the Chinese market.[11]

Population Age Mix

National populations vary in their age mix. At one extreme is Mexico, a country with a very young population and rapid population growth. At the other extreme is Japan, a country with one of the world's oldest populations. Milk, diapers, school supplies, and toys would be important products in Mexico. Japan's population would consume many more adult products.

A population can be subdivided into six age groups: preschool, school-age children, teens, young adults age 25 to 40, middle-aged adults age 40 to 65, and older adults age 65 and up. For marketers, the most populous age groups shape the marketing environment. In the United States, the "baby boomers," the 78 million people born between 1946 and 1964, are one of the most powerful forces shaping the marketplace. Baby boomers are fixated on their youth, not their age, and ads geared to them tend to capitalize on nostalgia for their past, such as those for the newly redesigned Volkswagen Beetle or the Mercedes-Benz ad featuring the rock music of Janis Joplin. Boomers grew up with TV advertising, so they are an easier market to reach than the 45 million born between 1965 and 1976, dubbed Generation X (and also the shadow generation, twentysomethings, and baby busters). Gen-Xers are typically cynical about hard-sell marketing pitches that promise more than they can deliver. Ads created to woo this market often puzzle older people, because they often don't seem to "sell" at all:[12]

- **M B C** Instead of the usual macho men, scantily clad women, beauty shots of beer and mountain vistas, Miller's new beer ads targeted to 21- to 27-year-olds feature the on-screen legend "It's time to embrace your inner idiot" and images of a frenetic, sloppy hot-dog eating contest.[13]
- **D J** Diesel jeans ads revolve around a celebration of the bizarre, and they playfully poke fun at mainstream situations. Called "Reasons for Living," the ads reverse our code of ethics with images like one of humans serving a roasted girl to pigs sitting at a dining table laden with exotic foods.[14]

Finally, both baby boomers and Gen-Xers will be passing the torch to the latest demographic group, the baby boomlet, born between 1977 and 1994. Now numbering 72 million, this group is almost equal in size to baby boomers. One distinguishing characteristic of this age group is their utter fluency and comfort with computer and Internet technology. Douglas Tapscott has christened them Net-Gens for this reason. He says: "To them, digital technology is no more intimidating than a VCR or a toaster." See the Marketing Memo "Tapping into the Internet Generation."[15]

But do marketers have to create separate ads for each generation? J. Walker Smith, co-author of *Rocking the Ages: The Yankelovich Report on Generational Marketing*, says that marketers do have to be careful about turning off one generation each time they craft a message that appeals effectively to another. "I think the idea is to try to be broadly inclusive and at the same time offer each generation something specifically designed for it. Tommy Hilfiger has big brand logos on his clothes for teenagers and little pocket polo logos on his shirts for baby boomers. It's a brand that has a more inclusive than exclusive strategy."[16]

MARKETING *memo*

Tapping into the Internet Generation

Net-Gens already influence adult purchases more than any preceding generation. The Alliance for Converging Technologies estimates that American preteens and teens spend $130 billion of their own dollars annually and influence upward of $500 billion of their parents' spending. How do you market to this group? Don Tapscott, author of *Growing Up Digital: The Rise of the Net Generation* (www.growingupdigital.com), advises marketers to keep five things in mind:

1. Options are a must—choice is one of their most deeply held values.
2. Customize to meet their needs. These are the kids who build their own levels in video games and write their own Web pages, and they want things their way.
3. Let them have the option of changing their minds. They're growing up in a world where fixing mistakes takes a stroke of the mouse, and they believe that changing their minds should be equally painless.
4. Let them try before they buy. They're users and doers. They reject expert opinions in favor of forming their own.
5. Never forget that they will choose function over form. "Unlike baby boomers, who witnessed the technological revolution," Tapscott says, "N-Geners have no awe of new technology. They have grown up with computers and treat them like any other household appliance. This is an audience that cares about what the technology will do, not the technology itself."

Source: Excerpted from Lisa Krakowka, "In the Net," *American Demographics*, August 1998, p. 56.

Ethnic Markets

Countries also vary in ethnic and racial makeup. At one extreme is Japan, where almost everyone is Japanese; at the other is the United States, where people from come virtually all nations. The United States was originally called a "melting pot," but there are increasing signs that the melting didn't occur. Now people call the United States a "salad bowl" society with ethnic groups maintaining their ethnic differences, neighborhoods, and cultures. The U.S. population (267 million in 1997) is 73 percent white. African Americans constitute another 13 percent, and Latinos another 10 percent. The Latino population has been growing fast, with the largest subgroups of Mexican (5.4 percent), Puerto Rican (1.1 percent), and Cuban (0.4 percent) descent. Asian Americans constitute 3.4 percent of the U.S. population, with the Chinese constituting the largest group, followed by the Filipinos, Japanese, Asian Indians, and Koreans, in that order. Latino and Asian American consumers are concentrated in the far western and southern parts of the country, although some dispersal is taking place. Moreover, there are nearly 25 million people living in the United States—more than 9 percent of the population—who were born in another country.

Each group has certain specific wants and buying habits. Several food, clothing, and furniture companies have directed their products and promotions to one or more of these groups.[17] For instance, Sears is taking note of the preferences of different ethnic groups:

- If a Sears, Roebuck and Company store has a shopping base that is at least 20 percent Latino, it is designated as a Hispanic store for the purpose of Sears's Hispanic marketing program. More than 130 stores in southern California, Texas, Florida, and New York have earned this label. "We make a special effort to staff those stores with bilingual sales personnel, to use bilingual signage, and to support community programs," says a Sears spokesperson. Choosing merchandise for the Latino marketplace is primarily a color and size issue. "What we find in Hispanic communities is that people tend to be smaller than the general market, and that there is a greater demand for special-occasion clothing and a preference for bright colors. In hardlines, there isn't much difference from the mainstream market."

Yet marketers must be careful not to overgeneralize about ethnic groups. Within each ethnic group are consumers who are as different from each other as they are from Americans of European background. "There is really no such thing as an Asian market," says Greg Macabenta, whose ethnic advertising agency specializes in the Filipino market. Macabenta emphasizes that the five major Asian American groups have their own very specific market characteristics, speak different languages, consume different cuisines, practice different religions, and represent very distinct national cultures.[18]

Educational Groups

The population in any society falls into five educational groups: illiterates, high school dropouts, high school degrees, college degrees, and professional degrees. In Japan, 99 percent of the population is literate, whereas in the United States 10 percent to 15 percent of the population may be functionally illiterate. However, the United States has one of the world's highest percentages of college-educated citizenry, around 36 percent. The high number of educated people in the United States spells a high demand for quality books, magazines, and travel.

Household Patterns

The "traditional household" consists of a husband, wife, and children (and sometimes grandparents). Yet, in the United States today, one out of eight households are "diverse" or "nontraditional," and include single live-alones, adult live-togethers of one or both sexes, single-parent families, childless married couples, and empty nesters. More people are divorcing or separating, choosing not to marry, marrying later, or marrying without the intention to have children. Each group has a distinctive set of needs and buying habits. For example, people in the SSWD group (single, separated, widowed, divorced) need smaller apartments; inexpensive and smaller appliances, furniture, and furnishings; and food packaged in smaller sizes. Marketers must increasingly consider the special needs of nontraditional households, because they are now growing more rapidly than traditional households.

The gay market, in particular, is a lucrative one. A 1997 Simmons Market Research study of readers of the National Gay Newspaper Guild's 12 publications found that, compared to the average American, respondents are 11.7 times more likely to be in professional jobs, almost twice as likely to own a vacation home, eight times more likely to own a computer notebook, and twice as likely to own individual stocks.[19] Insurance companies and financial services companies are now waking up to the needs and potential of not only the gay market but also the nontraditional household market as a whole:

- **A E F A ,I .** Minneapolis-based American Express Financial Advisors, Inc., launched print ads that depict same-sex couples planning their financial futures. The ads ran in *Out* and *The Advocate,* the two highest-circulation national gay publications. The company's director of segment marketing, Margaret Vergeyle, said: "We're targeting gay audiences with targeted ads and promotions that are relevant to them and say that we understand their specific needs. Often, gay couples are very concerned about issues like Social Security benefits and estate planning, since same-sex marriages often are not recognized under the law."[20]

- **J H M L I C** The John Hancock Mutual Insurance Company has been focusing on single parents and working women with two series of ads on cable television channels. The company is focusing on a very specific segment of women whose financial needs happen to be even more critical because of their situation. The slogan for the ads: "Insurance for the unexpected. Investments for the opportunities."[21]

Geographical Shifts in Population

This is a period of great migratory movements between and within countries. Since the collapse of Soviet eastern Europe, nationalities are reasserting themselves and forming independent countries. The new countries are making certain ethnic groups unwelcome (such as Russians in Latvia or Muslims in Serbia), and many of these groups are migrating to safer areas. As foreign groups enter other countries for political sanctuary, some local groups start protesting. In the United States, there has been opposition to the influx of immigrants from Mexico, the Caribbean, and certain Asian nations. Yet many immigrants have done very well. Forward-looking companies and entrepreneurs are taking advantage of the growth in immigrant populations and marketing their wares specifically to these new members of the population.

- **1-800-777-CL B, I .** When they came to the United States from Taiwan in the late 1970s, brother and sister Marty and Helen Shih earned a living by selling flowers on a street corner. They now own an 800-employee telemarketing business, 1-800-777-CLUB, Inc., based in El Monte, California. That number logs about 1,200 phone calls a day from Asian immigrants seeking information in six languages: Japanese, Korean, Mandarin and Cantonese Chinese, Tagalog, and English. The callers seek advice on dealing with immigration officials, perhaps, or help in understanding an electric bill. The Shihs use those calls to add to a database of names, phone numbers, and demographic information that is then used for highly targeted telemarketing. The Shihs' great advantage is that their telemarketers talk in their native language to people who are far from assimilated. A recent Vietnamese immigrant is thrilled to pick up the phone and hear someone speaking Vietnamese. Last year, the Shihs' telemarketers sold more than $146 million worth of goods and services for companies including Sprint Corporation and DHL Worldwide Express. Their database now has around 1.5 million individual names covering a high percentage of Asian American households and 300,000 businesses.[22]

Population movement also occurs as people migrate from rural to urban areas, and then to suburban areas. The U.S. population has now undergone another shift, which demographers call "the rural rebound." Nonmetropolitan counties that lost population to cities for most of this century are now attracting large numbers of urban refugees. Between 1990 and 1995, the rural population has grown 3.1 percent as people from the city have moved to small towns.[23]

- **C O** Wanda Urbanska and her husband, Frank Levering, moved from the media grind of Los Angeles to a simpler life in Mount Airy, North Carolina (population 7,200). Urbanska's former job as a reporter for the *Los Angeles Herald Examiner* and Levering's former job as a screenwriter for B movies had taken up so much of their time and energy that they couldn't really enjoy the material gains they were making. When Levering's father had a heart attack, the couple packed up and moved to Mt. Airy to help him with his fruit orchard. They still help him run the orchard while doing freelance writing on the side, such as two books about seeking a better life: *Simple Living* and *Moving to a Small Town*.[24]

Businesses with potential to cash in on the rural rebound might be those that cater to the growing SOHO (small office–home office) segment. For instance, makers of RTA (ready to assemble) furniture might find a strong consumer base among all the cashed-out former city residents setting up offices in small towns or telecommuting from there to larger companies.

Location makes a difference in goods and service preferences. The movement to the Sunbelt states has lessened the demand for warm clothing and home heating equipment and increased the demand for air conditioning. Those who live in large cities such as New York, Chicago, and San Francisco account for most of the sales of expensive furs, perfumes, luggage, and works of art. These cities also support the opera, ballet, and other forms of culture. Americans living in the suburbs lead more casual lives, do more outdoor living, and have greater neighbor interaction, higher incomes, and younger families. Suburbanites buy vans, home workshop equipment, outdoor furniture, lawn and gardening tools, and outdoor cooking equipment. There are also regional differences: People in Seattle buy more toothbrushes per capita than people in any other U.S. city; people in Salt Lake City eat more candy bars; people from New Orleans use more ketchup; and people in Miami drink more prune juice.

Shift from a Mass Market to Micromarkets

The effect of all these changes is fragmentation of the mass market into numerous *micromarkets* differentiated by age, sex, ethnic background, education, geography, lifestyle, and other characteristics. Each group has strong preferences and is reached through increasingly targeted communication and distribution channels. Companies are abandoning the "shotgun approach" that aimed at a mythical "average" consumer and are increasingly designing their products and marketing programs for specific micromarkets.

Demographic trends are highly reliable for the short and intermediate run. There is little excuse for a company's being suddenly surprised by demographic developments. The Singer Company should have known for years that its sewing machine business would be hurt by smaller families and more working wives, yet it was slow in responding. In contrast, think of the rewards marketers reap when they focus on a demographic development. Some marketers are actively courting the home office segment of the lucrative SOHO market. Nearly 40 million Americans are working out of their homes with the help of electronic conveniences like cell phones, fax machines, and handheld organizers. One company that is shifting gears to appeal to this micromarket is Kinko's Copy Centers:

■ **K ’ C C** Founded in the 1970s as a campus photocopying business, Kinko's is now reinventing itself as the well-appointed office outside the home. Where once there were copy machines, the 902 Kinko's stores in this country and abroad now feature a uniform mixture of fax machines, ultrafast color printers, and networks of computers equipped with popular software programs and high-speed Internet connections. People can come to a Kinko's store to do all their office jobs: They can copy, send and receive faxes, use various programs on the computer, go on the Internet, order stationery and other printed supplies, and even teleconference. And as more and more people join the work-at-home trend, Kinko's is offering an escape from the isolation of the home office. Kinko's, which charges $12 an hour for computer use, is hoping to increase its share of industry revenue by getting people to spend more time—and hence, more money—at its stores. Besides adding state-of-the-art equipment, the company is talking to Starbucks about opening up coffee shops adjacent to some Kinko's. The lettering on the Kinko's door sums up the $1 billion company's new business model: "Your branch office/Open 24 hours."[25]

ECONOMIC EN I ONMEN

Markets require purchasing power as well as people. The available purchasing power in an economy depends on current income, prices, savings, debt, and credit availability. Marketers must pay close attention to major trends in income and consumer-spending patterns.

Income Distribution

Nations vary greatly in level and distribution of income and industrial structure. There are four types of industrial structures:

1. *Subsistence economies:* In a subsistence economy, the vast majority of people engage in simple agriculture, consume most of their output, and barter the rest for simple goods and services. These economies offer few opportunities for marketers.
2. *Raw-material-exporting economies:* These economies are rich in one or more natural resources but poor in other respects. Much of their revenue comes from exporting these resources. Examples are Zaire (copper) and Saudi Arabia (oil). These countries are good markets for extractive equipment, tools and

supplies, materials-handling equipment, and trucks. Depending on the number of foreign residents and wealthy native rulers and landholders, they are also a market for Western-style commodities and luxury goods.

3. *Industrializing economies:* In an industrializing economy, manufacturing begins to account for 10 percent to 20 percent of gross domestic product. Examples include India, Egypt, and the Philippines. As manufacturing increases, the country relies more on imports of raw materials, steel, and heavy machinery and less on imports of finished textiles, paper products, and processed foods. Industrialization creates a new rich class and a small but growing middle class, both demanding new types of goods.
4. *Industrial economies:* Industrial economies are major exporters of manufactured goods and investment funds. They buy manufactured goods from one another and also export them to other types of economies in exchange for raw materials and semifinished goods. The large and varied manufacturing activities of these nations and their sizable middle class make them rich markets for all sorts of goods.

Marketers often distinguish countries with five different income-distribution patterns: (1) very low incomes; (2) mostly low incomes; (3) very low, very high incomes; (4) low, medium, high incomes; and (5) mostly medium incomes. Consider the market for Lamborghinis, an automobile costing more than $150,000. The market would be very small in countries with type 1 or 2 income patterns. One of the largest single markets for Lamborghinis turns out to be Portugal (income pattern 3)—one of the poorer countries in Western Europe, but one with enough wealthy families to afford expensive cars.

Since 1980, the wealthiest fifth of the U.S. population has seen its income grow by 21 percent, while wages for the bottom 60 percent have stagnated or even dipped. According to Census Bureau statisticians, the 1990s have seen a greater polarization of income in the United States than at any point since the end of World War II. This is leading to a two-tier U.S. market, with affluent people buying expensive goods and working-class people spending more carefully, shopping at discount stores and factory outlet malls, and selecting less expensive store brands. Conventional retailers who offer medium-price goods are the most vulnerable to these changes. Companies that respond to the trend by tailoring their products and pitches to these two very different Americas stand to gain a lot:[26]

- **G** At Gap's Banana Republic stores, jeans sell for $58. Its Old Navy stores sell a version for $22. Both chains are thriving.

- **D C** The Walt Disney Company, which owns the rights to A. A. Milne's Winnie-the-Pooh and his make-believe friends, is marketing two distinct Poohs. The original line-drawn figures appear on fine china, pewter spoons, and expensive kids' stationery found in upscale specialty and department stores like Nordstrom and Bloomingdales. A plump, cartoonlike Pooh, clad in a red T-shirt and a goofy smile, adorns plastic key chains, polyester bedsheets, and animated videos. This downscaled Pooh sells at Wal-Mart and other discount stores.
- **N B A** The National Basketball Association sells front-row seats in New York's Madison Square Garden for $1,000 apiece. Yet, worried they might lose fans who can't afford the typical $200 for a family night out at a sports event, NBA marketers have launched an array of much more affordable merchandise and entertainment properties such as traveling basketball exhibitions.

Savings, Debt, and Credit Availability

Consumer expenditures are affected by consumer savings, debt, and credit availability. The Japanese, for example, save about 13.1 percent of their income, whereas U.S. consumers save about 4.7 percent. The result has been that Japanese banks were able to loan money to Japanese companies at a much lower interest rate than U.S. banks could offer to U.S. companies. Access to lower interest rates helped Japanese companies expand faster. U.S. consumers also have a high debt-to-income ratio, which slows down further expenditures on housing and large-ticket items. Credit is very available in the United States but at fairly high interest rates, especially to lower-income borrowers. Marketers must pay careful attention to major changes in incomes, cost of living, interest rates, savings, and borrowing patterns because they can have a high impact on business, especially for companies whose products have high income and price sensitivity.

NA I AL EN I ONMEN

The deterioration of the natural environment is a major global concern. In many world cities, air and water pollution have reached dangerous levels. There is great concern about certain chemicals creating a hole in the ozone layer and producing a "greenhouse effect" that will lead to dangerous warming of the earth. In Western Europe, "green" parties have vigorously pressed for public action to reduce industrial pollution. In the United States, several thought leaders have documented ecological deterioration, whereas watchdog groups such as the Sierra Club and Friends of the Earth carried these concerns into political and social action.

New legislation passed as a result has hit certain industries very hard. Steel companies and public utilities have had to invest billions of dollars in pollution-control equipment and more environmentally friendly fuels. The auto industry has had to introduce expensive emission controls in cars. The soap industry has had to increase its products' biodegradability.

Marketers need to be aware of the threats and opportunities associated with four trends in the natural environment: the shortage of raw materials, the increased cost of energy, increased pollution levels, and the changing role of governments.

Shortage of Raw Materials

The earth's raw materials consist of the infinite, the finite renewable, and the finite nonrenewable. Infinite resources, such as air and water, pose no immediate problem, although some groups see a long-run danger. Environmental groups have lobbied for a ban on certain propellants used in aerosol cans because of the potential damage they can cause to the ozone layer. Water shortages and pollution are already major problems in some parts of the world.

Finite *renewable* resources, such as forests and food, must be used wisely. Forestry companies are required to reforest timberlands in order to protect the soil and to ensure sufficient wood to meet future demand. Because the amount of arable land is fixed and urban areas are constantly encroaching on farmland, food supply can also be a major problem. Finite *nonrenewable* resources—oil, coal, platinum, zinc, silver—will pose a serious problem as the point of depletion approaches. Firms making products that require these increasingly scarce minerals face substantial cost increases. They may not find it easy to pass these cost increases on to customers. Firms engaged in research and development have an excellent opportunity to develop substitute materials.

Increased Energy Costs

One finite nonrenewable resource, oil, has created serious problems for the world economy. Oil prices shot up from $2.23 a barrel in 1970 to $34.00 a barrel in 1982, creating a frantic search for alternative energy forms. Coal became popular again, and companies searched for practical means to harness solar, nuclear, wind, and other forms of energy. In the solar energy field alone, hundreds of firms introduced first-generation products to harness solar energy for heating homes and other uses. Other firms searched for ways to make a practical electric automobile, with a potential prize of billions for the winner.

The development of alternative sources of energy and more efficient ways to use energy and the weakening of the oil cartel led to a subsequent decline in oil prices. Lower prices had an adverse effect on the oil-exploration industry but considerably improved the income of oil-using industries and consumers. In the meantime, the search continues for alternative sources of energy.

Increased Pollution Levels

Some industrial activity will inevitably damage the natural environment. Consider the dangerous mercury levels in the ocean, the quantity of DDT and other chemical pollutants in the soil and food supply, and the littering of the environment with bottles, plastics, and other packaging materials.

Research has shown that about 42 percent of U.S. consumers are willing to pay higher prices for “green” products. This willingness creates a large market for pollution-control solutions, such as scrubbers, recycling centers, and landfill systems. It leads to a search for alternative ways to produce and package goods. Smart companies are initiating environment-friendly moves to show their concern. 3M runs a Pollution Prevention Pays program that has led to a substantial reduction in pollution and costs. Dow built a new ethylene plant in Alberta that uses 40 percent less energy and releases 97 percent less wastewater. AT&T uses a special software package to choose the least harmful materials, cut hazardous waste, reduce energy use, and improve product recycling in its operations. McDonald’s and Burger King eliminated their polystyrene cartons and now use smaller, recyclable paper wrappings and paper napkins.[27]

New concern over the toxic nature of dry cleaning solvents has opened up opportunities for a new breed of “green cleaners,” although these new businesses face an uphill battle. See the Marketing for the Millennium “A New Guard of Green Cleaners Vies for Concerned Customers.”

Changing Role of Governments

Governments vary in their concern and efforts to promote a clean environment. For example, the German government is vigorous in its pursuit of environmental quality, partly because of the strong green movement in Germany and partly because of the ecological devastation in the former East Germany. Many poor nations are doing little about pollution, largely because they lack the funds or the political will. It is in the richer nations’ interest to help the poorer nations control their pollution, but even the richer nations today lack the necessary funds. The major hopes are that companies around the world will accept more social responsibility and that less expensive devices will be invented to control and reduce pollution.

ECHNOLOGICAL EN I ONMEN

One of the most dramatic forces shaping people’s lives is technology. Technology has released such wonders as penicillin, open-heart surgery, and the birth-control pill. It

MARKETING FOR MILLENNIUM

AN G G C C C

You need to get your business suit cleaned for a sales conference in Miami, and your flight leaves in 24 hours. Are you going to go to the dry cleaner on the corner, which uses environmentally damaging, possibly carcinogenic chemicals? Or are you going to go across town and use a •wet cleaner,Ž who will get your clothes clean without damaging you or the environment (and make them smell a lot less toxic, too)? If you•re like most consumers, you•ll choose convenience and the quick fix over concerns about health and environment.

Percloroethylene, or •perc,Ž the solvent used by the majority of dry cleaners, has been labeled a probable human carcinogen by the EPA. More conclusive reports on its damaging effects are expected soon. Yet when it comes to products that enhance their own or their clothing•s appearance, consumers are notably indifferent to environmental concerns. In a 1996 survey of 30 dry-cleaners in suburban Pittsburgh, Dan Kovacks asked customers what they would do if they learned dry cleaning posed a threat to their well-being. Unable to think up alternatives, most said they would just get clothes dry-cleaned less frequently.

Yet a new guard of environmentally friendly dry cleaners is willing to bet that consumers will choose green over toxic if green alternatives are readily available. There are already 6,000 dry cleaning stores using alternative cleaning materials. About 95 percent of those use odorless petroleum-based solvents, which actually get rid of stains that seemed impervious to perc. A much smaller group of stores are •wet cleaners,Ž going back to soap-and-water basics. All the alternatives„with names such as Cleaner-by-Nature, Eco-Mat, and Greener Cleaner„are price-competitive with their toxic counterparts. Cleaner-by-Nature, which opened up smack between two traditional dry cleaners in Denver, broke even only six months after opening. Its owner, Chris Comfort, plans a second store in Boulder.

Although dry cleaners are the quintessential small business, the green cleaning trend could open up opportunities for giant multinational corporations. Exxon Corporation has come up with a new petroleum solvent called DF 2000, which is widely used in Europe. Hughes Environmental Systems, a unit of Raytheon Corporation, and Global Technologies, Inc., of El Segundo, California, have teamed up to market a new method for cleaning clothes using liquid carbon dioxide. Procter & Gamble has introduced a perc-free alternative for home use, Dryel, which allows people to do their dry cleaning at home. Yet, as a testimony to the resistance faced by companies in this burgeoning product category, Procter & Gamble advertises Dryel•s convenience, not its green advantage.

Sources: Jacquelyn Ottman, •Innovative Marketers Give New Products the Green Light,Ž *Marketing News,* March 30, 1998, p. 10; Shelly Reese, •Dressed to Kill,Ž *American Demographics,* May 1998, pp. 22…25; Stacy Kravetz, •Dry Cleaners• New Wrinkle: Going Green,Ž *Wall Street Journal,* June 3, 1998, p. B1.

has released such horrors as the hydrogen bomb, nerve gas, and the submachine gun. It has also released such mixed blessings as the automobile and video games.

Every new technology is a force for "creative destruction." Transistors hurt the vacuum-tube industry, xerography hurt the carbon-paper business, autos hurt the railroads, and television hurt the newspapers. Instead of moving into the new technologies, many old industries fought or ignored them, and their businesses declined.

The economy's growth rate is affected by how many major new technologies are discovered. Unfortunately, technological discoveries do not arise evenly through time—the railroad industry created a lot of investment, and then investment petered out until the auto industry emerged. Later, radio created a lot of investment, which then petered out until television appeared. In the time between major innovations, the economy can stagnate.

In the meantime, minor innovations fill the gap: freeze-dried coffee, combination shampoo and conditioner, antiperspirant/deodorants, and the like. Minor innovations involve less risk, but critics argue that today too much research effort is going into producing minor improvements rather than major breakthroughs.

New technology creates major long-run consequences that are not always foreseeable. The contraceptive pill, for example, led to smaller families, more working wives, and larger discretionary incomes—resulting in higher expenditures on vacation travel, durable goods, and luxury items.

The marketer should monitor the following trends in technology: the pace of change, the opportunities for innovation, varying R&D budgets, and increased regulation.

Accelerating Pace of Technological Change

Many of today's common products were not available 40 years ago. John F. Kennedy did not know personal computers, digital wristwatches, video recorders, or fax machines. More ideas are being worked on; the time lag between new ideas and their successful implementation is decreasing rapidly; and the time between introduction and peak production is shortening considerably. Ninety percent of all the scientists who ever lived are alive today, and technology feeds upon itself.

The advent of personal computers and fax machines has made it possible for people to *telecommute*—that is, work at home instead of traveling to offices that may be 30 or more minutes away. Some hope that this trend will reduce auto pollution, bring the family closer together, and create more home-centered entertainment and activity. It will also have substantial impact on shopping behavior and marketing performance.

Unlimited Opportunities for Innovation

Scientists today are working on a startling range of new technologies that will revolutionize products and production processes. Some of the most exciting work is being done in biotechnology, solid-state electronics, robotics, and materials sciences.[28] Researchers are working on AIDS cures, happiness pills, painkillers, totally safe contraceptives, and nonfattening foods. They are designing robots for firefighting, underwater exploration, and home nursing. In addition, scientists also work on fantasy products, such as small flying cars, three-dimensional television, and space colonies. The challenge in each case is not only technical but also commercial—to develop affordable versions of these products.

Companies are already harnessing the power of *virtual reality (VR)*, the combination of technologies that allows users to experience three-dimensional, computer-generated environments through sound, sight, and touch. Virtual reality has already been applied to gathering consumer reactions to new automobile designs, kitchen layouts, exterior home designs, and other potential offerings.

Varying R&D Budgets

The United States leads the world in annual R&D expenditures ($74 billion), but nearly 60 percent of these funds are still earmarked for defense. There is a need to transfer more of this money into research on material science, biotechnology, and micromechanics. Japan has increased its R&D expenditures much faster than has the United States and is spending it mostly on nondefense-related research in physics, biophysics, and computer science.[29]

A growing portion of U.S. R&D expenditures is going into the development side of R&D, raising concerns about whether the United States can maintain its lead in basic science. Many companies are content to put their money into copying competitors' products and making minor feature and style improvements. Even basic-research companies such as DuPont, Bell Laboratories, and Pfizer are proceeding cautiously. Much of the research is defensive rather than offensive. And, increasingly, research directed toward major breakthroughs is being conducted by consortiums of companies rather than by single companies.

Increased Regulation of Technological Change

As products become more complex, the public needs to be assured of their safety. Consequently, government agencies' powers to investigate and ban potentially unsafe products have been expanded. In the United States, the Federal Food and Drug Administration must approve all drugs before they can be sold. Safety and health regulations have also increased in the areas of food, automobiles, clothing, electrical appliances, and construction. Marketers must be aware of these regulations when proposing, developing, and launching new products.

POLITICAL-LEGAL ENVIRONMENT

Marketing decisions are strongly affected by developments in the political and legal environment. This environment is composed of laws, government agencies, and pressure groups that influence and limit various organizations and individuals. Sometimes these laws also create new opportunities for business. For example, mandatory recycling laws have given the recycling industry a major boost and spurred the creation of dozens of new companies making new products from recycled materials:

- In 1993, Wellman introduced Ecospun Post Consumer Recycled (PCR) fiber, made from recycled soda bottles, and sold 800,000 pounds in that first year alone. Today, Wellman boasts 15 million pounds in sales and is partnering with domestic fabric mills like Milliken & Company, Malden Mills, and Dybersburg. At the outdoor Retailer Winter Market in 1998, Wellman introduced its new EcoSpun Squared fiber, which has moisture-management properties and was designed specifically for a performance-apparel market anxious to jump aboard the recycling bandwagon.

Legislation Regulating Business

Business legislation has three main purposes: to protect companies from unfair competition, to protect consumers from unfair business practices, and to protect the interests of society from unbridled business behavior. A major purpose of business legislation and enforcement is to charge businesses with the social costs created by their products or production processes. Legislation affecting business has steadily increased over the years. The European Commission has been active in establishing a new framework of laws covering competitive behavior, product standards, product liability, and commercial transactions for the 15 member nations of the European Union. Ex-Soviet nations are rapidly passing laws to promote and regulate an open market economy. The United States has many laws on its books covering such issues as competition, product safety and liability, fair trade and credit practices, and packaging and labeling.[30] Several countries have gone further than the United States in passing strong consumer-protection legislation. Norway bans several forms of sales promotion—trading stamps, contests, premiums—as inappropriate or "unfair" instruments for promoting products. Thailand requires food processors selling national brands to market low-price brands also so that low-income consumers can find economy brands. In India, food companies need special approval to launch brands that duplicate what already exists on the market, such as another cola drink or brand of rice. A central concern about business legislation is: At what point do the costs of regulation exceed the benefits? The laws are not always administered fairly; regulators and enforcers may be lax or overzealous. Although each new law may have a legitimate rationale, it may have the unintended effect of sapping initiative and retarding economic growth.

Marketers must have a good working knowledge of the major laws protecting competition, consumers, and society. Companies generally establish legal review procedures and promulgate ethical standards to guide their marketing managers. As more and more business takes place in cyberspace, marketers must establish new parameters for doing business ethically. Although America Online has been hugely successful and is the country's most popular on-line service provider, it has lost millions of dollars due to consumer complaints regarding unethical marketing tactics:

- **A O , I .** In 1998, America Online, Inc., agreed to pay a $2.6 million penalty and revamp some of its business practices to settle deceptive-marketing complaints brought by 44 state attorneys general. In this instance, AOL failed to clearly notify consumers that the "50 free hours" in its on-line service's much-touted trial memberships must be used within a one-month period and that users would incur subscription fees after the first month. This was AOL's third settlement with state regulators in less than two years. Previous settlements dealt with the company's data network congestion in early 1997 (due to a move to flat rate pricing that gave the company more subscriptions than it had equipment to handle) and efforts in late 1996 to switch customers to a higher-priced subscription plan. The three agreements not only cost the company $34 million in total but also created a barrage of negative publicity that AOL had to work hard to counter.[31]

Growth of Special-Interest Groups

The number and power of special-interest groups have increased over the past three decades. *Political-action committees* (PACs) lobby government officials and pressure business executives to pay more attention to consumer rights, women's rights, senior citizen rights, minority rights, and gay rights. Many companies have established public-affairs departments to deal with these groups and issues. An important force affecting business is the *consumerist movement*—an organized movement of citizens and government to strengthen the rights and powers of buyers in relation to sellers. Consumerists have advocated and won the right to know the true interest cost of a loan, the true cost per standard unit of competing brands (unit pricing), the basic ingredients in a product, the nutritional quality of food, the freshness of products, and the true benefits of a product. In response to consumerism, several companies have established consumer-affairs departments to help formulate policies and respond to consumer complaints. Whirlpool Corporation is just one of the companies that have installed toll-free phone numbers for consumers. Whirlpool even expanded the coverage of its product warranties and rewrote them in basic English.

Clearly, new laws and growing numbers of pressure groups have put more restraints on marketers. Marketers have to clear their plans with the company's legal, public-relations, public-affairs, and consumer-affairs departments. Insurance companies directly or indirectly affect the design of smoke detectors; scientific groups affect the design of spray products by condemning aerosols. In essence, many private marketing transactions have moved into the public domain.

OCIAL-C L AL EN I ONMEN

Society shapes our beliefs, values, and norms. People absorb, almost unconsciously, a worldview that defines their relationship to themselves, to others, to organizations, to society, to nature, and to the universe.

- *Views of themselves:* People vary in the relative emphasis they place on self-gratification. In the United States during the 1960s and 1970s, "pleasure seekers" sought fun, change, and escape. Others sought "self-realization." People bought products, brands, and services as a means of self-expression. They bought dream cars and dream vacations and spent more time in health activities (jogging, tennis), in introspection, and in arts and crafts. Today, in contrast, people are adopting more conservative behaviors and ambitions. They have witnessed harder times and cannot rely on continuous employment and rising real income. They are more cautious in their spending pattern and more value-driven in their purchases.

- *Views of others:* Some observers have pointed to a countermovement from a "me society" to a "we society." People are concerned about the homeless, crime and victims, and other social problems. They would like to live in a more humane society. At the same time, people are seeking out their "own kind" and avoiding strangers. People hunger for serious and long-lasting relationships with a few others. These trends portend a growing market for social-support products and services that promote direct relations between human beings, such as health clubs, cruises, and religious activity. They also suggest a growing market for "social surrogates," things that allow people who are alone to feel that they are not, such as television, home video games, and chat rooms on the Internet.
- *Views of organizations:* People vary in their attitudes toward corporations, government agencies, trade unions, and other organizations. Most people are willing to work for these organizations, although they may be critical of particular ones. But there has been an overall decline in organizational loyalty. The massive wave of company downsizings has bred cynicism and distrust. Many people today see work not as a source of satisfaction but as a required chore to earn money to enjoy their nonwork hours.

  This outlook has several marketing implications. Companies need to find new ways to win back consumer and employee confidence. They need to make sure that they are good corporate citizens and that their consumer messages are honest. More companies are turning to social audits and public relations to improve their image with their publics.
- *Views of society:* People vary in their attitudes toward their society. Some defend it (preservers), some run it (makers), some take what they can from it (takers), some want to change it (changers), some are looking for something deeper (seekers), and some want to leave it (escapers).[32] Often consumption patterns reflect social attitude. Makers tend to be high achievers who eat, dress, and live well. Changers usually live more frugally, driving smaller cars and wearing simpler clothes. Escapers and seekers are a major market for movies, music, surfing, and camping.
- *Views of nature:* People vary in their attitude toward nature. Some feel subjugated by it, others feel harmony with it, and still others seek mastery over it. A long-term trend has been humankind's growing mastery of nature through technology. More recently, however, people have awakened to nature's fragility and finite resources. They recognize that nature can be destroyed by human activities.

  Love of nature is leading to more camping, hiking, boating, and fishing. Business has responded with hiking boots, tenting equipment, and other gear. Tour operators are packaging more tours to wilderness areas. Marketing communicators are using more scenic backgrounds in advertising. Food producers have found growing markets for "natural" products, such as natural cereal, natural ice cream, and health foods. Two natural-food grocery stores, Whole Foods Markets and Fresh Fields, merged in 1997 with sales of $1.1 billion.
- *Views of the universe:* People vary in their beliefs about the origin of the universe and their place in it. Most Americans are monotheistic, although religious conviction and practice have been waning through the years. Church attendance has fallen steadily, with the exception of certain evangelical movements that reach out to bring people back into organized religion. Some of the religious impulse has been redirected into an interest in Eastern religions, mysticism, the occult, and the human potential movement.

As people lose their religious orientation, they seek self-fulfillment and immediate gratification. At the same time, every trend seems to breed a countertrend, as indicated by a worldwide rise in religious fundamentalism. Here are some other cultural characteristics of interest to marketers: the persistence of core cultural values, the existence of subcultures, and shifts of values through time.

High Persistence of Core Cultural Values

The people living in a particular society hold many *core beliefs* and values that tend to persist. Most Americans still believe in work, in getting married, in giving to charity, and in being honest. Core beliefs and values are passed on from parents to children and are reinforced by major social institutions—schools, churches, business, and government. *Secondary beliefs* and values are more open to change. Believing in the institution of marriage is a core belief; believing that people ought to get married early is a secondary belief. Thus family-planning marketers could make some headway arguing that people should get married later rather than that they should not get married at all. Marketers have some chance of changing secondary values but little chance of changing core values. For instance, the nonprofit organization Mothers Against Drunk Drivers (MADD) does not try to stop the sale of alcohol, but it does promote the idea of appointing a designated driver who will not drink that evening. The group also lobbies to raise the legal drinking age.

Existence of Subcultures

Each society contains *subcultures*, groups with shared values emerging from their special life experiences or circumstances. *Star Trek* fans, Black Muslims, and Hell's Angels all represent subcultures whose members share common beliefs, preferences, and behaviors. To the extent that subcultural groups exhibit different wants and consumption behavior, marketers can choose particular subcultures as target markets.

Marketers sometimes reap unexpected rewards in targeting subcultures. For instance, marketers have always loved teenagers because they're society's trendsetters in fashion, music, entertainment, ideas, and attitudes. Marketers also know that if they attract someone as a teen, there's a good chance they'll keep the person as a customer in the years ahead. Frito-Lay, which draws 15 percent of its sales from teens, says it has seen a rise in chip-snacking by grown-ups. "We think it's because we brought them in as teenagers," says a Frito-Lay marketing director.[33]

Shifts of Secondary Cultural Values Through Time

Although core values are fairly persistent, cultural swings do take place. The advent in the 1960s of hippies, the Beatles, Elvis Presley, and other cultural phenomena had a major impact on young people's hairstyles, clothing, sexual norms, and life goals. Today's young people are influenced by new heroes and fads: Pearl Jam's Eddie Vedder, Michael Jordan, and rollerblading.

Marketers have a keen interest in spotting cultural shifts that might bring new marketing opportunities or threats. Several firms offer social-cultural forecasts. The Yankelovich Monitor interviews 2,500 people each year and tracks 35 social trends, such as "antibigness," "mysticism," "living for today," "away from possessions," and "sensuousness." It describes the percentage of the population who share the attitude as well as the percentage who do not. For example, the percentage of people who value physical fitness and well-being has risen steadily over the years, especially in the under-30 group, the young women and upscale group, and people living in the West. Marketers of health foods and exercise equipment cater to this trend with appropriate products and communications. In 1995, Taco Bell unveiled a new lower-fat "Border Lights" menu. The Center for Science in the Public Interest, a consumer advocacy group in Washington, praised the new menu as being "more than a marketing gimmick."[34]

SUMMARY

1. Successful companies realize that the marketing environment presents a never-ending series of opportunities and threats. The major responsibility for identifying significant changes in the macroenvironment falls to a company's marketers. More than any other group in the company, marketing managers must be the trend trackers and opportunity seekers.
2. Many opportunities are found by identifying *trends* (directions or sequences of events that have some momentum and durability) and *megatrends* (major social, economic, political, and technological changes that have long-lasting influence).

3. Within the rapidly changing global picture, marketers must monitor six major environmental forces: demographic, economic, natural, technological, political-legal, and social-cultural.
4. In the *demographic* environment, marketers must be aware of worldwide population growth; changing mixes of age, ethnic composition, and educational levels; the rise of nontraditional families; large geographic shifts in population; and the move to micromarketing and away from mass marketing.
5. In the *economic* arena, marketers need to focus on income distribution and levels of savings, debt, and credit availability.
6. In the *natural* environment, marketers need to be aware of raw-materials shortages, increased energy costs and pollution levels, and the changing role of governments in environmental protection.
7. In the *technological* arena, marketers should take account of the accelerating pace of technological change, opportunities for innovation, varying R&D budgets, and the increased governmental regulation brought about by technological change.
8. In the *political-legal* environment, marketers must work within the many laws regulating business practices and with various special-interest groups.
9. In the *social-cultural* arena, marketers must understand people's views of themselves, others, organizations, society, nature, and the universe. They must market products that correspond to society's core and secondary values, and address the needs of different subcultures within a society.

APPLICATIONS

CONCEPTS

1. One of the changes in the demographic environment is the increasing proportion of older adults, who comprise many markets for certain products. Discuss how this demographic trend could affect the product features and/or distribution arrangements of the following:
   - **a.** *Minute Maid orange juice*
   - **b.** *Mail-order businesses*
   - **c.** *the Social Security office*
2. You are a product manager at Minolta. Your boss has just received a copy of *The Popcorn Report* (see the Marketing Insight "Faith Popcorn Points to 16 Trends in the Economy"). Although her background is in engineering, your boss has always been interested in the sensory appeal of product features, and this book has aroused her curiosity about this phenomenon. Prepare a report summarizing the potential impact of each of Popcorn's 16 trends on Minolta's product (cameras). Specifically, how will each trend affect product development, features, and marketing?
3. Budweiser, Calvin Klein, McDonald's, Coca-Cola, and Chevrolet are examples of brands that have become cultural symbols for the United States. Name some brand names and products that are cultural symbols for the following countries: (a) Japan, (b) Germany, (c) Russia, (d) France, (e) Italy, (f) Ireland, (g) Colombia, (h) Mexico, (i) England, (j) Switzerland, (k) the Middle Eastern nations, (l) Australia.

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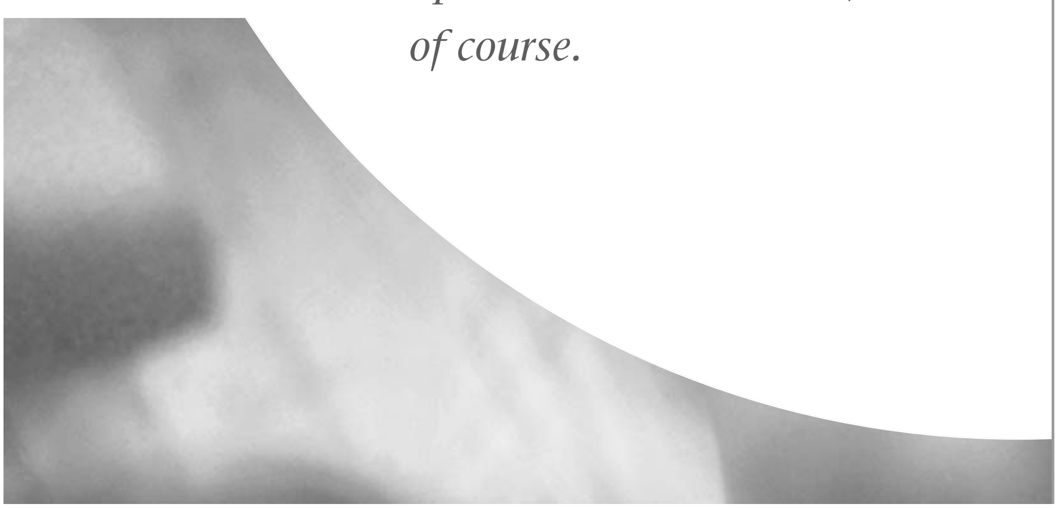
Developing New Market Offerings

Examine the following questions:

- What challenges does a company face in developing new products?
- What organizational structures are used to manage new-product development?
- What are the main stages in developing new products, and how can they be managed better?
- What factors affect the rate of diffusion and consumer adoption of newly launched products?

Who should ultimately design the product? The customer, of course.



Once a company has carefully segmented the market, chosen its target customers, identified their needs, and determined its market positioning, it is better able to develop new products. Marketers play a key role in the new-product process, by identifying and evaluating new-product ideas and working with R&D and others in every stage of development.

Every company must develop new products. New-product development shapes the company's future. Replacement products must be created to maintain or build sales. Customers want new products, and competitors will do their best to supply them. Each year over 16,000 new products (including line extensions and new brands) are introduced into groceries and drugstores.

A company can add new products through acquisition or development. The acquisition route can take three forms. The company can buy other companies, it can acquire patents from other companies, or it can buy a license or franchise from another company. The development route can take two forms. The company can develop new products in its own laboratories. Or it can contract with independent researchers or new-product-development firms to develop specific new products.

Booz, Allen & Hamilton has identified six categories of new products:[1]

1. *New-to-the-world products:* New products that create an entirely new market.
2. *New product lines:* New products that allow a company to enter an established market for the first time.
3. *Additions to existing product lines:* New products that supplement a company's established product lines (package sizes, flavors, and so on).
4. *Improvements and revisions of existing products:* New products that provide improved performance or greater perceived value and replace existing products.
5. *Repositionings:* Existing products that are targeted to new markets or market segments.
6. *Cost reductions:* New products that provide similar performance at lower cost.

Less than 10 percent of all new products are truly innovative and new to the world. These products involve the greatest cost and risk because they are new to both the company and the marketplace. Most new-product activity is devoted to improving existing products. At Sony, over 80 percent of new-product activity is undertaken to modify and improve existing Sony products.

CHALLENGES IN NEW-PRODUCT DEVELOPMENT

Companies that fail to develop new products are putting themselves at great risk. Their existing products are vulnerable to changing customer needs and tastes, new technologies, shortened product life cycles, and increased domestic and foreign competition.

At the same time, new-product development is risky. Texas Instruments lost $660 million before withdrawing from the home computer business, RCA lost $500 million on its videodisc players, Federal Express lost $340 million on its Zap mail, Ford lost $250 million on its Edsel, DuPont lost an estimated $100 million on a synthetic leather called Corfam, and the British–French Concorde aircraft will never recover its investment.[2]

To get a feel for how much money can be thrown at a product that is destined to fail, consider the fate of the smokeless cigarette.

- **.J.** By the late 1980s, R. J. Reynolds Tobacco Company (RJR) had already spent more than $300 million on the reduced-smoke Premier cigarette. Five months after its introduction in 1988, Premier disappeared from the test markets because smokers "didn't like the taste." It was also difficult to light. "Premier gave you a hernia trying to get the smoke through," said one tobacco industry analyst. Undeterred by the costly failure of Premier, RJR went on to spend an additional $125 million on another attempt. In 1997 RJR tested its smokeless Eclipse cigarette in Chattanooga, Tennessee. But smokers say they're not switching. Eclipse seemed like a good alternative; the cigarette heats the tobacco instead of burning it, resulting in only 10 percent of the smoke of conventional cigarettes. Only problem is smokers like smoke. Research shows that smokers enjoy the "security blanket" of being wreathed in smoke, regardless of how much nonsmokers dislike it. So far, *nonsmokers* are the only ones who like Eclipse.[3]

New products continue to fail at a disturbing rate. In 1997, a record 25,261 new packaged-goods products were launched, and that doesn't even include products you won't find at your local supermarket, like techno-gizmos and software programs. But equally stunning is the number that fail: Tom Vierhile, general manager of Market Intelligence Service Ltd., a new-product reporting and retrieval firm, estimates that 80 percent of recently launched products aren't around today.[4] When you consider that it costs $20 million to $50 million to launch a new product, you wonder why people continue to innovate at all. Yet product failures can serve one useful purpose: Inventors, entrepreneurs, and new-product team leaders can learn valuable lessons about what *not* to do. With this credo in mind, marketing consultant Robert McMath has collected about 80,000 consumer products, most of them abject flops, in his New Product Showcase and Learning Center in the rolling hills of Ithaca, New York. See the Marketing Insight box, "Mr. Failure's Lessons for Sweet Success: Robert McMath's New Product Showcase and Learning Center," for some insights on product failure.

Why do new products fail?

- A high-level executive pushes a favorite idea through in spite of negative market research findings.
- The idea is good, but the market size is overestimated.
- The product is not well designed.
- The product is incorrectly positioned in the market, not advertised effectively, or overpriced.
- Development costs are higher than expected.
- Competitors fight back harder than expected.

Several other factors hinder new-product development:

- *Shortage of important ideas in certain areas:* There may be few ways left to improve some basic products (such as steel, detergents).
- *Fragmented markets:* Keen competition is leading to market fragmentation. Companies have to aim their new products at smaller market segments, and this can mean lower sales and profits for each product.
- *Social and governmental constraints:* New products have to satisfy consumer safety and environmental concerns. Government requirements slow down innovation in drugs, toys, and some other industries.
- *Costliness of the development process:* A company typically has to generate many ideas to find just one worthy of development. Furthermore, the company often faces high R&D, manufacturing, and marketing costs.
- *Capital shortages:* Some companies with good ideas cannot raise the funds needed to research and launch them.

MARKETING INSIGHT

M. F ’ L : MM ’ N P L C

Strolling the aisles at Robert McMath•s New Product Showcase and Learning Center is like being in some nightmare version of a supermarket. There•s Gerber food for adults„pureed sweet-and-sour pork and chicken Madeira„microwaveable ice cream sundaes, parsnip chips, aerosol mustard, Ben-Gay aspirin, and Miller Clear Beer. How about Richard Simmons Dijon Vinaigrette Salad Spray, garlic cake in a jar, and Farrah shampoo? Most of the 80,000 products on display were flops. Behind each of them are squandered dollars and hopes, but the genial curator of this Smithsonian of consumerism, a former marketer for Colgate-Palmolive, believes that even„and perhaps, especially„failure has valuable lessons to teach.

The New Product Showcase and Learning Center is a place where product developers pay hundreds of dollars an hour to visit and learn from others• mistakes. McMath•s unusual showcase represents $4 billion in product investment. From it he has distilled dozens of lessons for an industry that, by its own admission, has a very short memory. For those who can•t make the trip to Ithaca or pay a steep consulting fee, McMath has now put his unique insights into a book, *What Were They Thinking?* Here are a few of the marketing lessons McMath espouses:

- The value of a brand is its good name, which it earns over time. People become loyal to it. They trust it to deliver a consistent set of attributes. Don•t squander this trust by attaching your good name to something totally out of character. When you hear Ben-Gay aspirin, don•t you immediately think of the way that Ben-Gay cream sears your skin? Can you imagine swallowing it? Louis Sherry No Sugar Added Gorgonzola Cheese dressing was everything that Louis Sherry, known for its rich candies and ice cream, shouldn•t be: sugarless, cheese, and salad dressing. Cracker Jack cereal, Smucker•s premium ketchup, and Fruit of the Loom laundry detergent were other misbegotten attempts to stretch a good name.
- Me-too marketing is the number-one killer of new products. Most such attempts fail. The ones that succeed usually require resources and persistence beyond the capabilities of most marketers. Pepsi-Cola led a very precarious existence for decades before establishing itself as the major competitor to Coca-Cola. More to the point, though, is that Pepsi is one of the few survivors among dozens of other brands that have challenged Coke for more than a century. Ever hear of Toca-Cola? Coco-Cola? Yum-Yum Cola? French Wine of Cola? How about King-Cola, •the royal drinkŽ? More recently, Afri Cola failed to attract African American soda drinkers, and Cajun Cola pretty well flopped in the land of gumbo. All things being equal, an established product has a distinct advantage over any new product that is not radically different from it.
- Don•t be fooled by the success of the *Complete Dummy's Guide to* . . . line of books. People usually don•t buy products that remind them of their shortcomings. Gillette•s For Oily Hair Only shampoo flopped because people did not want to confess that they had greasy hair. People will use products that discreetly say •for oily hairŽ or •for sensitive skinŽ in small print on containers that are otherwise identical to the regular product. But they do not want to be hit over the head with reminders that they are overweight, have bad breath, sweat too much, or are elderly. Nor do they wish to advertise their faults and foibles to other people by carrying such products in their grocery carts.
- Some products are radically different from the products, services, or experiences that consumers normally purchase. Too radically different. They fail because consumers don•t relate to them. You can tell that some innovative products are doomed as soon as you hear their names: Toaster Eggs. Cucumber Antiperspirant spray. Health-Sea Sea Sausage. Other innovative ideas have been victims of a brand•s past success. For example, Nabisco•s Oreo Little Fudgies, a confectionery product with a chocolate coating meant to compete with candy, sounds like a natural. But for many years Nabisco has encouraged people to pull apart Oreo cookies and lick out the filling. It•s very messy to open an Oreo with a chocolate coating, however; so Oreo Little Fudgies struck a discordant note with consumers.

Sources: Paul Lukas, •The Ghastliest Product Launches,Ž *Fortune,* March 16, 1996, p. 44; Jan Alexander, •Failure Inc.Ž *World Business,* May…June 1996, p. 46; Ted Anthony, •Where•s Farrah Shampoo? Next to the Salsa Ketchup,Ž *Marketing News,* May 6, 1996, p. 13; bulleted points are adapted from Robert M. McMath and Thom Forbes, *What Were They Thinking? Marketing Lessons I've Learned from Over 80,000 New-Product Innovations and Idiocies* (New York: Times Business, 1998), pp. 22…24, 28, 30…31, and 129…30.

- *Faster required development time:* Companies that cannot develop new products quickly will be at a disadvantage. Companies must learn how to compress development time by using computer-aided design and manufacturing techniques, strategic partners, early concept tests, and advanced marketing planning. Alert companies use *concurrent new-product development,* in which cross-functional teams collaborate to push new products through development and to market. Concurrent product development resembles a rubgy match rather than a relay race, with team members passing the new product back and forth as they head toward the goal. The Allen-Bradley Corporation (a maker of industrial controls) was able to develop a new electrical control device in just two years, as opposed to six years under its old system.

- *Shorter product life cycles:* When a new product is successful, rivals are quick to copy it. Sony used to enjoy a three-year lead on its new products. Now Matsushita will copy the product within six months, leaving hardly enough time for Sony to recoup its investment.

Given these challenges, what can a company do to develop successful new products? Cooper and Kleinschmidt found that the number-one success factor is a unique, superior product. Products with a high product advantage succeed 98 percent of the time, compared to products with a moderate advantage (58 percent success) or minimal advantage (18 percent success). Another key success factor is a well-defined product concept prior to development. The company carefully defines and assesses the target market, product requirements, and benefits before proceeding. Other success factors are technological and marketing synergy, quality of execution in all stages, and market attractiveness.[5]

Madique and Zirger, in a study of successful product launches in the electronics industry, found eight factors accounting for new-product success. New-product success is greater the deeper the company's understanding of customer needs, the higher the performance-to-cost ratio, the earlier the product is introduced ahead of competition, the greater the expected contribution margin, the more spent on announcing and launching the product, the greater the top management support, and the greater the cross-functional teamwork.[6]

New-product development is most effective when there is teamwork among R&D, engineering, manufacturing, purchasing, marketing, and finance. The product idea must be researched from a marketing point of view, and a specific cross-functional team must guide the project throughout its development. Studies of Japanese companies show that their new-product successes are due in large part to cross-functional teamwork.

EFFECTIVE ORGANIZATIONAL ARRANGEMENTS

Top management is ultimately accountable for the success of new products. New-product development requires senior management to define business domains, product categories, and specific criteria. For example, the Gould Corporation established the following acceptance criteria:

- The product can be introduced within five years.
- The product has a market potential of at least $50 million and a 15 percent growth rate.
- The product would provide at least 30 percent return on sales and 40 percent on investment.
- The product would achieve technical or market leadership.

B DGE ING FO NE P OD C DE ELOPMEN

Senior management must decide how much to budget for new-product development. R&D outcomes are so uncertain that it is difficult to use normal investment criteria. Some companies solve this problem by financing as many projects as possible, hoping to achieve a few winners. Other companies set their budget by applying a conventional percentage of sales figures or by spending what the competition spends. Still other companies decide how many successful new products they need and work backward to estimate the required investment.

The U.S. company best known for its commitment to new-product research and development is Minneapolis-based 3M Company:

- **3M** Minnesota Mining and Manufacturing (3M) fosters a culture of innovation and improvisation that was evident at its very beginnings: In 1906 the directors were faced with a failed mining operation, but they ended up making sandpaper out of the grit and wastage. Today 3M makes more than 60,000 products, including sandpaper, adhesives, computer diskettes, contact lenses, and Post-it notes. Each year 3M launches scores of new products. This $15 billion company's immodest goal is to have each of its divisions generate at least 30 percent of sales from products less than four years on the market.[7]
    - 3M encourages everyone, not just engineers, to become "product champions." The company's 15 percent rule allows all employees to spend up to 15 percent of their time working on projects of personal interest. Products such as Post-it notes, masking tape, and 3M's microreplication technology grew from 15 percent-rule activities.
    - Each promising new idea is assigned to a multidisciplinary venture team headed by an "executive champion."
    - 3M expects some failures and learns from them. Its slogan is "You have to kiss a lot of frogs to find a prince."
    - 3M hands out its Golden Step awards each year to the venture teams whose new product earned more than $2 million in U.S. sales or $4 million in worldwide sales within three years of its commercial introduction.

Table 2.1 shows how a company might calculate the cost of new-product development. The new-products manager at a large consumer packaged-goods company reviewed the results of 64 new-product ideas. Only one in four ideas, or 16, passed the screening stage. It cost $1,000 to review each idea at this stage. Half of these ideas, or eight, survived the concept-testing stage, at a cost of $20,000 each. Half of these, or four, survived the product-development stage, at a cost of $200,000 each. Half of these, or two, did well in the test market, at a cost of $500,000 each. When these two ideas were launched, at a cost of $5 million each, only one was highly successful. Thus the one successful idea had cost the company $5,721,000 to develop. In the process, 63 other ideas fell by the wayside. The total cost for developing one successful new product was $13,984,400. Unless the company can improve the pass ratios and reduce the costs at each stage, it will have to budget nearly $14 million for each suc-

TABLE 2.1

Estimated Cost of Finding One Successful New Product (Starting with 64 New Ideas)

Stage	Number of Ideas	Pass Ratio	Cost per Product Idea	Total Cost
1. Idea screening	64	1:4	$ 1,000	$ 64,000
2. Concept testing	16	1:2	20,000	320,000
3. Product development	8	1:2	200,000	1,600,000
4. Test marketing	4	1:2	500,000	2,000,000
5. National launch	2	1:2	5,000,000	10,000,000
			$5,721,000	$13,984,000

cessful new idea it hopes to find. If top management wants four successful new products in the next few years, it will have to budget at least $56 million ($4 \times 14$ million) for new-product development.

O GANI ING NE -P OD C DE ELOPMEN

Companies handle the organizational aspect of new-product development in several ways.[8] The most common are:

- *Product managers:* Many companies assign responsibility for new-product ideas to product managers. In practice, this system has several faults. Product managers are so busy managing existing lines that they give little thought to new products other than line extensions. They also lack the specific skills and knowledge needed to develop and critique new products.
- *New-product managers:* Kraft and Johnson & Johnson have new-product managers who report to category managers. This position professionalizes the new-product function. However, like product managers, new-product managers tend to think in terms of modifications and line extensions limited to their product market.
- *New-product committees:* Many companies have a high-level management committee charged with reviewing and approving proposals.
- *New-product departments*: Large companies often establish a department headed by a manager who has substantial authority and access to top management. The department's major responsibilities include generating and screening new ideas, working with the R&D department, and carrying out field testing and commercialization.
- *New-product venture teams:* 3M, Dow, Westinghouse, and General Mills often assign new-product development work to venture teams. A *venture team* is a group brought together from various operating departments and charged with developing a specific product or business. They are "intrapreneurs" relieved of their other duties and given a budget, a time frame, and a "skunkworks" setting. *Skunkworks* are informal workplaces, sometimes garages, where intrapreneurial teams attempt to develop new products. See the Marketing Insight box, "New-Product Development Not Just for Engineers: The Wisdom of Cross-Functional Teams," for more information on how companies benefit from cross-functional teamwork when developing new products.

The most sophisticated tool for managing the innovation process is the *stage-gate system* used by 3M and a number of other companies.[9] The innovation process is divided into several stages. At the end of each stage is a gate or checkpoint. The project leader, working with a cross-functional team, must bring a set of known deliverables to each gate before the project can pass to the next stage. To move from the business plan stage into product development requires a convincing market research study of consumer needs and interest, a competitive analysis, and a technical appraisal. Senior

MARKETING INSIGHT

N -P D N J E : C -F

In his best-selling book, *The Soul of a New Machine,* Tracy Kidder described how a group of engineers in a tightly knit team developed a revolutionary new computer for Data General. These engineers were part of a long tradition in product development, in which engineers and scientists worked in isolation, not only from the outsiders but also from other company departments, to develop original products. Although relegating new-product development solely to engineers or scientists often reaped brilliant results, it also produced crushing inefficiencies and marketing myopia„engineers driven to create a •better mousetrapŽ when potential customers didn•t really need or want a better mousetrap.

The venerable tradition of engineers working in isolation finally burst apart in the late 1980s and early 1990s with the implementation of cross-functional new-product teams. Under pressure to shrink design cycles, leverage new techniques, and lower product-development costs, manufacturers are transforming product design from a solitary activity handled by engineering to a dynamic process involving the input of multiple company functions and key suppliers, too. In a survey of *Design News and Purchasing* magazine readers, 80 percent of respondents reported that their companies use cross-functional teams to develop new products.

Chrysler, now the most profitable automaker in the world, is a pioneer in the use of these new-product teams. In the late 1980s, Chrysler began pairing car designers with cohorts in purchasing. The result: A whole layer of bureaucracy has been cut from the product-development process. Since instituting cross-functional design teams, Chrysler has slashed new-vehicle development cycles by over 40 percent and reduced costs dramatically. For instance, in the late 1980s, development lead times for domestic automakers often spanned five years. Today, Chrysler typically gets new cars or trucks from concept to market in three years or less. Another important benefit of adding key people from other functions is the creation of more knowledge. Harley-Davidson pairs engineering, purchasing, manufacturing, marketing, and suppliers for the conceptual stage of design. For complex components, such as brake systems, it has tapped suppliers to lead development. •Instead of hiring this expertise in-house, we•re relying on the competence that already exists within our supply base,Ž says Leroy Zimdars, Harley-Davidson•s director of development purchasing.

For all the benefits that come from the cross-functional design team process, no one should be lulled into thinking that forming a team and working on one is easy. Don H. Lester, a manager of operations for a Hoechst division, knows this firsthand. Lester has over 10 years of experience as a new-product venture team leader, and he•s developed the following criteria for staffing new-product venture teams:

- *Desired team leadership style and level of expertise:* The more complex the new-product concept, the greater the expertise that is desirable.
- *Team member skills and expertise:* Hoechst staffs its new venture teams with people with skills and expertise in chemistry, engineering, market research, financial analysis, and manufacturing. A different company would choose different functions to be represented.
- *Level of interest in the particular new-product concept:* Is there interest or, even better, a high level of ownership and commitment (a •concept championŽ)?
- *Potential for personal reward:* •What•s in it for me?Ž What motivates individuals to want to participate in this effort?
- *Diversity of team members, in the broadest sense:* This includes race, gender, nationality, breadth of experience, depth of expertise, and personality. The greater the diversity, the greater the range of viewpoints and the team•s decision-making potential.

Sources: Don H. Lester, •Critical Success Factors for New Product Development,Ž *Research-Technology Management,* January…February 1998, pp. 36…43; Tim Minahan, •Harley-Davidson Revs Up Development Process,Ž Design News, May 18, 1998, pp. S18…S23; Tim Minahan, •Platform Teams Pair with Suppliers to Better Designs,Ž *Purchasing,* May 7, 1998, pp. 44S3…44S7; Design Teams Bring Radical Change in Product Development,Ž *Design News,* May 18, 1998, p. S2; see also Gary S. Lynn, •New Product Team Learning: Developing and Profiting from Your Knowledge Capital,Ž *California Management Review,* Summer 1998, pp. 74…93.

managers review the criteria at each gate to judge whether the project deserves to move to the next stage. The gatekeepers make one of four decisions: go, kill, hold, or recycle.

Stage-gate systems put strong discipline into the innovation process, making its steps visible to all involved and clarifying the project leader's and team's responsibilities at each point. Some of the companies that rely on the stage-gate process are Mobil, 3M, Hewlett-Packard, and Seattle-based Fluke, a pioneer in handheld electronic instruments. Lego, the Danish toy maker, replaces about one-third of its product line every year with new products. Since the late 1980s, Lego has been relying on a stage-gate new-product process to ensure that everything comes together for rapid product launches.[10]

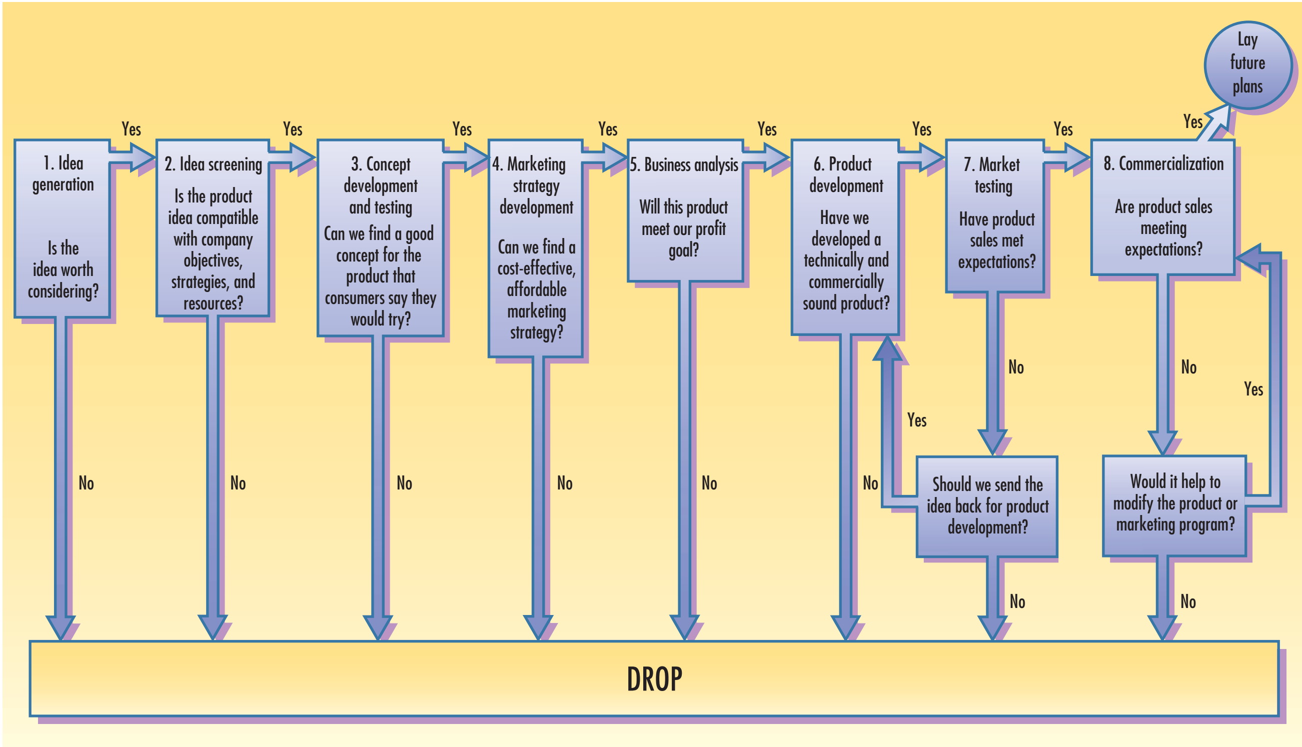


FIGURE 2-1

The New-Product-Development Decision Process

We will now look at the marketing challenges arising at each of the eight stages of the development process: idea generation, idea screening, concept development and testing, marketing strategy development, business analysis, product development, market testing, and commercialization. A preview of the various steps and decisions in the process is presented in Figure 2-1.

MANAGING THE DEVELOPMENT PROCESS: IDEAS

IDEA GENE A ION

The new-product development process starts with the search for ideas. Top managers should define the product and market scope and the new product's objectives. They should state how much effort should be devoted to developing breakthrough products, modifying existing products, and copying competitors' products. New-product ideas can come from many sources: customers, scientists, competitors, employees, channel members, and top management.

The marketing concept holds that *customer needs and wants* are the logical place to start the search for ideas. Hippel has shown that the highest percentage of ideas for new industrial products originate with customers.[11] Technical companies can learn a great deal by studying their *lead users,* those customers who make the most advanced use of the company's products and who recognize the need for improvements before other customers do. Many of the best ideas come from asking customers to describe their problems with current products. For instance, in an attempt to grab a foothold in steel wool soap pads a niche dominated by SOS and Brillo, 3M arranged eight focus groups with consumers around the country. 3M asked what problems consumers found with traditional soap pads, and found the most frequent complaint was that the pads scratched expensive cookware. This finding produced the idea for the

Scotch-Brite Never Scratch soap pad. Sales of the new soap pad have now exceeded 3M's expectations by 25 percent.[12]

Successful companies have established a company culture that encourages every employee to seek new ways of improving production, products, and services. Toyota claims its employees submit 2 million ideas annually (about 35 suggestions per employee), over 85 percent of which are implemented. Kodak and other firms give monetary, holiday, or recognition awards to employees who submit the best ideas.

Companies can also find good ideas by researching their *competitors' products and services*. They can learn from distributors, suppliers, and sales representatives. They can find out what customers like and dislike in their competitors' products. They can buy their competitors' products, take them apart, and build better ones. Company *sales representatives* and *intermediaries* are a particularly good source of ideas. These groups have firsthand exposure to customers and are often the first to learn about competitive developments. An increasing number of companies train and reward sales representatives, distributors, and dealers for finding new ideas.

Top management can be another major source of ideas. Some company leaders, such as Edwin H. Land, former CEO of Polaroid, took personal responsibility for technological innovation in their companies. On the other hand, Lewis Platt, CEO of Hewlett-Packard, believes senior management's role is to create an environment that encourages business managers to take risks and create new growth opportunities. Under Platt's leadership, HP has been structured as a collection of highly autonomous entrepreneurial businesses.

New-product ideas can come from other sources as well, including inventors, patent attorneys, university and commercial laboratories, industrial consultants, advertising agencies, marketing research firms, and industrial publications. But although ideas can flow from many sources, their chances of receiving serious attention often depend on someone in the organization taking the role of *product champion*. The product idea is not likely to receive serious consideration unless it has a strong advocate. See the Marketing Memo "Ten Ways to Great New-Product Ideas."

IDEA C EENING

Any company can attract good ideas by organizing itself properly. The company should motivate its employees to submit their ideas to an *idea manager* whose name and phone number are widely circulated. Ideas should be written down and reviewed each week by an *idea committee*, which sorts them into three groups: promising ideas, marginal ideas, and rejects. Each promising idea is researched by a committee member, who reports back to the committee. The surviving promising ideas then move into a full-scale screening process. The company should reward employees submitting the best ideas.

In screening ideas, the company must avoid two types of errors. A *DROP-error* occurs when the company dismisses an otherwise good idea. It is extremely easy to find fault with other people's ideas. Some companies shudder when they look back at ideas they dismissed: Xerox saw the novel promise of Chester Carlson's copying machine, but IBM and Eastman Kodak did not. IBM thought the market for personal computers was minuscule. RCA saw the opportunity of radio; the Victor Talking Machine Company did not. Marshall Field understood the unique market-development possibilities of installment buying; Endicott Johnson did not. Sears dismissed the importance of discounting; Wal-Mart and Kmart did not.[13] If a company makes too many DROP-errors, its standards are too conservative.

A *GO-error* occurs when the company permits a poor idea to move into development and commercialization. We can distinguish three types of product failures. An *absolute product failure* loses money; its sales do not cover variable costs. A *partial product failure* loses money, but its sales cover all its variable costs and some of its fixed costs. A *relative product failure* yields a profit that is less than the company's target rate of return.

The purpose of screening is to drop poor ideas as early as possible. The rationale is that product-development costs rise substantially with each successive development stage. Most companies require new-product ideas to be described on a standard form

MARKETING *memo*

Ten Ways to Great New-Product Ideas

1. Run pizza–video parties, as Kodak does—informal sessions where groups of customers meet with company engineers and designers to discuss problems and needs and brainstorm potential solutions.
2. Allow time off—scouting time—for technical people to putter on their own pet projects. 3M allows 15 percent time off; Rohm & Haas allows 10 percent.
3. Make a customer brainstorming session a standard feature of plant tours.
4. Survey your customers: Find out what they like and dislike in your and competitors' products.
5. Undertake "fly-on-the-wall" or "camping out" research with customers, as do Fluke and Hewlett-Packard.
6. Use iterative rounds: a group of customers in one room, focusing on identifying problems, and a group of your technical people in the next room, listening and brainstorming solutions. The proposed solutions are then tested immediately on the group of customers.
7. Set up a keyword search that routinely scans trade publications in multiple countries for new-product announcements and so on.
8. Treat trade shows as intelligence missions, where you view all that is new in your industry under one roof.
9. Have your technical and marketing people visit your suppliers' labs and spend time with their technical people—find out what's new.
10. Set up an idea vault, and make it open and easily accessed. Allow employees to review the ideas and add constructively to them.

Source: Adapted from Robert Cooper, *Product Leadership: Creating and Launching Superior New Products* (New York: Perseus Books, 1998).

that can be reviewed by a new-product committee. The description states the product idea, the target market, and the competition, and roughly estimates market size, product price, development time and costs, manufacturing costs, and rate of return.

The executive committee then reviews each idea against a set of criteria. Does the product meet a need? Would it offer superior value? Can it be distinctively advertised? Does the company have the necessary know-how and capital? Will the new product deliver the expected sales volume, sales growth, and profit? The surviving ideas can be rated using a weighted-index method like that in Table 2.2. The first column lists factors required for successful product launches, and the second column assigns importance weights. The third column scores the product idea on a scale from 0 to 1.0, with 1.0 the highest score. The final step multiplies each factor's importance by the product score to obtain an overall rating. In this example, the product idea scores .69, which places it in the "good idea" level. The purpose of this basic rating device is to promote systematic product-idea evaluation and discussion. It is not supposed to make the decision for management.

As the new-product idea moves through development, the company will constantly need to revise its estimate of the product's overall probability of success, using the following formula:

Overall probability of success	=	*Probability of technical completion*	×	*Probability of commercialization given technical completion*	×	*Probability of economic success given commercialization*

For example, if the three probabilities are estimated as .50, .65, and .74, respectively, the company would conclude that the overall probability of success is .24. The company then has to judge whether this probability is high enough to warrant continued development.

MANAGING THE DEVELOPMENT PROCESS: CONCEPT TO STRATEGY

CONCEP DE ELOPMEN AND E ING

Attractive ideas must be refined into testable product concepts. A *product idea* is a possible product the company might offer to the market. A *product concept* is an elaborated version of the idea expressed in meaningful consumer terms.

Concept Development

We shall illustrate concept development with the following situation: A large food processing company gets the idea of producing a powder to add to milk to increase its nutritional value and taste. This is a product idea. But consumers do not buy product ideas; they buy product concepts.

A product idea can be turned into several concepts. The first question is: Who will use this product? The powder can be aimed at infants, children, teenagers, young or middle-aged adults, or older adults. Second, what primary benefit should this product provide? Taste, nutrition, refreshment, energy? Third, when will people consume this drink? Breakfast, midmorning, lunch, midafternoon, dinner, late evening? By answering these questions, a company can form several concepts:

- *Concept 1:* An instant breakfast drink for adults who want a quick nutritious breakfast without preparing a breakfast.
- *Concept 2:* A tasty snack drink for children to drink as a midday refreshment.
- *Concept 3:* A health supplement for older adults to drink in the late evening before they go to bed.

Each concept represents a *category concept* that defines the product's competition. An instant breakfast drink would compete against bacon and eggs, breakfast cereals,

TABLE 2.2

Product-Idea Rating Device

Product Success Requirements	**Relative Weight (a)**	**Product Score (b)**	**Product Rating (c = a × b)**
Unique or superior product	.40	.8	.32
High performance-to-cost ratio	.30	.6	.18
High marketing dollar support	.20	.7	.14
Lack of strong competition	.10	.5	.05
Total	1.00		.69*

*Rating scale: .00….30 poor; .31….60 fair; .61….80 good. Minimum acceptance rate: .61

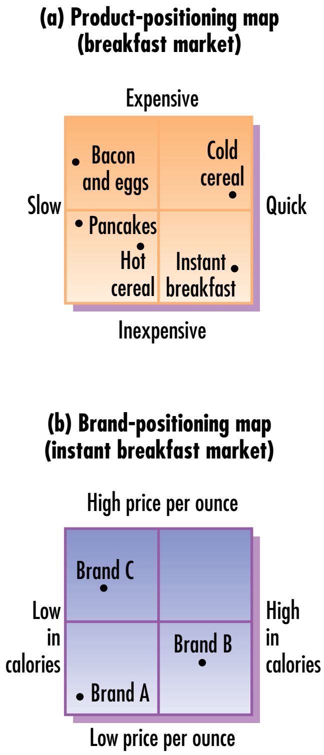


FIGURE 2-2

Product and Brand Positioning

coffee and pastry, and other breakfast alternatives. A tasty snack drink would compete against soft drinks, fruit juices, and other thirst quenchers.

Suppose the instant-breakfast-drink concept looks best. The next task is to show where this powdered product would stand in relation to other breakfast products. Figure 2-2 uses the two dimensions of cost and preparation time to create a *product-positioning map* for the breakfast drink. An instant breakfast drink offers low cost and quick preparation. Its nearest competitor is cold cereal; its most distant competitor is bacon and eggs. These contrasts can be utilized in communicating and promoting the concept to the market.

Next, the product concept has to be turned into a *brand concept*. Figure 2-2 is a *brand-positioning map* showing the current positions of three existing brands of instant breakfast drinks. The company needs to decide how much to charge and how calorific to make its drink. The new brand would be distinctive in the medium-price, medium-calorie market or in the high-price, high-calorie market. The company would not want to position it next to an existing brand, where it would have to fight for market share.

Concept Testing

Concept testing involves presenting the product concept to appropriate target consumers and getting their reactions. The concepts can be presented symbolically or physically. However, the more the tested concepts resemble the final product or experience, the more dependable concept testing is. In the past, creating physical prototypes was costly and time-consuming, but computer-aided design and manufacturing programs have changed that. Today firms can design alternative physical products (for example, small appliances or toys) on a computer, and then produce plastic models of each. Potential consumers can view the plastic models and give their reactions.[14]

Companies are also using virtual reality to test product concepts. Virtual reality programs use computers and sensory devices (such as gloves or goggles) to simulate reality. Gadd International has developed a research tool called Simul-Shop, a CD-ROM virtual reality approach that re-creates shopping situations in which researchers can test consumer reactions to factors such as product positioning, store layouts, and package designs. Suppose a cereal marketer wants to test reactions to a new package design and store shelf positioning. Using Simul-Shop on a standard desktop PC, test shoppers begin their shopping spree with a screen showing the outside of a grocery store. They click to enter the virtual store and are guided to the appropriate store section. Once there, they can scan the shelf, pick up various cereal packages, rotate them, study the labels—even look around to see what is on the shelf behind them. A Gadd's research director explains: "Once users move toward the item we want to test, [they] can look at different packaging, shelf layouts, and package colors. Depending on the activity, we can even ask users why they did what they did."[15]

Many companies today use *customer-driven engineering* to design new products. Customer-driven engineering attaches high importance to incorporating customer preferences in the final design. Here's how one company uses the World Wide Web to enhance its customer-driven engineering:

- **N** Based in Santa Clara, California, National Semiconductor has used "applets"—simple multimedia applications written in Java—and parametric search technologies to make its entire product database available on the Web. With the means to track customer searches, National Semiconductor can determine the performance metrics that are most important to them. Sometimes, says the company's Web services manager, it's more important to know when a customer didn't find a product than when he did. That information helps National Semiconductor shrink the time needed to identify market niches and to develop new products. It's basically high-quality market research—for free.[16]

Concept testing entails presenting consumers with an elaborated version of the concept. Here is the elaboration of concept 1 in our milk example:

> Our product is a powdered mixture that is added to milk to make an instant breakfast that gives the person all the needed nutrition along with good taste and high convenience. The product would be offered in three flavors (chocolate, vanilla, and strawberry) and would come in individual packets, six to a box, at $2.49 a box.

After receiving this information, consumers respond to the following questions:

Question	Product Dimension Measured
1. Are the benefits clear to you and believable?	*Communicability* and *believability*. If the scores are low, the concept must be refined or revised.
2. Do you see this product solving a problem or filling a need for you?	*Need level*. The stronger the need, the higher the expected consumer interest.
3. Do other products currently meet this need and satisfy you?	*Gap level*. The greater the gap, the higher the expected consumer interest. The need level can be multiplied by the gap level to produce a *need-gap score*. A high need-gap score means that the consumer sees the product as filling a strong need that is not satisfied by available alternatives.
4. Is the price reasonable in relation to the value?	*Perceived value*. The higher the perceived value, the higher the expected consumer interest.
5. Would you (definitely, probably, probably not, definitely not) buy the product?	*Purchase intention*. This would be high for consumers who answered the previous three questions positively.
6. Who would use this product, and when and how often will the product be used?	*User targets, purchase occasions,* and *purchasing frequency*.

The respondents' answers indicate whether the concept has a broad and strong consumer appeal, what products this new product competes against, and which consumers are the best targets. The need-gap levels and purchase-intention levels can be checked against norms for the product category to see whether the concept appears to be a winner, a long shot, or a loser. One food manufacturer rejects any concept that draws a definitely-would-buy score of less than 40 percent.

Conjoint Analysis

Consumer preferences for alternative product concepts can be measured through *conjoint analysis*, a method for deriving the utility values that consumers attach to varying levels of a product's attributes. Respondents are shown different hypothetical offers formed by combining varying levels of the attributes, then asked to rank the various offers. Management can identify the most appealing offer and the estimated market share and profit the company might realize.

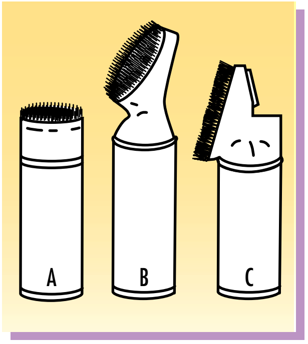


FIGURE 2-3

Samples for Conjoint Analysis

Green and Wind have illustrated this approach in connection with developing a new spot-removing carpet-cleaning agent for home use.[17] Suppose the new-product marketer is considering five design elements:

- Three package designs (A, B, C—see Figure 2-3)
- Three brand names (K2R, Glory, Bissell)
- Three prices ($1.19, $1.39, $1.59)
- A possible Good Housekeeping seal (yes, no)
- A possible money-back guarantee (yes, no)

Although the researcher can form 108 possible product concepts ($3 \times 3 \times 3 \times 2 \times 2$), it would be too much to ask consumers to rank 108 concepts. A sample of, say, 18 contrasting product concepts can be chosen, and consumers would rank them from the most preferred to the least preferred.

The marketer now uses a statistical program to derive the consumer's utility functions for each of the five attributes (Figure 2-4). Utility ranges between zero and one; the higher the utility, the stronger the consumer's preference for that level of the attribute. Looking at packaging, we see that package B is the most favored, followed by C and then A (A hardly has any utility). The preferred names are Bissell, K2R, and Glory, in that order. The consumer's utility varies inversely with price. A Good Housekeeping seal is preferred, but it does not add that much utility and may not be worth the effort to obtain it. A money-back guarantee is strongly preferred. Putting these results together, we can see that the consumer's most desired offer would be package design B, with the brand name Bissell, selling at the price of $1.19, with a Good Housekeeping seal and a money-back guarantee.

We can also determine the relative importance of each attribute to this consumer—the difference between the highest and lowest utility level for that attribute. The greater the difference, the more important the attribute. Clearly, this consumer sees price and package design as the most important attributes followed by money-back guarantee, brand name, and last, a Good Housekeeping seal.

When preference data are collected from a sufficient sample of target consumers, the data can be used to estimate the market share any specific offer is likely to achieve, given any assumptions about competitive response. The company, however, may not launch the market offer that promises to gain the greatest market share because of cost considerations. The most customer-appealing offer is not always the most profitable offer to make.

Under some conditions, researchers will collect the data not with a full-profile description of each offer but by presenting two factors at a time. For example, respondents may be shown a table with three price levels and three package types and asked which of the nine combinations they would like most, followed by which one they would prefer next, and so on. They would then be shown a further table consisting of trade-offs between two other variables. The trade-off approach may be easier to use when there are many variables and possible offers. However, it is less realistic in that respondents are focusing on only two variables at a time.

Conjoint analysis has become one of the most popular concept development and testing tools. Marriott designed its Courtyard hotel concept with the benefit of conjoint analysis. Other applications have included airline travel services, ethical drug design, and credit-card features.

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After testing, the new-product manager must develop a preliminary marketing-strategy plan for introducing the new product into the market. The plan consists of three parts. The first part describes the target market's size, structure, and behavior; the planned product positioning; and the sales, market share, and profit goals sought in the first few years:

> The target market for the instant breakfast drink is families with children who are receptive to a new, convenient, nutritious, and inexpensive form of breakfast. The company's brand will be positioned at the higher-price, higher-quality end of the instant-breakfast-drink category. The company will aim initially

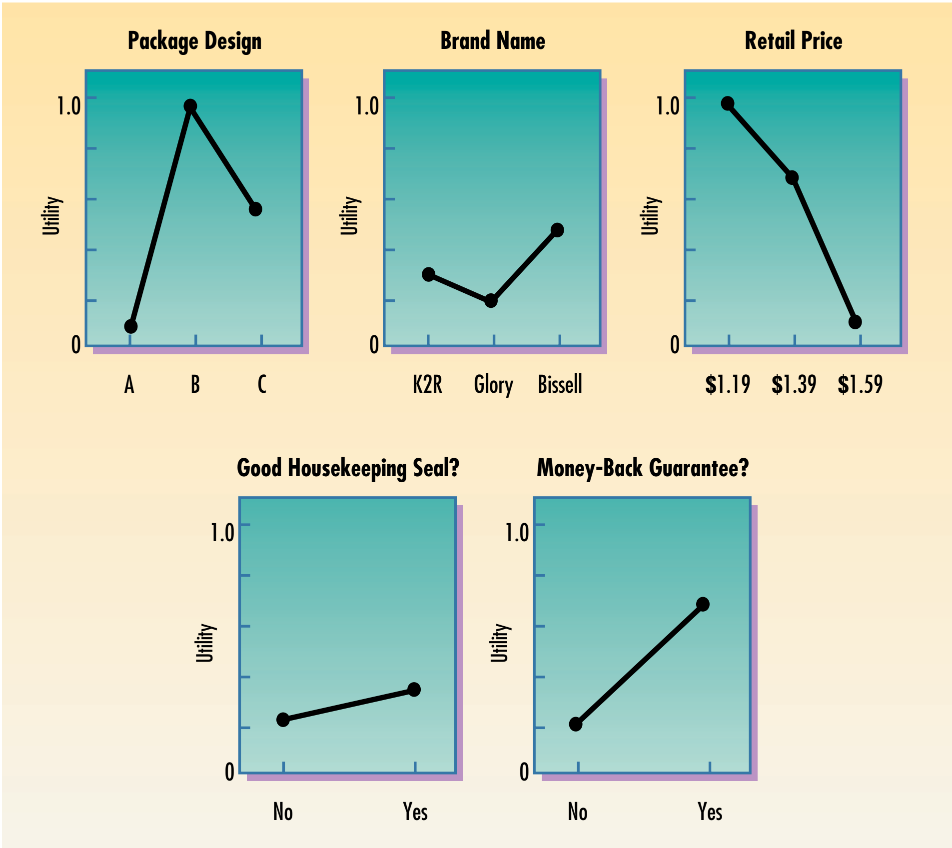

FIGURE 2-4

Utility Functions Based on Conjoint Analysis

to sell 500,000 cases or 10 percent of the market, with a loss in the first year not exceeding $1.3 million. The second year will aim for 700,000 cases or 14 percent of the market, with a planned profit of $2.2 million.

The second part outlines the planned price, distribution strategy, and marketing budget for the first year:

> The product will be offered in chocolate, vanilla, and strawberry in individual packets of six to a box at a retail price of $2.49 a box. There will be 48 boxes per case, and the case price to distributors will be $24. For the first two months, dealers will be offered one case free for every four cases bought, plus cooperative-advertising allowances. Free samples will be distributed door to door. Coupons for 20¢ off will appear in newspapers. The total sales-promotional budget will be $2.9 million. An advertising budget of $6 million will be split 50:50 between national and local. Two-thirds will go into television and one-third into newspapers. Advertising copy will emphasize the benefit concepts of nutrition and convenience. The advertising-execution concept will revolve around a small boy who drinks instant breakfast and grows strong. During the first year, $100,000 will be spent on marketing research to buy store audits and consumer-panel information to monitor market reaction and buying rates.

The third part of the marketing-strategy plan describes the long-run sales and profit goals and marketing-mix strategy over time:

> The company intends to win a 25 percent market share and realize an after-tax return on investment of 12 percent. To achieve this return, product quality will start high and be improved over time through technical research. Price will initially be set at a high level and lowered gradually to expand the market and meet competition. The total promotion budget will be boosted each year about 20 percent, with the initial advertising–sales promotion split

of 65:35 evolving eventually to 50:50. Marketing research will be reduced to $60,000 per year after the first year.

B I INE ANAL I

After management develops the product concept and marketing strategy, it can evaluate the proposal's business attractiveness. Management needs to prepare sales, cost, and profit projections to determine whether they satisfy company objectives. If they do, the product concept can move to the product-development stage. As new information comes in, the business analysis will undergo revision and expansion.

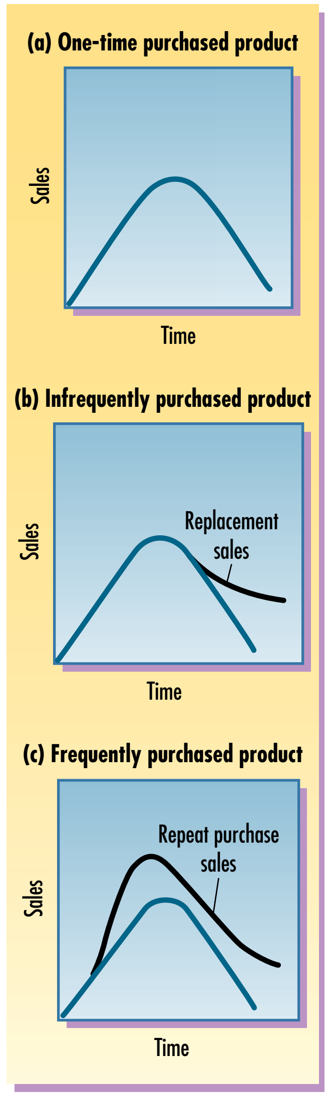

FIGURE 2-5

Product Life-Cycle Sales for Three Types of Products

Estimating Total Sales

Management needs to estimate whether sales will be high enough to yield a satisfactory profit. Total estimated sales are the sum of estimated first-time sales, replacement sales, and repeat sales. Sales-estimation methods depend on whether the product is a one-time purchase (such as an engagement ring or retirement home), an infrequently purchased product, or a frequently purchased product. For one-time purchased products, sales rise at the beginning, peak, and later approach zero as the number of potential buyers is exhausted (Figure 2-5). If new buyers keep entering the market, the curve will not go down to zero.

Infrequently purchased products—such as automobiles, toasters, and industrial equipment—exhibit replacement cycles dictated by physical wearing out or by obsolescence associated with changing styles, features, and performance. Sales forecasting for this product category calls for estimating first-time sales and replacement sales separately (Figure 2-5).

Frequently purchased products, such as consumer and industrial nondurables, have product life-cycle sales resembling Figure 2-5. The number of first-time buyers initially increases and then decreases as fewer buyers are left (assuming a fixed population). Repeat purchases occur soon, providing that the product satisfies some buyers. The sales curve eventually falls to a plateau representing a level of steady repeat-purchase volume; by this time, the product is no longer a new product.

In estimating a new product's sales, the manager's first task is to estimate first-time purchases of the new product in each period. A variety of techniques is available. To estimate replacement sales, management has to research the product's *survival-age distribution*—that is, the number of units that fail in year one, two, three, and so on. The low end of the distribution indicates when the first replacement sales will take place. The actual timing of replacement will be influenced by a variety of factors. Because replacement sales are difficult to estimate before the product is in use, some manufacturers base the decision to launch a new product solely on the estimate of first-time sales.

For a frequently purchased new product, the seller has to estimate repeat sales as well as first-time sales. A high rate of repeat purchasing means that customers are satisfied; sales are likely to stay high even after all first-time purchases take place. The seller should note the percentage of repeat purchases that take place in each repeat-purchase class: those who rebuy once, twice, three times, and so on. Some products and brands are bought a few times and dropped.[18]

Estimating Costs and Profits

After preparing the sales forecast, management should estimate expected costs and profits. Costs are estimated by the R&D, manufacturing, marketing, and finance departments. Table 2.3 illustrates a five-year projection of sales, costs, and profits for the instant breakfast drink.

Row 1 shows the projected sales revenue over the five-year period. The company expects to sell $11,889,000 (approximately 500,000 cases at $24 per case) in the first year. Behind this sales projection is a set of assumptions about the rate of market growth, the company's market share, and the factory-realized price.

Row 2 shows the cost of goods sold, which hovers around 33 percent of sales revenue. This cost is found by estimating the average cost of labor, ingredients, and packaging per case.

Row 3 shows the expected gross margin, which is the difference between sales revenue and cost of goods sold.

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
1. Sales revenue	$0	$11,889	$15,381	$19,654	$28,253	$32, 491
2. Cost of goods sold	0	3,981	5,150	6,581	9,461	10,880
3. Gross margin	0	7,908	10,231	13,073	18,792	21,611
4. Development costs	−3,500	0	0	0	0	0
5. Marketing costs	0	8,000	6,460	8,255	11,866	13,646
6. Allocated overhead	0	1,189	1,538	1,965	2,825	3,249
7. Gross contribution	−3,500	−1,281	2,233	2,853	4,101	4,716
8. Supplementary contribution	0	0	0	0	0	0
9. Net contribution	−3,500	−1,281	2,233	2,853	4,101	4,716
10. Discounted contribution (15%)	−3,500	−1,113	1,691	1,877	2,343	2,346
11. Cumulative discounted cash flow	−3,500	−4,613	−2,922	−1,045	1,298	3,644

TABLE 2.3

Projected Five-Year Cash-Flow Statement (in thousands of dollars)

Row 4 shows anticipated development costs of $3.5 million, including product-development cost, marketing research costs, and manufacturing-development costs.

Row 5 shows the estimated marketing costs over the five-year period to cover advertising, sales promotion, and marketing research and an amount allocated for sales force coverage and marketing administration.

Row 6 shows the allocated overhead to this new product to cover its share of the cost of executive salaries, heat, light, and so on.

Row 7, the gross contribution, is found by subtracting the preceding three costs from the gross margin.

Row 8, supplementary contribution, lists any change in income from other company products caused by the introduction of the new product. It has two components. Dragalong income is additional income on other company products resulting from adding this product to the line. Cannibalized income is the reduced income on other company products resulting from adding this product to the line.[19] Table 2.3 assumes no supplementary contributions.

Row 9 shows the net contribution, which in this case is the same as the gross contribution.

Row 10 shows the discounted contribution—that is, the present value of each future contribution discounted at 15 percent per annum. For example, the company will not receive $4,716,000 until the fifth year. This amount is worth only $2,346,000 today if the company can earn 15 percent on its money through other investments.[20]

Finally, row 11 shows the cumulative discounted cash flow, which is the cumulation of the annual contributions in row 10. Two things are of central interest. The first is the maximum investment exposure, which is the highest loss that the project can create. We see that the company will be in a maximum loss position of $4,613,000 in year 1. The second is the payback period, which is the time when the company recovers all of its investment including the built-in return of 15 percent. The payback period here is approximately three and a half years. Management therefore has to decide whether to risk a maximum investment loss of $4.6 million and a possible payback period of three and a half years.

Companies use other financial measures to evaluate the merit of a new-product proposal. The simplest is *break-even analysis*, in which management estimates how many units of the product the company would have to sell to break even with the given price and cost structure. If management believes sales could easily reach the break-even number, it is likely to move the project into product development.

The most complex method of estimating profit is *risk analysis*. Here three estimates (optimistic, pessimistic, and most likely) are obtained for each uncertain variable affecting profitability under an assumed marketing environment and marketing strategy for the planning period. The computer simulates possible outcomes and computes a rate-of-return probability distribution showing the range of possible rates of returns and their probabilities.[21]

MANAGING THE DEVELOPMENT PROCESS: DEVELOPMENT TO COMMERCIALIZATION

P OD C DE ELOPMEN

If the product concept passes the business test, it moves to R&D or engineering to be developed into a physical product. Up to now it has existed only as a word description, a drawing, or a prototype. This step involves a large jump in investment that dwarfs the costs incurred in the earlier stages. At this stage the company will determine whether the product idea can be translated into a technically and commercially feasible product. If it cannot, the accumulated project cost will be lost except for any useful information gained in the process.

The job of translating target customer requirements into a working prototype is helped by a set of methods known as *quality function deployment* (QFD). The methodology takes the list of desired *customer attributes* (CAs) generated by market research and turns them into a list of *engineering attributes* (EAs) that the engineers can use. For example, customers of a proposed truck may want a certain acceleration rate (CA). Engineers can turn this into the required horsepower and other engineering equivalents (EAs). The methodology permits measuring the trade-offs and costs of providing the customer requirements. A major contribution of QFD is that it improves communication between marketers, engineers, and the manufacturing people.[22]

The R&D department will develop one or more physical versions of the product concept. Its goal is to find a prototype that consumers see as embodying the key attributes described in the product-concept statement, that performs safely under normal use and conditions, and that can be produced within the budgeted manufacturing costs.

Developing and manufacturing a successful prototype can take days, weeks, months, or even years. Designing a new commercial aircraft takes several years of development work, yet sophisticated virtual reality technology is speeding the process. By designing and testing product designs through simulation, for example, companies achieve the flexibility to respond to new information and to resolve uncertainties by quickly exploring alternatives.

- **B** At Boeing, the all-digital development of the 777 aircraft made use of a computer-generated "human" who would climb inside the three-dimensional design on-screen to show how difficult maintenance access would be for a live mechanic. Such computer modeling allowed engineers to spot design errors that otherwise would have remained undiscovered until a person began to work on a physical prototype. By avoiding the time and cost associated with building physical prototypes at several stages, Boeing's development process has acquired the flexibility to evaluate a wider range of design options than previously thought possible.[23]

Even developing a new taste formula can take time. Maxwell House discovered that consumers wanted coffee that was "bold, vigorous, and deep tasting." Its laboratory technicians spent over four months working with various coffee blends and flavors to formulate a corresponding taste that turned out to be too expensive to produce. The company cost-reduced the blend to meet the target manufacturing cost. The change compromised the taste, and the new brand did not sell well in the market.

With the rise of the World Wide Web, there is a need for more rapid prototyping and more flexible development processes. Michael Schrage, research associate at MIT's

MARKETING FOR THE MILLENNIUM

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Traditional [product] development processes . . . are highly structured. A future product is designed, developed, transferred to production, and rolled out to the market in clearly articulated, sequential phases. . In contrast, flexible product development delays until as late as possible any commitment to a final design configuration. The concept development phase and the implementation phase„the translation of concept into reality„thus overlap instead of following each other sequentially. By accepting the need for and reducing the cost of changes, companies are able to respond to new information that arises during the course of a product•s development.

When technology, product features, and competitive conditions are predictable or evolve slowly, a traditional development process works well. But in turbulent business environments, a sequential approach . . . is more than inefficient, it risks creating an obsolete product„one that fails to address customer needs and to make use of the latest technologies. [Netscape faced just such a turbulent environment when it developed the second generation of its Navigator Web browser.] Industry giant Microsoft, which had already developed its own flexible product-development process, was readying a product to compete with Navigator. .

Netscape introduced Navigator 2.0 to the market in January of 1996 and immediately thereafter began to develop the next version of the Web browser, Navigator 3.0, which was to be released in August of the same year. The Netscape development group„which included staff from engineering, marketing, and customer support„produced the first prototype quickly. By February 14, just six weeks into the project, it had put a beta 0 version of the program up on the company•s internal project Web site for testing by the development staff. Although many of the intended functions were not yet available, the prototype captured enough of the essence of the new product to generate meaningful feedback from members of the development group. On February 22, less than two weeks later, the team posted an updated version, Beta 1, again for internal development staff only. In early March, with major bugs in the product worked out, the first public release, Beta 2, appeared on Netscape•s Internet Web site. Additional public releases followed thereafter every few weeks until the official release date in August, with gradual refinements appearing in each beta iteration. The sequence of beta versions was extremely useful to Netscape because it enabled the development team to react both to feedback from users and to changes in the marketplace while the team was still working on the Web browser•s design. Beta users by and large are more sophisticated than Netscape•s broader customer base and therefore are a valuable source of information. . . . the team also paid careful attention to competing products. Netscape continually monitored the latest beta versions of Microsoft•s competing product, Explorer, to compare features and format.

To facilitate the integration of the vast amounts of information generated during the project, Netscape set up a project Web site on its Intranet. The site contained the product•s development schedule and specifications, each of which was updated as target dates changed or new features were added. In addition, it contained bulletin boards through which team members could monitor the evolution of various parts of the design, noting the completion of specific features and logging problems in the existing version. Once the Navigator moved to public beta testing, these Intranet features became especially valuable because an increasing amount of information then had to be received, classified, and processed. . .

Source: Adapted from Marco Iansiti and Alan MacCormack, •Developing Products on Internet Time,Ž *Harvard Business Review,* September…October 1997, pp. 108…17.

media lab, has correctly predicted: “Effective prototyping may be the most valuable ‘core competence’ an innovative organization can hope to have.”[24] This has certainly been true for software companies such as Microsoft, Netscape, and the hundreds of Silicon Valley start-ups. Although Schrage says that specification-driven companies require that every “i” be dotted and “t” be crossed before anything can be shown to the next level of management, prototype-driven companies—such as Yahoo!, Microsoft, and Netscape—cherish quick-and-dirty tests and experiments. See the Marketing for the Millennium box, “Developing Products on Internet Time: The Story of Netscape’s Navigator.”

Lab scientists must not only design the product’s functional characteristics but also communicate its psychological aspects through physical cues. How will consumers react to different colors, sizes, and weights? In the case of a mouthwash, a yellow color supports an “antiseptic” claim (Listerine), a red color supports a “refreshing” claim (Lavoris), and a green or blue color supports a “cool” claim (Scope). Marketers need to supply lab people with information on what attributes consumers seek and how consumers judge whether these attributes are present.

When the prototypes are ready, they must be put through rigorous *functional tests* and *customer tests*. *Alpha testing* is the name given to testing the product within the firm to see how it performs in different applications. After refining the prototype further, the company moves to *beta testing*. It enlists a set of customers to use the prototype and give feedback on their experiences. Beta testing is most useful when the potential customers are heterogeneous, the potential applications are not fully known, several decision makers are involved in purchasing the product, and opinion leadership from early adopters is sought.[25] Here are some of the functional tests that products go through before they enter the marketplace:

- **I** At Shaw Industries, temps are paid $5 an hour to pace up and down five long rows of sample carpets for up to eight hours a day, logging an average of 14 miles each. One regular reads three mysteries a week while pacing and shed 40 pounds in two years. Shaw Industries counts walkers' steps and figures that 20,000 steps equal several years of average wear.
- **A C** Apple Computer assumes the worst for its PowerBook customers and submits the computers to a battery of indignities: It drenches the computers in Pepsi and other sodas, smears them with mayonnaise, and bakes them in ovens at temperatures of 140 degrees or more to simulate conditions in a car trunk.
- **G** At Gillette, 200 volunteers from various departments come to work unshaven each day, troop to the second floor of the company's South Boston manufacturing and research plant, and enter small booths with a sink and mirror. There they take instructions from technicians on the other side of a small window as to which razor, shaving cream, or aftershave to use, and then they fill out questionnaires. "We bleed so you'll get a good shave at home," says one Gillette employee.[26]

Companies that position products on the basis of their durability even incorporate functional product testing into their advertising:

- **C D** High durability was the focus of some unusual advertising for Corning's Consumer Products Division's Corelle dinnerware. On five city buses in Phoenix, out-of-home media network TDI constructed a special Plexiglas cage, four feet long by one foot high, that housed a Corelle plate. Within the cage, the plate was free to roll back and forth as the bus accelerated, decelerated, and took turns.[27]

Consumer testing can take a variety of forms, from bringing consumers into a laboratory to giving them samples to use in their homes. In-home placement tests are common with products ranging from ice cream flavors to new appliances. When DuPont developed its new synthetic carpeting, it installed free carpeting in several homes in exchange for the homeowners' willingness to report their likes and dislikes about the carpeting.

When testing cutting-edge products such as electric cars, marketers must be as creative as the product designers and engineers: Rügen, a small island in the Baltic Sea, has become the testing ground for the cars of the future. Fifty-eight residents of the former East German island have gone from driving decrepit gas-guzzling cars to sleek new electric models manufactured by BMW, Daimler Chrysler, and Audi. The Rügen tests have made the auto manufacturers aware of several problems: Rügen drivers have found that trips of any length must be carefully mapped out because of the batteries' limited life. Recharging the batteries can consume anywhere from a half hour to an entire evening.[28]

Consumer preferences can be measured in several ways. Suppose a consumer is shown three items—A, B, and C, such as three cameras, three insurance plans, or three advertisements.

- The *rank-order* method asks the consumer to rank the three items in order of preference. The consumer might respond with A > B > C. Although this method has the advantage of simplicity, it does not reveal how intensely the consumer feels about each item nor whether the consumer likes any item very much. It is also difficult to use this method when there are many objects to be ranked.
- The *paired-comparison* method calls for presenting pairs of items and asking the consumer which one is preferred in each pair. Thus the consumer could be presented with the pairs AB, AC, and BC and say that she prefers A to B, A to C, and B to C. Then we could conclude that A > B > C. People find it easy to state their preference between two items, and this method allows the consumer to focus on the two items, noting their differences and similarities.
- The *monadic-rating* method asks the consumer to rate liking of each product on a scale. Suppose a seven-point scale is used, where 1 signifies intense dislike, 4 indifference, and 7 intense like. Suppose the consumer returns the following ratings: A = 6, B = 5, C = 3. We can derive the individual's preference order (i.e., A > B > C) and even know the qualitative levels of the person's preference for each and the rough distance between preferences.

MARKET TESTING

After management is satisfied with functional and psychological performance, the product is ready to be dressed up with a brand name and packaging, and put to a market test. The new product is introduced into an authentic setting to learn how large the market is and how consumers and dealers react to handling, using, and repurchasing the product.

Not all companies undertake market testing. A company officer at Revlon, Inc., stated: "In our field—primarily higher-priced cosmetics not geared for mass distribution—it would be unnecessary for us to market test. When we develop a new product, say an improved liquid makeup, we know it's going to sell because we're familiar with the field. And we've got 1,500 demonstrators in department stores to promote it." Most companies, however, know that market testing can yield valuable information about buyers, dealers, marketing program effectiveness, and market potential. The main issues are: How much market testing should be done, and what kind(s)?

The amount of market testing is influenced by the investment cost and risk on the one hand, and the time pressure and research cost on the other. High investment–high risk products, where the chance of failure is high, must be market tested; the cost of the market tests will be an insignificant percentage of the total project cost. High-risk products—those that create new-product categories (first instant breakfast drink) or have novel features (first fluoride toothpaste)—warrant more market testing than modified products (another toothpaste brand). Procter & Gamble spent two years market testing its new no-calorie fat substitute, Olestra. While the Food and Drug Administration approved the new product in 1996, a very small percentage (estimated at 2 percent) of consumers experienced stomach problems and the indelicately named side effect, "anal leakage." The company made a slight change in the formula, but even after test marketing has proved that this side effect does not occur, the FDA requires that every package containing food made with Olestra bear a label that reads: "This product contains Olestra. Olestra may cause abdominal cramping and loose stools. Olestra inhibits the absorption of some vitamins and other nutrients. . . . "[29] But the amount of market testing may be severely reduced if the company is under great time pressure because the season is just starting or because competitors are about to launch their brands. The company may therefore prefer to face the risk of a product failure to the risk of losing distribution or market penetration on a highly successful product.

Next we describe consumer-goods market testing and business-goods testing.

Consumer-Goods Market Testing

In testing consumer products, the company seeks to estimate four variables: trial, first repeat, adoption, and purchase frequency. The company hopes to find all these variables at high levels. In some cases, it will find many consumers trying the product but few rebuying it. Or it might find high permanent adoption but low purchase frequency (as with gourmet frozen foods).

Here we describe the major methods of consumer-goods market testing, from the least to the most costly.

Sales-Wave Research. In *sales-wave research*, consumers who initially try the product at no cost are reoffered the product, or a competitor's product, at slightly reduced prices. They might be reoffered the product as many as three to five times (sales waves), with the company noting how many customers selected that company's product again and their reported level of satisfaction. Sales-wave research can also include exposing consumers to one or more advertising concepts to see the impact of that advertising on repeat purchase.

Sales-wave research can be implemented quickly, conducted with a fair amount of security, and carried out without final packaging and advertising. However, sales-wave research does not indicate the trial rates that would be achieved with different sales-promotion incentives, because the consumers are preselected to try the product. Nor does it indicate the brand's power to gain distribution and favorable shelf position.

Simulated Test Marketing. *Simulated test marketing* calls for finding 30 to 40 qualified shoppers and questioning them about brand familiarity and preferences in a specific product category. These people are then invited to a brief screening of both well-known and new commercials or print ads. One ad advertises the new product, but it is not singled out for attention. Consumers receive a small amount of money and are invited into a store where they may buy any items. The company notes how many consumers buy the new brand and competing brands. This provides a measure of the ad's relative effectiveness against competing ads in stimulating trial. Consumers are asked the reasons for their purchases or nonpurchases. Those who did not buy the new brand are given a free sample. Some weeks later, they are reinterviewed by phone to determine product attitudes, usage, satisfaction, and repurchase intention and are offered an opportunity to repurchase any products.

This method has several advantages. It gives fairly accurate results on advertising effectiveness and trial rates (and repeat rates if extended) in a much shorter time and at a fraction of the cost of using real test markets. Pretests often take only three months and may cost $250,000.[30] The results are incorporated into new-product forecasting models to project ultimate sales levels. Marketing research firms report surprisingly accurate predictions of sales levels of products that are subsequently launched in the market.[31]

Controlled Test Marketing. In this method, a research firm manages a panel of stores that will carry new products for a fee. The company with the new product specifies the number of stores and geographic locations it wants to test. The research firm delivers the product to the participating stores and controls shelf position; number of facings, displays, and point-of-purchase promotions; and pricing. Sales results can be measured through electronic scanners at the checkout. The company can also evaluate the impact of local advertising and promotions during the test.

Controlled test marketing allows the company to test the impact of in-store factors and limited advertising on buying behavior. A sample of consumers can be interviewed later to give their impressions of the product. The company does not have to use its own sales force, give trade allowances, or "buy" distribution. However, controlled test marketing provides no information on how to sell the trade on carrying the new product. This technique also exposes the product and its features to competitors' scrutiny.

Test Markets. The ultimate way to test a new consumer product is to put it into full-blown test markets. The company chooses a few representative cities, and the sales force tries to sell the trade on carrying the product and giving it good shelf exposure. The company puts on a full advertising and promotion campaign in these markets similar to the one that it would use in national marketing. A full-scale test can cost over $1 million, depending on the number of test cities, the test duration, and the amount of data the company wants to collect.

Management faces several questions:

1. *How many test cities?* Most tests use between two and six cities. The greater the maximum possible loss, the greater the number of contending marketing

strategies, the greater the regional differences, and the greater the chance of test-market interference by competitors, the greater the number of cities that should be used.

2. *Which cities?* Each company must develop test-city selection criteria. One company looks for test cities that have diversified industry, good media coverage, cooperative chain stores, average competitive activity, and no evidence of being overtested.

3. *Length of test?* Market tests last anywhere from a few months to a year. The longer the product's average repurchase period, the longer the test period necessary to observe repeat-purchase rates. This period should be cut down if competitors are rushing to the market.

4. *What information?* Warehouse shipment data will show gross inventory buying but will not indicate weekly sales at the retail level. *Store audits* will show retail sales and competitors' market shares but will not reveal buyer characteristics. *Consumer panels* will indicate which people are buying which brands and their loyalty and switching rates. *Buyer surveys* will yield in-depth information about consumer attitudes, usage, and satisfaction.

5. *What action to take?* If the test markets show high trial and repurchase rates, the product should be launched nationally. If the test markets show a high trial rate and a low repurchase rate, customers are not satisfied and the product should be redesigned or dropped. If the test markets show a low trial rate and a high repurchase rate, the product is satisfying but more people have to try it. This means increasing advertising and sales promotion. If trial and repurchase rates are both low, the product should be abandoned.

Test marketing permits testing the impact of alternative marketing plans. Colgate-Palmolive used a different marketing mix in each of four cities to market a new soap product: (1) an average amount of advertising coupled with free samples distributed door to door, (2) heavy advertising plus samples, (3) an average amount of advertising linked with mailed redeemable coupons, and (4) an average amount of advertising with no special introductory offer. The third alternative generated the best profit level, although not the highest sales level.

In spite of the benefits of test marketing, many companies question its value today. In a fast-changing marketplace, companies are eager to get to market first. Test marketing slows them down and reveals their plans to competitors. Procter & Gamble began testing a ready-to-spread Duncan Hines frosting. General Mills took note and rushed out its own Betty Crocker brand, which now dominates the category. Furthermore, aggressive competitors increasingly take steps to spoil the test markets. When Pepsi tested its Mountain Dew sport drink in Minneapolis, Gatorade counterattacked furiously with coupons and ads.[32]

Many companies today are skipping test marketing and relying on faster and more economical market-testing methods. General Mills now prefers to launch new products in perhaps 25 percent of the country, an area too large for rivals to disrupt. Managers review retail scanner data, which tell them within days how the product is doing and what corrective fine-tuning to do. Colgate-Palmolive often launches a new product in a set of small "lead countries" and keeps rolling it out if it proves successful.

Nonetheless, managers should consider all the angles before deciding to dispense with test marketing. In this case, not testing a formula modification before the product launch had disastrous—and soggy—results:

■ **N F C** Nabisco hit a marketing home run with its Teddy Grahams, teddy-bear-shaped graham crackers in several different flavors. So, the company decided to extend Teddy Grahams into a new area. In 1989, it introduced chocolate, cinnamon, and honey versions of Breakfast Bears Graham Cereal. When the product came out, however, consumers didn't like the taste enough, so the product developers went back to the kitchen and modified the formula, but didn't test it. The result was a disaster. Although the cereal may have tasted better, it no longer stayed crunchy in milk, as the advertising on the box promised. Instead, it left a gooey mess of graham mush on the bottom of cereal bowls. Supermarket managers soon refused to restock the cereal, and Nabisco executives decided it was too late to reformulate the product again. So a promising new product was killed through haste to get it to market.[33]

Business-Goods Market Testing

Business goods can also benefit from market testing. Expensive industrial goods and new technologies will normally undergo *alpha testing* (within the company) and *beta testing* (with outside customers). During beta testing, the vendor's technical people observe how test customers use the product, a practice that often exposes unanticipated problems of safety and servicing and alerts the vendor to customer training and servicing requirements. The vendor can also observe how much value the equipment adds to the customer's operation as a clue to subsequent pricing. The vendor will ask the test customers to express their purchase intention and other reactions after the test.

The test customers benefit in several ways: They can influence product design, gain experience with the new product ahead of competitors, receive a price break in return for cooperation, and enhance their reputation as technological pioneers. Vendors must carefully interpret the beta test results because only a small number of test customers are used, they are not randomly drawn, and the tests are somewhat customized to each site. Another risk is that test customers who are unimpressed with the product may leak unfavorable reports about it.

A second common test method for business goods is to introduce the new product at trade shows. Trade shows draw a large number of buyers, who view many new products in a few concentrated days. The vendor can observe how much interest buyers show in the new product, how they react to various features and terms, and how many express purchase intentions or place orders. Book publishers, for instance, regularly launch their fall titles at the American Booksellers Association convention each spring. There they display page proofs wrapped in dummy book covers. If a large bookstore chain objects to a cover design or title of a promising new book, the publisher will consider changing the cover or title. The disadvantage of trade shows is that they reveal the product to competitors; therefore, the vendor should be ready to launch the product soon after the trade show.

New industrial products can be tested in distributor and dealer display rooms, where they may stand next to the manufacturer's other products and possibly competitors' products. This method yields preference and pricing information in the product's normal selling atmosphere. The disadvantages are that the customers might want to place early orders that cannot be filled, and those customers who come in might not represent the target market.

Industrial manufacturers come close to using full test marketing when they give a limited supply of the product to the sales force to sell in a limited number of areas that receive promotion support and printed catalog sheets. In this way, management can make a more informed decision about commercializing the product.

COMME CIALI A ION

If the company goes ahead with commercialization, it will face its largest costs to date. The company will have to contract for manufacture or build or rent a full-scale manufacturing facility. Plant size will be a critical decision. The company can build a smaller plant than called for by the sales forecast, to be on the safe side. That is what Quaker Oats did when it launched its 100 Percent Natural breakfast cereal. The demand so exceeded the company's sales forecast that for about a year it could not supply enough product to the stores. Although Quaker Oats was gratified with the response, the low forecast cost it a considerable amount of profit.

Another major cost is marketing. To introduce a major new consumer packaged good into the national market, the company may have to spend between $20 million and $80 million in advertising and promotion in the first year. In the introduction of new food products, marketing expenditures typically represent 57 percent of sales during the first year.

In the movie business, it's not unusual for the cost of marketing a movie to eclipse the cost of making it, particularly for what Hollywood calls "tentpole" films, those big summer blockbusters that can carry the rest of the studio's projects on the strength of their revenues. In the decade between 1987 and 1997, the average cost of making a movie went from $20 million to $53 million, but marketing costs zoomed from $6.7 million to $22 million. Here's a story that illustrates what money and marketing can do for a new movie—and what it can't do:

■ **P E** During the summer of 1998, you probably noticed the giant billboards with the teasing, double entendre, "Size does matter." However, you may have already forgotten the movie that the billboards were touting. Sony Pictures spent $125 million to make its summer blockbuster, *Godzilla,* and some $200 million to make sure it was a hit. Actually, Sony's 250 marketing partners, such as Taco Bell, put up $150 million of that $200 million for licensing rights to *Godzilla* backpacks, T-shirts, and other scaly paraphernalia. The huge ad campaign infiltrated billboards and buses, buttons and T-shirts, TV and radio. Yet, for all of Sony's marketing muscle, the only truly big thing about *Godzilla* was that it was a big flop. Three weeks after it opened, it had grossed only $110 million, about half of what Sony had predicted. Critics panned the movie and audiences agreed. However, Sony's claim that "Size does matter" certainly rings true when it comes to marketing movies. When Sony's top brass saw the initial screening and realized *Godzilla* would be a bomb, they went out and spent even more money on marketing. By luring as many moviegoers as possible into theaters early, Sony's gamble paid off. It would end up grossing more than the $175 million it spent to make and market *Godzilla*.[34]

When (Timing)

In commercializing a new product, market-entry timing is critical. Suppose a company has almost completed the development work on its new product and learns that a competitor is nearing the end of its development work. The company faces three choices:

1. *First entry:* The first firm entering a market usually enjoys the "first mover advantages" of locking up key distributors and customers and gaining reputational leadership. But, if the product is rushed to market before it is thoroughly debugged, the product can acquire a flawed image.
2. *Parallel entry:* The firm might time its entry to coincide with the competitor's entry. The market may pay more attention when two companies are advertising the new product.
3. *Late entry:* The firm might delay its launch until after the competitor has entered. The competitor will have borne the cost of educating the market. The competitor's product may reveal faults the late entrant can avoid. The company can also learn the size of the market.

The timing decision involves additional considerations. If a new product replaces an older product, the company might delay the introduction until the old product's stock is drawn down. If the product is highly seasonal, it might be delayed until the right season arrives.[35]

Where (Geographic Strategy)

The company must decide whether to launch the new product in a single locality, a region, several regions, the national market, or the international market. Most will develop a planned market rollout over time. For instance, Coca-Cola launched its new soda, Citra, a caffeine-free, grapefruit-flavored drink, in about half the United States. The multistaged rollout, following test marketing in Phoenix, south Texas, and south Florida, began in January 1998 in Dallas, Denver, and Cincinnati.[36] Company size is an important factor here. Small companies will select an attractive city and put on a blitz campaign. They will enter other cities one at a time. Large companies will introduce their product into a whole region and then move to the next region.

Companies with national distribution networks, such as auto companies, will launch their new models in the national market.

Most companies design new products to sell primarily in the domestic market. If the product does well, the company considers exporting to neighboring countries or the world market, redesigning if necessary. Cooper and Kleinschmidt, in their study of industrial products, found that domestic products designed solely for the domestic market tend to show a high failure rate, low market share, and low growth. In contrast, products designed for the world market—or at least to include neighboring countries—achieve significantly more profits, both at home and abroad. Yet only 17 percent of the products in Cooper and Kleinschmidt's study were designed with an international orientation.[37] The implication is that companies should adopt an international focus in designing and developing new products.

In choosing rollout markets, the candidate markets can be listed as rows, and rollout attractiveness criteria can be listed as columns. The major rating criteria are market potential, company's local reputation, cost of filling the pipeline, cost of communication media, influence of area on other areas, and competitive penetration.

The presence of strong competitors will influence rollout strategy. Suppose McDonald's wants to launch a new chain of fast-food pizza parlors. Pizza Hut, a formidable competitor, is strongly entrenched on the East Coast. Another pizza chain is entrenched on the West Coast but is weak. The Midwest is the battleground between two other chains. The South is open, but Shakey's is planning to move in. McDonald's faces a complex decision in choosing a geographic rollout strategy.

With the World Wide Web connecting far-flung parts of the globe, competition is more likely to cross national borders. Companies are increasingly rolling out new products simultaneously across the globe, rather than nationally or even regionally. However, masterminding a global launch provides challenges. Autodesk, the world's leading supplier of PC design software and multimedia tools, has 3 million customers in more than 150 countries. Carol Bartz, chairman and CEO, says that the biggest obstacle to a global launch success is getting all the different marketers to agree with the positioning: "Then the issue is speed—getting the materials out fast enough. We get them to agree on the look (using one image), and then it's a matter of putting a local spin on it. It requires an immense amount of concentration."[38] Coordinating an international launch also requires very deep pockets, as was the case with the launch of Iridium's "world phone."

■ **I I.** It's a phone the size of a brick with an antenna as thick as a stout breadstick. It costs $3,000, but this satellite-linked phone allows users to communicate from anywhere on earth. Iridium faced countless challenges in marketing this unwieldy, expensive device to a diverse, globe-trotting market. Brazil expected to presell 46,000 Iridium phones because of the country's creaky phone system. Iridium Mideast wanted the phone in hunting-supply shops, because it was the perfect toy for desert falconry. An executive from Iridium India planned exclusive parties for rich businessmen who might want the new status symbol. Eventually, the company relied on APL, a division of Interpublic Group, to craft a single campaign for what is, arguably, the most intensive effort ever to build a global brand overnight. The $140 million campaign is running in 45 countries. Direct-mail materials are being translated into 13 languages. TV ads are scheduled on 17 different airlines. Iridium booths, where travelers will be able to handle the phones in person, are being set up in executive lounges in airports around the world. Finally, in what is surely the ultimate symbol of a global launch, APL hired laser specialists to beam the company's Big Dipper logo onto the clouds.[39]

To Whom (Target-Market Prospects)

Within the rollout markets, the company must target its initial distribution and promotion to the best prospect groups. Presumably, the company has already profiled the prime prospects, who would ideally have the following characteristics: They would be early adopters, heavy users, and opinion leaders, and they could be reached at a low cost.[40] Few groups have all these characteristics. The company should rate the various prospect groups on these characteristics and target the best prospect group. The aim is to generate strong sales as soon as possible to motivate the sales force and attract further prospects.

Many companies are surprised to learn who really buys their product and why. Microwave ovens began to enjoy explosive growth only after microwave-oven popcorn was developed. Households dramatically increased their purchase of computers when the CD-ROM multimedia feature was introduced.

How (Introductory Market Strategy)

The company must develop an action plan for introducing the new product into the rollout markets. With its debut in 1998, the competitively priced iMac represented Apple Computer's reentry into the computer PC business after a hiatus of 14 years. The company staged a massive marketing blitz to launch the new machine.

- **A C - I .** Apple's launch of the iMac, the sleek, egg-shaped computer with one-touch Internet access, was dramatic. For starters, the iMac was a closely guarded secret until May 6, 1998, when Jobs literally unveiled the machine to awestruck reporters. The buzz continued to mount, on-line and off, until the machine went on sale in August. On the weekend of August 14, computer retailers prepared Midnight Madness sales featuring 20-foot-high inflatable iMacs flying above the stores. Radio stations across the country began an iMac countdown, topped off with iMac giveaways. Jobs personally signed five "golden" tickets and placed them in the boxes of five iMacs, with the winner receiving a free iMac each year for the next five years. Apple augmented these efforts with a $100 million ad campaign, its biggest ever, to promote iMac through TV, print, radio, and billboards. The campaign featured images of the iMac alongside slogans such as "Mental Floss" and "I think, therefore iMac."[41]

To coordinate the many activities involved in launching a new product, management can use network-planning techniques such as critical path scheduling. *Critical path scheduling (CPS)* calls for developing a master chart showing the simultaneous and sequential activities that must take place to launch the product. By estimating how much time each activity takes, the planners estimate completion time for the entire project. Any delay in any activity on the critical path will cause the project to be delayed. If the launch must be completed earlier, the planner searches for ways to reduce time along the critical path.[42]

THE CONSUMER-ADOPTION PROCESS

How do potential customers learn about new products, try them, and adopt or reject them? (*Adoption* is an individual's decision to become a regular user of a product.) *The consumer-adoption process* is later followed by the *consumer-loyalty process*, which is the concern of the established producer.

Years ago, new-product marketers used a *mass-market approach* in launching products. They would distribute a product everywhere and advertise it to everyone on the assumption that most people are potential buyers. This approach had two main drawbacks: It called for heavy marketing expenditures, and it involved many wasted exposures to people who are not potential consumers. These drawbacks led to a second approach, *heavy-user target marketing*, where the product is initially aimed at heavy users.

This approach makes sense, provided that heavy users are identifiable and are early adopters. But even within the heavy-user group, consumers differ in interest in new products and brands; many heavy users are loyal to existing brands. Many new-product marketers now aim at consumers who are early adopters. According to *early-adopter theory*:

- Persons within a target market differ in the amount of elapsed time between their exposure to a new product and their trying it.

- Early adopters share some traits that differentiate them from late adopters.
- Efficient media exist for reaching early adopters.
- Early adopters tend to be opinion leaders and helpful in “advertising” the new product to other potential buyers.

The theory of innovation diffusion and consumer adoption helps marketers identify early adopters.

AGE IN HE ADOP ION P OCE

An *innovation* refers to any good, service, or idea that is *perceived* by someone as new. The idea may have a long history, but it is an innovation to the person who sees it as new. Innovations take time to spread through the social system. Rogers defines the *innovation diffusion process* as “the spread of a new idea from its source of invention or creation to its ultimate users or adopters.”[43] The consumer-adoption process focuses on the mental process through which an individual passes from first hearing about an innovation to final adoption.

Adopters of new products have been observed to move through five stages:

1. *Awareness:* The consumer becomes aware of the innovation but lacks information about it.
2. *Interest:* The consumer is stimulated to seek information about the innovation.
3. *Evaluation:* The consumer considers whether to try the innovation.
4. *Trial:* The consumer tries the innovation to improve his or her estimate of its value.
5. *Adoption:* The consumer decides to make full and regular use of the innovation.

The new-product marketer should facilitate consumer movement through these stages. A portable electric-dishwasher manufacturer might discover that many consumers are stuck in the interest stage; they do not buy because of their uncertainty and the large investment cost. But these same consumers would be willing to use an electric dishwasher on a trial basis for a small monthly fee. The manufacturer should consider offering a trial-use plan with option to buy. Developers of most general-interest interactive CD-ROM titles found that consumers were stuck in the interest or trial stage and moved less rapidly to adoption.

- **CD- OM** In the early 1990s, there seemed to be room in the CD-ROM industry for everyone. Multimedia developers were producing action games and educational software and moving into a hodgepodge of interactive products that ranged from hypertext novels to multimedia music anthologies. Today, few of these titles are selling well or even on the market. One of the main causes of the poor sales is the ascendance of the Web. Most CD-ROMs, particularly reference titles, found a more cost-effective home on the Web, a medium that also enables them to keep up-to-date and link to a community of users. CD-ROMs also faced hundreds of competitors in an extremely fragmented entertainment market. Another problem was the glut of titles with serious quality problems. Although consumers were willing to put up with lower quality, they were not patient with technical glitches. When Disney was beset by massive store returns of its defective Lion King CD-ROM, the *New York Times* promptly claimed that CD-ROMs were dead.[44]

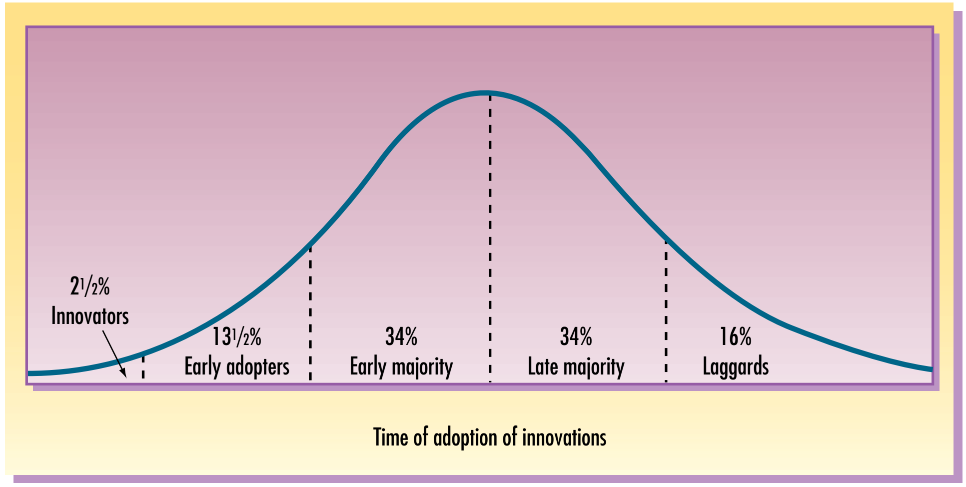
FAC O INFL ENCING HE ADOP ION P OCE

Marketers recognize the following characteristics of the adoption process: differences in individual readiness to try new products; the effect of personal influence; differing rates of adoption; and differences in organizations’ readiness to try new products.

FIGURE 2-6

Adopter Categorization on the Basis of Relative Time of Adoption of Innovations

Source: Redrawn from Everett M. Rogers, *Diffusion of Innovations* (New York: Free Press, 1983).



People Differ in Readiness to Try New Products

Rogers defines a person's innovativeness as "the degree to which an individual is relatively earlier in adopting new ideas than the other members of his social system." In each product area, there are consumption pioneers and early adopters. Some people are the first to adopt new clothing fashions or new appliances; some doctors are the first to prescribe new medicines; and some farmers are the first to adopt new farming methods. Other individuals adopt new products much later. People can be classified into the adopter categories shown in Figure 2-6. After a slow start, an increasing number of people adopt the innovation, the number reaches a peak, and then it diminishes as fewer nonadopters remain.

Rogers sees the five adopter groups as differing in their value orientations. Innovators are venturesome; they are willing to try new ideas. Early adopters are guided by respect; they are opinion leaders in their community and adopt new ideas early but carefully. The early majority are deliberate; they adopt new ideas before the average person, although they rarely are leaders. The late majority are skeptical; they adopt an innovation only after a majority of people have tried it. Finally, laggards are tradition bound; they are suspicious of change, mix with other tradition-bound people, and adopt the innovation only when it takes on a measure of tradition itself.

This classification suggests that an innovating firm should research the demographic, psychographic, and media characteristics of innovators and early adopters and direct communications specifically to them. For example, innovative farmers are likely to be better educated and more efficient. Innovative homemakers are more gregarious and usually higher in social status. Certain communities have a high share of early adopters. According to Rogers, earlier adopters tend to be younger in age, have higher social status, and a more favorable financial position. They utilize a greater number of more cosmopolitan information sources than do later adopters.[45]

Personal Influence Plays a Large Role

Personal influence is the effect one person has on another's attitude or purchase probability. Although personal influence is an important factor, its significance is greater in some situations and for some individuals than for others. Personal influence is more important in the evaluation stage of the adoption process than in the other stages. It has more influence on late adopters than early adopters. It also is more important in risky situations.

Characteristics of the Innovation Affect Rate of Adoption

Some products catch on immediately (e.g., rollerblades), whereas others take a long time to gain acceptance (e.g., diesel-engine autos). Five characteristics influence the rate of adoption of an innovation. We will consider them in relation to the adoption of personal computers for home use.

The first is *relative advantage*—the degree to which the innovation appears superior to existing products. The greater the perceived relative advantage of using a personal computer, say, in preparing income taxes and keeping financial records, the more quickly personal computers will be adopted.

The second is *compatibility*—the degree to which the innovation matches the values and experiences of the individuals. Personal computers, for example, are highly compatible with upper-middle-class lifestyles.

Third is *complexity*—the degree to which the innovation is relatively difficult to understand or use. Personal computers are complex and will therefore take a longer time to penetrate into home use.

Fourth is *divisibility*—the degree to which the innovation can be tried on a limited basis. The availability of rentals of personal computers with an option to buy increases their rate of adoption.

Fifth is *communicability*—the degree to which the beneficial results of use are observable or describable to others. The fact that personal computers lend themselves to demonstration and description helps them diffuse faster in the social system.

Other characteristics that influence the rate of adoption are cost, risk and uncertainty, scientific credibility, and social approval. The new-product marketer has to research all these factors and give the key ones maximum attention in designing the new-product and marketing program.[46]

Organizations Also Vary in Readiness to Adopt Innovations

The creator of a new teaching method would want to identify innovative schools. The producer of a new piece of medical equipment would want to identify innovative hospitals. Adoption is associated with variables in the organization's environment (community progressiveness, community income), the organization itself (size, profits, pressure to change), and the administrators (education level, age, sophistication). Other forces come into play when trying to get a product adopted into organizations that receive the bulk of their funding from the government, such as public schools. A controversial or innovative product can be squelched by negative public opinion. This was certainly the case with Christopher Whittle's Channel One, a television station for secondary schools.

■ C O C I . K-III C C

Do you remember Channel One? This was Christopher Whittle's grand plan to put free television sets in every secondary school. The catch? Teachers would have to flick on a twelve-minute news broadcast every morning, including two minutes of paid ads. Whittle came across as a slick huckster and drew protests from parents and teachers who didn't think commercials had any place in the school. It also didn't help that the original Channel One newscast, with its thumping rock music, looked more like a setting for the ads than for news. Whittle's media empire crumbled in 1994. However, in an interesting epilogue, and a testimony to the lessons to be learned from product failure, another company has bought Channel One and managed to gain adoption in enough schools to reach 8 million kids, 40 percent of the nation's teenagers.

K-III Communications Corporation listened to teachers and parents and made news programming more serious. There is still paid advertising, but the public furor had died down, and, as one principal says, "Even the commercials let us talk about how images are constructed." So maybe Whittle had the right product idea; he just flubbed the execution.[47]

SUMMARY

1. Once a company has segmented the market, chosen its target customer groups, identified their needs, and determined its desired market positioning, it is ready to develop and launch appropriate new products. Marketing should actively participate with other departments in every stage of new-product development.

2. Successful new-product development requires the company to establish an effective organization for managing the development process. Companies can choose to use product managers, new-product managers, new-product committees, new-product departments, or new-product venture teams.
3. Eight stages are involved in the new-product development process: idea generation, screening, concept development and testing, marketing strategy development, business analysis, product development, market testing, and commercialization. The purpose of each stage is to determine whether the idea should be dropped or moved to the next stage.
4. The consumer-adoption process is the process by which customers learn about new products, try them, and adopt or reject them. Today many marketers are targeting heavy users and early adopters of new products, because both groups can be reached by specific media and tend to be opinion leaders. The consumer-adoption process is influenced by many factors beyond the marketer's control, including consumers' and organizations' willingness to try new products, personal influences, and the characteristics of the new product or innovation.

APPLICATIONS

CONCEPTS

1. To generate really good new-product ideas you need inspiration, perspiration, and good techniques. Some companies struggle with trying to develop new-product ideas because they place more emphasis on inspiration and perspiration than they do on technique. Attribute listing, Alex Osborn's powerful creative tool, can activate the creative juices in just about everyone. Identify a product or service that you are familiar with and list its attributes. Then modify each attribute in search of an improved product. The following form will be useful in your deliberations. If you are having trouble getting started, consider a famous example

Attribute Listing Worksheet

Attributes	Magnify	Minify	Substitute	Adapt	Rearrange	Reverse	Combine	New Uses	Replace

of attribute alteration and expansion: that of Oreo cookies. From the simple, black-and-white Oreo, Nabisco has developed double-stuff Oreos, chocolate-covered Oreos, giant-size Oreos, mini-size Oreos, low-fat Oreos, lower-calorie Oreos, different packaging and package sizes, Oreo cookie ice cream, Oreo cookie ice cream cones, Oreo granola bars, Oreo cereal, and Oreo snack treats.

2. Prepare a list of questions that management should answer prior to developing a new product or service. Organize the questions according to the following categories: (a) market opportunity, (b) competition, (c) production, (d) patentable features, (e) distribution (for products) or delivery (for services), and (f) finance. Then answer each question for a new-product idea you have. Would the development and testing of a new service differ from those of a new product?

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
		Type of Sock				Package Size and Price			
	Total Respon-dents	24-inch Tube Sock	18-inch Tube Sock	Athletic Sock	Crew Sock	1 pair at $1.79–$1.99	1 pair at $1.99–$2.4 9	3 pairs at $4.99–$5.99	3 pairs at $5.49–$6.49
Respondent base*	(185)	(60)	(22)	(34)	(69)	(53)	(42)	(42)	(48)
Definitely would buy	38%	43%	45%	42%	29%	42%	45%	31%	33%
Probably would buy	44	47	27	35	51	38	40	48	50
Might or might not buy	14	7	23	15	16	13	20	19	13
Probably would not buy	3	3	5	6	1	4	5	„	4
Definitely would not buy	2	„	„	3	3	4	„	2	„

*Based on four-week consumer home-use test.
Source: CU Market Research.

TABLE 2.4

Likelihood of Purchasing Odor-Eaters

3. Before beginning an in-home-use test of Odor-Eater socks, each consumer participant selected the Odor-Eaters sock style he or she preferred. At the end of the test, the participants summarized how likely they would be to purchase Odor-Eaters in the future. These data are reported in Table 2.4. What conclusions can you draw from these data? What type of sock is most popular with consumers? Assuming that the consumer testers are representative of the market, how price sensitive is this market? Should the company package Odor-Eaters one to the box (columns 6 and 7), or would multiple packs (columns 8 and 9) be preferable?

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SECTION THREE

Analyzing Consumer Markets and Buyer Behavior

We will address the following questions:

- How do cultural, social, personal, and psychological factors influence consumer buying behavior?
- How does the consumer make a purchasing decision?

The aim of marketing is to meet and satisfy target customers' needs and wants. The field of consumer behavior studies how individuals, groups, and organizations select, buy, use, and dispose of goods, services, ideas, or experiences to satisfy their needs and desires. Understanding consumer behavior is never simple, because customers may say one thing but do another. They may not be in touch with their deeper motivations, and they may respond to influences and change their minds at the last minute.

Still, all marketers can profit from understanding how and why consumers buy. For example, Whirlpool's staff anthropologists go into people's homes, observe how they use appliances, and talk with household members. Whirlpool has found that in busy families, women are not the only ones doing the laundry. Knowing this, the company's engineers developed color-coded washer and dryer controls to make it easier for kids and men to pitch in.[1]

In fact, not understanding your customer's motivations, needs, and preferences can lead to major mistakes. This is what happened when Kodak introduced its Advanta camera—a costly bust. The company proudly touted it as a high-tech product, but the marketplace was dominated by middle-aged baby-boomers. In midlife, fancy new technology generally loses its appeal, and simplicity begins to edge out complexity in consumer preferences, so Advanta sales did not skyrocket.

Such examples show why successful marketers use both rigorous scientific procedures and more intuitive methods to study customers and uncover clues for developing new products, product features, prices, channels, messages, and other marketing-mix elements. This chapter explores individual consumers' buying dynamics; the next chapter explores the buying dynamics of business buyers.

HOW AND WHY CONSUMERS BUY

The starting point for understanding consumer buying behavior is the stimulus-response model shown in Figure 3-1. As this model shows, both marketing and environmental stimuli enter the buyer's consciousness. In turn, the buyer's characteristics and decision process lead to certain purchase decisions. The marketer's task is to understand what happens in the buyer's consciousness between the arrival of outside stimuli and the buyer's purchase decisions.

As this model indicates, a consumer's buying behavior is influenced by cultural, social, personal, and psychological factors.

Cultural Factors Influencing Buyer Behavior

Culture, subculture, and social class are particularly important influences on consumer buying behavior.

- *Culture. Culture* is the most fundamental determinant of a person's wants and behavior. A child growing up in the United States is exposed to these broad cultural values: achievement and success, activity, efficiency and practicality, progress, material comfort, individualism, freedom, external comfort, humanitarianism, and youthfulness.[2]
- *Subculture.* Each culture consists of smaller subcultures that provide more specific identification and socialization for their members. Subcultures include nationalities, religions, racial groups, and geographic regions. Many subcultures make up important market segments, leading marketers to tailor products and marketing programs to their needs. Latinos, for example, the fastest-growing U.S. subculture, are targeted by Dallas-based Carnival Food Stores, among other marketers. Dallas is one of the top 10 cities in terms of Latino population, and when the chain uses Spanish language promotions, customers are more responsive. Marketers are targeting another subculture, African Americans, because of its hefty $500 billion in purchasing power. Hallmark, for instance, created its Mahogany line of 800 greeting cards especially for African Americans. Age forms subcultures, as well; the 75 million Americans in the 50-plus market are being targeted by marketers such as Pfizer, which airs ads showing how its medications help seniors live life to the fullest.[3]

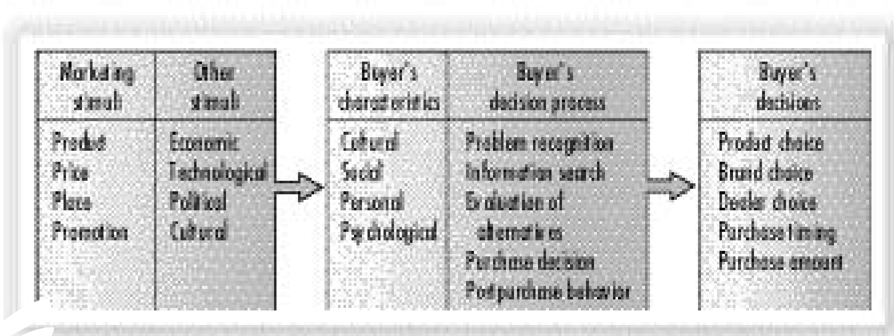


Figure 3-1 Model of Consumer Buyer Behavior

- *Social class.* **Social classes** are relatively homogeneous and enduring divisions in a society. They are hierarchically ordered and their members share similar values, interests, and behavior (see Table 3.1). Social classes reflect income as well as occupation, education, and other indicators. Those within each social class tend to behave more alike than do persons from different social classes. Also, within the culture, persons are perceived as occupying inferior or superior positions according to social class. Social class is indicated by a cluster of variables rather than by any single variable. Still, individuals can move from one social class to another—up or down—during their lifetime. Because social classes often show distinct product and brand preferences, some marketers focus their efforts on one social class. Neiman Marcus, for example, focuses on the upper classes, offering top-quality merchandise in upscale stores with many personal services geared to these customers' needs.

Social Factors Influencing Buyer Behavior

In addition to cultural factors, a consumer's behavior is influenced by such social factors as reference groups, family, and social roles and statuses.

Reference Groups

Reference groups consist of all of the groups that have a direct (face-to-face) or indirect influence on a person's attitudes or behavior. Groups that have a direct influence on a person are called *membership groups.* Some primary membership groups are family, friends, neighbors, and co-workers, with whom individuals interact fairly continuously and informally. Secondary groups, such as professional and trade-union groups, tend to be more formal and require less continuous interaction. Reference groups expose people to new behaviors and lifestyles, influence attitudes and self-concept, and create pressures for conformity that may affect product and brand choices.

People are also influenced by groups to which they do not belong. *Aspirational groups* are those the person hopes to join; *dissociative groups* are those whose values or behavior an individual rejects.

Although marketers try to identify target customers' reference groups, the level of reference-group influence varies among products and brands. Manufacturers of products and brands with strong group influence must reach and influence the opinion leaders in these reference groups. An *opinion leader* is the person in informal product-related communications who offers advice or information about a product or product category.[4] Marketers try to reach opinion leaders by identifying demographic and psychographic characteristics associated with opinion leadership, identifying the preferred media of opinion leaders, and directing messages at the opinion leaders. For example, the hottest trends in teenage music and fashion start in America's inner cities, then spread to youth in the suburbs. As a result, clothing companies that target teens carefully monitor the style and behavior of urban opinion leaders.

Family

The family is the most important consumer-buying organization in society, and it has been researched extensively.[5] The *family of orientation* consists of one's parents and siblings. From parents, a person acquires an orientation toward religion, politics, and economics as well as a sense of personal ambition, self-worth, and love.[6] A more direct influence on the everyday buying behavior of adults is the *family of procreation*—namely, one's spouse and children.

Marketers are interested in the roles and relative influence of the husband, wife, and children in the purchase of a large variety of products and services. These roles vary widely in different cultures and social classes. Vietnamese Americans, for example,

Table 3.1 Selected Characteristics of Major U.S. Social Classes

Social Class	Characteristics
Upper Uppers (less than 1 percent of U.S. population)	The social elite who live on inherited wealth; they give large sums to charity, maintain more than one home, and send their children to top schools. This small group serves as a reference group for other social classes.
Lower Uppers (about 2 percent of U.S. population)	People coming up from the middle class who have earned high income or wealth through professions or business; they tend to be active in social and civic affairs, buy status-symbol products, and aspire to be accepted in the upper-upper stratum.
Upper Middles (12 percent of U.S. population)	People without family status or unusual wealth who are focused on their careers as professionals, independent business persons, and corporate managers; they believe in education and are civic-minded and home-oriented.
Middle Class (32 percent of U.S. population)	Average-pay white- and blue-collar workers; they often buy popular products to keep up with trends, and they believe in spending more money on worthwhile experiences for their children and aiming them toward a college education.
Working Class (38 percent of U.S. population)	Average-pay blue-collar workers and those who lead a working-class lifestyle; they depend on relatives for economic and emotional support, job tips, and assistance, and they tend to maintain sharp sex-role divisions and stereotyping.
Upper Lowers (9 percent of U.S. population)	Workers whose living standard is just above poverty; they perform unskilled work, are poorly paid, and are educationally deficient.
Lower Lowers (7 percent of U.S. population)	People on welfare, visibly poverty stricken, and usually out of work; some are uninterested in finding permanent work, and most depend on public aid or charity for income.

Sources: Richard P. Coleman, "The Continuing Significance of Social Class to Marketing," *Journal of Consumer Research,* December 1983, pp. 265–80, and Richard P. Coleman and Lee P. Rainwater, *Social Standing in America: New Dimension of Class* (New York: Basic Books, 1978).

are more likely to adhere to the model in which the man makes large-purchase decisions. In the United States, husband-wife involvement has traditionally varied widely by product category, so marketers need to determine which member has the greater influence in choosing particular products. Today, traditional household purchasing patterns are changing, with baby-boomer husbands and wives shopping jointly for products traditionally thought to be under the separate control of one spouse or the other.[7] For this reason, marketers of products traditionally purchased by one spouse may need to start thinking of the other as a possible purchaser.

Another shift in buying patterns is an increase in the amount of money spent and influence wielded by children and teens.[8] Children age 4 to 12 spend an estimated $24.4 billion annually—three times the value of the ready-to-eat cereal market. Indirect influence means that parents know the brands, product choices, and preferences of their children without hints or outright requests; direct influence refers to children's hints, requests, and demands.

Because the fastest route to Mom and Dad's wallets may be through Junior, many successful companies are showing off their products to children—and soliciting marketing information from them—over the Internet. This has consumer groups and parents up in arms. Many marketers have come under fire for not requiring parental consent when requesting personal information and not clearly differentiating ads from games or entertainment.

One company that uses ethical tactics to market to children is Disney, which operates the popular children's site Disney Online. Disney clearly states its on-line policies on its home page and on the home pages of its other sites, including Disney's Daily Blast, a subscription-based Internet service geared to children age 3 to 12. Disney's on-line practices include alerting parents through e-mail when a child has submitted personal information to a Web site, whether it be to enter a contest, cast a vote, or register at a site. Whereas many sites and advertisers use "cookies," tiny bits of data that a Web site puts on a user's computer to enhance his or her visit, Disney does not use cookies for promotional or marketing purposes and does not share them with third parties.[9]

Roles and Statuses

A person participates in many groups, such as family, clubs, or organizations. The person's position in each group can be defined in terms of role and status. A *role* consists of the activities that a person is expected to perform. Each role carries a *status*. A Supreme Court justice has more status than a sales manager, and a sales manager has more status than an administrative assistant. In general, people choose products that communicate their role and status in society. Thus, company presidents often drive Mercedes, wear expensive suits, and drink Chivas Regal scotch. Savvy marketers are aware of the *status symbol* potential of products and brands.

Personal Factors Influencing Buyer Behavior

Cultural and social factors are just two of the four major factors that influence consumer buying behavior. The third factor is personal characteristics, including the buyer's age, stage in the life cycle, occupation, economic circumstances, lifestyle, personality, and self-concept.

Age and Stage in the Life Cycle

People buy different goods and services over a lifetime. They eat baby food in the early years, most foods in the growing and mature years, and special diets in the later years. Taste in clothes, furniture, and recreation is also age-related, which is why smart marketers are attentive to the influence of age.

Similarly, consumption is shaped by the *family life cycle*. The traditional family life cycle covers stages in adult lives, starting with independence from parents and continuing into marriage, child-rearing, empty-nest years, retirement, and later life. Marketers often choose a specific group from this traditional life-cycle as their target market. Yet target households are not always family based: There are also single households, gay households, and cohabitor households.

Some recent research has identified *psychological life-cycle stages*. Adults experience certain "passages" or "transformations" as they go through life.[10] Leading marketers pay close attention to changing life circumstances—divorce, widowhood, remarriage—and their effect on consumption behavior.

Occupation and Economic Circumstances

Occupation also influences a person's consumption pattern. A blue-collar worker will buy work clothes and lunchboxes, while a company president will buy expensive suits and a country club membership. For this reason, marketers should identify the occupational groups that are more interested in their products and services, and consider specializing their products for certain occupations. Software manufacturers, for example, have developed special programs for lawyers, physicians, and other occupational groups.

In addition, product choice is greatly affected by a consumer's economic circumstances: spendable income (level, stability, and time pattern), savings and assets (including the percentage that is liquid), debts, borrowing power, and attitude toward spending versus saving. Thus, marketers of income-sensitive goods must track trends in personal income, savings, and interest rates. If a recession is likely, marketers can redesign, reposition, and reprice their products to offer more value to target customers.

Lifestyle

People from the same subculture, social class, and occupation may actually lead quite different lifestyles. A **lifestyle** is the person's pattern of living in the world as expressed in activities, interests, and opinions. Lifestyle portrays the "whole person" interacting with his or her environment.

Successful marketers search for relationships between their products and lifestyle groups. For example, a computer manufacturer might find that most computer buyers are achievement-oriented. The marketer may then aim its brand more clearly at the achiever lifestyle.

Psychographics is the science of measuring and categorizing consumer lifestyles. One of the most popular classifications based on psychographic measurements is SRI International's Values and Lifestyles (VALS) framework. The VALS 2 system classifies all U.S. adults into eight groups based on psychological attributes drawn from survey responses to demographic, attitudinal, and behavioral questions, including questions about Internet usage.[11] The major tendencies of these groups are:

- *Actualizers:* Successful, sophisticated, active, "take-charge" people whose purchases often reflect cultivated tastes for relatively upscale, niche-oriented products.
- *Fulfilleds:* Mature, satisfied, comfortable, and reflective people who favor durability, functionality, and value in products.
- *Achievers:* Successful, career- and work-oriented consumers who favor established, prestige products that demonstrate success.
- *Experiencers:* Young, vital, enthusiastic, impulsive, and rebellious people who spend much of their income on clothing, fast food, music, movies, and video.
- *Believers:* Conservative, conventional, and traditional people who favor familiar products and established brands.
- *Strivers:* Uncertain, insecure, approval-seeking, resource constrained consumers who favor stylish products that emulate the purchases of wealthier people.
- *Makers:* Practical, self-sufficient, traditional, and family-oriented people who favor products with a practical or functional purpose, such as tools and fishing equipment.
- *Strugglers:* Elderly, resigned, passive, concerned, and resource-constrained consumers who are cautious and loyal to favorite brands.

Although psychographics is a valid and valued methodology for many marketers, social scientists are realizing that older tools for predicting consumer behavior are not always applicable to the use of the Internet or on-line services and purchases of technology products. As a result, researchers are coming up with new research methods for segmenting consumers based on technology types. Forrester Research's Technographics system segments consumers according to motivation, desire, and ability to invest in technology; SRI's iVALS system segments consumers into segments based on Internet usage.[12]

Lifestyle segmentation schemes vary by culture. McCann-Erickson London, for example, has identified these British lifestyles: Avant-Gardians (interested in change); Pontificators (traditionalists); Chameleons (follow the crowd); and Sleepwalkers (contented underachievers). The advertising agency D'Arcy, Masius, Benton & Bowles has identified these segments of Russian consumers: "Kuptsi" (merchants), "Cossacks" (ambitious and status seeking), "Students," "Business Executives," and "Russian Souls" (passive, fearful of choices).[13]

Personality and Self-Concept

Each person has a distinct personality that influences buying behavior. **Personality** refers to the distinguishing psychological characteristics that lead to relatively consistent and enduring responses to environment. Personality is usually described in terms of such traits as self-confidence, dominance, autonomy, deference, sociability, defensiveness, and adaptability.[14]

Personality can be useful in analyzing consumer behavior, provided that personality types can be classified accurately and that strong correlations exist between certain personality types and product or brand choices. For example, a computer company might discover that many prospects show high self-confidence, dominance, and autonomy, suggesting that computer ads should appeal to these traits.

Self-concept (or self-image) is related to personality. Marketers often try to develop brand images that match the target market's self-image. Yet it is possible that a person's *actual self-concept* (how she views herself) differs from her *ideal self-concept* (how she would like to view herself) and from her *others-self-concept* (how she thinks others see her). Which self will she try to satisfy in making a purchase? Because it is difficult to answer this question, self-concept theory has had a mixed record of success in predicting consumer responses to brand images.[15]

Psychological Factors Influencing Buyer Behavior

Psychological factors are the fourth major influence on consumer buying behavior (in addition to cultural, social, and personal factors). In general, a person's buying choices are influenced by the psychological factors of motivation, perception, learning, beliefs, and attitudes.

Motivation

A person has many needs at any given time. Some needs are *biogenic;* they arise from physiological states of tension such as hunger, thirst, discomfort. Other needs are *psychogenic;* they arise from psychological states of tension such as the need for recognition, esteem, or belonging. A need becomes a motive when it is aroused to a sufficient level of intensity. A *motive* is a need that is sufficiently pressing to drive the person to act.

Psychologists have developed theories of human motivation. Three of the best known—the theories of Sigmund Freud, Abraham Maslow, and Frederick Herzberg—carry quite different implications for consumer analysis and marketing strategy.

- *Freud's theory.* Sigmund Freud assumed that the psychological forces shaping people's behavior are largely unconscious, and that a person cannot fully understand his or her own motivations. A technique called *laddering* can be used to trace a person's motivations from the stated instrumental ones to the more terminal ones. Then the marketer can decide at what level to develop the message and appeal.[16] In line with Freud's theory, consumers react not only to the stated capabilities of specific brands, but also to other, less conscious cues. Successful marketers are therefore mindful that shape, size, weight, material, color, and brand name can all trigger certain associations and emotions.
- *Maslow's theory.* Abraham Maslow sought to explain why people are driven by particular needs at particular times.[17] His theory is that human needs are arranged in a hierarchy, from the most to the least pressing. In order of importance, these five categories are physiological, safety, social, esteem, and self-actualization needs. A consumer will try to satisfy the most important need first; when that need is satisfied, the person will try to satisfy the next-most-pressing need. Maslow's theory helps marketers understand how various products fit into the plans, goals, and lives of consumers.
- *Herzberg's theory.* Frederick Herzberg developed a *two-factor theory* that distinguishes dissatisfiers (factors that cause dissatisfaction) from satisfiers (factors that cause satisfaction).[18] The absence of dissatisfiers is not enough; satisfiers must be actively present to motivate a purchase. For example, a computer that comes without a warranty would be a dissatisfier. Yet the presence of a product warranty would not act as a satisfier or motivator of a purchase, because it is not a source of intrinsic satisfaction with the computer. Ease of use would, however, be a satisfier for a computer buyer. In line with this theory, marketers should avoid dissatisfiers that might unsell their products. They should also identify and supply the major satisfiers or motivators of purchase, because these satisfiers determine which brand consumers will buy.

Perception

A motivated person is ready to act, yet how that person actually acts is influenced by his or her perception of the situation. **Perception** is the process by which an individual selects, organizes, and interprets information inputs to create a meaningful picture of the world.[19] Perception depends not only on physical stimuli, but also on the stimuli's relation to the surrounding field and on conditions within the individual. The key word is *individual.* Individuals can have different perceptions of the same object because of three perceptual processes: selective attention, selective distortion, and selective retention.

- *Selective attention.* People are exposed to many daily stimuli such as ads; most of these stimuli are screened out—a process called *selective attention.* The end result is that marketers have to work hard to attract consumers' attention. Through research, marketers have learned that people are more likely to notice stimuli that relate to a current need, which is why car shoppers notice car ads but not appliance ads. Furthermore, people are more likely to notice stimuli that they anticipate—such as foods being promoted on a food Web site. And people are more likely to notice stimuli whose deviations are large in relation to the normal size of the stimuli, such as a banner ad offering $100 (not just $5) off a product's list price.
- *Selective distortion.* Even noticed stimuli do not always come across the way that marketers intend. *Selective distortion* is the tendency to twist information into

personal meanings and interpret information in a way that fits our preconceptions. Unfortunately, marketers can do little about selective distortion.

- *Selective retention.* People forget much that they learn but tend to retain information that supports their attitudes and beliefs. Because of *selective retention,* we are likely to remember good points mentioned about a product we like and forget good points mentioned about competing products. Selective retention explains why marketers use drama and repetition in messages to target audiences.

Learning

When people act, they learn. **Learning** involves changes in an individual's behavior that arise from experience. Most human behavior is learned. Theorists believe that learning is produced through the interplay of drives, stimuli, cues, responses, and reinforcement. A *drive* is a strong internal stimulus that impels action. *Cues* are minor stimuli that determine when, where, and how a person responds.

Suppose you buy an IBM computer. If your experience is rewarding, your response to computers and IBM will be positively reinforced. Later, when you want to buy a printer, you may assume that because IBM makes good computers, it also makes good printers. You have now *generalized* your response to similar stimuli. A countertendency to generalization is *discrimination,* in which the person learns to recognize differences in sets of similar stimuli and adjust responses accordingly. Applying learning theory, marketers can build up demand for a product by associating it with strong drives, using motivating cues, and providing positive reinforcement.

Beliefs and Attitudes

Through doing and learning, people acquire beliefs and attitudes that, in turn, influence buying behavior. A **belief** is a descriptive thought that a person holds about something. Beliefs may be based on knowledge, opinion, or faith, and they may or may not carry an emotional charge. Of course, manufacturers are very interested in the beliefs that people have about their products and services. These beliefs make up product and brand images, and people act on their images. If some beliefs are wrong and inhibit purchase, the manufacturer will want to launch a campaign to correct these beliefs.[20]

Particularly important to global marketers is the fact that buyers often hold distinct beliefs about brands or products based on their country of origin. Studies have found, for example, that the impact of country of origin varies with the type of product. Consumers want to know where a car was made but not where lubricating oil came from. In addition, attitudes toward country of origin can change over time; Japan, for instance, had a poor quality image before World War II.

A company has several options when its products' place of origin turns off consumers. The company can consider co-production with a foreign company that has a better name. Another alternative is to hire a well-known celebrity to endorse the product. Or the company can adopt a strategy to achieve world-class quality in the local industry, as is the case with Belgian chocolates and Colombian coffee.

This is what South African wineries are attempting to do as their wine exports increase. South African wines have been hurt by the perception that the country's vineyards are primitive in comparison to those in other countries and that wine farmers are continuing crude labor practices. In reality, South Africa's wine farmers have improved the lives of their workers. "Wine is such a product of origin that we cannot succeed if South Africa doesn't look good," says Willem Barnard, chief executive of the Ko-operatieve Wijnbouwers Vereniging, the farmers' co-op that dominates the industry.[21]

Attitudes are just as important as beliefs for influencing buying behavior. An **attitude** is a person's enduring favorable or unfavorable evaluations, emotional feelings, and action tendencies toward some object or idea.[22] People have attitudes toward almost everything: religion, politics, clothes, music, food. Attitudes put them into a frame of mind of liking or disliking an object, moving toward or away from it. Attitudes lead people to behave in a fairly consistent way toward similar objects. Because attitudes economize on energy and thought, they are very difficult to change; to change a single attitude may require major adjustments in other attitudes.

Thus, a company would be well advised to fit its product into existing attitudes rather than to try to change people's attitudes. Of course, trying to change attitudes can pay off occasionally. Look at the milk industry. By the early 1990s, milk consumption had been in decline for 25 years, because the general perception was that milk was unhealthy, outdated, just for kids, or only good with cookies and cakes. Then the National Fluid Milk Processor Education Program kicked off a multi-million dollar print ad campaign featuring milk be-mustached celebrities like Hanson and Tyra Banks with the tag line "Where's your mustache?" The wildly popular campaign has changed attitudes and, in the process, boosted milk consumption. The milk producers have also established an on-line Club Milk (www.whymilk.com), limiting membership to people who pledge to drink three glasses of milk a day.[23]

THE CONSUMER BUYING DECISION PROCESS

Marketers have to go beyond the various influences on buyers and develop an in-depth understanding of how consumers actually make their buying decisions. Specifically, marketers must identify who makes the buying decision, the types of buying decisions, and the stages in the buying process.

Buying Roles

Marketers can identify the buyer for many products easily. In the United States, men normally choose their shaving equipment, and women choose their pantyhose. Still, marketers must be careful, because buying roles can change. After the giant British chemical firm ICI discovered that women made 60 percent of the decisions on the brand of household paint, it began advertising its DeLux brand to women.

We can distinguish five roles that people might play in a buying decision. An *initiator* first suggests the idea of buying the product or service. An *influencer* is the person whose view or advice influences the decision. A *decider* actually decides whether to buy, what to buy, how to buy, or where to buy. A *buyer* makes the actual purchase, while a *user* consumes or uses the product or service.

Buying Behavior

Marketers also need to be aware that consumer decision making varies with the type of buying decision. The decisions to buy toothpaste, a tennis racket, a personal computer, and a new car are all very different. In general, complex and expensive purchases are likely to involve more buyer deliberation and more participants. As shown in Table 3.2, Assael distinguished four types of consumer buying behavior, based on the degree of buyer involvement and the degree of differences among brands:[24]

- *Complex buying behavior* applies to high-involvement products such as personal computers. Buyers may not know what attributes to consider in these products, so they do research. Knowing this, marketers can help educate buyers about product

Table 3.2 Four Types of Consumer Buying Behavior

	High Involvement	Low Involvement
Significant Differences between Brands	*Complex buying behavior*—applies when product is expensive, bought infrequently, risky, and self-expressive; buyer first develops beliefs about the product, then develops attitudes about it, and finally makes a thoughtful choice.	*Variety-seeking buying behavior*—applies when buyer switches brands for the sake of variety rather than dissatisfaction; buyer has some beliefs about the product, chooses a brand with little evaluation, and evaluates the product during consumption.
Few Differences between Brands	*Dissonance-reducing behavior*—applies when the product is expensive, bought infrequently, and risky; buyer shops around and buys fairly quickly, then later experiences dissonance but stays alert to information supporting the purchase decision.	*Habitual buying behavior*—applies when the product is low-cost and frequently purchased; buyers do not pass through normal sequence of belief, attitude, and behavior but instead make decisions based on brand familiarity.

Source: Modified from Henry Assael, *Consumer Behavior and Marketing Action* (Boston: Kent Publishing Co., 1987), p. 87. Copyright © 1987 by Wadsworth, Inc. Printed by permission of Kent Publishing Co., a division of Wadsworth, Inc.

attributes, differentiate and describe the brand's features, and motivate store personnel and others to influence the final brand choice.

- *Dissonance-reducing buyer behavior* applies to high-involvement products such as carpeting. Carpeting is expensive and self-expressive, yet the buyer may consider most brands in a given price range to be the same. After buying, the consumer might experience dissonance after noticing certain disquieting features or hearing favorable things about other brands. Marketers should therefore supply beliefs and evaluations that help consumers feel good about their brand choices.
- *Habitual buying behavior* applies to low-involvement products such as salt. Consumers keep buying the same brand out of habit, not due to strong brand loyalty, because they are passive recipients of information conveyed by advertising. Ad repetition creates *brand familiarity* rather than *brand conviction*. Marketers of such products can use price and sales promotions to entice new customers to try their products.
- *Variety-seeking buying behavior* applies to low-involvement products such as cookies. In this category, consumers switch brands often because they want more variety. The market leader will therefore try to encourage habitual buying behavior by dominating the shelf space, keeping shelves stocked, and running frequent reminder ads. Challenger firms will encourage variety seeking by offering lower prices, coupons, free samples, and ads that offer reasons for trying something new.

The Stages of the Buying Decision Process

In addition to examining buying roles and behavior, smart companies research the buying decision process involved in their product category. They ask consumers when they first became acquainted with the product category and brands, what their brand beliefs are, how involved they are with the product, how they make their brand choices, and how satisfied they are after purchase.

Figure 3-2 shows a five-stage model of the typical buying process. Starting with problem recognition, the consumer passes through the stages of information search, evaluation of alternatives, purchase decision, and postpurchase behavior. As this model demonstrates, the consumer buying process starts long before the actual purchase and has consequences long afterward.[25] Although the model implies that consumers pass sequentially through all five stages in buying a product, consumers sometimes skip or reverse some stages. However, we use this model because it captures the full range of considerations that arise when a consumer faces a highly involving new purchase.[26]

Stage 1: Problem Recognition

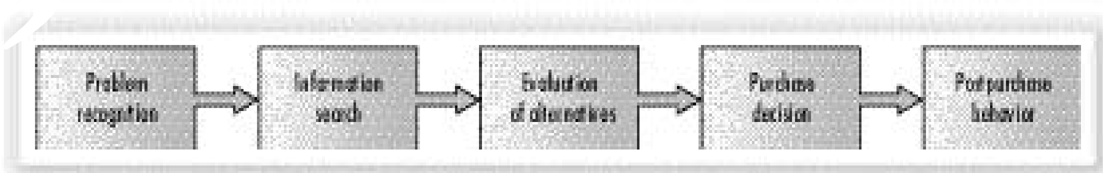
The buying process starts when the buyer recognizes a problem or need. This need can be triggered by internal stimuli (such as feeling hunger or thirst) or external stimuli (such as seeing an ad) that then becomes a drive. By gathering information from a number of consumers, marketers can identify the most frequent stimuli that spark interest in a product category. They can then develop marketing strategies that trigger consumer interest and lead to the second stage in the buying process.

Stage 2: Information Search

An aroused consumer who recognizes a problem will be inclined to search for more information. We can distinguish between two levels of arousal. At the milder search state of *heightened attention,* a person simply becomes more receptive to information about a product. At the *active information search* level, a person surfs the Internet, talks with friends, and visits stores to learn more about the product. Consumer information sources include personal sources (family, friends, neighbors, acquaintances), commercial sources (advertising, Web sites, salespersons, dealers, packaging, displays), public sources (mass media, consumer-rating organizations), and experiential sources (handling, examining, using the product). The consumer usually receives the most information from commercial (marketer-dominated) sources, although the most influential information comes from personal sources.

Through gathering information, the consumer learns more and more about competing brands. The first box in Figure 3-3 shows the *total set* of brands available to the consumer. The individual consumer will come to know only a subset of these brands (*awareness set*). Some of these brands will meet initial buying criteria (*consideration set*). As the person gathers more information, only a few brands will remain as strong contenders (*choice set*). The person makes a final choice from this set.[27]

Figure 3-2 Five-Stage Model of the Consumer Buying Process



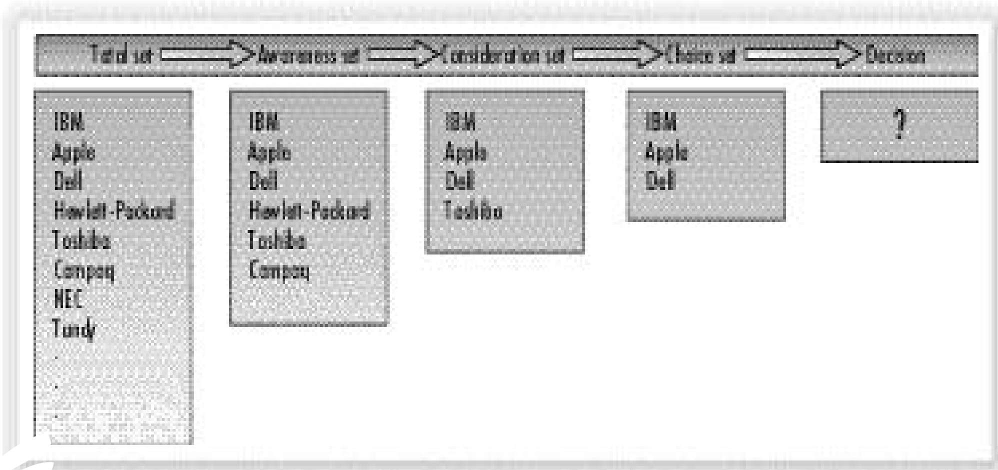


Figure 3-3 Successive Sets Involved in Consumer Decision Making

Figure 3-3 makes it clear that a company must strategize to get its brand into the prospect's awareness set, consideration set, and choice set. The company must also identify the other brands in the consumer's choice set so that it can plan competitive appeals. In addition, the company should identify the consumer's information sources and evaluate their relative importance so it can prepare a range of effective communications for the target market.

Stage 3: Evaluation of Alternatives

Once the consumer has conducted an information search, how does he or she process competitive brand information and make a final judgment? There are several evaluation processes; the most current models view the process as being cognitively oriented, meaning that consumers form judgments largely on a conscious and rational basis.

Some basic concepts underlie consumer evaluation processes. As noted earlier, the consumer is trying to satisfy a *need.* In seeking certain *benefits* from the product solution, the consumer sees each product as a *bundle of attributes* with varying abilities of delivering the benefits to satisfy this need. However, the attributes of interest to buyers vary by product. For example, the attributes sought in a camera might be picture sharpness, camera size, and price. In addition, consumers vary as to which product attributes they see as most relevant and the importance they attach to each attribute. Knowing that consumers pay the most attention to attributes that deliver the benefits they seek, many successful marketers segment their markets according to the attributes that are salient to different consumer groups.

In the course of evaluating alternatives, the consumer develops a set of *brand beliefs* about where each brand stands on each attribute. The set of beliefs about a particular brand, which make up the *brand image,* will vary with the consumer's experiences as filtered by the effects of selective perception, selective distortion, and selective retention.

Ultimately, consumers develop attitudes toward various brand alternatives through an attribute evaluation procedure.[28] Suppose, for example, that Linda Brown has narrowed her choice set to four computers (A, B, C, D) on the basis of four attributes: memory capacity, graphics capability, size and weight, and price. If one computer dominated the others on all of the criteria, we could predict that Linda would choose it. But her choice set consists of brands that vary in their appeal. She sees A as having the best memory capacity, B as having the best graphics capability, C as having the best size and weight, and D as having the best price.

Like most buyers, Linda is considering several attributes in her purchase decision, and she gives each a particular weight. She has assigned 40 percent of the importance to the computer's memory capacity, 30 percent to its graphics capability, 20 percent to its size and weight, and 10 percent to its price. To find Linda's perceived value for each computer, we multiply her weights by the scores indicating her beliefs about each computer's attributes. So for computer A, if she assigns a score of 10 for memory capacity, 8 for graphics capability, 6 for size and weight, and 4 for price, the overall score would be:

$$0.4\ (10) + 0.3\ (8) + 0.2\ (6) + 0.1\ (4) = 8$$

Calculating the scores for all of the other computers that Linda is evaluating would show which one has the highest perceived value.[29] This is critical, because a manufacturer who knows how buyers evaluate alternatives and form preferences can take steps to influence buyer decisions. In the case of computers, a manufacturer might redesign the computer (a technique called *real repositioning*), alter consumer beliefs about the brand (*psychological repositioning*), alter consumer beliefs about competitors' brands (*competitive depositioning*), alter the importance weights (to persuade buyers to attach more importance to the attributes in which the brand excels), call attention to neglected attributes (such as styling), shift the buyer's ideals (to persuade buyers to change ideal levels on one or more attributes).[30]

Stage 4: Purchase Decision

In the evaluation stage, the consumer forms preferences among the brands in the choice set and may also form an intention to buy the most preferred brand. However, two factors can intervene between the purchase intention and the purchase decision.[31]

The first factor is the *attitudes of others*. The extent to which another person's attitude reduces one's preferred alternative depends on two things: (1) the intensity of the other person's negative attitude toward the consumer's preferred alternative, and (2) the consumer's motivation to comply with the other person's wishes.[32] The influence of others becomes even more complex when several people close to the buyer hold contradictory opinions and the buyer would like to please them all.

The second factor is *unanticipated situational factors* that may erupt to change the purchase intention. A consumer could lose his job, some other purchase might become more urgent, or a store salesperson may turn him or her off, which is why preferences and even purchase intentions are not completely reliable predictors of purchase behavior.

Just as important, a consumer's decision to modify, postpone, or avoid a purchase decision is heavily influenced by *perceived risk*.[33] The amount of perceived risk varies with the amount of money at stake, the amount of attribute uncertainty, and the amount of consumer self-confidence. Consumers develop routines for reducing risk, such as decision avoidance, information gathering from friends, and preference for national brand names and warranties. Smart marketers study the factors that provoke a feeling of risk in consumers and then provide information and support to reduce the perceived risk.

Stage 5: Postpurchase Behavior

After purchasing the product, the consumer moves into the final stage of the consumer buying process, in which he or she will experience some level of satisfaction or dissatisfaction. This is why the marketer's job does not end when the product is bought. In particular, marketers must monitor postpurchase satisfaction, postpurchase actions, and postpurchase product uses.

Postpurchase Satisfaction The buyer's satisfaction with a purchase is a function of the closeness between the buyer's expectations and the product's perceived performance.[34] If performance falls short of expectations, the customer is *disappointed;* if it meets expectations, the customer is *satisfied;* if it exceeds expectations, the customer is *delighted.* These feelings of satisfaction influence whether the customer buys the product again and talks favorably or unfavorably about the product to others.

The importance of postpurchase satisfaction suggests that product claims must truthfully represent the product's likely performance. Some sellers might even understate performance levels so that consumers experience higher-than-expected satisfaction with the product.

Postpurchase Actions The consumer's satisfaction or dissatisfaction with the product after purchase will influence subsequent behavior. Satisfied consumers will be more likely to purchase the product again. This has been confirmed by the data on automobile brand choice, which show a high correlation between satisfaction with the last brand bought and intention to rebuy the brand. One survey showed that 75 percent of Toyota buyers were highly satisfied and about 75 percent intended to buy a Toyota again; 35 percent of Chevrolet buyers were highly satisfied and about 35 percent intended to buy a Chevrolet again. Satisfied customers also tend to say good things about the brand to others, which is why many marketers say: "Our best advertisement is a satisfied customer."[35]

Dissatisfied consumers, on the other hand, may abandon or return the product; seek information that confirms its high value; take public action by complaining to the company, going to a lawyer, or complaining to government agencies and other groups; or take private actions such as not buying the product or warning friends.[36] In these cases, the seller has done a poor job of satisfying the customer.[37]

Marketers can use postpurchase communications to buyers as a way to reduce product returns and order cancellations.[38] Computer companies, for example, might take a number of actions, including sending e-mail messages to new buyers congratulating them on having selected a fine computer, placing ads showing satisfied brand owners, soliciting customer suggestions for improvements, and providing channels for speedy resolution of customer complaints.

Postpurchase Use and Disposal Marketers should also monitor how buyers use and dispose of the product after purchase. The various options that are open to consumers are shown in Figure 3-4. If consumers store the product and never use it, the product is probably not very satisfying, and word-of-mouth will not be strong. If they sell or trade the product, new-product sales will be depressed.

Consumers sometimes find new uses for a product, as Avon discovered when its customers talked about Skin-So-Soft bath oil and moisturizer as an insect repellant. This prompted Avon to seek and receive Environmental Protection Agency approval so it could officially tout Skin-So-Soft as a triple-action product that provides insect repellent, waterproof sunscreen, and moisturizers.[39]

As Figure 3-4 indicates, getting rid of the product permanently leads to a new set of options. If consumers throw the product away, the marketer needs to consider how they dispose of it, especially if it can hurt the environment. For example, increased public awareness of recycling and ecological concerns as well as consumer complaints about having to throw away beautiful bottles led French perfume maker Rochas to

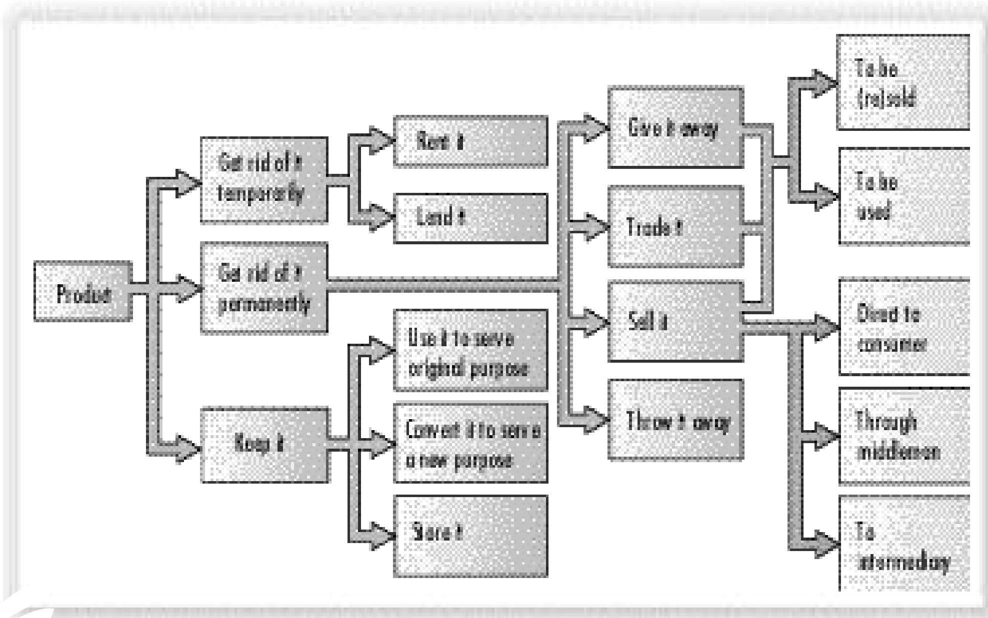


Figure 3-4 How Consumers Use or Dispose of Products

think about introducing a new, refillable bottle fragrance line. This is a more creative, satisfying response to an element that could potentially cause dissatisfaction among buyers.

Just as firms that target consumers must understand how and why consumers buy, those that target businesses and other organizations must be aware of the differences between consumer and business buying behaviors and the way that businesses make buying decisions. These topics are covered in the next chapter.

EXECUTIVE SUMMARY

Before developing their marketing plans, marketers need to use both rigorous scientific procedures and more intuitive methods to study consumer behavior, which is influenced by four factors: cultural (culture, subculture, and social class), social (reference groups, family, and social roles and statuses), personal (age, stage in the life cycle, occupation, economic circumstances, lifestyle, personality, and self-concept), and psychological (motivation, perception, learning, beliefs, and attitudes). Research into all of these factors can provide clues as to how to reach and serve consumers more effectively.

To understand how consumers actually make their buying decisions, marketers must identify who makes and influences the buying decision. People can be initiators, influencers, deciders, buyers, or users, and different marketing campaigns might be targeted to each type of person. Marketers must also examine buyers' levels of involvement and the number of brands available to determine whether consumers are engaging in complex buying behavior, dissonance-reducing buying behavior, habitual buying behavior, or variety-seeking buying behavior.

The five-stage consumer buying process consists of problem recognition, information search, evaluation of alternatives, purchase decision, and postpurchase behavior. The marketer's job is to understand the buyer's behavior at each stage and what influences are operating. The attitudes of others, unanticipated situational factors, and perceived risk may all affect the decision to buy, as will consumers' levels of postpurchase satisfaction, the company's postpurchase actions, and consumers' postpurchase use and disposal of the product. Satisfied customers will continue to purchase; dissatisfied customers will stop purchasing the product and are likely to spread the word among their friends. For this reason, smart companies work to ensure customer satisfaction in every stage of the buying process.

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Analyzing Business Markets and Buyer Behavior

We will address the following questions:

- What is the business market, and how does it differ from the consumer market?
- How do institutions and government agencies do their buying?
- What buying situations do organizational buyers face?
- Who participates in business buying, and what are the influences on business buying decisions?
- How do business buyers make their decisions?

Business organizations do not only sell. They also buy vast quantities of raw materials, manufactured components, plants and equipment, supplies, and business services. Over 13 million business, institutional, and government organizations in the United States alone—plus millions more in other countries—represent a huge, lucrative buying market for goods and services purchased from both domestic and international suppliers.

Business buyers purchase goods and services to achieve specific goals, such as making money, reducing operating costs, and satisfying social or legal obligations. For example, a mini-mill steelmaker like Nucor will add another plant if it sees a chance to boost profits, upgrade its computerized accounting system to reduce operating costs, and add pollution-control equipment to meet legal requirements.

In principle, a business buyer seeks to obtain for his or her organization the best package of economic, technical, service, and social benefits in relation to a market offering's costs. In reality, a business buyer (like a consumer) will have more incentive to choose the offering with the highest ratio of perceived benefits to costs—that is, the highest perceived value. The marketer must therefore provide an offering that delivers superior customer value to the targeted business buyers and be familiar with the underlying dynamics and process of business buying.

WHAT IS ORGANIZATIONAL BUYING?

Organizational buying, according to Webster and Wind, is the decision-making process by which formal organizations establish the need for purchased products and services and identify, evaluate, and choose among alternative brands and suppliers.[1] Just as no two consumers buy in exactly the same way, no two organizations buy in exactly the same way. Therefore, as they do for the consumer market, business sellers work hard to distinguish clusters of customers that buy in similar ways and then create suitable marketing strategies for reaching those targeted business market segments. However, the business market differs from the consumer market in a number of significant ways.

The Business Market Versus the Consumer Market

The *business market* consists of all of the organizations that acquire goods and services used in the production of other products or services that are sold, rented, or supplied to other customers. The major industries making up the business market are agriculture, forestry, and fisheries; mining; manufacturing; construction; transportation; communication; public utilities; banking, finance, and insurance; distribution; and services. U.S. marketers can learn more about specific industries by consulting the North American Industry Classification System (NAICS), a categorized listing of all of the industries operating in Canada, the United States, and Mexico.

In general, more dollars and items are involved in sales to business buyers than to consumers. Consider the process of producing and selling a simple pair of shoes. Hide dealers must sell hides to tanners, who sell leather to shoe manufacturers, who sell shoes to wholesalers, who sell shoes to retailers, who finally sell them to consumers. Along the way, each party in the supply chain also has to buy many other goods and services, which means that every business seller is a business buyer, as well.

From the number and size of buyers to geographical location, demand, and buying behaviors, business markets have a number of characteristics that contrast sharply with those of consumer markets. These characteristics are described in Table 3.3.

Understanding the impact of these characteristics can help a supplier target business buyers more effectively. Pittsburgh-based Cutler-Hammer, for example, sells circuit breakers, motor starters, and other electrical equipment to industrial manufacturers such as Ford Motor. As its product line grew larger and more complex, C-H developed "pods" of salespeople that focus on a particular geographical region, industry, or market concentration. Each individual brings a degree of expertise about a product or service that the other members of the team can take to the customer. This allows the salespeople to leverage the knowledge of co-workers to sell to increasingly sophisticated buying teams, instead of working in isolation.[2]

Specialized Organizational Markets

The overall business market includes institutional and government organizations in addition to profit-seeking companies. However, the buying goals, needs, and methods of these two specialized organizational markets are generally different from those of businesses, something firms must keep in mind when planning their business marketing strategies.

The Institutional Market

The *institutional market* consists of schools, hospitals, nursing homes, prisons, and other institutions that provide goods and services to people in their care. Many of

Table 3.3 Characteristics of Business Markets

Characteristic	Description	Example
Fewer buyers	Business marketers normally deal with far fewer buyers than do consumer marketers.	Goodyear Tire Company aims to get orders from buyers for the Big Three U.S. automakers (General Motors, Ford, and Daimler-Chrysler).
Larger buyers	Buyers for a few large firms do most of the purchasing in many industries.	Major companies are big customers in industries such as aircraft engines and defense weapons.
Close supplier-customer relationship	With the smaller customer base and the importance and power of the larger customers, suppliers are frequently required to customize offerings, practices, and performance to meet the needs of individual customers.	Tooling supplier Stillwater Technologies shares office and manufacturing space with key customer Motoman, a supplier of industrial robots, to minimize delivery distances and enhance their symbiotic working relationship.[1]
Geographically concentrated buyers	More than half of U.S. business buyers are concentrated in seven states: New York, California, Pennsylvania, Illinois, Ohio, New Jersey, and Michigan, which helps to reduce selling costs.	Because the Big Three U.S. automakers have their U.S. headquarters in the Detroit area, industry suppliers head there on sales calls.
Derived demand	Demand for business goods is ultimately derived from demand for consumer goods, so business marketers must monitor the buying patterns of ultimate consumers.	The Big Three U.S. automakers are seeing higher demand for steel-bar products, mostly derived from consumers' demand for minivans and other light trucks, which consume far more steel than cars.
Inelastic demand	Total demand for many business goods and services is inelastic and not much affected by price changes, especially in the short run, because producers cannot make quick production changes.	Shoe manufacturers will not buy much more leather if the price of leather falls. Nor will they buy much less leather if the price rises unless they can find satisfactory substitutes.
Fluctuating demand	Demand for business products tends to be more volatile than demand for consumer products. An increase in consumer demand can lead to a much larger increase in demand for plant and equipment needed to produce the additional output.	An increase of only 10% in consumer demand for computers might result in a 200% increase in business demand for related parts, supplies, and services; a 10% drop in consumer demand for computers might cause a complete collapse in business demand.

Continued

Table 3.3 Characteristics of Business Markets—*Continued*

Characteristic	Description	Example
Professional purchasing	Trained purchasing agents follow organizational purchasing policies, constraints, and requirements to buy business products. Many of the buying instruments—such as proposals and purchase contracts—are not typical of consumer buying.	Programs on the Cisco Systems Web site allow purchasing agents to research, select, and price new networking systems at any hour and obtain speedy online answers about products, orders, and service.[2]
Multiple buying influences	More people typically influence business buying decisions. Buying committees are common in the purchase of major goods; marketers have to send well-trained sales reps and often sales teams to deal with these well-trained buyers.	Metal supplier Phelps Dodge uses an "account management approach" to reach all the key people who influence business buying decisions in customer organizations.[3]
Multiple sales calls	With more people involved in the process, it takes multiple sales calls to win most business orders, and the sales cycle can take years.	In the case of major capital equipment sales, customers may take multiple attempts to fund a project, and the sales cycle—between quoting a job and delivering the product—is often measured in years.[4]
Direct purchasing	Business buyers often buy directly from manufacturers rather than through intermediaries, especially items that are technically complex or expensive.	Southwest Airlines, Air Madagascar, and other airlines around the world buy airplanes directly from Boeing.
Reciprocity	Business buyers often select suppliers who also buy from them.	A paper manufacturer buys chemicals from a chemical company that buys a considerable amount of its paper.
Leasing	Many industrial buyers lease rather than buy heavy equipment to conserve capital, get the latest products, receive better service, and gain tax advantages. The lessor often makes more profit and sells to customers who could not afford outright purchase.	General Electric leases truck and car fleets, aircraft, commercial trailers, railcars, and other major equipment products to business buyers.

Sources for examples: [1]John H. Sheridan, "An Alliance Built on Trust," *Industry Week,* March 17, 1997, pp. 66–70; [2]Andy Reinhardt, "Meet Mr. Internet," *Business Week,* September 13, 1999, pp. 128–40; [3]Minda Zetlin, "It's All the Same to Me," *Sales & Marketing Management,* February 1994, pp. 71–75; [4]Michael Collins, "Breaking into the Big Leagues," *American Demographics,* January 1996, p. 24.

these organizations have low budgets and captive clienteles. For example, hospitals have to decide what quality of food to buy for their patients. The buying objective here is not profit, because the food is provided to the patients as part of the total service package. Nor is cost minimization the sole objective, because poor food will cause patients to complain and hurt the hospital's reputation. The hospital purchasing agent has to search for institutional food vendors whose quality meets or exceeds a certain minimum standard and whose prices are low. Knowing this, many food vendors set up a separate division to respond to the special needs of institutional buyers. Thus, Heinz, for example, will produce, package, and price its ketchup differently to meet the different requirements of hospitals, colleges, and prisons.

Being a supplier of choice for the nation's schools or hospitals means big business for marketers such as Allegiance Healthcare. This firm has become the largest U.S. supplier of medical, surgical, and laboratory products. Through its stockless inventory program, known as "ValueLink," Allegiance delivers ordered products to more than 150 hospitals when and where staff members need them. Under the old system, the most needed items were inevitably in short supply, while the rarely used items were available in great number. By using Allegiance's ValueLink system, hospitals save an average of $500,000 or more yearly and gain faster, easier access to the items they need.[3]

The Government Market

In most countries, government organizations are a major buyer of goods and services. The U.S. government, for example, buys goods and services valued at $200 billion, making it the largest customer in the world. The number of individual purchases is equally staggering: Over 20 million individual contract actions are processed every year. Although the cost of most items purchased is between $2,500 and $25,000, the government also makes purchases of $25,000 and up, sometimes well into the millions of dollars.

Government organizations typically require suppliers to submit bids. Normally, they award the contract to the lowest bidder, although they sometimes take into account a supplier's superior quality or reputation for completing contracts on time. Because their spending decisions are subject to public review, government organizations require considerable documentation from suppliers, who often complain about excessive paperwork, bureaucracy, regulations, decision-making delays, and shifts in procurement personnel.

Consider the experience of ADI Technology Corporation. The U.S. government has always been ADI's most important client, accounting for about 90 percent of its nearly $6 million in annual revenues. Yet managers at this professional services company often shake their heads at all of the work that goes into winning the coveted government contracts. A comprehensive bid proposal will run from 500 to 700 pages, and ADI's president estimates that the firm has spent as much as $20,000, mostly in worker hours, to prepare a single bid proposal.

Fortunately for businesses of all sizes, the federal government has been putting reforms in place to streamline buying procedures. Now the government is moving all purchasing on-line, with the use of Web-based technologies such as digital signatures.[4] Several federal agencies that act as purchasing agents for the rest of the government have already launched Web-based catalogs, allowing defense and civilian agencies to buy everything from medical and office supplies to clothing through on-line purchasing. State and local governments are following suit: The city of Fort Collins, Colorado, for example, announces its buying needs, posts requests for proposals, and offers downloads of standard supplier documents on its Web site. Internet-based purchasing has enabled Fort Collins to more efficiently buy computers, flooring, and an ever-widening range of goods for city use.

A number of major companies, such as Gateway, Rockwell, Kodak, and Goodyear, make a special effort to anticipate the needs and projects of the government market. In this market, success comes to firms that participate in the product specification phase, gather competitive intelligence, prepare bids carefully, and produce strong communications to enhance their companies' reputations.

Business Buying Situations

Business buyers in companies, institutions, and government organizations face many decisions in the course of making a purchase. The number of decisions depends on the type of buying situation. Robinson and others distinguish three types of buying situations: the straight rebuy, the modified rebuy, and the new task.[5]

- *Straight rebuy:* The *straight rebuy* is a buying situation in which the purchasing department reorders on a routine basis (e.g., office supplies, bulk chemicals). The buyer chooses from suppliers on an "approved list." These suppliers make an effort to maintain product and service quality. They often propose automatic reordering systems to help purchasing agents save time. The "out-suppliers" attempt to offer something new or to exploit dissatisfaction with a current supplier. Out-suppliers try to get a small order and then enlarge their purchase share over time.
- *Modified rebuy:* The *modified rebuy* is a situation in which the buyer wants to modify product specifications, prices, delivery requirements, or other terms. The modified rebuy usually involves additional decision participants on both sides. The in-suppliers become nervous and have to protect the account; the out-suppliers see an opportunity to gain some business.
- *New task:* The *new task* is a buying situation in which a purchaser buys a product or service for the first time (e.g., office building, new security system). The greater the cost or risk, the larger the number of decision participants and the greater their information gathering—and therefore the longer the time to decision completion.[6]

New-task buying passes through several stages: awareness, interest, evaluation, trial, and adoption.[7] Communication tools' effectiveness varies at each stage. Mass media are most important during the initial awareness stage, salespeople have their greatest impact at the interest stage, and technical sources are the most important during the evaluation stage.

The business buyer makes the fewest decisions in the straight-rebuy situation and the most in the new-task situation. In the new-task situation, the buyer has to determine product specifications, price limits, delivery terms and times, service terms, payment terms, order quantities, acceptable suppliers, and the selected supplier. Different participants influence each decision, and the order in which these decisions are made can vary. The new-task situation is, therefore, the business marketer's greatest opportunity and challenge. For this reason, marketers should try to reach as many key buying influencers as possible and provide helpful information and assistance. Because of the complicated selling involved in new-task situations, many companies use a *missionary sales force* consisting of their best salespeople.

Systems Buying and Selling

Many business buyers prefer to buy a total solution to their problem from one seller. This practice, called *systems buying,* originated with government purchases of major weapons and communication systems. The government solicited bids from prime contractors; the winning contractor then bid out and assembled the system from subcomponents purchased from other contractors. Thus, the prime contractor was providing a "turnkey solution" that allowed the buyer to, in effect, turn one key and get the job done.

Sellers have increasingly recognized that buyers like to purchase in this way, and many have adopted systems selling as a marketing tool. Systems selling can take different forms. For example, many auto parts manufacturers now sell whole systems, such as the seating system, the braking system, or the door system. A variant on systems selling is *systems contracting*, in which a single supply source provides the buyer with all required *MRO supplies* (maintenance, repair, and operating supplies). This lowers the buyer's costs because the seller maintains the inventory, less time is spent on supplier selection, and the buyer enjoys price protection during the life of the contract. The seller benefits from lower operating costs because of steady demand and reduced paperwork.

Systems selling is a key industrial marketing strategy in bidding to build large-scale industrial projects such as dams, steel factories, and pipelines. Project engineering firms must compete on price, quality, reliability, and other attributes to win these contracts. For example, when the Indonesian government requested bids to build a cement factory near Jakarta, a U.S. firm made a proposal that included choosing the site, designing the cement factory, hiring the construction crews, assembling the materials and equipment, and turning over the finished factory to the Indonesian government. The proposal of a Japanese bidder included all of these services, plus hiring and training the factory workers, exporting the cement, and using the cement to build roads and office buildings around Jakarta. Although the Japanese proposal was more costly, it won. This is true system selling: The firm took the broadest view of its customer's needs and positioned itself as an economic development agency.

PARTICIPANTS IN THE BUSINESS BUYING PROCESS

Who does the buying of the trillions of dollars' worth of goods and services needed by business organizations? Purchasing agents are influential in straight-rebuy and modified-rebuy situations, whereas other department personnel are more influential in new-buy situations. Engineering personnel carry the most influence in selecting product components, and purchasing agents dominate in selecting suppliers.[8] These are just some of the people who may be part of the buying center.

The Buying Center

Webster and Wind call the decision-making unit of a buying organization the *buying center*. The buying center is composed of "all those individuals and groups who participate in the purchasing decision-making process, who share some common goals and the risks arising from the decisions."[9] The buying center includes organizational members who play any of seven roles in the purchase decision process:[10]

- *Initiators:* People who request that something be purchased, including users or others.
- *Users:* Those who will use the product or service; often, users initiate the buying proposal and help define product requirements.
- *Influencers:* People who influence the buying decision, including technical personnel. They often help define specifications and also provide information for evaluating alternatives.
- *Deciders:* Those who decide on product requirements or on suppliers.
- *Approvers:* People who authorize the proposed actions of deciders or buyers.

- *Buyers:* People who have formal authority to select the supplier and arrange the purchase terms, including high-level managers. Buyers may help shape product specifications, but their major role is selecting vendors and negotiating.
- *Gatekeepers:* People who have the power to prevent sellers or information from reaching members of the buying center; examples are purchasing agents, receptionists, and telephone operators.

There is also a trend toward team-based buying. In one survey, 87 percent of the purchasing executives at Fortune 1000 companies see more use of teams drawn from different departments and functions to make buying decisions.[11] This trend is leading to more team selling, as shown in the earlier Cutler-Hammer example.

To target their efforts properly, business marketers have to figure out: Who are the major decision participants? What decisions do they influence? What is their level of influence? What evaluation criteria do they use? When a buying center includes many participants, the business marketer will not have the time or resources to reach all of them. Small sellers concentrate on reaching the *key buying influencers.* Larger sellers go for *multilevel in-depth selling* to reach as many buying-center participants as possible. Their salespeople virtually "live" with their high-volume customers. In general, the most successful companies rely more heavily on communications to reach hidden buying influences and keep their current customers sold.[12]

Furthermore, the buying center can be highly dynamic, so business marketers need to periodically review their assumptions about who is participating. For years, Kodak sold X-ray film to hospital lab technicians, not noticing that buying decisions were increasingly being made by professional administrators. As sales declined, Kodak was finally forced to revise its market targeting strategy.

Major Influences on Business Buying

Business buyers respond to many influences when they make their decisions. When supplier offerings are similar, buyers can satisfy the purchasing requirements with any supplier, and they place more weight on the personal treatment they receive. When supplier offerings differ substantially, buyers are more accountable for their choices and pay more attention to economic factors. Business buyers respond to four main influences: environmental, organizational, interpersonal, and individual[13] (Figure 3-5); culture is also a factor.

Environmental Factors

Within the macroenvironment, business buyers pay close attention to numerous economic factors, including interest rates and levels of production, investment, and consumer spending. In a recession, business buyers reduce their investment in plant, equipment, and inventories. Business marketers can do little to stimulate total demand in recessionary periods; they can only fight harder to increase or maintain their share of demand.

Companies that fear materials shortages often buy and hold large inventories and sign long-term contracts with suppliers to ensure steady availability. In fact, DuPont, Ford, and other major companies regard long-term *supply planning* as a major responsibility of their purchasing managers.

Business buyers also actively monitor technological, political-regulatory, and competitive developments. For example, environmental concerns can cause changes in business buyer behavior. A printing firm might favor suppliers that carry recycled papers or use environmentally safe ink. One buyer claimed, "We push suppliers with technical expertise to be more socially conscious."

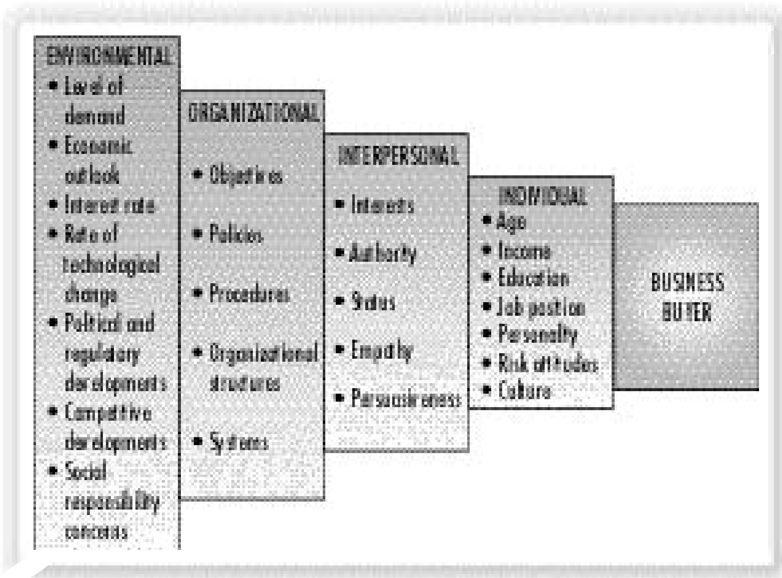

Figure 3-5 Major Influences on Business Buying Behavior

Organizational Factors

Every organization has specific purchasing objectives, policies, procedures, organizational structures, and systems. Business marketers need to be aware of the following organizational trends in purchasing:

- *Purchasing department upgrading.* Spurred by competitive pressures, companies are staffing their purchasing departments with MBAs who aspire to be CEOs—like Thomas Stallkamp, DaimlerChrysler's recently retired president. In his earlier role as executive vice president of procurement and supply, Stallkamp was highly successful in cost-cutting and in streamlining manufacturing processes.[14] These new, more strategically positioned "procurement departments" seek out the best value from fewer and better suppliers. At Caterpillar and other multinationals, purchasing departments have been elevated into "strategic supply departments" with responsibility for global sourcing and partnering. In response to this trend, business marketers must correspondingly upgrade their sales personnel to match the higher caliber of the business buyers.
- *Cross-functional roles.* In a recent survey, most purchasing professionals described their job as more strategic, technical, team-oriented, and involving more responsibility than ever before. "Purchasing is doing more cross-functional work than it did in the past," says David Duprey, a buyer for Anaren Microwave Inc., which makes microwave-signal processing devices for communication and defense. Sixty-one percent of buyers surveyed said the buying group was more involved in new-product design and development than it was 5 years ago. More than half of the buyers now participate in cross-functional teams, with suppliers well represented.[15]
- *Centralized purchasing.* In multidivisional companies, most purchasing is carried out by separate divisions because of their differing needs. Some companies, however, have recentralized their purchasing, identifying materials purchased by several

divisions and buying them centrally to gain more purchasing clout. Individual divisions can buy from other sources if they can get a better deal, but centralized purchasing usually produces substantial savings. For the business marketer, this means dealing with fewer and higher-level buyers, and using a national account sales group to deal with large corporate buyers.

- *Decentralized purchasing of small-ticket items.* More companies are decentralizing selected purchasing operations by empowering employees to purchase small-ticket items such as special binders and coffee makers. This has come about through the availability of corporate purchasing cards issued by credit-card firms. Companies distribute the cards to supervisors, clerks, and secretaries; the cards incorporate codes that set credit limits and restrict usage. National Semiconductor's purchasing chief says these cards have cut processing costs from $30 an order to a few cents. "Now buyers and suppliers can spend less time on paperwork, so purchasing departments have more time for building partnerships."[16]
- *Internet purchasing.* By 2003, business-to-business buying on the Internet is projected to reach $1 trillion per year (compared with a projected $108 billion for consumer buying).[17] The move to Internet purchasing has dramatic and far-reaching implications. Companies are not only posting their own Web pages to sell to business buyers, they are establishing Intranets for internal communication and extranets to link with regular suppliers and distributors. So far, most businesses are using extranets to buy MRO supplies. However, a growing number, such as General Electric, are preparing to buy nearly all supplies on-line to shave transaction and personnel costs, reduce time between order and delivery, and consolidate purchasing. In fact, GE Information Services is a leader in helping GE internal business units and outside companies use the Internet to buy from and sell to other businesses; its Trading Process Network lets companies buy raw materials, components, and just about anything else with a few clicks of the mouse. Internet purchasing can help forge closer relations between partners and buyers, and it levels the playing field between large and small suppliers. At the same time, it can potentially erode supplier-buyer loyalty and open the door to possible security disasters.[18]
- *Long-term contracts.* Business buyers are increasingly initiating or accepting long-term contracts with reliable suppliers. For example, General Motors wants to buy from fewer suppliers who are willing to locate close to its plants and produce high-quality components. In addition, business marketers are setting up electronic data interchange (EDI) systems so their customers such as hospitals and bookstores can enter and transmit purchase orders electronically.
- *Purchasing-performance evaluation and buyers' professional development.* Many companies have set up incentive systems to reward purchasing managers for good buying performance, in much the same way that sales personnel receive bonuses for good selling performance. These systems are leading purchasing managers to increase their pressure on sellers for the best terms.
- *Lean production.* Many manufacturers have moved toward lean production, which enables them to produce a more high-quality product at lower cost, in less time, using less labor. Lean production incorporates just-in-time (JIT) production, stricter quality control, frequent and reliable supply delivery, suppliers locating closer to customers, computerized purchasing, stable production schedules made available to suppliers, and single sourcing with early supplier involvement. JIT II, the next level of customer-supplier partnerships, focuses on reducing the costs and time involved in day-to-day purchasing transactions by locating one or more supplier employees at

the customer's site, in the role of buyer-materials planners. Massachusetts's Bose Corporation pioneered this arrangement with G&F Industries, its first in-plant supplier. Says Christ Labonte, a G&F manager, "It's a fresh, nontraditional agreement based on trust. After people get comfortable in their partnering, they start turning up rocks they wouldn't have turned up and revealing causes that were sacred cows."[19]

Interpersonal Factors

Buying centers usually include several participants with differing interests, authority, status, empathy, and persuasiveness. The business marketer is not likely to know what kind of group dynamics take place during the buying decision process. Therefore, successful firms strive to find out as much as possible about individual buying center participants and their interaction and train sales personnel and others from the marketing organization to be more attuned to the influence of interpersonal factors.

Individual Factors

Each buyer carries personal motivations, perceptions, and preferences, as influenced by the buyer's age, income, education, job position, personality, attitudes toward risk, and culture. Moreover, buyers definitely exhibit different buying styles. For example, some younger, highly educated buyers are expert at conducting rigorous, computerized analyses of competitive proposals before choosing a supplier. Other buyers are "toughies" from the old school and pit competitors against one another. Understanding these factors can better prepare marketers for dealing with individuals within the buying center.

Cultural Factors

Savvy marketers carefully study the culture and customs of each country or region where they want to sell their products, to better understand the cultural factors that can affect buyers and the buying organization. For example, in Germany, businesspeople prefer to be introduced by their full, correct titles, and they shake hands at both the beginning and the end of business meetings. As another example, both Korean and Japanese businesspeople observe Confucian ethics based on respect for authority and the primacy of the group over the individual.[20] Marketers that sell to firms in other nations must be aware of such cultural attitudes and practices, because they permeate business-to-business transactions.

THE PURCHASING/PROCUREMENT PROCESS

Industrial buying passes through eight stages called *buyphases,* as identified by Robinson and associates in the *buygrid* framework shown in Table 3.4.[21] In modified-rebuy or straight-rebuy situations, some of these stages are compressed or bypassed. For example, in a straight-rebuy situation, the buyer normally has a favorite supplier or a ranked list of suppliers. Thus, the supplier search and proposal solicitation stages are skipped. In the sections that follow, we examine each of the eight stages for a typical new-task buying situation.

Stage 1: Problem Recognition

The buying process begins when someone in the company recognizes a problem or need that can be met by acquiring a good or service. The recognition can be triggered by internal or external stimuli. Internally, problem recognition commonly occurs when a firm decides to develop a new product and needs new equipment and materi-

Table 3.4 Buygrid Framework: Major Stages (Buyphases) of the Industrial Buying Process in Relation to Major Buying Situations (Buyclasses)

		Buyphases		
		New Task	Modified Rebuy	Straight Rebuy
Buyphases	1. Problem recognition	Yes	Maybe	No
	2. General need description	Yes	Maybe	No
	3. Product specification	Yes	Yes	Yes
	4. Supplier search	Yes	Maybe	No
	5. Proposal solicitation	Yes	Maybe	No
	6. Supplier selection	Yes	Maybe	No
	7. Order-routine specification	Yes	Maybe	No
	8. Performance review	Yes	Yes	Yes

Source: Adapted from Patrick J. Robinson, Charles W. Faris, and Yoram Wind, *Industrial Buying and Creative Marketing* (Boston: Allyn & Bacon, 1967), p. 14.

als, when a machine breaks down and requires new parts, when purchased material turns out to be unsatisfactory, and when a purchasing manager senses an opportunity to obtain lower prices or better quality. Externally, problem recognition can occur when a buyer gets new ideas at a trade show, sees a supplier's ad, or is contacted by a sales representative offering a better product or a lower price. For their part, business marketers can stimulate problem recognition by direct mail, telemarketing, effective Internet communications, and calling on prospects.

Stage 2: General Need Description

Once a problem has been recognized, the buyer has to determine the needed item's general characteristics and the required quantity. For standard items, this is not a very involved process. For complex items, the buyer will work with others—engineers, users, and so on—to define the needed characteristics. These may include reliability, durability, price, or other attributes. In this stage, business marketers can assist buyers by describing how their products would meet such needs.

Stage 3: Product Specification

With a general need description in hand, the buying organization can develop the item's technical specifications. Often, the company will assign a product value analysis (PVA) engineering team to the project. **Product value analysis** is an approach to cost reduction in which components are carefully studied to determine if they can be redesigned or standardized or made by cheaper methods of production.

The PVA team will examine the high-cost components in a given product, because 20 percent of the parts usually account for 80 percent of the costs of manufacturing it. The team will also identify overdesigned product components that last longer than the product itself, then decide on the optimal product characteristics. Tightly written specifications will allow the buyer to refuse components that are too expensive or that fail to meet the specified standards. Suppliers, too, can use product value analysis as a tool for positioning themselves to win an account. By getting in early and influencing buyer specifications, a supplier can significantly increase its chances of being chosen.

Stage 4: Supplier Search

The buyer now tries to identify the most appropriate suppliers, by examining trade directories, doing a computer search, phoning other firms for recommendations, scanning trade advertisements, and attending trade shows. However, these days the most likely place to look is on the Internet. This levels the playing field, because smaller suppliers have the same advantages as larger ones and can be listed in the same on-line catalogs for a nominal fee.

One of the more comprehensive, global on-line catalog libraries is being assembled by Worldwide Internet Solutions Network Inc, better known as WIZ-net (www.wiznet.net). The firm's database includes full catalogs from more than 72,000 manufacturers, distributors, and industrial service providers around the world, containing more than 8 million product specifications. For purchasing managers, this kind of one-stop shopping can be an incredible time saver (and price saver, because it allows easier comparison shopping). And it is more convenient: WIZ-Net also offers secure e-mail so buyers can communicate directly with suppliers to ask for bids or to place orders.[22]

To get noticed during this buyphase, the supplier should get listed in major on-line catalogs or services, develop communications to reach buyers who are seeking new suppliers, and build a good reputation in the marketplace. Suppliers who lack capacity or have a poor reputation will be rejected, while those who qualify may be visited by buyer's agents, who will examine their facilities and meet their personnel. After evaluating each company, the buyer will end up with a short list of qualified suppliers.

Stage 5: Proposal Solicitation

In this stage, the buyer is ready to invite qualified suppliers to submit proposals. When the item is complex or expensive, the buyer will require a detailed written proposal from each qualified supplier. After evaluating the proposals, the buyer will invite a few suppliers to make formal presentations.

Business marketers must thus be skilled in researching, writing, and presenting proposals. Their written proposals should be marketing documents, not just technical documents. Their oral presentations should inspire confidence, positioning their company's capabilities and resources so that they stand out from the competition.

A supplier's first priority during this stage is to become qualified or, in some cases, to become certified, so it will be invited to submit proposals. Consider the hurdles that Xerox has set up for suppliers. Only suppliers that meet ISO 9000 international quality standards can qualify for certification. These suppliers must complete the Xerox Multinational Supplier Quality Survey, participate in Xerox's Continuous Supplier Involvement process, and undergo rigorous quality training and evaluation based on the Malcolm Baldrige National Quality Award criteria. Not surprisingly, only 176 companies worldwide have become certified Xerox suppliers.[23]

Stage 6: Supplier Selection

Before selecting a supplier, the buying center will specify desired supplier attributes (such as product reliability and service reliability) and indicate their relative importance. It will then rate each supplier on these attributes to identify the most attractive one.

At this point, the buyer may attempt to negotiate with preferred suppliers for better prices and terms before making the final selection. Despite moves toward strategic sourcing, partnering, and participation in cross-functional teams, buyers still spend a large chunk of their time haggling over price, which remains a key criterion for supplier selection.[24] Marketers can counter a buyer's request for a lower price in a number of ways. They may be able to show evidence that the "life-cycle cost" of using the product is lower than that of competitors' products. They can also cite the value of the services the buyer now receives, especially where those services are superior to those offered by competitors.

Hewlett-Packard, for example, has worked hard to become a "trusted advisor" to its customers, selling specific solutions to their unique problems. Along the way, HP discovered that some companies want a partner and others simply want a product that works. Still, the company estimates that the trusted-advisor approach has contributed to 60 percent growth of its high-end computer business.[25]

As part of the supplier selection process, buying centers must decide how many suppliers to use. In the past, many companies preferred a large supplier base to ensure adequate supplies and to obtain price concessions. Out-suppliers would try to get in the door by offering an especially low price.

Increasingly, however, companies are reducing the number of suppliers. Companies such as Ford, Motorola, and AlliedSignal have cut the number of suppliers anywhere from 20 percent to 80 percent. The suppliers who remain are responsible for larger component systems, for achieving continuous quality and performance improvements, and for lowering prices annually by a given percentage.

There is even a trend toward single sourcing, using one supplier. The *Knoxville News-Sentinel* and the *New York Daily News* newspapers both rely on a single source for their newsprint. This makes it easier to control newsprint inventories and maintain paper consistency to avoid the time and expense of changing presses for different papers.[26]

Stage 7: Order-Routine Specification

After selecting suppliers, the buyer negotiates the final order, listing the technical specifications, the quantity needed, the delivery schedule, and so on. In the case of MRO items, buyers are moving toward blanket contracts rather than periodic purchase orders. A *blanket contract* establishes a long-term relationship in which the supplier promises to resupply the buyer as needed at agreed-upon prices over a specified period. Because the seller holds the stock, blanket contracts are sometimes called *stockless purchase plans.* The buyer's computer automatically sends an order to the seller when stock is needed, and the supplier arranges delivery and billing according to the blanket contract.

Blanket contracting leads to more single-source buying and ordering of more items from that single source. This system locks suppliers in tighter with the buyer and makes it difficult for out-suppliers to break in unless the buyer becomes dissatisfied with the in-supplier's prices, quality, or service.

Stage 8: Performance Review

In the final stage of the buying process, the buyer periodically reviews the performance of the chosen supplier(s). Three methods are commonly used. The buyer may contact the end users and ask for their evaluations. Or the buyer may rate the supplier on several criteria using a weighted score method. Or the buyer might aggregate the cost of poor supplier performance to come up with adjusted costs of purchase, including price. The performance review may lead the buyer to continue, modify, or end the relationship with the supplier. Therefore, to stay in the running for future purchases, suppliers should monitor their performance carefully using the same criteria applied by the product's buyers and end users. Smart suppliers also analyze the rivals who compete for the same business, as discussed in the next chapter.

EXECUTIVE SUMMARY

Organizational buying is the decision-making process by which formal organizations establish the need for purchased products and services, and then identify, evaluate, and choose among alternative brands and suppliers. The business market consists of all of the organizations that acquire goods and services used in the production of other products or services that are sold, rented, or supplied to others: profit-seeking companies, institutions, and government agencies.

Compared to consumer markets, business markets generally have fewer and larger buyers, a closer customer-supplier relationship, and more geographically concentrated buyers. Demand in the business market is derived from demand in the consumer market and fluctuates with the business cycle. Nonetheless, the total demand for many business goods and services is quite price-inelastic. Business marketers need to be aware of the role of professional purchasers and their influencers, the need for multiple sales calls, and the importance of direct purchasing, reciprocity, and leasing.

Three types of buying situations are the straight rebuy, the modified rebuy, and the new task. Systems buying is a practice in which the buyer wants to purchase a total solution to its problem from one seller. The buying center is the decision-making unit of a buying organization. It consists of initiators, users, influencers, deciders, approvers, buyers, and gatekeepers.

To influence the buying center, marketers must be aware of environmental, organizational, interpersonal, individual, and cultural factors. The buying process consists of eight stages called buyphases: (1) problem recognition, (2) general need description, (3) product specification, (4) supplier search, (5) proposal solicitation, (6) supplier selection, (7) order-routine specification, and (8) performance review. Successful marketers anticipate and provide what buyers are seeking in each buyphase, increasing the chances that they will be selected and, ultimately, build a long-term relationship with their customers.

NOTES

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Identifying Market Segments and Selecting Target Markets

We will address the following questions:

- How and why is segmentation applied to consumer and business markets?
- How can a company use mass customization to effectively meet the needs of individual customers?
- What targeting strategies can a company use to select and enter the most attractive market segments?

A company cannot serve everyone in broad markets such as soft drinks (for consumers) and computers (for businesses), because the customers are too numerous and diverse in their buying requirements. This is why successful marketers look for specific market segments that they can serve more effectively. Instead of scattering their marketing efforts (a "shotgun" approach), they will be able to focus on the buyers whom they have the greatest chance of satisfying (a "rifle" approach).

The most targeted marketing strategies are built around meeting each customer's unique requirements. Such mass customization strategies are particularly well suited to Internet marketing, where leaders such as Dell can maintain an interactive dialogue with customers and create a unique bundle of goods and services specifically for their individual needs and wants.

Target marketing requires marketers to take three major steps: (1) Identify and profile distinct groups of buyers who might require separate products or marketing mixes (market segmentation); (2) select one or more market segments to enter (market targeting); and (3) establish and communicate the products' key distinctive benefits in the market (market positioning). This chapter focuses on the first two steps; the following chapter will discuss positioning strategy.

USING MARKET SEGMENTATION

Market segmentation aims to increase a company's precision marketing. In contrast, sellers that use *mass marketing* engage in the mass production, distribution, and promotion of one product for all buyers. Henry Ford epitomized this strategy when he offered the Model T Ford "in any color, as long as it is black." Coca-Cola also used mass marketing when it sold only one kind of Coke in a 6.5-ounce bottle.

The argument for mass marketing is that it creates the largest potential market, which leads to the lowest costs, which in turn can lead to lower prices or higher margins. However, many critics point to the increasing splintering of the market, which makes mass marketing more difficult. According to Regis McKenna, "[Consumers] have more ways to shop: at giant malls, specialty shops, and superstores; through mail-order catalogs, home shopping networks, and virtual stores on the Internet. And they are bombarded with messages pitched through a growing number of channels: broadcast and narrow-cast television, radio, on-line computer networks, the Internet, telephone services such as fax and telemarketing, and niche magazines and other print media."[1]

This proliferation of media and distribution channels is making it difficult to practice "one size fits all" marketing. Some observers even claim that mass marketing is dying. Therefore, to stay focused rather than scattering their marketing resources, more marketers are using market segmentation. In this approach, which falls midway between mass marketing and individual marketing, each segment's buyers are assumed to be quite similar in wants and needs, yet no two buyers are really alike. To use this technique, a company must understand both the levels and the patterns of market segmentation.

Levels of Market Segmentation

Regardless of whether they serve the consumer market or the business market—offering either goods or services—companies can apply segmentation at one of four levels: segments, niches, local areas, and individuals.

Segment Marketing

A *market segment* consists of a large identifiable group within a market, with similar wants, purchasing power, geographical location, buying attitudes, or buying habits. For example, an automaker may identify four broad segments in the car market: buyers who are primarily seeking (1) basic transportation, (2) high performance, (3) luxury, or (4) safety.

Because the needs, preferences, and behavior of segment members are similar but not identical, Anderson and Narus urge marketers to present *flexible market offerings* instead of one standard offering to all members of a segment.[2] A flexible market offering consists of the product and service elements that all segment members value, plus options (for an additional charge) that some segment members value. For example, Delta Airlines offers all economy passengers a seat, food, and soft drinks, but it charges extra for alcoholic beverages and earphones.

Segment marketing allows a firm to create a more fine-tuned product or service offering and price it appropriately for the target audience. The choice of distribution channels and communications channels becomes much easier, and the firm may find it faces fewer competitors in certain segments.

Niche Marketing

A *niche* is a more narrowly defined group, typically a small market whose needs are not being well served. Marketers usually identify niches by dividing a segment into subsegments or by defining a group seeking a distinctive mix of benefits. For example, a tobacco company might identify two subsegments of heavy smokers: those who are trying to stop smoking, and those who don't care.

In an attractive niche, customers have a distinct set of needs; they will pay a premium to the firm that best satisfies their needs; the niche is not likely to attract other competitors; the nicher gains certain economies through specialization; and the niche has size, profit, and growth potential. Whereas segments are fairly large and normally attract several competitors, niches are fairly small and may attract only one or two rivals. Still, giants such as IBM can and do lose pieces of their market to nichers: Dalgic labeled this confrontation "guerrillas against gorillas."[3]

Some larger firms have therefore turned to niche marketing. Ramada Franchises Enterprises, for example, offers lodgings in several niches: Ramada Limited for economy travelers; Ramada Inn as a mid-price, full-service hotel; Ramada Plaza for the upper-mid-price niche; Ramada Hotels for good quality, three-star service; and Ramada Renaissance hotels, offering excellent, four-star service. Many German midsize companies are also profiting through smart niching: Tetra Food supplies 80 percent of the food for tropical fish; Hohner holds 85 percent of the world harmonica market; and Becher has 50 percent of the world's oversized umbrella market. These firms are succeeding in their chosen niches because they are dedicated to their customers, offer superior service, and innovate continuously.[4]

Now the low cost of marketing on the Internet is making it more profitable for firms—including small businesses—to serve even seemingly minuscule niches. In fact, 15 percent of all commercial Web sites with fewer than 10 employees take in more than $100,000, and 2 percent ring up more than $1 million. The recipe for Internet niching success: Choose a hard-to-find product that customers don't need to see and touch. Consider Steve Warrington's successful on-line venture selling ostriches and every product derived from them (www.ostrichesonline.com). Launched for next to nothing on the Web, Warrington's business generates annual sales of $4 million-plus. Visitors to the site can buy ostrich meat, feathers, leather jackets, videos, eggshells, and skin-care products derived from ostrich body oil.[5]

Local Marketing

Target marketing is leading to some marketing programs that are tailored to the needs and wants of local customer groups (trading areas, neighborhoods, even individual stores). Citibank, for instance, adjusts its banking services in each branch depending on neighborhood demographics; Kraft helps supermarket chains identify the cheese assortment and shelf positioning that will optimize cheese sales in low-, middle-, and high-income stores and in different ethnic neighborhoods.

Those favoring local marketing see national advertising as wasteful because it fails to address local needs. On the other hand, opponents argue that local marketing drives up manufacturing and marketing costs by reducing economies of scale. Moreover, logistical problems become magnified when companies try to meet varying local requirements, and a brand's overall image might be diluted if the product and message differ in different localities.

Individual Marketing

The ultimate level of segmentation leads to "segments of one," "customized marketing," or "one-to-one marketing."[6] For centuries, consumers were served as individuals: The tailor made the suit and the cobbler designed shoes for the individual. Much business-to-business marketing today is customized, in that a manufacturer will customize the offer, logistics, communications, and financial terms for each major account. Now technologies such as computers, databases, robotic production, intranets and extranets, e-mail, and fax communication are permitting companies to return to customized marketing, also called "mass customization."[7] *Mass customization* is the ability to prepare individually designed products and communications on a mass basis to meet each customer's requirements.

For example, Andersen Windows, a $1 billion Minnesota-based manufacturer of residential windows, turned to mass customization after additions to its product line led to fat, unwieldy catalogs and a bewildering array of choices for homeowners and contractors. Then the firm equipped 650 showrooms with an interactive computer catalog linked directly to the factory. Using this catalog, salespeople help customers customize each window, check the design for structural soundness, and generate a price quote. Andersen has also developed a "batch of one" manufacturing process in which everything is made to order, thus reducing its finished parts inventory (a major cost to the company).[8]

Joseph Pine, author of *Mass Customization,* says, "Anything you can digitize, you can customize." In fact, the Internet is bringing mass customization to an astonishing array of products. Mattel's Barbie.com site invites girls to log on and design their own Barbie Pal doll by specifying skin tone, eye color, hairdo and hair color, clothes, accessories, and name. CDuctive, a hip, New York-based company, lets customers cut their own CDs online. If a customer likes acid jazz, he can click on the category, see the various titles, listen to a brief sample of each, and then click to order a CD with his chosen tunes.[9] Technology like this is transforming marketing from "a broadcast medium to a dialog medium," allowing the customer to actively participate in the design of the product and offer.

Although individual customers are taking more initiative in designing and buying products, marketers still need to influence the process in a variety of ways. They need toll-free phone numbers and e-mail addresses to enable buyers to reach them with questions, suggestions, and complaints; they must involve customers more in the product-specification process; and they need a Web site with complete, updated information about the company's products, service guarantees, and locations.

Patterns of Market Segmentation

Market segments can be built up in many ways. One common method is to identify *preference segments.* Suppose ice cream buyers are asked how much they value sweetness and creaminess as two product attributes. Three different patterns can emerge:

- *Homogeneous preferences:* Figure 3-6 shows a market in which all of the consumers have roughly the same preference, so there are no natural segments. We predict that existing brands would be similar and cluster around the middle of the scale in both sweetness and creaminess.
- *Diffused preferences:* At the other extreme, consumer preferences may be scattered throughout the space (Figure 3-6), indicating great variance in consumer preferences. One brand might position in the center to appeal to the most people; if several brands are in the market, they are likely to position throughout the space and show real differences to reflect consumer-preference differences.
- *Clustered preferences:* The market might reveal distinct preference clusters, called *natural market segments* (Figure 3-6). The first firm in this market might position in the center to appeal to all groups, choose the largest market segment (*concentrated marketing*), or develop several brands for different segments. If the first firm has only one brand, competitors would enter and introduce brands in the other segments.

Smart marketers examine such segmentation patterns carefully to better understand the various positions they might take in a market—and the competitive implications.

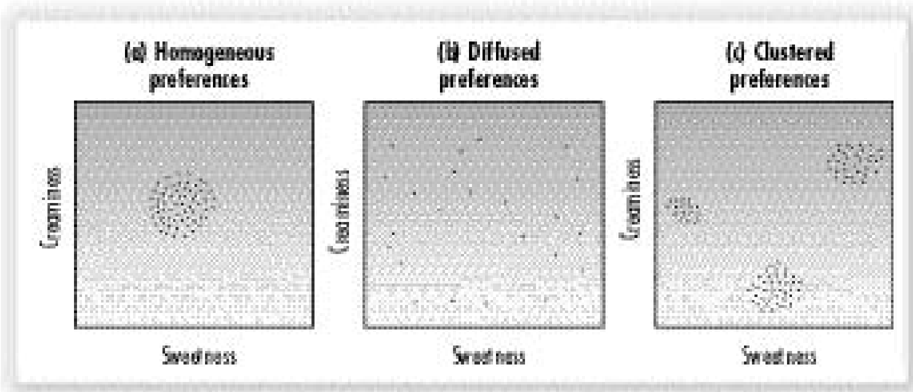


Figure 3-6 Basic Market-Preference Patterns

Market-Segmentation Procedure

Marketers use a three-step procedure for identifying market segments:

1. *Survey stage.* The researcher conducts exploratory interviews and focus groups to gain insight into customer motivations, attitudes, and behavior. Then the researcher prepares a questionnaire and collects data on attributes and their importance ratings, brand awareness and brand ratings, product-usage patterns, attitudes toward the product category, and respondents' demographics, geographics, psychographics, and mediagraphics.
2. *Analysis stage.* The researcher applies *factor analysis* to the data to remove highly correlated variables, then applies *cluster analysis* to create a specified number of maximally different segments.
3. *Profiling stage.* Each cluster is profiled in terms of its distinguishing attitudes, behavior, demographics, psychographics, and media patterns, then each segment is given a name based on its dominant characteristic. In a study of the leisure market, Andreasen and Belk found six segments:[10] passive homebody, active sports enthusiast, inner-directed self-sufficient, culture patron, active homebody, and socially active. They found that performing arts organizations could sell the most tickets by targeting culture patrons as well as socially active people.

Companies can uncover new segments by researching the hierarchy of attributes that customers consider when choosing a brand. For instance, car buyers who first decide on price are price dominant; those who first decide on car type (e.g., passenger, sport-utility) are type dominant; those who first decide on brand are brand dominant. With these segments, customers may have distinct demographics, psychographics, and mediagraphics to be analyzed and addressed through marketing programs.[11]

SEGMENTING CONSUMER AND BUSINESS MARKETS

Because of the inherent differences between consumer and business markets, marketers cannot use exactly the same variables to segment both. Instead, they use one broad group of variables as the basis for consumer segmentation and another broad group for business segmentation.

Bases for Segmenting Consumer Markets

In segmenting consumer markets, marketers can apply geographic, demographic, and psychographic variables related to *consumer characteristics* as well as behavioral variables related to *consumer responses* (see Table 3.5). Once the segments are formed, the marketer sees whether different characteristics are associated with each consumer-response segment. For example, the researcher might examine whether car buyers who want "quality" versus "low price" differ in their geographic, demographic, and psychographic makeup. This will determine whether the segments are useful for marketing purposes.

Geographic Segmentation

Geographic segmentation calls for dividing the market into different geographical units such as nations, states, regions, counties, cities, or neighborhoods. The company can operate in one or a few geographic areas or operate in all but pay attention to local variations. Some marketers even segment down to a specific zip code. Consider Blockbuster, which has databases to track the video preferences of its 85 million members and buys additional demographic data about each store's local area. As a result of this segmentation, it stocks its San Francisco stores with more gay-oriented videos, reflecting the city's large gay population, while it stocks Chicago stores with more family-oriented videos. Blockbuster can even distinguish between patterns of East Dallas and South Dallas customers.[12]

Demographic Segmentation

In *demographic segmentation,* the market is divided into groups on the basis of age and the other variables in Table 3.5. One reason this is the most popular consumer segmentation method is that consumer wants, preferences, and usage rates are often associated with demographic variables. Another reason is that demographic variables are easier to measure. Even when the target market is described in nondemographic terms (say, a personality type), the link back to demographic characteristics is needed in order to estimate the size of the target market and the media that should be used to reach it efficiently.

Here is how certain demographic variables have been used to segment consumer markets:

- *Age and life-cycle stage.* Consumer wants and abilities change with age, as Gerber realized when it decided to expand beyond its traditional baby foods line because the market was growing more slowly due to lower birthrates, babies staying on formula longer, and children moving to solid foods sooner. The company hopes that parents who buy its baby food will go on to buy its Graduates foods for 1- to 3-year olds.[13] However, age and life cycle can be tricky variables. For example, Ford originally designed its Mustang automobile to appeal to young people who wanted an inexpensive sport car. But when Ford found that the car was being purchased by all age groups, it recognized that the target market was not the chronologically young, but the psychologically young.
- *Gender.* Gender segmentation has long been applied in clothing, hairstyling, cosmetics, and magazines. Occasionally other marketers notice an opportunity for gender segmentation. The Internet portal iVillage.com reaped the benefits of gender segmentation after initially trying to appeal to a broader market of baby boomers. Noticing that Parent Soup and other offerings for women were the most popular, iVillage soon evolved into the leading women's on-line community. Its home page entreats visitors to "Join our community of smart, compassionate, real women."[14]

Table 3.5 Major Segmentation Variables for Consumer Markets

Geographic	
Region	Pacific, Mountain, West North Central, West South Central, East North Central, East South Central, South Atlantic, Middle Atlantic, New England
City or metro size	Under 4,999; 5,000–19,999; 20,000–49,999; 50,000–99,999; 100,000–249,999; 250,000–499,999; 500,000–999,999; 1,000,000–3,999,999; 4,000,000 or over
Density	Urban, suburban, rural
Climate	Northern, southern
Demographic	
Age	Under 6, 6–11, 12–19, 20–34, 35–49, 50–64, 65+
Family Size	1–2, 3–4, 5+
Family life cycle	Young, single; young, married, no children; young, married, youngest child under 6; young, married, youngest child 6 or over; older, married, with children; older, married, no children under 18; older, single; other
Gender	Male, female
Income	Under $9,999; $10,000–$14,999; $15,000–$19,999; $20,000–$29,999; $30,000–$49,999; $50,000–$99,999; $100,000 and over
Occupation	Professional and technical; managers, officials, and proprietors; clerical, sales; craftspeople; forepersons; operatives; farmers; retired; students; homemakers; unemployed
Education	Grade school or less; some high school; high school graduate; some college; college graduate
Religion	Catholic, Protestant, Jewish, Muslim, Hindu, other
Race	White, Black, Asian, Hispanic
Generation	Baby boomers, Generation Xers
Nationality	North American, South American, British, French, German, Italian, Japanese
Social class	Lower lowers, upper lowers, working class, middle class, upper middles, lower uppers, upper uppers
Psychographic	
Lifestyle	Straights, swingers, longhairs
Personality	Compulsive, gregarious, authoritarian, ambitious
Behavioral	
Occasions	Regular occasion, special occasion
Benefits	Quality, service, economy, speed
User status	Nonuser, ex-user, potential user, first-time user, regular user
Usage rate	Light user, medium user, heavy user
Loyalty status	None, medium, strong, absolute
Readiness stage	Unaware, aware, informed, interested, desirous, intending to buy
Attitude toward product	Enthusiastic, positive, indifferent, negative, hostile

- *Income.* Income segmentation is a long-standing practice in such categories as automobiles, boats, clothing, cosmetics, and travel. However, income does not always predict the best customers for a given product. The most economical cars are not bought by the really poor, but rather by those who think of themselves as poor relative to their status aspirations; medium-price and expensive cars tend to be purchased by the overprivileged segments of each social class.
- *Generation.* Each generation is profoundly influenced by the times in which it grows up—the music, movies, politics, and events of that period. Some marketers target Generation Xers (those born between 1964 and 1984), while others target Baby Boomers (those born between 1946 and 1964).[15] Meredith and Schewe have proposed a more focused concept they call cohort segmentation.[16] *Cohorts* are groups of people who share experiences of major external events (such as World War II) that have deeply affected their attitudes and preferences. Because members of a cohort group feel a bond with each other for having shared these experiences, effective marketing appeals use the icons and images that are prominent in the targeted cohort group's experience.
- *Social class.* Social class strongly influences preference in cars, clothing, home furnishings, leisure activities, reading habits, and retailers, which is why many firms design products for specific social classes. However, the tastes of social classes can change over time. The 1980s were about greed and ostentation for the upper classes, but the 1990s were more about values and self-fulfillment. Affluent tastes now run toward more utilitarian rather than ostentatious products.[17]

Psychographic Segmentation

In *psychographic segmentation,* buyers are divided into different groups on the basis of lifestyle or personality and values. People within the same demographic group can exhibit very different psychographic profiles.

- *Lifestyle.* People exhibit many more lifestyles than are suggested by the seven social classes, and the goods they consume express their lifestyles. Meat seems an unlikely product for lifestyle segmentation, but one Kroger supermarket in Nashville found that segmenting self-service meat products by lifestyle, not by type of meat, had a big payoff. This store grouped meats by lifestyle, creating such sections as "Meals in Minutes" and "Kids Love This Stuff" (hot dogs, hamburger patties, and the like). By focusing on lifestyle needs, not protein categories, Kroger's encouraged habitual beef and pork buyers to consider lamb and veal as well—boosting sales and profits.[18] But lifestyle segmentation does not always work: Nestlé introduced a special brand of decaffeinated coffee for "late nighters," and it failed, presumably because people saw no need for such a specialized product.
- *Personality.* Marketers can endow their products with *brand personalities* that correspond to consumer personalities. Apple Computer's iMac computers, for example, have a friendly, stylish personality that appeals to buyers who do not want boring, ordinary personal computers.[19]
- *Values.* Core values are the belief systems that underlie consumer attitudes and behaviors. Core values go much deeper than behavior or attitude, and determine, at a basic level, people's choices and desires over the long term. Marketers who use this segmentation variable believe that by appealing to people's inner selves, it is possible to influence purchase behavior. Although values often differ from culture to culture, Roper Reports has identified six values segments stretching across 35 countries: strivers (who focus more on material and professional goals), devouts

(who consider tradition and duty very important), altruists (who are interested in social issues), intimates (who value close personal relationships and family highly), fun seekers (who tend to be younger and usually male), and creatives (who are interested in education, knowledge, and technology).[20]

Behavioral Segmentation

In *behavioral segmentation,* buyers are divided into groups on the basis of their knowledge of, attitude toward, use of, or response to a product. Many marketers believe that behavioral variables—occasions, benefits, user status, usage rate, loyalty status, buyer-readiness stage, and attitude—are the best starting points for constructing market segments.

- *Occasions.* Buyers can be distinguished according to the occasions on which they develop a need, purchase a product, or use a product. For example, air travel is triggered by occasions related to business, vacation, or family, so an airline can specialize in one of these occasions. Thus, charter airlines serve groups of people who fly to a vacation destination. Occasion segmentation can help firms expand product usage, as the Curtis Candy Company did when it promoted trick-or-treating at Halloween and urged consumers to buy candy for the eager little callers. A company can also consider critical life events to see whether they are accompanied by certain needs. This kind of analysis has led to service providers such as marriage, employment, and bereavement counselors.
- *Benefits.* Buyers can be classified according to the benefits they seek. One study of travelers uncovered three benefit segments: those who travel to be with family, those who travel for adventure or education, and those who enjoy the "gambling" and "fun" aspects of travel.[21]
- *User status.* Markets can be segmented into nonusers, ex-users, potential users, first-time users, and regular users of a product. The company's market position also influences its focus. Market leaders (such as America Online) focus on attracting potential users, whereas smaller firms (such as Earthlink, a fast-growing Internet service provider) try to lure users away from the leader.
- *Usage rate.* Markets can be segmented into light, medium, and heavy product users. Heavy users are often a small percentage of the market but account for a high percentage of total consumption. Marketers usually prefer to attract one heavy user rather than several light users, and they vary their promotional efforts accordingly. Repp's Big & Tall Stores, which operates 200 stores and a catalog business, has identified 12 segments by analyzing customer response rates, average sales, and so on. Some segments get up to eight mailings a year, while some get only one to three mailings. The chain tries to steer low-volume catalog shoppers into nearby stores, and it offers infrequent customers an incentive such as 15 percent off to buy during a particular period. Repp gets a 6 percent response to these segmented mailings, far more than the typical 0.5 response rate for nonsegmented mailings.[22]
- *Loyalty status.* Buyers can be divided into four groups according to brand loyalty status: (1) hard-core loyals (who always buy one brand), (2) split loyals (who are loyal to two or three brands), (3) shifting loyals (who shift from one brand to another, and (4) switchers (who show no loyalty to any brand).[23] Each market consists of different numbers of these four types of buyers; thus, a *brand-loyal market* has a high percentage of hard-core loyals. Companies that sell in such a market have a hard time gaining more market share, and new competitors have a hard time breaking in. One caution: What appears to be brand loyalty may actually reflect habit, indifference, a low price, a high switching cost, or the nonavailability of other

brands. For this reason, marketers must carefully interpret what is behind observed purchasing patterns.

- *Buyer-readiness stage.* A market consists of people in different stages of readiness to buy a product: Some are unaware of the product, some are aware, some are informed, some are interested, some desire the product, and some intend to buy. The relative numbers make a big difference in designing the marketing program.
- *Attitude.* Five attitude groups can be found in a market: (1) enthusiastic, (2) positive, (3) indifferent, (4) negative, and (5) hostile. So, for example, workers in a political campaign use the voter's attitude to determine how much time to spend with that voter. They may thank enthusiastic voters and remind them to vote, reinforce those who are positively disposed, try to win the votes of indifferent voters, and spend no time trying to change the attitudes of negative and hostile voters.

Multi-Attribute Segmentation (Geoclustering)

Marketers are increasingly combining several variables in an effort to identify smaller, better defined target groups. Thus, a bank may not only identify a group of wealthy retired adults, but within that group may distinguish several segments depending on current income, assets, savings, and risk preferences.

One of the most promising developments in multi-attribute segmentation is *geoclustering*, which yields richer descriptions of consumers and neighborhoods than does traditional demographics. Geoclustering can help a firm answer such questions as: Which clusters (neighborhoods or zip codes) contain our most valuable customers? How deeply have we already penetrated these segments? Which markets provide the best opportunities for growth?

Claritas Inc. has developed a geoclustering approach called PRIZM (Potential Rating Index by Zip Markets), classifying over half a million U.S. residential neighborhoods into 62 lifestyle groupings called PRIZM Clusters.[24] The groupings take into consideration 39 factors in five broad categories: (1) education and affluence, (2) family life cycle, (3) urbanization, (4) race and ethnicity, and (5) mobility, and cover specific geographic areas defined by Zip code, Zip + 4, census tract, and block group.

Each cluster has a descriptive title, such as *American Dreams* and *Rural Industria.* Within each cluster, members tend to lead similar lives, drive similar cars, have similar jobs, and read similar magazines. The American Dreams cluster, for example, is upscale and ethnic—a big-city mosaic of people likely to buy imported cars, *Elle* magazine, Mueslix cereal, tennis weekends, and designer jeans. In contrast, Rural Industria contains young families in heartland offices and factories whose lifestyle is typified by trucks, *True Story* magazine, Shake n' Bake, fishing trips, and tropical fish.[25]

Geoclustering is an especially valuable segmentation tool because it captures the increasing diversity of the American population. Moreover, it can help even smaller firms identify microsegments that are economically feasible because of lower database costs, more sophisticated software, increased data integration, and wider use of the Internet.[26]

Bases for Segmenting Business Markets

Business markets can be segmented with some variables that are employed in consumer market segmentation, such as geography, benefits sought, and usage rate. Yet business marketers can also use several other variables. Bonoma and Shapiro proposed segmenting the business market with the variables shown in Table 3.6. The demographic variables are the most important, followed by the operating variables—down to the personal characteristics of the buyer.

Table 3.6 Major Segmentation Variables for Business Markets

Demographic

1. *Industry:* Which industries should we serve?
2. *Company size:* What size companies should we serve?
3. *Location:* What geographical areas should we serve?

Operating Variables

4. *Technology:* What customer technologies should we focus on?
5. *User or nonuser status:* Should we serve heavy users, medium users, light users, or nonusers?
6. *Customer capabilities:* Should we serve customers needing many or fewer services?

Purchasing Approaches

7. *Purchasing-function organization:* Should we serve companies with highly centralized or decentralized purchasing organizations?
8. *Power structure:* Should we serve companies that are engineering dominated, financially dominated, and so on?
9. *Nature of existing relationships:* Should we serve companies with which we have strong relationships or simply go after the most desirable companies?
10. *General purchase policies:* Should we serve companies that prefer leasing? Service contracts? Systems purchases? Sealed bidding?
11. *Purchasing criteria:* Should we serve companies that are seeking quality? Service? Price?

Situational Factors

12. ***Urgency:*** Should we serve companies that need quick and sudden delivery or service?
13. ***Specific application:*** Should we focus on certain applications of our product rather than all applications?
14. ***Size of order:*** Should we focus on large or small orders?

Personal Characteristics

15. ***Buyer–seller similarity:*** Should we serve companies whose people and values are similar to ours?
16. ***Attitudes toward risk:*** Should we serve risk-taking or risk-avoiding customers?
17. ***Loyalty:*** Should we serve companies that show high loyalty to their suppliers?

Source: Adapted from Thomas V. Bonoma and Benson P. Shapiro, *Segmenting the Industrial Market* (Lexington, MA: Lexington Books, 1983).

A company should first decide which industries it wants to serve. Then, within a chosen target industry, the company can further segment by company size, possibly setting up separate operations for selling to large and small customers. Small businesses, in particular, have become a Holy Grail for business marketers, both on and off the Internet.[27] Small businesses are now responsible for 50 percent of the U.S. gross domestic product, according to the Small Business Administration—and this segment is growing even faster than the large company segment.

IBM, already successful in marketing to corporate giants, is one of many companies targeting small businesses. Within the segment of U.S. firms with 1,000 or fewer employees, IBM is further targeting the segment of minority-owned businesses. IBM's strategy is to devote some field salespeople exclusively to small and medium-size businesses, hire executives responsible for targeting subsegments, become more involved in professional associations frequented by minority small-business owners, and offer more flexible contact options such as telesales and service.[28]

Looking beyond small businesses, marketers can be more effective even within mature commodity industries if they use segmentation for better targeting. For example, Rangan, Moriarty, and Swartz found these four business segments within the steel strapping industry:[29]

1. *Programmed buyers:* Buyers who see the product as not very important to their operation. This is a very profitable segment: The buyers view the product as a routine purchase item, usually paying full price and receiving below-average service.
2. *Relationship buyers:* Buyers who regard the product as moderately important and are knowledgeable about competitive offerings. They get a small discount and a modest amount of service and prefer the vendor as long as the price is not far out of line. This is the second most profitable segment.
3. *Transaction buyers:* Buyers who see the product as very important to their operations. They are price and service sensitive and receive some discounts, but they know the competition and will switch for a better price, even at the sacrifice of some service.
4. *Bargain hunters:* Buyers who see the product as very important and demand low prices and top service. They know the alternative suppliers, bargain hard, and are ready to switch if dissatisfied. The company needs these buyers for volume purposes, but they are not very profitable.

Clearly, developing a segmentation scheme for this kind of industry will help a business marketer determine where to increase or decrease price and service, since each segment reacts differently.[30]

Effective Segmentation

Even after applying segmentation variables to a consumer or business market, marketers must realize that not all segmentations are useful. For example, table salt buyers could be divided into blond and brunette customers, but hair color is not relevant to the purchase of salt. Furthermore, if all salt buyers buy the same amount of salt each month, believe all salt is the same, and would pay only one price for salt, this market would be minimally segmentable from a marketing perspective.

To be useful, market segments must be:

- *Measurable:* The size, purchasing power, and characteristics of the segments can be measured.
- *Substantial:* The segments are large and profitable enough to serve. A segment should be the largest possible homogeneous group worth going after with a tailored marketing program.
- *Accessible:* The segments can be effectively reached and served.
- *Differentiable:* The segments are conceptually distinguishable and respond differently to different marketing mixes. If two segments respond identically to a particular offer, they do not constitute separate segments.
- *Actionable:* Effective programs can be formulated for attracting and serving the segments.

MARKET TARGETING STRATEGIES

Once the firm has identified its market-segment opportunities, it is ready to initiate market targeting. Here, marketers evaluate each segment to determine how many and which ones to target and enter.

Evaluating Market Segments

In evaluating different market segments, the firm must look at two factors: (1) the segment's overall attractiveness, and (2) the company's objectives and resources. First, the firm must ask whether a potential segment has the characteristics that make it generally attractive, such as size, growth, profitability, scale economies, and low risk.

Second, the firm must consider whether investing in the segment makes sense given the firm's objectives and resources. Some attractive segments could be dismissed because they do not mesh with the company's long-run objectives; some should be dismissed if the company lacks one or more of the competences needed to offer superior value.

Selecting and Entering Market Segments

Having evaluated different segments, the company can consider five patterns of target market selection, as shown in Figure 3-7.

Single-Segment Concentration

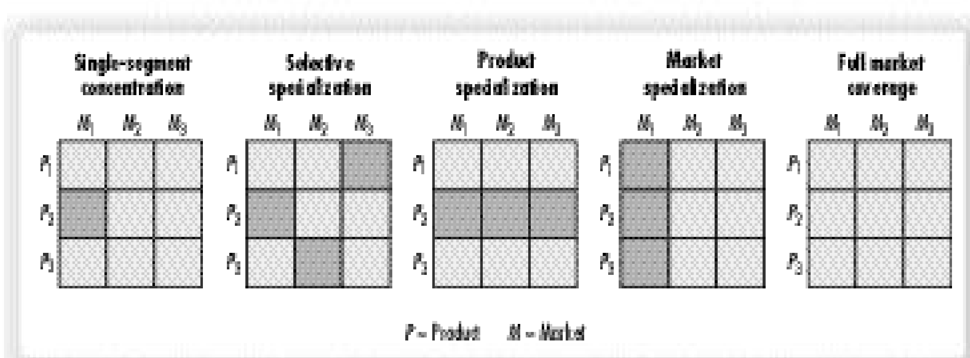
Many companies concentrate on a single segment: Volkswagen, for example, concentrates on the small-car market, while Porsche concentrates on the sports car market. Through concentrated marketing, the firm gains a thorough understanding of the segment's needs and achieves a strong market presence. Furthermore, the firm enjoys operating economies by specializing its production, distribution, and promotion; if it attains segment leadership, it can earn a high return on its investment.

However, concentrated marketing involves higher than normal risks if the segment turns sour because of changes in buying patterns or new competition. For these reasons, many companies prefer to operate in more than one segment.

Selective Specialization

Here the firm selects a number of segments, each objectively attractive and appropriate. There may be little or no synergy among the segments, but each segment

Figure 3-7 Five Patterns of Target Market Selection



promises to be a moneymaker. This multisegment coverage strategy has the advantage of diversifying the firm's risk.

Consider a radio broadcaster that wants to appeal to both younger and older listeners using selective specialization. Emmis Communications owns New York's WRKS-RM, which describes itself as "smooth R&B [rhythm and blues] and classic soul" and appeals to older listeners, as well as WQHT-FM, which plays hip-hop (urban street music) for under-25 listeners.[31]

Product Specialization

Another approach is to specialize in making a certain product for several segments. An example would be a microscope manufacturer that sells microscopes to university laboratories, government laboratories, and commercial laboratories. The firm makes different microscopes for different customer groups but does not manufacture other instruments that laboratories might use. Through a product specialization strategy, the firm builds a strong reputation in the specific product area. The downside risk is that the product may be supplanted by an entirely new technology.

Market Specialization

With market specialization, the firm concentrates on serving many needs of a particular customer group. An example would be a firm that sells an assortment of products only to university laboratories, including microscopes, oscilloscopes, and chemical flasks. The firm gains a strong reputation in serving this customer group and becomes a channel for further products that the customer group could use. However, the downside risk is that the customer group may have its budgets cut.

Full Market Coverage

Here a firm attempts to serve all customer groups with all of the products they might need. Only very large firms can undertake a full market coverage strategy. Examples include IBM (computer market), General Motors (vehicle market), and Coca-Cola (drink market). Large firms can cover a whole market in two broad ways: through undifferentiated marketing or differentiated marketing.

In *undifferentiated marketing,* the firm ignores market-segment differences and goes after the whole market with one market offer. Focusing on a basic buyer need, it designs a product and a marketing program that will appeal to the broadest number of buyers. To reach the market, the firm uses mass distribution backed by mass advertising to create a superior product image in people's minds. The narrow product line keeps down costs of research and development, production, inventory, transportation, marketing research, advertising, and product management; the undifferentiated advertising program keeps down advertising costs. Presumably, the company can turn its lower costs into lower prices to win the price-sensitive segment of the market.

In *differentiated marketing,* the firm operates in several market segments and designs different programs for each segment. General Motors does this with its various vehicle brands and models; Intel does this with chips and programs for consumer, business, small business, networking, digital imaging, and video markets.[32] Differentiated marketing typically creates more total sales than does undifferentiated marketing. However, the need for different products and marketing programs also increases the firm's costs for product modification, manufacturing, administration, inventory, and promotion.

Because differentiated marketing leads to both higher sales and higher costs, we cannot generalize regarding this strategy's profitability. Still, companies should be cautious about oversegmenting their market. If this happens, they may want to use *coun-*

tersegmentation to broaden their customer base. Smith Kline Beecham introduced Aquafresh toothpaste to attract three benefit segments simultaneously: those seeking fresh breath, whiter teeth, and cavity protection. Next, the company moved deeper into countersegmentation by launching flavored toothpastes for children, toothpaste for people with sensitive teeth, and other toothpaste products.

Targeting Multiple Segments and Supersegments

Very often, companies start out by marketing to one segment, then expand to others. For example, Paging Network Inc.—known as PageNet—is a small developer of paging systems, and was the first to offer voice mail on pagers. To compete with Southwestern Bell and other Bell companies, it sets its prices about 20 percent below rivals' prices. Initially, PageNet used geographic segmentation to identify attractive markets in Ohio and Texas where local competitors were vulnerable to its aggressive pricing. Next, the firm developed a profile of users for paging services so it could target salespeople, messengers, and service people. PageNet also used lifestyle segmentation to target additional consumer groups, such as parents who leave their children with a sitter. Finally, PageNet began distributing its pagers through Kmart, Wal-Mart, and Home Depot, offering attractive discounts in return for the right to keep the monthly service charge revenues on any pagers sold.[33]

In targeting more than one segment, a company should examine segment interrelationships on the cost, performance, and technology side. A company that is carrying fixed costs, such as a sales force or store outlets, can generally add products to absorb and share some of these costs. Smart companies know that economies of scope can be just as important as economies of scale. Moreover, companies should look beyond isolated segments to target a *supersegment,* a set of segments that share some exploitable similarity. For example, many symphony orchestras target people with broad cultural interests, rather than only those who regularly attend concerts.

Still, a company's invasion plans can be thwarted when it confronts blocked markets. This problem calls for *megamarketing,* the strategic coordination of economic, psychological, political, and public-relations skills to gain the cooperation of a number of parties in order to enter or operate in a given market. Pepsi used megamarketing to enter India after Coca-Cola left the market. First, it worked with a local business group to gain government approval for its entry over the objections of domestic soft-drink companies and antimultinational legislators. Pepsi also offered to help India export enough agricultural products to more than cover the cost of importing soft-drink concentrate and promised economic development for some rural areas. By winning the support of these and other interest groups, Pepsi was finally able to crack the Indian market.

Ethical Choice of Market Targets

Market targeting sometimes generates public controversy.[34] The public is concerned when marketers take unfair advantage of vulnerable groups (such as children) or disadvantaged groups (such as inner-city poor people), or promote potentially harmful products. For example, the cereal industry has been criticized for marketing to children. Critics worry that high-powered appeals presented through the mouths of lovable animated characters will overwhelm children's defenses and lead them to eat too much sugared cereal or poorly balanced breakfasts.

As another example, R. J. Reynolds was criticized for plans to market Uptown, a menthol cigarette targeted toward low-income African Americans. Recently, internal documents from R. J. Reynolds and Brown & Williamson Tobacco Corporation (marketer of the Kool brand) have revealed the extent to which these companies target black youths aged 16 to 25, particularly with menthol brands.[35]

Not all attempts to target children, minorities, or other segments draw criticism. Colgate-Palmolive's Colgate Junior toothpaste has special features designed to get children to brush longer and more often. Golden Ribbon Playthings has developed a highly acclaimed and very successful black character doll named "Huggy Bean" to connect minority consumers with their African heritage. Other companies are also responding to the needs of specific segments. Black-owned ICE theaters noticed that although moviegoing by blacks has surged, there is a dearth of inner-city theaters, so it began opening theaters in Chicago and other cities. ICE partners with the black communities in which it operates, using local radio stations to promote films and featuring favorite foods at concession stands.[36]

Thus, in the choice of market targets, the issue is not who is targeted, but rather how and for what purpose. Socially responsible marketing calls for targeting and positioning that serve not only the company's interests but also the interests of those targeted.[37]

EXECUTIVE SUMMARY

Companies usually are more effective when they target their markets. Target marketing involves three activities: market segmentation, market targeting, and market positioning. Markets can be targeted at four levels: segments, niches, local areas, and individuals. Market segments are large, identifiable groups within a market, with similar wants, purchasing power, location, buying attitudes, or buying habits. A niche is a more narrowly defined group.

Many marketers localize their marketing programs for certain trading areas, neighborhoods, and even individual stores. The ultimate in segmentation is individual marketing and mass customization, a trend that is growing as more customers take the initiative in designing and buying products and brands. In addition, marketers must analyze the patterns of segmentation in a market to get a sense of their positioning alternatives and that of the competitors.

Markets are segmented in a three-step procedure of surveying, analyzing, and profiling. The major segmentation variables for consumer markets are geographic, demographic, psychographic, and behavioral, to be used singly or in combination. Business marketers can use all of these variables along with operating variables, purchasing approaches, situational factors, and personal characteristics. To be useful, market segments must be measurable, substantial, accessible, differentiable, and actionable.

Once a firm has identified its market-segment opportunities, it has to evaluate the various segments and decide how many and which ones to target. In evaluating segments, managers look at the segment's attractiveness indicators and the company's objectives and resources. In choosing which segments to target, the company can focus on a single segment, selected segments, a specific product, a specific market, or the full market; in the full market, it can use either differentiated or undifferentiated marketing. It is important for marketers to choose target markets in a socially responsible manner, by ensuring that the targeting serves the interests of the market being targeted as well as the company.

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Developing, Differentiating, and Positioning Products Through the Life Cycle

We will address the following questions:

- What challenges does a company face in developing and introducing new products?
- What are the main stages in developing new products, and how can they be better managed?
- What factors affect the rate at which consumers adopt new products?
- What marketing strategies are appropriate at each stage of the product life cycle?
- How can a company choose and communicate an effective positioning in the market?

Every company, regardless of size, must research and create new products to maintain or build sales. Why? Customers want new products and choices, and competitors will be doing their best to supply them. Over 16,000 new products (including line extensions and new brands) arrive on grocery and drugstore shelves every year, having made their way through the new product development process from bright idea to testing to commercialization.

Not every new product catches on, of course, and those that do are adopted by customers at different rates. This is why smart marketers target early adopters and use marketing tactics that will facilitate consumer movement through the various stages in the adoption process.

Companies normally reformulate their marketing strategy several times during a product's life as economic conditions change, competitors launch new assaults, and the product passes through new stages of buyer interest and requirements. Successful companies plan marketing strategies that are appropriate to each stage in the product's life cycle and hope to extend each product's life and profitability, knowing that no product lasts forever. The key to setting one offering apart from competing offers throughout the life cycle is to select a suitable differentiation strategy and create a distinctive position in the market.

CHALLENGES IN NEW PRODUCT DEVELOPMENT

Companies that fail to develop new products (either goods or services) are putting themselves at great risk. Over time, existing products are vulnerable to changing customer needs and tastes, new technologies, shortened product life cycles, and increased competition. Yet new-product development also entails considerable risk: Texas Instruments lost $660 million before withdrawing from the home computer business; RCA lost $500 million on its videodisc players; Federal Express lost $340 million on its Zap mail service; and the British-French Concorde aircraft will never recover its investment.[1]

A company can add new products in two ways: through acquisition (buying another company, buying another firm's patent, or buying a license or franchise) or through development (using its own laboratories, hiring independent researchers, or hiring a new-product-development firm). Moreover, there is more than one category of new product.

Types of New Products

Even though thousands of products are offered for the first time each year, less than 10 percent are entirely new and innovative. Booz, Allen & Hamilton has identified six categories of new products:[2]

1. *New-to-the-world products:* New, innovative products that create an entirely new market, such as the Palm Pilot handheld computerized organizer.
2. *New product lines:* New products that allow a company to enter an established market for the first time, such as Fuji's brand of disks for Zip drives.
3. *Additions to existing product lines:* New products that supplement a company's established product lines (package sizes, flavors, and so on), such as Amazon.com's auctions and e-mail greeting cards.
4. *Improvements and revisions of existing products:* New products that provide improved performance or greater perceived value and replace existing products, such as Microsoft Office 2000.
5. *Repositionings:* Existing products that are targeted to new markets or market segments, such as repositioning Johnson & Johnson's Baby Shampoo for adults as well as youngsters.
6. *Cost reductions:* New products that provide similar performance at lower cost, such as Intel's Celeron chip.

The new-to-the-world category involves the greatest cost and risk because these products are new to both the company and the marketplace, so positive customer response is far from certain. That's why most new-product activities are improvements on existing products. At Sony, for example, over 80 percent of new-product activity is undertaken to modify and improve existing Sony products. Even new-product improvements are not guaranteed to succeed, however.

Why New Products Fail—and Succeed

New products are failing at a disturbing rate; by one estimate, 80 percent of recently launched products are no longer around.[3] Given the high costs—a company can spend $20 million to $50 million to develop and advertise one new product—it is a wonder that companies continue to innovate at all. Yet product failures can serve one useful purpose: Inventors, entrepreneurs, and new-product team leaders can learn valuable lessons about what *not* to do.

Some of the reasons for new-product failure are: (1) a high-level executive pushes a favorite idea through in spite of negative market research findings; (2) the idea is good, but the market size is overestimated; (3) the product is not well designed; (4) the product is incorrectly positioned, ineffectively advertised, or overpriced; (5) development costs are higher than expected; or (6) competitors fight back harder than expected.

What can a company do to develop successful new products? Cooper and Kleinschmidt found that new products with a high product advantage succeed 98 percent of the time, compared to products with a moderate advantage (58 percent success) or minimal advantage (18 percent success).[4] Madique and Zirger studied successful product launches in the electronics industry and found greater new-product success when the firm: has a better understanding of customer needs; a higher performance-to-cost ratio; a head-start in introducing the product before competitors; a higher expected contribution margin; a higher budget for promoting and launching the product; more use of cross-functional teamwork; and stronger top-management support.[5]

MANAGING NEW PRODUCTS: IDEAS TO STRATEGY

The process of developing new products spans eight stages, each with a particular set of marketing challenges and questions to answer (see Figure 3-8). If the company cannot answer "yes" to the key question at each of the first six stages, the new product will be dropped; in the final two stages, the company has the option of further development or modification rather than immediately dropping the new product. This section covers the stages from idea to strategy and analysis; the following section covers the stages from product development through market testing and commercialization.

Idea Generation

The marketing concept holds that *customer needs and wants* are the logical place to start the search for new product ideas. Hippel has shown that the highest percentage of ideas for new industrial products originates with customers.[6] Many of the best ideas come from asking customers to describe their problems with current products. For instance, in an attempt to grab a foothold in steel wool soap pads, 3M organized consumer focus groups and asked about problems with these products. The most frequent complaint was that the pads scratched expensive cookware. This finding produced the idea for the highly successful Scotch-Brite Never Scratch soap pad.[7] In addition to customers, new-product ideas can come from many sources: scientists, competitors, employees, channel members, sales reps, top management, inventors, patent attorneys, university and commercial laboratories, industrial consultants, advertising agencies, marketing research firms, and industry publications.

Idea Screening

Once the firm has collected a number of new product ideas, the next step is to screen out the weaker ideas, because product-development costs rise substantially with each successive development stage. Most companies require new-product ideas to be described on a standard form that can be reviewed by a new-product committee. The

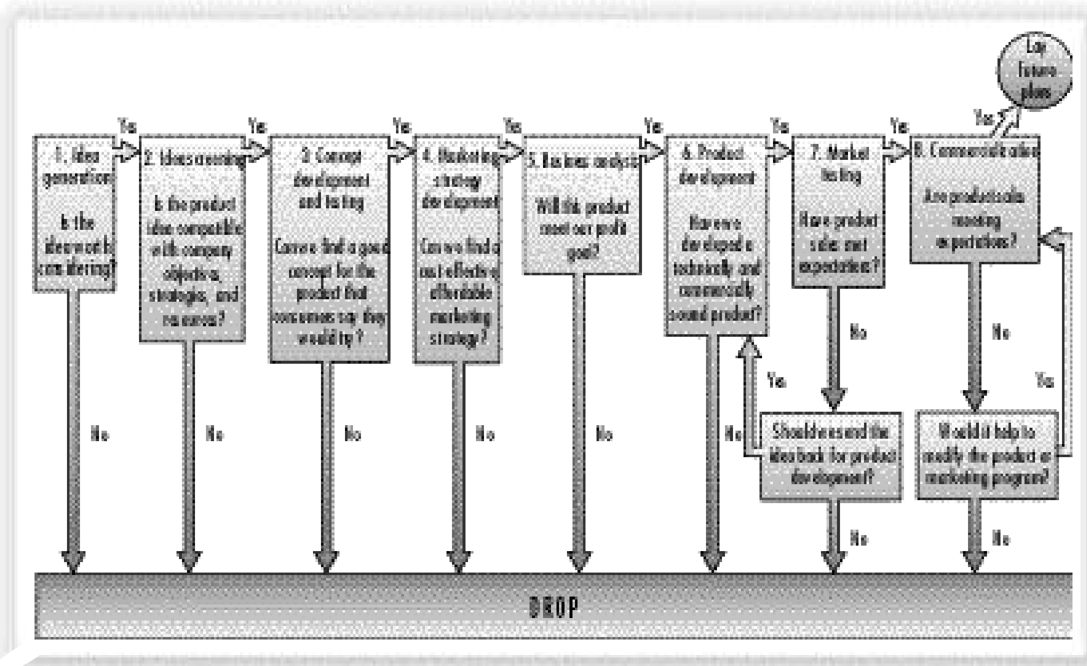


Figure 3-8 The New-Product-Development Decision Process

description states the product idea, the target market, and the competition, along with a rough estimate of the market size, product price, development time and costs, manufacturing costs, and rate of return. The new-product committee then reviews each idea against criteria such as: Does the product meet a need? Would it offer superior value? Will the new product deliver the expected sales volume, sales growth, and profit? The ideas that survive this screening move on to the concept development stage.

Concept Development

A *product idea* is a possible product the company might offer to the market. In contrast, a *product concept* is an elaborated version of the idea expressed in meaningful consumer terms. A product idea can be turned into several concepts by asking: Who will use this product? What primary benefit should this product provide? When will people consume or use this product? By answering such questions, a company can often form several product concepts, select the single most promising concept, and create a *product-positioning map* for it. Figure 3-9 shows the positioning of a product concept, a low-cost instant breakfast drink, compared to other breakfast foods already on the market.

Next, the product concept has to be turned into a *brand concept*. To transform the concept of a low-cost instant breakfast drink into a brand concept, the company must decide how much to charge and how calorific to make its drink. Figure 3-9 shows a *brand-positioning map* that reflects the positions of three instant breakfast drink brands. The gaps on this map indicate that the new brand concept would have to be distinctive in the medium-price, medium-calorie market or the high-price, high-calorie market.

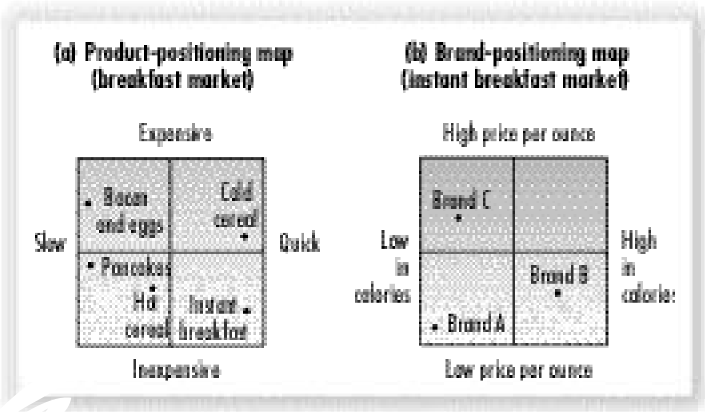


Figure 3-9 Product and Brand Positioning

Concept Testing

Concept testing involves presenting the product concept to appropriate target consumers and getting their reactions. The concepts can be presented symbolically or physically. However, the more the tested concepts resemble the final product or experience, the more dependable concept testing is. In the past, creating physical prototypes was costly and time-consuming, but computer-aided design and manufacturing programs have changed that. Today firms can design a number of prototypes via computer and then create plastic models to obtain feedback from potential consumers.[8] Companies are also using virtual reality to test product concepts.

Many companies today use *customer-driven engineering* to design new products. Customer-driven engineering attaches high importance to incorporating customer preferences in the final design. National Semiconductor uses the Internet to enhance its customer-driven engineering by tracking what customers search for on its Web site. Sometimes, says the company's Web services manager, it is more important to know when a customer did not find a product than when he did. That helps National Semiconductor shrink the time needed to identify market niches and create new products.[9]

Marketing Strategy Development

After testing and selecting a product concept for development, the new-product manager must draft a three-part preliminary marketing-strategy plan for introducing the new product into the market. The first part will describe the target market's size, structure, and behavior; the planned product positioning; and the sales, market share, and profit goals sought in the first few years. The second part will outline the planned price, distribution strategy, and marketing budget for the first year. The third part will describe the long-run sales and profit goals and marketing-mix strategy over time. This plan forms the basis for the business analysis that is conducted before management makes a final decision on the new product.

Business Analysis

In this stage, the company evaluates the proposed new product's business attractiveness by preparing sales, cost, and profit projections to determine whether these satisfy company objectives. If they do, the product concept can move to the product-development stage. Note that this cannot be a static process: As new information emerges, the business analysis must be revised and expanded accordingly.

Estimating Total Sales

First, management needs to estimate whether sales will be high enough to yield a satisfactory profit. Total estimated sales are the sum of estimated first-time sales, replacement sales, and repeat sales. For one-time purchased products, such as a retirement home, sales rise at the beginning, then peak, and later approach zero as the number of potential buyers is exhausted; if new buyers keep entering the market, the curve will not drop to zero. Infrequently purchased products—such as automobiles and industrial equipment—exhibit replacement cycles that are dictated by physical wearing out or by obsolescence due to changing styles, features, and performance; sales forecasting calls for estimating first-time sales and replacement sales separately.

For frequently purchased products, such as consumer and industrial nondurables like soap, the number of first-time buyers initially increases and then decreases as fewer buyers are left (assuming a fixed population). Repeat purchases occur soon, providing that the product satisfies some buyers. The sales curve eventually falls to a plateau representing a level of steady repeat-purchase volume; by this time, the product is no longer a new product.

Estimating Costs and Profits

After preparing the sales forecast, management should analyze expected costs and profits based on estimates prepared by the R&D, manufacturing, marketing, and finance departments. Companies can also use other financial measures to evaluate new-product proposals. The simplest is *break-even analysis,* in which management estimates how many units of the product the company will have to sell to break even with the given price and cost structure.

The most complex method of estimating profit is *risk analysis.* Here, three estimates (optimistic, pessimistic, and most likely) are obtained for each uncertain variable affecting profitability under an assumed marketing environment and marketing strategy for the planning period. The computer simulates possible outcomes and computes a rate-of-return probability distribution showing the range of possible rates of returns and their probabilities.[10]

MANAGING NEW PRODUCTS: DEVELOPMENT TO COMMERCIALIZATION

If the product concept passes the business analysis test, it moves on to be developed into a physical product. Up to now, it has existed only as a word description, drawing, or prototype. This step involves a large jump in investment that dwarfs the costs incurred in the earlier stages. If the company determines that the product idea cannot be translated into a technically and commercially feasible product, the accumulated project cost will be lost—except for any useful information gained in the process.

Product Development

The job of translating target customer requirements into a working prototype is helped by a set of methods known as *quality function deployment* (QFD). This methodology takes the list of desired *customer attributes* (CAs) generated by market research and turns them into a list of *engineering attributes* (EAs) that the engineers can use. For example, customers of a proposed truck may want a certain acceleration rate (CA). Engineers turn this into the required horsepower and other engineering equivalents (EAs). QFD allows firms to measure the trade-offs and costs of satisfying customer requirements; it also improves communication among marketing, engineering, and manufacturing.[11]

Next, the firm uses QFD to develop one or more physical versions of the product concept. The goal is to find a prototype that customers believe embodies the key attributes described in the product-concept statement, that performs safely under normal use, and that can be produced within the budget. The rise of the World Wide Web has driven more rapid prototyping and more flexible development; prototype-driven firms such as Yahoo! and Microsoft cherish quick-and-dirty tests and experiments.[12]

When the prototypes are ready, they are put through rigorous *functional tests* and *customer tests. Alpha testing* means testing the product within the firm to see how it performs in different applications. After refining the prototype further, the company moves to *beta testing,* enlisting customers to use the prototype and give feedback on their experiences. Beta testing is most useful when the potential customers are heterogeneous, the potential applications are not fully known, several decision makers are involved in purchasing the product, and opinion leadership from early adopters is sought.[13]

Consumer testing can take a variety of forms, from bringing consumers into a laboratory to giving them samples to use in their homes. In-home placement tests are common with products ranging from ice cream flavors to new appliances. For example, when DuPont developed its new synthetic carpeting, it installed free carpeting in several homes in exchange for the homeowners' willingness to report their likes and dislikes about the carpeting.

Market Testing

After management is satisfied with functional and psychological performance, the product is ready to be dressed up with a brand name and packaging, and put to a market test. The new product is now introduced into an authentic setting to learn how large the market is and how consumers and dealers react to handling, using, and repurchasing the product. For example, idealab! is in the business of launching new Internet ventures (eToys was one). Before starting CarsDirect, a Web-based car buying service, idealab! put up a live Web page and monitored on-line market reaction. In just one evening, the site sold four cars—results that hinted at the product's potential for strong market acceptance.[14]

Consumer-Goods Market Testing

In testing consumer products, the company seeks to estimate four variables: trial, first repeat purchase, adoption, and purchase frequency. The company hopes to find all of these variables at high levels. In some cases, however, it will find many consumers trying the product but few rebuying it. Or it might find high permanent adoption but low purchase frequency (as with gourmet frozen foods).

The major methods of consumer-goods market testing, from the least to the most costly, are:

- *Sales-wave research.* Consumers who initially try the product at no cost are reoffered the product, or a competitor's product, at slightly reduced prices, as many as three to five times (sales waves). The company notes how many customers select its product again and their reported level of satisfaction.
- *Simulated test marketing.* Up to 40 qualified buyers first answer questions about brand familiarity and product preferences. These buyers are invited to look at

commercials or print ads, including one for the new product, then they are given money and brought into a store where they can make purchases. The company notes how many people buy the new brand and competing brands as a test of the ad's relative effectiveness against competing ads in simulating trial. Consumers are also asked why they bought or did not buy; nonbuyers receive a free sample of the new product and are reinterviewed later to determine product attitudes, usage, satisfaction, and repurchase intention.[15]

- *Controlled test marketing.* A research firm manages a panel of stores that will carry new products for a fee. The company with the new product specifies the number of stores and geographic locations it wants to test. The research firm delivers the product to the participating stores and controls shelf position; number of facings, displays, and point-of-purchase promotions; and pricing. Sales results can be measured through electronic scanners at the checkout. The company can also evaluate the impact of local advertising and promotions during this test.
- *Test markets.* When full-blown, the company chooses a few representative cities, the sales force tries to sell the trade on carrying the product and giving it good exposure, and the company unleashes a full advertising and promotion campaign in these markets. Here, marketers must decide on the number and location of test cities, length of the test, what to track, and what action to take. Today, many firms are skipping extended test marketing and relying instead on faster and more economical market-testing methods, such as smaller test areas and shorter test periods.

Business-Goods Market Testing

Business goods can also benefit from market testing. Expensive industrial goods and new technologies will normally undergo both alpha and beta testing. In addition, new business products are sometimes market-tested at trade shows. Trade shows such as the annual Toy Fair and semiannual Internet World draw a large number of buyers who view many new products in a few concentrated days. The vendor can observe how much interest buyers show in the new product, how they react to various features and terms, and how many express purchase intentions or place orders. The disadvantage of trade shows is that they reveal the product to competitors; therefore, the vendor should be ready to launch the product soon after the trade show.

Commercialization

If the company goes ahead with commercialization, it will face its largest costs to date. The company will have to contract for manufacture or build or rent a full-scale manufacturing facility. Plant size will be a critical decision. The company may choose to build a smaller plant than called for by the sales forecast, to be on the safe side. Quaker Oats did this when it launched its 100 Percent Natural breakfast cereal. Unfortunately, demand so exceeded the company's sales forecast that for about a year it could not supply enough product to the stores. Although Quaker Oats was gratified with the response, the low forecast cost it a considerable amount of profit.

In addition to promotional decisions, other major decisions during this stage include:

- *When (timing).* Marketing timing is critical. If a firm learns that a competitor is nearing the end of its development work, it can choose: *first entry* (being first to market, locking up key distributors and customers, and gaining reputational leadership; however, if the product is not thoroughly debugged, it can acquire a flawed image); *parallel entry* (launching at the same time as a rival may gain both products more attention from the market); or *late entry* (waiting until after a competitor has entered lets the competitor bear the cost of educating the market and may reveal problems to avoid).

- *Where (geographic strategy).* The company must decide whether to launch the new product in a single locality, a region, several regions, the national market, or the international market. Smaller companies often select one city for a blitz campaign, entering other cities one at a time; in contrast, large companies usually launch within a whole region and then move to the next region, although companies with national distribution generally launch new models nationally. Firms are increasingly rolling out new products simultaneously across the globe, which raises new challenges in coordinating activities and obtaining agreement on strategy and tactics.
- *To whom (target-market prospects).* Within the rollout markets, the company must target its initial distribution and promotion to the best prospect groups. Presumably, the company has already profiled the prime prospects—who would ideally be early adopters, heavy users, and opinion leaders who are able to be reached at a low cost.[16] The company should rate the various prospect groups on these characteristics and then target the best prospect group to generate strong sales as soon as possible, motivate the sales force, and attract further prospects.
- *How (introductory market strategy).* The company must develop an action plan for introducing the new product into the rollout markets. To coordinate the many activities involved in launching a new product, management can use network-planning techniques such as *critical path scheduling* (CPS), which uses a master chart to show the simultaneous and sequential activities that must take place to launch the product. By estimating how much time each activity takes, the planners can estimate the project's completion time. A delay in any activity on the critical path will delay the entire project.[17]

THE CONSUMER ADOPTION PROCESS

Adoption is an individual's decision to become a regular user of a product. How do potential customers learn about new products, try them, and adopt or reject them? In the past, companies used a *mass-market approach* to introduce new products, on the assumption that most people are potential buyers. Yet consumers have different levels of interest in new products and brands. The theory of innovation diffusion and consumer adoption helps marketers to identify and target *early adopters*—people who adopt products before the majority of consumers in the market.

Stages in the Adoption Process

An *innovation* refers to any good, service, or idea that is *perceived* by someone as new. The idea may have a long history, but it is an innovation to the person who sees it as new. Innovations take time to spread through the social system. Rogers defines the *innovation diffusion process* as "the spread of a new idea from its source of invention or creation to its ultimate users or adopters."[18] The consumer-adoption process focuses on the mental process through which an individual passes from first hearing about an innovation to final adoption.

Adopters of new products have been observed to move through five stages: (1) *awareness* (consumer becomes aware of the innovation but has no information about it); (2) *interest* (consumer is stimulated to seek information about the innovation); (3) *evaluation* (consumer considers whether to try the innovation); (4) *trial* (consumer tries the innovation to estimate its value; and (5) *adoption* (consumer decides to make full and regular use of the innovation).

Factors Influencing the Adoption Process

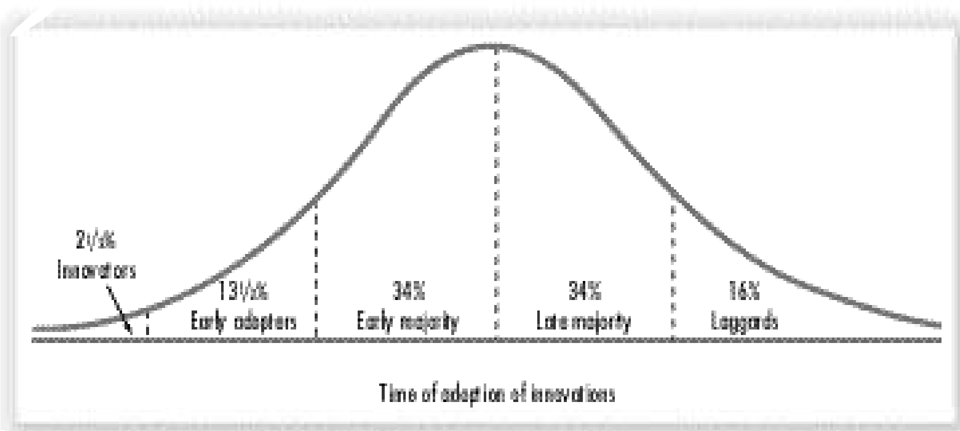
As Figure 3-10 shows, people adopt new products at different rates: Innovators are the first to adopt something new, while laggards are the last. Rogers defines a person's innovativeness as "the degree to which an individual is relatively earlier in adopting new ideas than the other members of his social system." Because people differ in their readiness to try new products, there are consumption pioneers and early adopters for each product. After a slow start, an increasing number of people adopt the innovation, the number reaches a peak, and then it diminishes as fewer nonadopters remain.

Another factor affecting adoption is *personal influence,* the effect one person has on another's attitude or purchase probability. Although personal influence is greater in some situations and for some individuals, it is more important in the evaluation stage of the adoption process than in the other stages. It generally has more influence on late adopters and is more important in risky situations, as well.

Five characteristics influence the rate of adoption of an innovation: (1) *relative advantage*—the degree to which the innovation appears superior to existing products; (2) *compatibility*—the degree to which the innovation matches the values and experiences of the individuals; (3) *complexity*—the degree to which the innovation is relatively difficult to understand or use; (4) *divisibility*—the degree to which the innovation can be tried on a limited basis; and (5) *communicability*—the degree to which the beneficial results of use are observable or describable to others. The new-product marketer has to research and consider all of these factors in designing the new product and its marketing program.[19]

Finally, organizations vary in their readiness to adopt innovations. Adoption is associated with variables in the organization's environment, the organization itself (size, profits, pressure to change), and its managers. Other forces come into play when trying to get a product adopted into organizations that receive the bulk of their funding from the government. And a controversial or innovative product can be squelched by negative public opinion.

Figure 3-10 Adopter Categorization on the Basis of Relative Time of Adoption of Innovation



MARKETING THROUGH THE PRODUCT LIFE CYCLE

In today's highly dynamic marketing environment, a company's marketing strategy must change as the product, market, and competitors change over time. Here, we describe the concept of the product life cycle (PLC) and the changes that companies make as the product passes through each stage of the life cycle.

The Concept of the Product Life Cycle

To say that a product has a life cycle is to assert four things: (1) Products have a limited life; (2) product sales pass through distinct stages with different challenges, opportunities, and problems for the seller; (3) profits rise and fall at different stages of the product life cycle; and (4) products require different marketing, financial, manufacturing, purchasing, and human resource strategies in each stage. Most product life-cycle curves are portrayed as a bell-shape (Figure 3-11).

This PLC curve is typically divided into four stages:[20]

- *Introduction:* A period of slow sales growth as the product is introduced in the market. Profits are nonexistent in this stage because of the heavy expenses incurred with product introduction.
- *Growth:* A period of rapid market acceptance and substantial profit improvement.
- *Maturity:* A period of a slowdown in sales growth because the product has achieved acceptance by most potential buyers. Profits stabilize or decline because of increased competition.
- *Decline:* The period when sales show a downward drift and profits erode.

Table 3.7 summarizes the characteristics, objectives, and strategies associated with each stage.

Marketing Strategies: Introduction Stage

Because it takes time to roll out a new product and fill dealer pipelines, sales growth tends to be slow at this stage. Buzzell identified several causes for the slow growth:

Figure 3-11 Sales and Profit Life Cycles

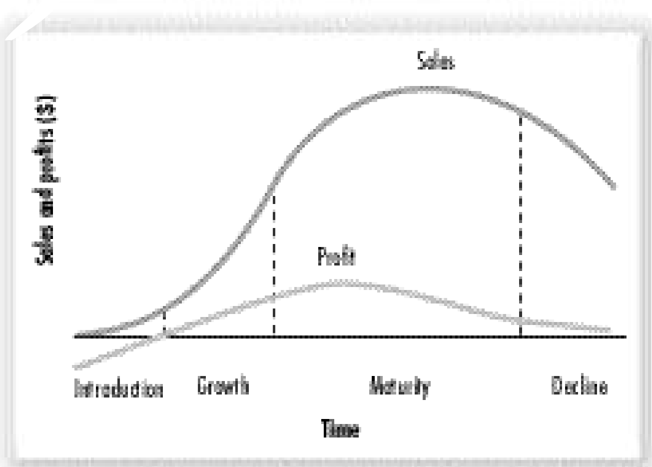


Table 3.7 Summary of Product Life Cycle Characteristics, Objectives, and Strategies

	Introduction	Growth	Maturity	Decline
Characteristics				
Sales	Low sales	Rapidly rising sales	Peak sales	Declining sales
Costs	High cost per customer	Average cost per customer	Low cost per customer	Low cost per customer
Profits	Negative	Rising profits	High profits	Declining profits
Customers	Innovators	Early adopters	Middle majority	Laggards
Competitors	Few	Growing number	Stable number beginning to decline	Declining number
Marketing Objectives				
	Create product awareness and trial	Maximize market share	Maximize profit while defending market share	Reduce expenditure and milk the brand
Strategies				
Product	Offer a basic product	Offer product extensions, service, warranty	Diversify brands and items	Phase out weak models
Price	Charge cost-plus	Price to penetrate market	Price to match or best competitors'	Cut price
Distribution	Build selective distribution	Build intensive distribution	Build more intensive distribution	Go selective: phase out unprofitable outlets
Advertising	Build product awareness among early adopters and dealers	Build awareness and interest in the mass market	Stress brand differences and benefits	Reduce to level needed to retain hard-core loyals
Sales Promotion	Use heavy sales promotion to entice trial	Reduce to take advantage of heavy consumer demand	Increase to encourage brand switching	Reduce to minimal level

Sources: Chester R. Wasson, *Dynamic Competitive and Product Life Cycles* (Austin, TX: Austin Press, 1978); John A. Weber, "Planning Corporate Growth with Inverted Product Life Cycles," *Long Range Planning,* October 1976, pp. 12–29; and Peter Doyle, "The Realities of the Product Life Cycle," *Quarterly Review of Marketing,* Summer 1976.

delays in the expansion of production capacity, technical problems ("working out the bugs"), delays in obtaining adequate distribution through retail outlets, and customer reluctance to change established behaviors.[21] Sales of expensive new products are retarded by additional factors such as product complexity and fewer buyers.

Profits are negative or low in the introduction stage because of low sales and heavy distribution and promotion expenses. Much money is needed to attract distributors. Promotional expenditures are high because of the need to (1) inform potential consumers, (2) induce product trial, and (3) secure distribution. Firms focus their selling on those buyers who are the readiest to buy, usually higher-income groups. Prices tend to be high because costs are high due to relatively low output rates, technological problems in production, and high required margins to support the heavy promotional expenditures.

Companies must decide when to enter the market with a new product. Most studies indicate that the *market pioneer* gains the most advantage. Such pioneers as Amazon.com, Cisco, Coca-Cola, eBay, Eastman Kodak, Hallmark, Microsoft, Peapod.com, and Xerox developed sustained market dominance.

However, the pioneer advantage is not inevitable. Schnaars studied 28 industries in which the imitators surpassed the innovators and found several weaknesses among the failing pioneers, including new products that were too crude, were improperly positioned, or appeared before there was strong demand; product-development costs that exhausted the innovator's resources; a lack of resources to compete against entering larger firms; and managerial incompetence or unhealthy complacency. Successful imitators thrived by offering lower prices, improving the product more continuously, or using brute market power to overtake the pioneer.[22] As one example, Apple's Newton, the first handheld personal digital assistant, failed because it could not decipher the handwriting of users consistently. In contrast, imitator Palm Pilot's smaller, more advanced product was enormously successful because it allowed users to input information with a few standardized strokes of the stylus.[23]

Still, the pioneer knows that competition will eventually enter the market and charge a lower price, which will force the pioneer to lower prices. As competition and market share stabilize, buyers will no longer pay a price premium; some competitors will withdraw at this point, and the pioneer can then build share if it chooses.[24]

Marketing Strategies: Growth Stage

The growth stage is marked by a rapid climb in sales, as DVD players are currently experiencing.[25] Early adopters like the product, and additional consumers start buying it. Attracted by the opportunities, new competitors enter with new product features and expanded distribution. Prices remain where they are or fall slightly, depending on how fast demand increases. Companies maintain or increase their promotional expenditures to meet competition and to continue to educate the market. Sales rise much faster than promotional expenditures, causing a welcome decline in the promotion-sales ratio.

Profits increase during this stage as promotion costs are spread over a larger volume and unit manufacturing costs fall faster than price declines owing to the producer learning effect. During this stage, the firm uses several strategies to sustain rapid market growth as long as possible: (1) improving product quality and adding new product features and improved styling; (2) adding new models and flanker products; (3) entering new market segments; (4) increasing distribution coverage and entering new distribution channels; (5) shifting from product-awareness advertising to product-preference advertising; and (6) lowering prices to attract the next layer of price-sensitive buyers.

Marketing Strategies: Maturity Stage

At some point, the rate of sales growth will slow, and the product will enter a stage of relative maturity. This stage normally lasts longer than the previous stages, and poses formidable challenges to marketing management. *Most products are in the maturity stage of the life cycle, and most marketing managers cope with the problem of marketing the mature product.*

Three strategies for the maturity stage are market modification, product modification, and marketing-mix modification:

- *Market modification.* The company might try to expand the market for its mature brand by working to expand the number of brand users. This is accomplished by (1) converting nonusers; (2) entering new market segments (as Johnson & Johnson did when promoting baby shampoo for adult use); or (3) winning competitors' customers (the way Pepsi-Cola tries to woo away Coca-Cola users). Volume can also be increased by convincing current brand users to increase their usage of the brand.
- *Product modification.* Managers try to stimulate sales by modifying the product's characteristics through quality improvement, feature improvement, or style improvement. *Quality improvement* aims at increasing the product's functional performance—its durability, reliability, speed, taste. New features build the company's image as an innovator and win the loyalty of market segments that value these features; this is why America Online regularly introduces new versions of its Internet software. However, feature improvements are easily imitated; unless there is a permanent gain from being first, the feature improvement might not pay off in the long run.[26]
- *Marketing-mix modification.* Product managers can try to stimulate sales by modifying other marketing-mix elements such as prices, distribution, advertising, sales promotion, personal selling, and services. For example, Goodyear boosted its market share from 14 to 16 percent in 1 year when it began selling tires through Wal-Mart, Sears, and Discount Tire.[27] Sales promotion has more impact at this stage because consumers have reached an equilibrium in their buying patterns, and psychological persuasion (advertising) is not as effective as financial persuasion (sales-promotion deals). However, excessive sales-promotion activity can hurt the brand's image and long-run profit performance. In addition, price reductions and many other marketing-mix changes are easily imitated. The firm may not gain as much as expected, and all firms might experience profit erosion as they step up their marketing attacks on each other.

Marketing Strategies: Decline Stage

The sales of most product forms and brands eventually decline for a number of reasons, including technological advances, shifts in consumer tastes, and increased domestic and foreign competition. All of these factors lead ultimately to overcapacity, increased price cutting, and profit erosion. As sales and profits decline, some firms withdraw from the market. Those remaining may reduce the number of products they offer. They may withdraw from smaller market segments and weaker trade channels, and they may cut their promotion budget and reduce their prices further.

In a study of company strategies in declining industries, Harrigan identified five possible decline strategies:

1. *Increasing* the firm's investment (to dominate the market or strengthen its competitive position);
2. *Maintaining* the firm's investment level until the uncertainties about the industry are resolved;
3. *Decreasing* the firm's investment level selectively, by dropping unprofitable customer groups, while simultaneously strengthening the firm's investment in lucrative niches;
4. *Harvesting* ("milking") the firm's investment to recover cash quickly; and
5. *Divesting* the business quickly by disposing of its assets as advantageously as possible.[28]

The appropriate decline strategy depends on the industry's relative attractiveness and the company's competitive strength in that industry. Procter & Gamble has, on a number of occasions, successfully restaged disappointing brands that were competing in strong markets. One example is its "not oily" hand cream called Wondra, which came packaged in an inverted bottle so the cream would flow out from the bottom. Although initial sales were high, repeat purchases were disappointing. Consumers complained that the bottom got sticky and that "not oily" suggested it would not work well. P&G carried out two restagings for this product: First, it reintroduced Wondra in an upright bottle, and later, it reformulated the ingredients so they would work better. Sales then picked up.

If the company were choosing between harvesting and divesting, its strategies would be quite different. *Harvesting* calls for gradually reducing a product's or business's costs while trying to maintain its sales. The first costs to cut are R&D costs and plant and equipment investment. The company might also reduce product quality, sales force size, marginal services, and advertising expenditures. It would try to cut these costs without letting customers, competitors, and employees know what is happening. Harvesting is an ethically ambivalent strategy, and it is also difficult to execute. Yet harvesting can substantially increase the company's current cash flow.[29]

Critique of the Product Life-Cycle Concept

The PLC concept is best used to interpret product and market dynamics. As a planning tool, this concept helps managers characterize the main marketing challenges in each stage of a product's life and develop major alternative marketing strategies. As a control tool, this concept helps the company measure product performance against similar products launched in the past. The PLC concept is less useful as a forecasting tool because sales histories exhibit diverse patterns, and the stages vary in duration.

Critics claim that life-cycle patterns are too variable in their shape and duration. They also say that marketers can seldom tell what stage the product is in: A product may appear to be mature when it is actually only in a plateau prior to another upsurge. One final criticism is that the PLC pattern is the result of marketing strategies rather than an inevitable course that sales must follow. For example, when Borden owned Eagle Brand Sweetened Condensed Milk, its marketing positioned this mature product as a key ingredient in favorite holiday recipes. When the brand was sold to Eagle Family Foods, however, the new brand manager was able to boost sales with an ad campaign educating consumers on the wider range of uses for condensed milk.[30] Savvy marketers are therefore careful when using the PLC concept to analyze their products and markets.

DIFFERENTIATION AND POSITIONING STRATEGY

Companies such as Hewlett-Packard and Priceline.com invest precious resources to develop and then shepherd their new products through the product life cycle. Yet in today's highly competitive global marketplace, a product will not survive—let alone thrive—without some distinct competitive difference that sets it apart from every rival product. This is why smart companies rely on **differentiation,** the act of designing a set of meaningful differences to distinguish the company's offering from competitors' offerings. Here we examine how a company can differentiate its market offering along five dimensions: product, services, personnel, channel, and image (Table 3.8).

Table 3.8 Differentiation Variables

Product	Services	Personnel	Channel	Image
Form	Ordering ease	Competence	Coverage	Symbols
Features	Delivery	Courtesy	Expertise	Media
Performance	Installation	Credibility	Performance	Atmosphere
Conformance	Customer training	Reliability		Events
Durability	Customer consulting	Responsiveness		
Reliability	Maintenance and repair	Communication		
Repairability	Miscellaneous			
Style				
Design				

Product Differentiation

Physical products vary in their potential for differentiation. At one extreme we find products that allow little variation: chicken, steel, aspirin. Yet even here, some differentiation is possible: Starbucks brands its coffee, and P&G offers several brands of laundry detergent, each with a separate brand identity. At the other extreme are products that are capable of high differentiation, such as automobiles and furniture. Here the seller faces an abundance of design parameters, including:[31]

- *Form.* Many products can be differentiated in *form*—the size, shape, or physical structure of a product. Consider the many possible forms taken by products such as aspirin. Although aspirin is essentially a commodity, it can be differentiated by dosage size, shape, coating, and action time.
- *Features. Features* are the characteristics that supplement the product's basic function. Marketers start by asking recent buyers about additional features that would improve satisfaction, then determining which would be profitable to add, given the potential market, cost, and price.
- *Performance quality. Performance quality* is the level at which the product's primary characteristics operate. The Strategic Planning Institute found a significantly positive correlation between relative product quality and return on investment. Yet there are diminishing returns to higher performance quality, so marketers must choose a level suited to the target market and rivals' performance levels.
- *Conformance quality.* Buyers expect products to have a high *conformance quality,* which is the degree to which all of the produced units are identical and meet the promised specifications. The problem with low conformance quality is that the product will disappoint some buyers.
- *Durability. Durability,* a measure of the product's expected operating life under natural or stressful conditions, is important for products such as vehicles and kitchen appliances. However, the extra price must not be excessive, and the product must not be subject to rapid technological obsolescence.
- *Reliability.* Buyers normally will pay a premium for high *reliability,* a measure of the probability that a product will not malfunction or fail within a specified time period. Maytag, which manufactures major home appliances, has an outstanding reputation for creating reliable appliances.

- *Repairability*. Buyers prefer products that are easy to repair. *Repairability* is a measure of the ease of fixing a product when it malfunctions or fails. An automobile made with standard parts that are easily replaced has high repairability. Ideal repairability would exist if users could fix the product themselves with little cost or time.
- *Style*. *Style* describes the product's look and feel to the buyer. Buyers are normally willing to pay a premium for products that are attractively styled. Aesthetics have played a key role in such brands as Absolut vodka, Apple computers, Montblanc pens, Godiva chocolate, and Harley-Davidson motorcycles.[32] Style has the advantage of creating distinctiveness that is difficult to copy; however, strong style does not always mean high performance.
- *Design*. As competition intensifies, *design* offers a potent way to differentiate and position a company's products and services.[33] Design is the integrating force that incorporates all of the qualities just discussed; this means the designer has to figure out how much to invest in form, feature development, performance, conformance, durability, reliability, repairability, and style. To the company, a well-designed product is one that is easy to manufacture and distribute. To the customer, a well-designed product is one that is pleasant to look at and easy to open, install, use, repair, and dispose of. The designer has to take all of these factors into account.

Services Differentiation

When the physical product cannot be differentiated easily, the key to competitive success may lie in adding valued services and improving their quality. The main service differentiators are:

- *Ordering ease* refers to how easy it is for the customer to place an order with the company. Baxter Healthcare has eased the ordering process by supplying hospitals with computers through which they send orders directly to Baxter; consumers can now order and receive groceries without going to the supermarket by using Web-based services such as Peapod and NetGrocer.
- *Delivery* refers to how well the product or service is delivered to the customer, covering speed, accuracy, and customer care. Deluxe Check Printers, Inc., has built an impressive reputation for shipping out its checks one day after receiving an order—without being late once in 18 years.
- *Installation* refers to the work done to make a product operational in its planned location. Buyers of heavy equipment expect good installation service. Differentiation by installation is particularly important for companies that offer complex products such as computers.
- *Customer training* refers to how the customer's employees are trained to use the vendor's equipment properly and efficiently. General Electric not only sells and installs expensive X-ray equipment in hospitals, but also gives extensive training to users of this equipment.
- *Customer consulting* refers to data, information systems, and advising services that the seller offers to buyers. For example, the Rite Aid drugstore chain's communications program, called the Vitamin Institute, provides customers with research so they can make more educated judgments and feel comfortable asking for help. On the Web, Rite Aid has teamed with drugstore.com to offer even more health-related information.[34]
- *Maintenance and repair* describes the service program for helping customers keep purchased products in good working order, an important consideration for many products.

Personnel Differentiation

Companies can gain a strong competitive advantage through having better-trained people. Singapore Airlines enjoys an excellent reputation in large part because of its flight attendants. The McDonald's people are courteous, the IBM people are professional, and the Disney people are upbeat. The sales forces of such companies as General Electric, Cisco, Frito-Lay, Northwestern Mutual Life, and Pfizer enjoy an excellent reputation.[35] Well-trained personnel exhibit six characteristics: competence, courtesy, credibility, reliability, responsiveness, and communication.[36]

Channel Differentiation

Companies can achieve competitive advantage through the way they design their distribution channels' coverage, expertise, and performance. Caterpillar's success in the construction-equipment industry is based partly on superior channel development. Its dealers are found in more locations, are better trained, and perform more reliably than competitors' dealers. Dell Computers has also distinguished itself by developing and managing superior direct-marketing channels using telephone and Internet sales.[37]

Image Differentiation

Buyers respond differently to company and brand images. *Identity* comprises the ways that a company aims to identify or position itself or its product, whereas *image* is the way the public perceives the company or its products. Image is affected by many factors beyond the company's control. For example, Nike's mainstream popularity turns off 12-to-24-year-olds, who prefer Airwalk and other alternative brands that convey a more extreme sports image.[38] An effective image establishes the product's character and value proposition; it conveys this character in a distinctive way; and it delivers emotional power beyond a mental image. For the image to work, it must be conveyed through every available communication vehicle and brand contact, including logos, media, and special events.

Developing and Communicating a Positioning Strategy

All products can be differentiated to some extent.[39] But not all brand differences are meaningful or worthwhile. A difference is worth establishing to the extent that it satisfies the following criteria:

- *Important:* The difference delivers a highly valued benefit to a sufficient number of buyers.
- *Distinctive:* The difference is delivered in a distinctive way.
- *Superior:* The difference is superior to other ways of obtaining the benefit.
- *Preemptive:* The difference cannot be copied easily by competitors.
- *Affordable:* The buyer can afford to pay for the difference.
- *Profitable:* The company will find it profitable to introduce the difference.

Each firm needs to develop a distinctive positioning for its market offering. **Positioning** is the act of designing the company's offering and image to occupy a distinctive place in the target market's mind. The end result of positioning is the successful creation of a market-focused value proposition, a cogent reason why the target market should buy the product.

The word *positioning* was popularized by two advertising executives, Al Ries and Jack Trout. They see positioning as a creative exercise done with an existing product:

"Positioning starts with a product. A piece of merchandise, a service, a company, an institution, or even a person. . . . But positioning is not what you do to a product. Positioning is what you do to the mind of the prospect. That is, you position the product in the mind of the prospect."

Ries and Trout argue that well-known products generally hold a distinctive position in customers' minds; Coca-Cola, for example, holds the position of world's largest soft-drink firm. To compete against this kind of position, a rival can (1) strengthen its own current position in the consumer's mind (the way 7-Up advertised itself as the Uncola), (2) grab an unoccupied position (as Snapple did with its tea-based beverages), (3) deposition or reposition the competition, or (4) promote the idea that it is in the club with the "best."[40]

How Many Differences to Promote?

Each company must decide how many differences (e.g., benefits, features) to promote. Ries and Trout favor one consistent positioning message.[41] With this approach, each brand is touted as "number one" on a particular attribute, such as "best quality," "best service," "lowest price," or "most advanced technology." If a company hammers away at one positioning and delivers on it, it will probably be best known and recalled for this strength.

Not everyone sticks to single-benefit positioning. Smith Kline Beecham promotes its Aquafresh toothpaste as offering three benefits: anticavity protection, better breath, and whiter teeth. The company's challenge is to convince consumers that the brand delivers all three. Smith Kline's solution was to create a toothpaste that squeezes out of the tube in three colors, thus visually confirming the three benefits.

Communicating the Company's Positioning

Once the company has developed a clear positioning strategy, it must communicate that positioning effectively through all facets of the marketing mix and every point of contact with customers. Suppose a service company chooses the "best-in-quality" strategy. A good example is Ritz Carlton hotels, which signals high quality by training its employees to answer calls within three rings, to answer with a genuine "smile" in their voices, and to be extremely knowledgeable about all hotel information.

On the other hand, companies risk confusing the target audience if their marketing tactics run counter to their positioning. For example, a well-known frozen-food brand lost its prestige image by putting its products on sale too often. A smart company carefully coordinates its marketing-mix activities and its offer to support its positioning. New products may be the lifeblood of a growing firm, but they must be clearly differentiated and properly positioned to be competitive. The firm also faces numerous decisions in the course of managing product lines and brands, as discussed in the next chapter.

EXECUTIVE SUMMARY

Once a company has segmented the market, chosen its target customer groups, identified their needs, and determined its desired market positioning, it is ready to develop and launch new products. Although the rate of new product failure is disturbingly high, companies can improve their chances of success by creating new products with a high product advantage. Eight stages are involved in the new-product development process: idea generation, screening, concept development and testing, marketing strategy development, business analysis, product development, market testing, and commercialization. The purpose of each stage is to determine whether the idea should be dropped or moved to the next stage.

The consumer-adoption process is the process by which customers learn about new products, try them, and adopt or reject them. The five stages in this process are awareness, interest, evaluation, trial, and adoption. This process is influenced by many factors beyond the marketer's control, including consumers' and organizations' willingness to try new products, personal influences, and the characteristics of the new product or innovation.

Because economic conditions change and competitive activity varies, companies normally reformulate their marketing strategy several times during the product life cycle. The introduction stage of this cycle is marked by slow growth and minimal profits as the new product gains distribution. If successful, the product enters a growth stage marked by rapid sales and increasing profits. The company attempts to improve the product, enter new market segments and distribution channels, and reduce prices slightly. In the maturity stage, sales growth slows and profits stabilize, causing the firm to try to modify the market, the product, or the marketing mix to renew sales growth. Finally, the product enters the decline stage, when the firm must decide whether to increase, maintain, or decrease its investment; harvest the product; or divest as advantageously as possible.

In the competitive global marketplace, the key to competitive advantage is differentiation. A market offering can be differentiated by product, services, personnel, channel, and image. A difference is worth establishing to the extent that it is important, distinctive, superior, preemptive, affordable, and profitable. Positioning is the act of designing the company's offering and image to occupy a distinctive place in the target market's mind. Many marketers advocate positioning according to a single product benefit, although double- and triple-benefit positioning can be successful if used carefully.

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SECTION FOUR

Managing Product Lines and Brands

We will address the following questions:

- What are the characteristics of products?
- How can a company build and manage its product mix and product lines?
- How can a company make better brand decisions?
- How can packaging and labeling be used as marketing tools?

Product, as successful firms the world over are keenly aware, is a key element in the *market offering*. This holds true whether the product is a television show (offered by Arts & Entertainment Network), an Internet access service (offered by AT&T), a hamburger (offered by Wendy's), a DVD player (offered by Sony), a sweater (offered by Benetton), or a chocolate bar (offered by Nestlé). No matter where the product originates, no matter which market segment is being targeted, marketing-mix planning begins with formulating an offering to meet customers' needs or wants.

Previously, we looked at how companies develop, differentiate, and position their products throughout the life cycle. Here, we examine the concept of product and product-line decisions. We also explore basic brand decisions and key packaging and labeling issues. Three elements—product, services, and price—must be meshed into a competitively attractive offering if a company wants to perform well in the marketplace.

THE PRODUCT AND THE PRODUCT MIX

A **product** is anything that can be offered to a market to satisfy a want or need. Products include *physical goods, services, experiences, events, persons, places, properties, organizations, information,* and *ideas.* The customer will judge the offering by three basic elements: product features and quality, services mix and quality, and price appropriateness (Figure 4-1). As a result, marketers must carefully think through the level at which they set each product's features, benefits, and quality.

Product Levels

Marketers plan their market offering at five levels, as shown in Figure 4-2.[1] Each level adds more customer value, and together the five levels constitute a *customer value hierarchy*. The most fundamental level is the *core benefit:* the fundamental service or benefit that the customer is really buying. A hotel guest is buying "rest and sleep"; the pur-

Figure 4-1 Components of the Market Offering

chaser of a drill is buying "holes." Effective marketers therefore see themselves as providers of product *benefits,* not merely product features.

At the second level, the marketer has to turn the core benefit into a *basic product.* Thus, a hotel room includes a bed, bathroom, towels, and closet. At the third level, the marketer prepares an *expected product,* a set of attributes and conditions that buyers normally expect when they buy the product. Hotel guests expect a clean bed, fresh towels, and so on. Because most hotels can meet this minimum expectation, the traveler normally will settle for whichever hotel is most convenient or least expensive.

At the fourth level, the marketer prepares an *augmented product* that exceeds customer expectations. A hotel might include a remote-control television set, fresh flowers, and express check-in and checkout. Today's competition essentially takes place at the product-augmentation level. (In less developed countries, competition takes place mostly at the expected product level.) Product augmentation leads the mar-

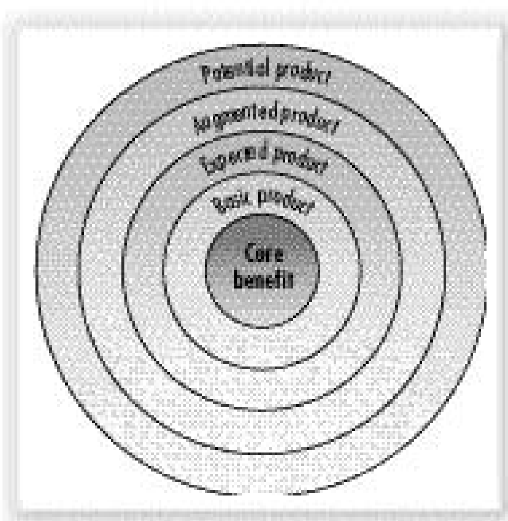


Figure 4-2 Five Product Levels

keter to look at the user's total *consumption system:* the way the user performs the tasks of getting, using, fixing, and disposing of the product.[2] As Levitt notes: "The new competition is not between what companies produce in their factories, but between what they add to their factory output in the form of packaging, services, advertising, customer advice, financing, delivery arrangements, warehousing, and other things that people value."[3]

However, product augmentation adds cost, so the marketer must determine whether customers will pay enough to cover the extra cost (of remote-control television in a hotel room, for example). Moreover, augmented benefits soon become expected benefits, which means that competitors have to search for still other features and benefits. And as companies raise the price of their augmented product, some competitors can offer a "stripped-down" version of the product at a much lower price. Thus, the hotel industry has seen the growth of fine hotels offering augmented products (Four Seasons, Ritz Carlton) as well as lower-cost lodgings offering basic products (Motel Six, Comfort Inn).

At the fifth level stands the *potential product,* which encompasses all of the possible augmentations and transformations the product might undergo in the future. Here, a company searches for entirely new ways to satisfy its customers and distinguish its offer. As one example, Marriott's TownePlace Suites all-suite hotels represent an innovative transformation of the traditional hotel product.

Product Classifications

In addition to understanding a product's position in the hierarchy, the marketer also must understand how to classify the product on the basis of three characteristics: durability, tangibility, and consumer or industrial use. Each product classification is associated with a different marketing-mix strategy.[4]

- *Durability and tangibility. Nondurable goods* are tangible goods that are normally consumed in one or a few uses (such as beer and soap). Because these goods are consumed quickly and purchased frequently, the appropriate strategy is to make them available in many locations, charge only a small markup, and advertise heavily to induce trial and build preference. *Durable goods* are tangible goods that normally survive many uses (such as refrigerators). These products normally require more personal selling and service, command a higher margin, and require more seller guarantees. Services are intangible, inseparable, variable, and perishable products (such as haircuts or cell phone service), so they normally require more quality control, supplier credibility, and adaptability.
- *Consumer-goods classification.* Classified according to consumer shopping habits, these products include: **convenience goods** that are usually purchased frequently, immediately, and with a minimum of effort, such as newspapers; **shopping goods** that the customer, in the process of selection and purchase, characteristically compares on the basis of suitability, quality, price, and style, such as furniture; **specialty goods** with unique characteristics or brand identification, such as cars, for which a sufficient number of buyers are willing to make a special purchasing effort; and **unsought goods** that consumers do not know about or do not normally think of buying, such as smoke detectors. Dealers that sell specialty goods need not be conveniently located but must communicate their locations to buyers; unsought goods require more advertising and personal sales support.
- *Industrial-goods classification.* **Materials** and **parts** are goods that enter the manufacturer's product completely. *Raw materials* can be either *farm products* (e.g.,

wheat) or *natural products* (e.g., lumber). Farm products are sold through intermediaries; natural products are generally sold through long-term supply contracts, for which price and delivery reliability are key purchase factors. *Manufactured materials* and *parts* fall into two categories: component materials (iron) and component parts (small motors); again, price and supplier reliability are important considerations. **Capital items** are long-lasting goods that facilitate developing or managing the finished product. They include two groups: installations (such as factories) and equipment (such as trucks and computers), both sold through personal selling. **Supplies** and **business services** are short-lasting goods and services that facilitate developing or managing the finished product.

Product Mix

A **product mix** (also called **product assortment**) is the set of all products and items that a particular marketer offers for sale. At Kodak, the product mix consists of two strong product lines: information products and image products. At NEC (Japan), the product mix consists of communication products and computer products.

The product mix of an individual company can be described in terms of width, length, depth, and consistency. The *width* refers to how many different product lines the company carries. The *length* refers to the total number of items in the mix. The *depth* of a product mix refers to how many variants of each product are offered. The *consistency* of the product mix refers to how closely related the various product lines are in end use, production requirements, distribution channels, or some other way.

These four product-mix dimensions permit the company to expand its business by (1) adding new product lines, thus widening its product mix; (2) lengthening each product line; (3) deepening the product mix by adding more variants; and (4) pursuing more product-line consistency.

PRODUCT-LINE DECISIONS

Especially in large companies such as Kodak and NEC, the product mix consists of a variety of product lines. In offering a product line, the company normally develops a basic platform and modules that can then be expanded to meet different customer requirements. As one example, many home builders show a model home to which additional features can be added, enabling the builders to offer variety while lowering their production costs. Regardless of the type of products being offered, successful marketers do not make product-line decisions without rigorous analysis.

Product-Line Analysis

To support decisions about which items to build, maintain, harvest, or divest, product-line managers need to analyze the sales and profits as well as the market profile of each item:

- *Sales and profits.* The manager must calculate the percentage contribution of each item to total sales and profits. A high concentration of sales in a few items means line vulnerability. On the other hand, the firm may consider eliminating items that deliver a low percentage of sales and profits—unless these exhibit strong growth potential.
- *Market profile.* The manager must review how the line is positioned against competitors' lines. A useful tool here is a product map showing which competitive products compete against the company's products on specific features or benefits. This helps management identify different market segments and determine how well the firm is positioned to serve the needs of each.

After performing these two analyses, the product-line manager is ready to consider decisions on product-line length, line modernization, line featuring, and line pruning.

Product-Line Length

Companies seeking high market share and market growth will carry longer lines; companies emphasizing high profitability will carry shorter lines of carefully chosen items. *Line stretching* occurs when a firm lengthens its product line.

With a downmarket stretch, a firm introduces a lower price line. However, moving downmarket can be risky, as Kodak found out. It introduced Kodak Funtime film to counter lower-priced brands, but the price was not low enough to match the lower-priced competitive products. When regular customers started buying Funtime—cannibalizing the core brand—Kodak withdrew Funtime.

With an upmarket stretch, a company enters the high end of the market for more growth, higher margins, or to position itself as a full-line manufacturer. All of the leading Japanese automakers have launched an upscale automobile: Toyota launched Lexus; Nissan launched Infinity; and Honda launched Acura. (Note that these marketers invented entirely new names rather than using their own names.)

Companies that serve the middle market can stretch their product lines in both directions, as the Marriott Hotel group did. Alongside its medium-price hotels, it added the Marriott Marquis to serve the upper end of the market, the Courtyard to serve a lower segment, and Fairfield Inns to serve the low-to-moderate segment.[5] The major risk of this two-way stretch is that some travelers will trade down after finding the lower-price hotels have most of what they want. But it is still better for Marriott to capture customers who move downward than to lose them to competitors.

A product line can also be lengthened by adding more items within the present range. There are several motives for *line filling:* reaching for incremental profits, trying to satisfy dealers who complain about lost sales because of missing items in the line, trying to utilize excess capacity, trying to be the leading full-line company, and trying to plug holes to keep out competitors.

Line Featuring and Line Pruning

The product-line manager typically selects one or a few items in the line to feature; this is a way of attracting customers, lending prestige, or achieving other goals. If one end of its line is selling well and the other end is selling poorly, the company may use featuring to boost demand for the slower sellers, especially if those items are produced in a factory that is idled by lack of demand. In addition, managers must periodically review the entire product line for pruning, identifying weak items through sales and cost analysis. They may also prune when the company is short of production capacity or demand is slow.

BRAND DECISIONS

Branding is a major issue in product strategy. On the one hand, developing a branded product requires a huge long-term investment, especially for advertising, promotion, and packaging. However, it need not entail actual production: Many brand-oriented companies such as Sarah Lee subcontract manufacturing to other companies. On the other hand, manufacturers eventually learn that market power comes from building their own brands. The Japanese firms Sony and Toyota, for example, have spent liberally to build their brand names globally. Even when companies can no longer afford to manufacture their products in their homelands, strong brand names continue to command customer loyalty.

What Is a Brand?

Perhaps the most distinctive skill of professional marketers is their ability to create, maintain, protect, and enhance brands.

The American Marketing Association defines a **brand** as a name, term, sign, symbol, or design, or a combination of these, intended to identify the goods or services of one seller or group of sellers and to differentiate them from those of competitors.

In essence, a brand identifies the seller or maker. Whether it is a name, trademark, logo, or another symbol, a brand is essentially a seller's promise to deliver a specific set of features, benefits, and services consistently to the buyers. The best brands convey a warranty of quality. But a brand is an even more complex symbol.[6] It can convey up to six levels of meaning, as shown in Table 4.1.

The branding challenge is to develop a deep set of positive associations for the brand. Marketers must decide at which level(s) to anchor the brand's identity. One mistake would be to promote only attributes. First, buyers are not as interested in attributes as they are in benefits. Second, competitors can easily copy attributes. Third, today's attributes may become less desirable tomorrow. Ultimately, a brand's most enduring meanings are its values, culture, and personality, which define the brand's essence. Smart firms therefore craft strategies that do not dilute the brand values and personality built up over the years.

Table 4.1 Levels of Brand Meaning

Meaning	Description	Example
Attributes	A brand brings to mind certain attributes.	Mercedes suggests expensive, well-built, durable, high-prestige vehicles.
Benefits	Attributes must be translated into functional and emotional benefits.	The attribute "durable" could translate into the functional benefit "I won't have to buy another car for several years."
Values	The brand says something about the producer's values.	Mercedes stands for high performance, safety, and prestige.
Culture	The brand may represent a certain culture.	Mercedes represents German culture: organized, efficient, high quality.
Personality	The brand can project a certain personality.	Mercedes may suggest a non-nonsense boss (person) or a reigning lion (animal).
User	The brand suggests the kind of customer who buys or uses the product.	Mercedes vehicles are more likely to be bought by 55-year-old top managers than by 20-year-old store clerks.

Brand Equity

Brands vary in the amount of power and value they have in the marketplace. At one extreme are brands that are not known by most buyers. Then there are brands for which buyers have a fairly high degree of *brand awareness.* Beyond this are brands with a high degree of *brand acceptability.* Next are brands that enjoy a high degree of *brand preference.* Finally there are brands that command a high degree of *brand loyalty.* Aaker distinguished five levels of customer attitude toward a brand:

1. Customer will change brands, especially for price reasons. No brand loyalty.
2. Customer is satisfied. No reason to change the brand.
3. Customer is satisfied and would incur costs by changing brand.
4. Customer values the brand and sees it as a friend.
5. Customer is devoted to the brand.

Brand equity is highly related to how many customers are in classes 3, 4, or 5. It is also related, according to Aaker, to the degree of brand-name recognition, perceived brand quality, strong mental and emotional associations, and other assets such as patents, trademarks, and channel relationships.[7] High brand equity allows a company to enjoy reduced marketing costs because of high brand awareness and loyalty, gives a company more leverage in bargaining with distributors and retailers, permits the firm to charge more because the brand has higher perceived quality, allows the firm to more easily launch extensions because the brand has high credibility, and offers some defense against price competition.

Some analysts see brands as outlasting a company's specific products and facilities, so brands become the company's major enduring asset. Yet every powerful brand really represents a set of loyal customers. Therefore, the fundamental asset underlying brand equity is *customer equity.* This suggests that the proper focus of marketing planning is that of extending *loyal customer lifetime value,* with brand management serving as a major marketing tool.

Unfortunately, some companies have mismanaged their greatest asset—their brands. This is what befell the popular Snapple brand almost as soon as Quaker Oats bought the beverage marketer for $1.7 billion in 1994. Snapple had become a hit through powerful grassroots marketing and distribution through small outlets and convenience stores. Analysts said that because Quaker did not understand the brand's appeal, it made the mistake of changing the ads and the distribution. Snapple lost so much money and market share that in 1997, Quaker finally sold the company for $300 million to Triarc, which has since revived the floundering brand.[8]

Branding Challenges

Branding poses several challenges to the marketer (see Figure 4-3). The first is whether or not to brand, the second is how to handle brand sponsorship, the third is choosing a brand name, the fourth is deciding on brand strategy, and the fifth is whether to reposition a brand later on.

To Brand or Not to Brand?

The first decision is whether the company should develop a brand name for its product. Branding is such a strong force today that hardly anything goes unbranded,

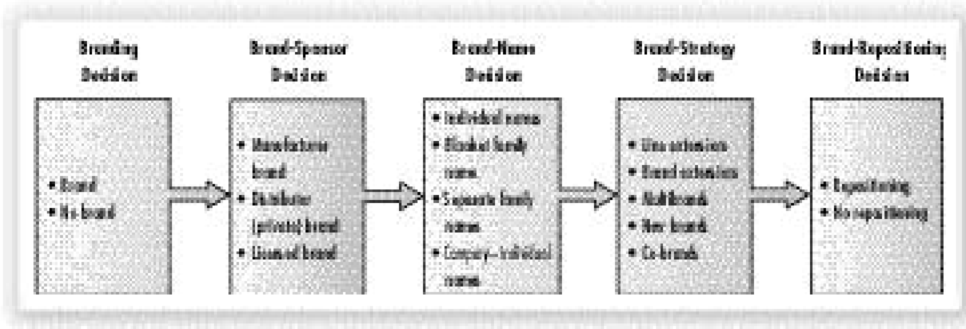


Figure 4-3 An Overview of Branding Decisions

including salt, oranges, nuts and bolts, and a growing number of fresh food products such as chicken and turkey.

In some cases, there has been a return to "no branding" of certain staple consumer goods and pharmaceuticals. *Generics* are unbranded, plainly packaged, less expensive versions of common products such as spaghetti or paper towels. They offer standard or lower quality at a price that may be as much as 20 percent to 40 percent lower than nationally advertised brands and 10 percent to 20 percent lower than retailer private-label brands. The lower price is made possible by lower-quality ingredients, lower-cost labeling and packaging, and minimal advertising.

Sellers brand their products, despite the costs, because they gain a number of advantages: The brand makes it easier for the seller to process orders; the seller's brand name and trademark legally protect unique product features; branding allows sellers to attract loyal, profitable customers and offers some protection from competition; branding helps the seller segment markets by offering different brands with different features for different benefit-seeking segments; and strong brands help build the corporate image, easing the way for new brands and wider acceptance by distributors and customers.

Distributors and retailers want brands because they make the product easier to handle, indicate certain quality standards, strengthen buyer preferences, and make it easier to identify suppliers. For their part, customers find that brand names help them distinguish quality differences and shop more efficiently.

Brand-Sponsor Decision

A manufacturer has several options with respect to brand sponsorship. The product may be launched as a *manufacturer brand* (sometimes called a national brand), a *distributor brand* (also called reseller, store, house, or private brand), or a *licensed brand name.* Another alternative is for the manufacturer to produce some output under its own name and some under reseller labels. Kellogg, John Deere, and IBM sell virtually all of their output under their own brand names, whereas Whirlpool produces both under its own name and under distributors' names (Sears Kenmore appliances).

Although manufacturers' brands dominate, large retailers and wholesalers have been developing their own brands by contracting production from willing manufacturers. Sears has created several names—Diehard batteries, Craftsman tools, Kenmore appliances—that command brand preference and even brand loyalty. Retailers such as The Body Shop and Gap sell mostly own-brand merchandise. Sainsbury, Britain's largest food chain, sells 50 percent store-label goods, and its operating margins are six times those of U.S. retailers (U.S. supermarkets average 19.7 percent private-brand sales).

Why do middlemen sponsor their own brands? First, these brands are more profitable, since they are produced at a low cost by manufacturers with excess capacity. Other costs, such as research and development, advertising, sales promotion, and physical distribution, are also much lower. This means that the private brander can charge a lower price and yet make a higher profit margin. Second, retailers develop exclusive store brands to differentiate themselves from competitors.

In years past, consumers viewed the brands in a category arranged in a brand ladder, with their favorite brand at the top and remaining brands in descending order of preference. There are now signs that this ladder is being replaced with a consumer perception of brand parity—that many brands are equivalent.[9] Instead of a strongly preferred brand, consumers buy from a set of acceptable brands, choosing whichever is on sale that day.

Today's consumers are also more price sensitive, because a steady barrage of coupons and price specials has trained them to buy on price. In fact, over time, companies have reduced advertising to 30 percent of their total promotion budget, weakening brand equity. Moreover, the endless stream of brand extensions and line extensions has blurred brand identity and led to a confusing amount of product proliferation. Further, consumers see little difference in quality among brands now that competing manufacturers and retailers are copying and duplicating the qualities of the best brands.

Of course, one of the factors that is changing the entire branding landscape is the Internet. While some "born digital" companies like America Online (AOL) and Amazon.com have used the Internet to gain brand recognition seemingly overnight, other companies have poured millions of dollars into on-line advertising with little effect on brand awareness or preference. For some low-price, low-involvement products, such as soap, the Internet offers little potential as a commerce vehicle. Still, the packaged-goods powerhouses are trying different approaches to Web marketing. Procter & Gamble, for example, has put much of its on-line marketing budget behind brands like Always panty liners, Tampax tampons, and Pampers diapers, which have narrow target audiences with more personal subject matter. With this strategy, the company has turned Pampers.com into Pampers Parenting Institute, reaching out to customers by addressing various issues of concern to new or expectant parents.[10]

All companies that have powerful brand awareness on the Web have sites that help customers do something—whether it's configuring a computer system on-line at Dell.com or offering customization options for services at Yahoo.com. Yet some of the biggest superstars of e-commerce conduct most of their branding efforts off-line: Cisco advertises in business publications, while Dell advertises in tech trade magazines and on television.[11]

AOL, like many high-tech companies, has been adept at achieving solid brand recognition through less conventional marketing approaches. Today, over half of all U.S. households are familiar with AOL brand. That's because AOL has blanketed the country for years with free software and free trial offers. The company has also cut deals to put its product in some unlikely places: inside Rice Chex cereal boxes, United Airlines in-flight meals, and Omaha Steaks packages, to name a few. AOL's marketers believe that novices need to try the service to appreciate its benefits. Then, once consumers start using AOL, the company reasons that the user-friendly program will lure them to subscribe. Also on AOL's side is sheer inertia, which prevents many people from switching to another Internet service provider.[12]

Brand-Name Decision

Manufacturers and service companies who brand their products must choose which brand names to use. Four strategies are available, as shown in Table 4.2.

Table 4.2 Brand-Name Strategies

Strategy	Examples	Rationale
Individual names	General Mills (Bisquick, Gold Medal, Betty Crocker)	The firm does not tie its reputation to the product's; if the product fails or seems low quality, the company's name or image is not hurt.
Blanket family names	Campbell's, Heinz, General Electric	The firm spends less on development because there is no need for "name" research or heavy ad spending to create brand-name recognition; also, product sales are likely to be strong if the manufacturer's name is good.
Separate family names for all products	Sears (Kenmore for appliances, Craftsman for tools); Bank One (Bank One for the physical branches, WingspanBank.com for the Internet-based bank)	Where a firm offers quite different products, separate family names are more appropriate than one blanket family name.
Company trade name with individual product names	Kellogg (Kellogg's Rice Krispies, Kellogg's Raisin Bran)	The company name legitimizes while the individual name individualizes each product.

Once a company decides on its brand-name strategy, it must choose a specific brand name. The company could choose the name of a person (Honda, Estée Lauder), location (American Airlines, Kentucky Fried Chicken), quality (Safeway, Duracell), lifestyle (Weight Watchers, Healthy Choice), or an artificial name (Exxon, eBay). Among the desirable qualities for a brand name are the following:[13]

- *It should suggest something about the product's benefits.* Examples: Beauty-rest, Priceline.com
- *It should suggest product qualities.* Examples: Spic and Span, Jiffy Lube
- *It should be easy to pronounce, recognize, and remember.* Examples: Tide, Amazon.com
- *It should be distinctive.* Examples: Kodak, Yahoo!
- *It should not carry poor meanings in other countries and languages.* Example: Nova is a poor name for a car to be sold in Spanish-speaking countries because it means "doesn't go."

Many firms strive to build a unique brand name that eventually will become intimately identified with the product category. Examples are Frigidaire, Kleenex, Kitty Litter, Levis, Jell-O, Popsicle, Scotch Tape, Xerox, and Fiberglas. In 1994, Federal Express officially shortened its marketing identity to FedEx, a term that has become a synonym for "to ship overnight." Yet identifying a brand name with a product category may threaten the company's exclusive rights to that name. For example, cellophane and shredded wheat are now in the public domain and are available for any manufacturer to use.

Given the rapid growth of the global marketplace, successful companies and e-businesses are careful to choose brand names that are meaningful worldwide and pronounceable in other languages. One thing Compaq liked about the name Presario for its line of home computers is that it conjures up similar meanings in various Latin-influenced languages. In French, Spanish, Latin, or Portuguese, Presario has the same, or similar, association that it does in English: It suggests an "Impresario," the magical master of the whirl and fantasy of a stage production.

Brand Strategy Decision

A company has five choices when it comes to brand strategy. The company can introduce *line extensions* (existing brand name extended to new sizes or flavors in the existing product category), *brand extensions* (brand names extended to new-product categories), *multibrands* (new brand names introduced in the same product category), *new brands* (new brand name for a new category product), and *co-brands* (brands bearing two or more well-known brand names).

Line Extensions Line extensions introduce additional items in the same product category under the same brand name, such as new flavors, forms, colors, added ingredients, and package sizes. Dannon introduced several Dannon yogurt line extensions, including fat-free "light" yogurt and dessert flavors such as "mint chocolate cream pie." The vast majority of new products are actually line extensions.

Line extension involves risks and has provoked heated debate among marketing professionals.[14] On the downside, extensions may lead to the brand name losing its specific meaning; Ries and Trout call this the "line-extension trap."[15] A consumer asking for a Coke in the past would receive a 6.5-ounce bottle. Today the seller will have to ask: New, Classic, or Cherry Coke? Regular or diet? With or without caffeine? Bottle or can? Sometimes the original brand identity is so strong that its line extensions serve only to confuse and do not sell enough to cover development and promotion costs. For example, A-1 poultry sauce flopped because people identify A-1 with beef.

However, the success of a new line extension sometimes hurts other items in the line. Although Fig Newton's cousins Cranberry Newtons, Blueberry Newtons, and Apple Newtons all sell well for Nabisco, the original Fig Newton now seems like just another flavor. A line extension works best when it takes sales away from rivals, not when it deflates or cannibalizes the company's other items.

On the upside, line extensions have a much higher chance of survival than do brand-new products. In fact, some marketing executives defend line extensions as the best way to build a business. Kimberly-Clark's Kleenex unit has had great success with line extensions. "We try to get facial tissue in every room of the home," says one Kimberly-Clark executive. "If it is there, it will get used." This philosophy led to 20 varieties of Kleenex facial tissues, including a line packaged for children.

Brand Extensions A company may use its existing brand name to launch new products in other categories. Autobytel.com, a pioneer of Internet-based car sales, used brand extensions to introduce automotive financing, insurance, and car repairs on its Web site. A recent trend in corporate brand-building is corporations licensing their names to manufacturers of a wide range of products—from bedding to shoes. Harley-Davidson, for example, uses licensing to reach audiences that are not part of its core market, with branded armchairs for women and branded a Barbie doll for the future generation of Harley purchasers.[16]

Brand-extension strategy offers many of the same advantages as line extensions—but it also involves risks. One risk is that the new product might disappoint buyers and damage their respect for the company's other products. Another is that the brand name may be inappropriate to the new product—consider Bic perfume, a classic failure because buyers did not associate the Bic brand with fragrance products. A third risk is *brand dilution,* which occurs when consumers no longer associate a brand with a specific product or highly similar products.

Multibrands A company will often introduce additional brands in the same product category. Sometimes the firm is trying to establish different features or appeal to different buying motives. Multibranding also enables the company to lock up more distributor shelf space and to protect its major brand by setting up *flanker brands.* For example, Seiko uses one brand for higher-priced watches (Seiko Lasalle) and another for lower-priced watches (Pulsar) to protect its flanks. Ideally, a company's brands within a category should cannibalize the competitors' brands and not each other. At the very least, net profits from multibrands should be larger despite some cannibalism.[17]

New Brands When a company launches products in a new category, it may find that none of its current brand names are appropriate. If Timex decides to make toothbrushes, it is not likely to call them Timex toothbrushes. Yet establishing a new brand name in the U.S. marketplace for a mass-consumer-packaged good can cost anywhere from $50 million to $100 million, making this an extremely critical decision.

Co-brands A rising phenomenon is the emergence of *co-branding* (also called *dual branding*), in which two or more well-known brands are combined in an offer. Each brand sponsor expects that the other brand name will strengthen preference or purchase intention. In the case of co-packaged products, each brand hopes it might be reaching a new audience by associating with the other brand.

Co-branding takes a variety of forms. One is *ingredient co-branding,* as when Volvo advertises that it uses Michelin tires or Betty Crocker's brownie mix includes Hershey's chocolate syrup. Another form is *same-company co-branding,* as when General Mills advertises Trix and Yoplait yogurt. Still another form is *joint venture co-branding,* as in the case of General Electric and Hitachi lightbulbs in Japan and the MSNBC Web site from Microsoft and NBC. Finally, there is *multiple-sponsor co-branding,* as in the case of Taligent, a technological alliance of Apple, IBM, and Motorola.[18]

Many manufacturers make components—motors, computer chips, carpet fibers—that enter into final branded products, and whose individual identity normally gets lost. These manufacturers hope their brand will be featured as part of the final product. Intel's consumer-directed brand campaign convinced many people to buy only PCs with "Intel Inside." As a result, many PC manufacturers buy chips from Intel at a premium price rather than buying equivalent chips from other suppliers.

Brand Repositioning

However well a brand is currently positioned, the company may have to reposition it later when facing new competitors or changing customer preferences. Consider 7-Up, which was one of several soft drinks bought primarily by older people who wanted a bland, lemon-flavored drink. Research indicated that although a majority of soft-drink consumers preferred a cola, they did not prefer it all of the time, and many other consumers were noncola drinkers. 7-Up sought leadership in the noncola market by calling itself the Uncola and positioning itself as a youthful and refreshing drink, the one to reach for instead of a cola. Thus, 7-Up successfully established itself as the alternative to colas, not just another soft drink.

PACKAGING AND LABELING

Most physical products have to be packaged and labeled. Some packages—such as the Coke bottle—are world famous. Many marketers have called packaging a fifth P, along with price, product, place, and promotion; however, packaging and labeling are usually treated as an element of product strategy.

Packaging

Packaging includes the activities of designing and producing the container for a product. The container is called the *package,* and it might include up to three levels of material. Old Spice aftershave lotion is in a bottle *(primary package)* that is in a cardboard box *(secondary package)* that is in a corrugated box *(shipping package)* containing six dozen boxes of Old Spice.

The following factors have contributed to packaging's growing use as a potent marketing tool:

- *Self-service:* The typical supermarket shopper passes by some 300 items per minute. Given that 53 percent of all purchases are made on impulse, an effective package attracts attention, describes features, creates confidence, and makes a favorable impression.
- *Consumer affluence:* Rising consumer affluence means consumers are willing to pay a little more for the convenience, appearance, dependability, and prestige of better packages.
- *Company and brand image:* Packages contribute to instant recognition of the company or brand. Campbell Soup estimates that the average shopper sees its red and white can 76 times a year, the equivalent of $26 million worth of advertising.
- *Innovation opportunity:* Innovative packaging can bring benefits to consumers and profits to producers. Toothpaste pump dispensers, for example, have captured 12 percent of the toothpaste market because they are more convenient and less messy.

Developing an effective package for a new product requires several decisions. The first task is to establish the *packaging concept,* defining what the package should basically *be* or *do* for the particular product. Then decisions must be made on additional elements—size, shape, materials, color, text, and brand mark, plus the use of any "tamperproof" devices. All packaging elements must be in harmony and, in turn, must harmonize with the product's pricing, advertising, and other marketing elements. Next come engineering tests to ensure that the package stands up under normal conditions; visual tests, to ensure that the script is legible and the colors harmonious; dealer tests, to ensure that dealers find the packages attractive and easy to handle; and, finally, consumer tests, to ensure favorable response.

Tetra Pak, a major Swedish multinational, provides an example of the power of innovative packaging and customer orientation. The firm invented an "aseptic" package that enables milk, fruit juice, and other perishable liquid foods to be distributed without refrigeration. This allows dairies to distribute milk over a wider area without investing in refrigerated trucks and facilities. Supermarkets can carry Tetra Pak packaged products on ordinary shelves, which saves expensive refrigerator space. The firm's motto is "the package should save more than it costs."

Labeling

Every physical product must carry a label, which may be a simple tag attached to the product or an elaborately designed graphic that is part of the package. Labels perform several functions. First, the label *identifies* the product or brand—for instance, the name Sunkist stamped on oranges. The label might also *grade* the product, the way canned peaches are grade labeled A, B, and C. The label might *describe* the product: who made it, where it was made, when it was made, what it contains, how it is to be used, and how to use it safely. Finally, the label might *promote* the product through attractive graphics.

Labels eventually become outmoded and need freshening up. The label on Ivory soap has been redone 18 times since the 1890s, with gradual changes in the size and design of the letters. The label on Orange Crush soft drink was substantially changed when competitors' labels began to picture fresh fruits, thereby pulling in more sales. In response, Orange Crush developed a label with new symbols to suggest freshness and with much stronger and deeper colors.

Legal concerns about labels and packaging stretch back to the early 1900s and continue today. The Food and Drug Administration (FDA) recently took action against the potentially misleading use of such descriptions as "light," "high fiber," and "low fat." Meanwhile, consumerists are lobbying for additional labeling laws to require *open dating* (to describe product freshness), *unit pricing* (to state the product cost in standard measurement units), *grade labeling* (to rate the quality level), and *percentage labeling* (to show the percentage of each important ingredient).

Some tangible products that incorporate packaging and labels also involve some service component, such as delivery or installation. Therefore, marketers must be skillful not only in managing product lines and brands, but also in designing and managing services—the subject of the next chapter.

EXECUTIVE SUMMARY

Planning the product portion of a market offering calls for coordinated decisions on the product mix, product lines, brands, and packaging and labeling. The marketer needs to think through the five levels of the product: core benefit (the fundamental benefit or service the customer is really buying), basic product, expected product (a set of attributes that buyers expect), augmented product (additional services and benefits that distinguish the company's offer from the competition), and potential product (all of the augmentations and transformations the product might ultimately undergo).

Products can be classified in several ways. In terms of durability and reliability, products can be nondurable goods, durable goods, or services. In the consumer-goods category are convenience goods, shopping goods, specialty goods, and unsought goods. In the industrial-goods category are materials and parts, capital items, and supplies and business services.

A product mix is the set of all products and items offered for sale by the marketer. This mix can be classified according to width, length, depth, and consistency, providing four dimensions for developing the company's marketing strategy. To support product decisions, product-line managers first analyze each product's sales, profits, and market profile. Managers can then change their product-line strategy by line stretching or line filling, by featuring certain products, and by pruning to eliminate some products.

Branding is a major product-strategy issue. High brand equity translates into high brand-name recognition, high perceived brand quality, strong mental associations, and other important assets. In creating brand strategy, firms must decide whether or not to brand; whether to produce manufacturer brands, or distributor or private brands; which brand name to use, and whether to use line extensions, brand extensions, multibrands, new brands, or co-brands. The best brand names suggest something about the product's benefits; suggest product qualities; are easy to pronounce, recognize, and remember; are distinctive; and do not carry negative meanings or connotations in other countries or languages.

Many physical products have to be packaged and labeled. Well-designed packages create convenience value for customers and promotional value for producers. Marketers start by developing a packaging concept and then testing it functionally and psychologically to make sure it achieves its desired objectives and is compatible with public policy and environmental concerns. Physical products also require labeling for identification and possible grading, description, and product promotion.

NOTES

1. This discussion is adapted from Theodore Levitt, "Marketing Success through Differentiation—of Anything," *Harvard Business Review,* January-February 1980, pp. 83–91. The first level, core benefit, has been added to Levitt's discussion.
2. See Harper W. Boyd Jr. and Sidney Levy, "New Dimensions in Consumer Analysis," *Harvard Business Review,* November–December 1963, pp. 129–40.
3. Theodore Levitt, *The Marketing Mode* (New York: McGraw-Hill, 1969), p. 2.
4. For some definitions, see *Dictionary of Marketing Terms,* ed. Peter D. Bennett (Chicago: American Marketing Association, 1995). Also see Patrick E. Murphy and Ben M. Enis, "Classifying Products Strategically," *Journal of Marketing,* July 1986, pp. 24–42.
5. "Fairfield Inn by Marriott to be Positioned in Lower-Moderate Lodging Segment," *PR Newswire,* January 19, 2000.
6. See Jean-Noel Kapferer, *Strategic Brand Management: New Approaches to Creating and Evaluating Brand Equity* (London: Kogan Page, 1992), pp. 38 ff; Jennifer L. Aaker, "Dimensions of Brand Personality," *Journal of Marketing Research,* August 1997, pp. 347–56.
7. David A. Aaker, *Building Strong Brands* (New York: Free Press, 1995). Also see Kevin Lane Keller, *Strategic Brand Management: Building, Measuring, and Managing Brand Equity* (Upper Saddle River, NJ: Prentice-Hall, 1998).
8. Margaret Webb Pressler, "The Power of Branding," *Washington Post,* July 27, 1997, p. H1; "Triarc Reports Strong Second Quarter 1999 Results With Adjusted EBITDA Up 12 Percent," Triarc news release, August 19, 1999, www.triarc.com.
9. See Paul S. Richardson, Alan S. Dick, and Arun K. Jain, "Extrinsic and Intrinsic Cue Effects on Perceptions of Store Brand Quality," *Journal of Marketing,* October 1994, pp. 28–36.
10. Saul Hensell, "Selling Soap Without the Soap Operas, Mass Marketers Seek Ways to Build Brands on the Web," *New York Times,* August 24, 1998, p. D1.
11. Jeffrey O'Brien, "Web Advertising and the Branding Mission," *Upside,* September 1998, pp. 90–94; Ellen Neuborne, "Branding on the Net," *Business Week,* November 9, 1998, pp. 76–86.
12. Patricia Nakache, "Secrets of the New Brand Builders," *Fortune,* June 22, 1998, pp. 167–70; John Ellis, "Digital Matters: 'People Need a Haven from the Web That's on the Web,' " *Fast Company,* January-February 2000, pp. 242–46.

13. See Kim Robertson, "Strategically Desirable Brand Name Characteristics," *Journal of Consumer Marketing*, Fall 1989, pp. 61–70.
14. Robert McMath, "Product Proliferation," *Adweek (Eastern Ed.) Superbrands 1995 Supplement,* 1995, pp. 34–40; John A. Quelch and David Kenny, "Extend Profits, Not Product Lines," *Harvard Business Review,* September–October 1994, pp. 153–60; and Bruce G. S. Hardle, Leonard M. Lodish, James V. Kilmer, David R. Beatty, et al., "The Logic of Product-Line Extensions," *Harvard Business Review,* November–December 1994, pp. 53–62.
15. Al Ries and Jack Trout, *Positioning: The Battle for Your Mind* (New York: McGraw-Hill, 1981).
16. Constance L. Hays, "No More Brand X: Licensing of Names Adds to Image and Profit," *New York Times,* June 12, 1998.
17. See Mark B. Taylor, "Cannibalism in Multibrand Firms," *Journal of Business Strategy,* Spring 1986, pp. 69–75.
18. Bernard L. Simonin and Julie A. Ruth, "Is a Company Known by the Company It Keeps? Assessing the Spillover Effects of Brand Alliances on Consumer Brand Attitudes," *Journal of Marketing Research,* February 1998, pp. 30–42.

Designing and Managing Services

We will address the following questions:

- How are services defined and classified?
- How can service firms improve their competitive differentiation, service quality, and productivity?
- How can goods-producing companies improve their customer support services?

Marketing theory and practice developed initially in connection with physical products such as toothpaste, cars, and steel. Yet one of the major megatrends of recent years has been the phenomenal growth of services. In the United States, service jobs now account for 79 percent of all jobs and 74 percent of gross domestic product. According to the Bureau of Labor Statistics, service occupations will be responsible for all net job growth through the year 2005.[1] These numbers have led to a growing interest in the special challenges and opportunities of services marketing.[2]

More and more market offerings now contain a service component, both to meet the needs of the targeted customer segment and to create a distinctive differentiation for competitive reasons. Many manufactured goods are supported by services such as *warranties* (formal statements of expected product performance) or *guarantees* (assurances that the product can be returned if its performance is unsatisfactory). By judiciously offering one or more service features, a smart marketer can enhance its image while adding value that, in turn, attracts loyal customers and builds long-term profits.

THE NATURE OF SERVICES

Service industries are quite varied. The *government sector,* with its courts, employment services, hospitals, loan agencies, military services, police and fire departments, post office, regulatory agencies, and schools, is in the service business. The *private nonprofit sector,* with its museums, charities, churches, colleges, foundations, and hospitals, is in the service business. A good part of the *business sector,* with its airlines, banks, hotels, insurance companies, Internet service providers, law firms, management consulting firms, medical practices, motion-picture companies, plumbing-repair companies, real estate firms, and Web-based services, is in the service business. Many workers in the *manufacturing sector,* such as computer operators, accountants, and legal staff, are really service providers. In fact, they make up a "service factory" that provides services to the "goods factory."

A **service** is any act or performance that one party can offer to another that is essentially intangible and does not result in the ownership of anything. Its production may or may not be tied to a physical product.

Services such as banking and other financial services are a mainstay of the Internet. E*Trade, for example, the second-largest U.S. on-line broker, allows customers to quickly buy and sell stocks, bonds, and mutual funds at a low cost through its Web site. E*Trade's nearly 2 million accountholders can also use the Web site to locate research about stocks and bonds, plan their portfolios, and get checking accounts and loans through the firm's Telebanc subsidiary. Even noncustomers can access the site's free financial news, tax and investment tips, and money-related chat rooms.[3]

Many manufacturers and distributors also use a service strategy to differentiate themselves. Acme Construction Supply in Portland, Oregon, has invested more than $135,000 in its Night Owl delivery service: Acme personnel deposit orders into lockboxes at construction sites during the nighttime hours, so materials are available first thing in the morning. Says the company's regional team leader, "People that are very, very price sensitive don't do business here. But people who see the overall value we provide do. And it's very intimidating to our competition. They have to walk around our delivery boxes every day to make their sales calls."[4]

Categories of Service Mix

As the previous examples show, services are often part of a company's total offering in the marketplace. Five categories of an offering's service mix can be distinguished:

1. *Pure tangible good:* The offering is a tangible good such as soap; no services accompany the product.
2. *Tangible good with accompanying services:* The offering consists of a tangible good accompanied by one or more services. General Motors, for example, offers repairs, maintenance, warranty fulfillment, and other services along with its cars and trucks.
3. *Hybrid:* The offering consists of equal parts of goods and services. For example, people patronize restaurants for both food and service.
4. *Major service with accompanying minor goods and services:* The offering consists of a major service along with additional services or supporting goods. For example, airline passengers are buying transportation service, but they get food and drinks, as well.
5. *Pure service:* The offering consists primarily of a service; examples include baby-sitting and psychotherapy.

An increasing number of companies that are known for their tangible goods offerings are now looking to boost profits from services. Consider General Electric, which built its business on the production of goods such as refrigerators and light bulbs. These days, its fastest-growing unit is GE Capital, which consists of 28 businesses ranging from credit cards to truck leasing to insurance. Germany's Siemens is moving in the same direction by setting up a financial services division as a profit center.[5]

Characteristics of Services and Their Marketing Implications

Services have four major characteristics that greatly affect the design of marketing programs: intangibility, inseparability, variability, and perishability.

Intangibility

Services are intangible. Unlike physical products, they cannot be seen, tasted, felt, heard, or smelled before they are bought. The person who is getting a face lift cannot see the exact results before the purchase, just as the patient in the psychiatrist's office cannot know the exact outcome before treatment.

To reduce uncertainty, buyers will look for signs or evidence of the service quality. They will draw inferences about quality from the place, people, equipment, communication material, symbols, and price that they see. Therefore, the service provider's task is to "manage the evidence," to "tangibilize the intangible."[6] Whereas product marketers are challenged to add abstract ideas, service marketers are challenged to add physical evidence and imagery to abstract offers. This is why Allstate uses the slogan "You're in good *hands* with Allstate."

In general, service marketers must be able to transform intangible services into concrete benefits. Consider Dun & Bradstreet, a $2 billion firm with a database of 11 million U.S. firms that businesses can access to check the creditworthiness of their commercial customers. D&B's senior VP of marketing says, "If we're calling on a bank's credit manager, we'll research the bank's portfolio of customers, and using the information in our database, score them based on their creditworthiness and stability and say, 'You have X% of customers in the high-risk category and X% in low-risk.'"[7] This translates D&B's intangible services into tangible benefits for banking customers.

Inseparability

Services are typically produced and consumed simultaneously, unlike physical goods, which are manufactured, put into inventory, distributed through resellers, and consumed later. If a person renders the service, then the provider is part of the service. Because the client is also present as the service is produced, provider-client interaction is a special feature of services marketing—both provider and client affect the outcome.

Often, buyers of services have strong provider preferences. Several strategies exist for getting around this limitation. One is higher pricing in line with the provider's limited time. Another is having the provider work with larger groups or work faster. A third alternative is to train more service providers and build up client confidence, as H&R Block has done with its national network of trained tax consultants.

Variability

Because services depend on who provides them and when and where they are provided, they are highly variable. Knowing this, service firms can take three steps toward quality control. The first is recruiting the right service employees and providing them with excellent training. This is crucial regardless of whether employees are highly skilled professionals or low-skilled workers.

For example, the California-based Horn Group handles public relations for high-powered Silicon Valley software makers and technology consultants. Founder Sabrina Horn invests heavily in training her employees and in building morale and enthusiasm. She has developed education programs that include lunchtime seminars on everything from how to write a press release to how to manage an account. Employees also receive tuition reimbursement for continuing education.[8]

The second step is standardizing the service-performance process throughout the organization. Companies can do this by preparing a flowchart that depicts every service event and process. Using this flowchart, management can identify potential fail points and then plan improvements. The third step—taken by Priceline.com and many other service firms—is monitoring customer satisfaction through suggestion and complaint systems, customer surveys, and comparison shopping.

Table 4.3 Strategies for Improving the Match between Demand and Supply

Demand-Side Strategies	Supply-Side Strategies
Use *differential pricing* to shift demand from peak to off-peak periods; movie theaters and car rental firms do this by lowering prices during off-peak periods.	*Hire part-time employees* to meet peak demand; restaurants, stores, and Web-based businesses often bring in temporary staffers to help out during holidays and other peak periods.
Cultivate nonpeak demand to build sales during off-peak periods; hotels do this with their weekend minivacation packages.	*Introduce peak-time efficiency routines* to keep productivity high during periods of high demand; paramedics often assist physicians during busy periods.
Develop complementary services to provide alternatives for customers during peak periods; many banks do this by providing drop-off boxes for deposits and payments.	*Increase consumer participation* to speed transactions; this is one reason why supermarkets are experimenting with self-service checkouts where shoppers scan and bag their own groceries.
Install reservation systems to better manage demand levels; airlines, hotels, and physicians employ such systems extensively.	*Plan facilities for future expansion* to increase supply; an amusement park can buy surrounding land for later development as demand increases.
	Share services with other providers to help manage demand; hospitals can do this by sharing medical-equipment purchases and scheduling.

Source: Adapted from W. Earl Sasser, "Match Supply and Demand in Service Industries," *Harvard Business Review,* November-December 1976, pp. 133–40.

Perishability

Services cannot be stored; once an airplane takes off or a movie starts, any unsold seats cannot be held for future sale. Perishability is not a problem when demand for a service is steady, but fluctuating demand can cause problems. For example, public-transportation companies have to own much more equipment because of higher rush-hour demand, just as Charles Schwab must have sufficient server capacity to handle its brokerage customers' on-line trading during peak stock market periods.

Service providers can deal with perishability challenges in a number of ways. Table 4.3 shows some strategies proposed by Sasser for better matching demand and supply in a service business.[9]

MARKETING STRATEGIES FOR SERVICE FIRMS

In addition to the traditional four Ps of marketing, service providers must pay attention to three more Ps suggested by Booms and Bitner for services marketing: people, physical evidence, and process.[10] Because most services are provided by *people,* the selection, training, and motivation of employees can make a huge difference in customer satisfaction. Ideally, service employees should exhibit competence, a caring attitude, responsiveness, initiative, problem-solving ability, and goodwill.

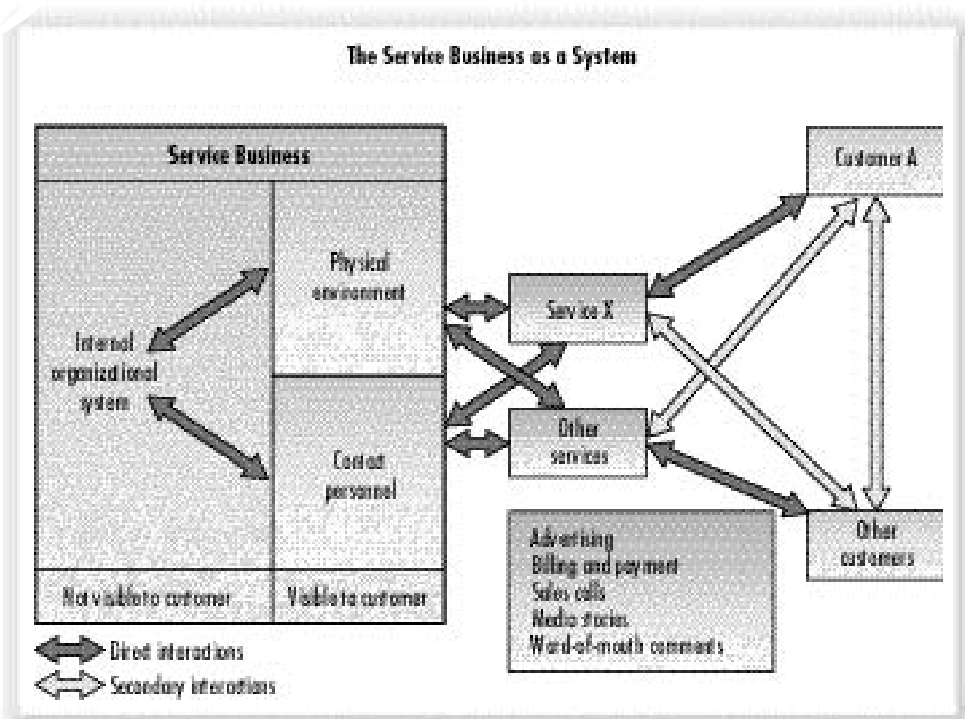
Companies should also try to demonstrate their service quality through *physical evidence* and presentation. Thus, a hotel such as the Four Seasons will develop a look and observable style of handling customers that embodies its intended customer value proposition (in this case, luxury accommodations). Finally, service companies can choose among different *processes* to deliver their service. For instance, McDonald's outlets offer self-service, while Olive Garden restaurants offer table service.

A service encounter is affected by both visible and invisible elements (see Figure 4-4). Consider a customer visiting a bank to get a loan (service X). The customer sees other customers waiting for this and other services. The customer also sees a physical environment (the building, interior, equipment, and furniture) as well as bank personnel. Not visible to the customer is a whole "backroom" production process and organization system that supports the visible business. Thus, the service outcome, and whether or not people will be satisfied and ultimately remain loyal to a service provider, are influenced by a host of variables.[11]

In view of this complexity, Gronroos has argued that service marketing requires not only external marketing, but also internal and interactive marketing (Figure 4-5).[12] *External marketing* describes the normal work to prepare, price, distribute, and promote the service to customers. *Internal marketing* describes the work to train and motivate employees to serve customers well. Berry has argued that the most important contribution the marketing department can make is to be "exceptionally clever in getting everyone else in the organization to practice marketing."[13]

Interactive marketing describes the employees' skill in serving the client. Because the client judges service not only by its *technical quality* (e.g., Was the surgery successful?) but also by its *functional quality* (e.g., Did the surgeon show concern and inspire

Figure 4-4 Elements in a Service Encounter



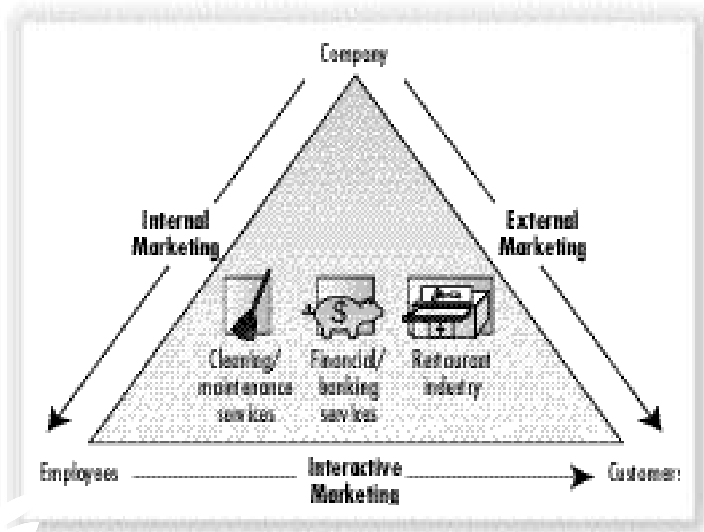


Figure 4-5 Three Types of Marketing in Service Industries

confidence?),[14] service providers must deliver services that are "high touch" as well as "high tech."[15]

Consider how Charles Schwab, the nation's largest discount brokerage house, uses the Web to create an innovative combination of high-tech and high-touch services. One of the first major brokerage firms to provide on-line trading, Schwab now provides millions of investors with Web-based financial and company information, account data, and detailed research. By offering high-tech services, Schwab has taken on the role of on-line investment adviser. Nonetheless, the on-line trading service does not entirely replace the personal service offered by Schwab in its local branches or via the telephone.[16]

In some cases, customers cannot judge the technical quality of a service even after they have received it, as shown in Figure 4-6.[17] At the left are goods that are high in *search qualities*—characteristics the buyer can evaluate before purchase. In the middle are goods and services that are high in *experience qualities*—characteristics the buyer can evaluate after purchase. At the right are services that are high in *credence qualities*—characteristics the buyer normally finds hard to evaluate even after consumption.[18]

Because services are generally high in experience and credence qualities, there is more risk in their purchase. As a result, service buyers tend to rely more on word of mouth than on advertising when selecting a provider. Second, they rely heavily on price, personnel, and physical cues to judge quality. Third, they are highly loyal to service providers who satisfy them.

Given these issues, service firms face three key marketing tasks: increasing *competitive differentiation, service quality,* and *productivity*. Although these interact, we will examine each separately.

Managing Differentiation

Service marketers frequently complain about the difficulty of differentiating their services on more than price alone. Price is a major marketing focus in service industries such as communications, transportation, and energy, which have experienced intense

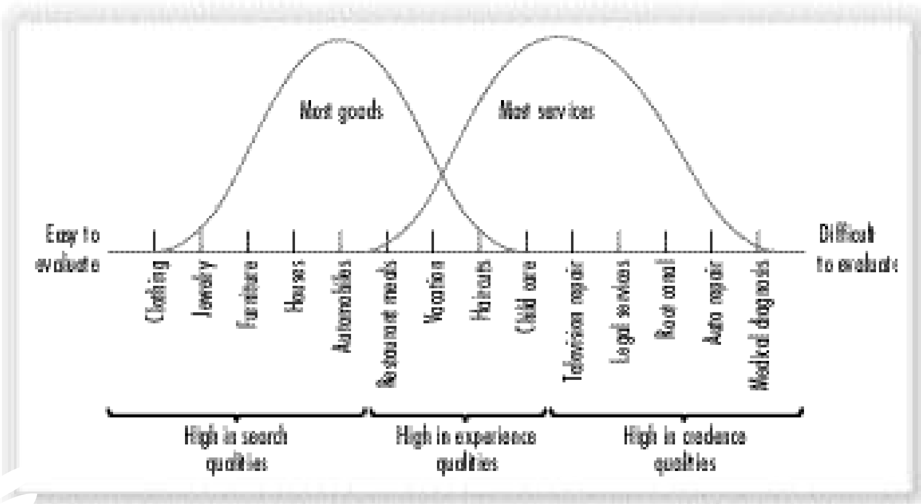


Figure 4-6 Continuum of Evaluation for Different Types of Products

price competition since deregulation. In a deregulated environment, the continued expansion of budget-priced airlines like Southwest Airlines indicated that many fliers care more about travel costs than service. Similarly, the success of E*Trade and other discount Web-based brokerages showed that many customers had little loyalty to more established brokerages when they could save money by trading on-line. To the extent that customers view a service as fairly homogeneous, they care less about the provider than the price.

The alternative to price competition in services marketing is to develop a differentiated offer, delivery, or image.

- *Offer.* The service offering can include innovative features. The customer expects the *primary service package;* to this *secondary service features* can be added. Marriott, for example, offers hotel rooms (primary service package) with connections for computers, fax machines, and e-mail (secondary service features). Although most service innovations are easily copied, the company that regularly introduces new features will gain a succession of temporary competitive advantages and earn a reputation for innovation. Amazon.com has continually expanded its offering to include auctions, e-mail greeting cards, and other services, reinforcing the firm's reputation as an Internet pioneer and retaining loyal customers.
- *Delivery.* A service company can hire and train better people to deliver its service (Home Depot, Nordstrom). It can develop a more attractive physical environment in which to deliver the service (Borders Books and Music stores, Cineplex Odeon movie theaters). Or it can design a superior delivery process (McDonald's, eBay). Delivery thus enhances the firm's differentiation.
- *Image.* Service companies can also differentiate their image through symbols and branding. Prudential uses the Rock of Gibralter as its corporate symbol to signify strength and stability. Differentiation through branding is a specialty of the charge-card division of American Express. Worldwide, a record 41.5 million people "can't leave home without it." Yet, now the company needs to reinvent itself: Credit cards like Visa and MasterCard have eaten into Amex's turf, and

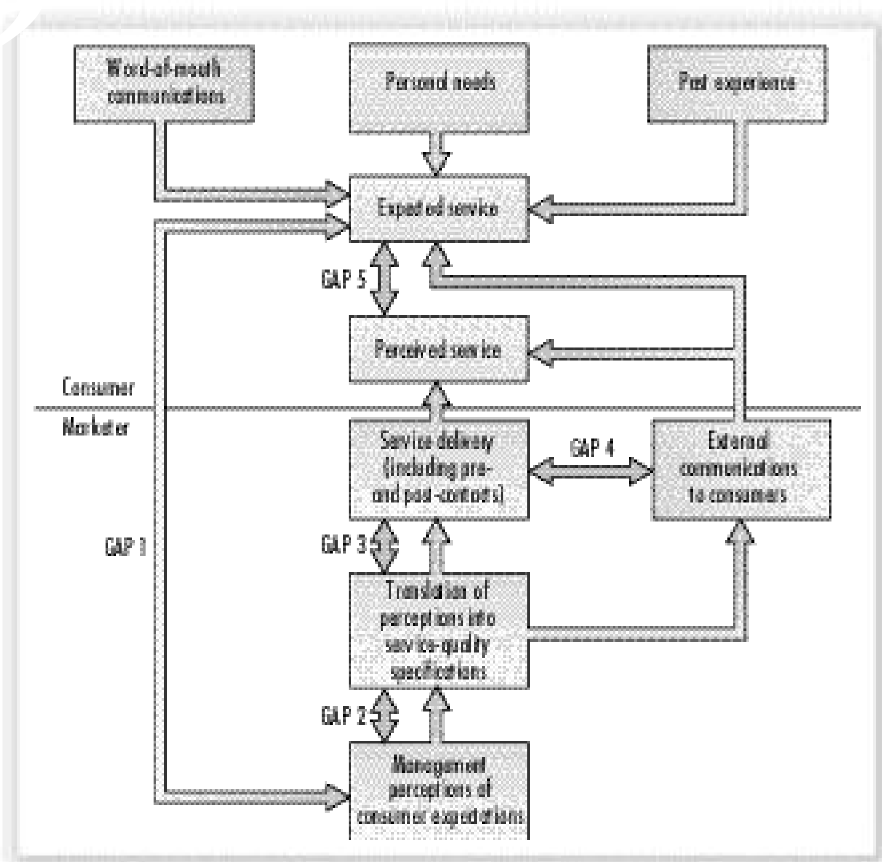
customers are flocking to no-fee credit cards with frequent-flier miles and other benefits. Fighting back, Amex has launched a walletful of new products, including the "Blue Card," aimed at upscale 25- to 35-year-olds. And the firm has carefully retained all of the positive things its brand stands for, such as good service, prestige, and value, making them relevant to the young, hip, affluent consumer.[19]

Managing Service Quality

Another way for a service firm to succeed is by delivering consistently higher-quality service than that of its competitors and by exceeding customers' expectations. These expectations are formed by the firm's past experiences, word of mouth, and advertising. After receiving the service, customers compare the perceived service with the expected service. If the perceived service falls below the expected service, customers lose interest in the provider. If the perceived service meets or exceeds their expectations, they are apt to use the provider again.

Parasuraman, Zeithaml, and Berry formulated a service-quality model that highlights the main requirements for delivering high service quality.[20] The model, shown in Figure 4-7, identifies five gaps that cause unsuccessful service delivery:

Figure 4-7 Service-Quality Model



1. *Gap between consumer expectation and management perception:* Management does not always perceive correctly what customers want. Hospital administrators may think that patients want better food, but patients may be more concerned with nurse responsiveness.
2. *Gap between management perception and service-quality specification:* Management might correctly perceive the customers' wants but not set a specified performance standard. Hospital administrators may tell the nurses to give "fast" service without specifying it quantitatively.
3. *Gap between service-quality specifications and service delivery:* Service personnel might be poorly trained, or incapable or unwilling to meet the standard. Or they may be held to conflicting standards, such as taking time to listen to customers and serving them fast.
4. *Gap between service delivery and external communications:* Customer expectations are affected by statements made by company representatives and ads. If a hospital brochure shows an attractive, modern room, but the patient finds an older, unappealing room, external communications will have distorted the customer's expectations.
5. *Gap between perceived service and expected service:* This gap occurs when the consumer misperceives the service quality. The physician may keep visiting the patient to show care, but the patient may interpret this as an indication that something really is wrong.

In addressing these gaps and pursuing service quality, well-managed service companies share the following common practices: a strategic concept, a history of top-management commitment to quality, high standards, systems for monitoring service performance and customer complaints, and an emphasis on employee satisfaction.

Strategic Concept

Top service companies are "customer obsessed." These firms have a clear sense of their target customers and their needs, and they have developed a distinctive strategy for satisfying these needs. Cleveland-based Progressive Insurance, for example, knows its customers want to get their auto accident claims processed and paid as quickly as possible. Thus, its service strategy focuses on expediting claims handling. The company now has a fleet of claims adjusters ready to rush to the scene of any auto accident in their territory. There, the adjusters record all of the information they need and often settle claims on the spot.[21]

Top-Management Commitment

Market-leading companies such as Marriott, Disney, and McDonald's have thorough commitments to service quality. Every month, their management looks not only at financial performance but also at service performance. Top-management commitment can be demonstrated in various ways. Founder Sam Walton of Wal-Mart required the following employee pledge: "I solemnly swear and declare that every customer that comes within 10 feet of me, I will smile, look them in the eye, and greet them, so help me Sam." To reinforce its corporate-wide commitment to service quality, L.L. Bean's management has tacked up a "What is a Customer?" poster in every office.

High Standards

The best service providers set high service-quality standards. Swissair, for example, aims at having 96 percent or more of its passengers rate its service as good or superior. Citibank aims to answer phone calls within 10 seconds and customer letters within 2 days. Still, service standards must be set appropriately high. A 98 percent accuracy standard may sound good, but it would result in FedEx losing 64,000 packages a day, 10 misspelled words on each page, 400,000 misfilled prescriptions daily, and unsafe drinking water 8 days a year. Companies can be distinguished between those offering "merely good" service and those offering "breakthrough" service aiming at 100 percent defect-free service.[22]

Monitoring Systems

Top firms regularly audit service performance, both their own and their competitors'. They use a number of measurement devices: comparison shopping, ghost shopping, customer surveys, suggestion and complaint forms, service-audit teams, and letters to the president. General Electric sends out 700,000 response cards a year asking households to rate its service people's performance; Citibank checks continuously on measures of ART (accuracy, responsiveness, and timeliness). RedEnvelope Gifts Online, an on-line retailer specializing in upscale gifts, analyzes how many of its orders were correctly filled, how many were shipped on time, and how many orders were returned by customers.[23]

When designing customer feedback mechanisms, service marketers need to ask the right questions, as United Parcel Service (UPS) discovered. UPS always assumed that on-time delivery was its customers' paramount concern, and based its definition of quality on the results of time-and-motion studies. To get packages to customers faster, UPS would factor in such details as how long it took elevators to open and how long it took people to answer their doorbells. Accordingly, UPS's surveys included questions about whether customers were pleased with delivery time and whether they thought the company could be any speedier. Yet, when the company began asking broader questions about service improvements, it discovered that what customers wanted most was more face-to-face contact with drivers. If drivers were less hurried and would answer questions, customers might get practical advice on shipping. UPS has now taken service a step further, allowing customers to track their UPS shipments and deliveries through its Web site (www.ups.com), where customers can also order shipping supplies and request parcel pick-up.[24]

Satisfying Customer Complaints

Studies of customer dissatisfaction show that although customers are dissatisfied with their purchases about 25 percent of the time, only about 5 percent complain. The other 95 percent either feel that complaining is not worth the effort, or that they don't know how or to whom to complain. Of the 5 percent who complain, only about half report a satisfactory problem resolution. Yet the need to resolve a customer problem in a satisfactory manner is critical. On average, a satisfied customer tells three people about a good product experience, but the average dissatisfied customer gripes to 11 people. If each of them tells still other people, the number of people exposed to bad word of mouth may grow exponentially.

Toys 'R' Us found this out recently when it failed to deliver toys ordered through its Web site (www.toysrus.com) in time for Christmas. Even though the retailer offered $100 gift certificates to make up for the inconvenience, so many customers were outraged by the delivery problems that the situation made national news and led to a class-action lawsuit.[25]

Nonetheless, customers whose complaints are satisfactorily resolved often become more company-loyal than customers who were never dissatisfied. About 34 percent of customers who register major complaints will buy again from the company if their complaint is resolved, and this number rises to 52 percent for minor complaints. If the complaint is resolved quickly, between 52 percent (major complaints) and 95 percent (minor complaints) will buy again from the company.[26]

Tax and Brown have found that companies that encourage disappointed customers to complain—and also empower employees to remedy the situation on the spot—achieve higher revenues and greater profits than companies that do not have a systematic approach for addressing service failures.[27] They also found that companies that are effective at resolving complaints:

- Develop hiring criteria and training programs that take into account employees' service-recovery role.
- Develop guidelines for service recovery that focus on achieving fairness and customer satisfaction.
- Remove barriers that make it difficult for customers to complain, while developing effective response systems. Pizza Hut prints its toll-free number on all pizza boxes. When a customer complains, Pizza Hut sends voice mail to the store manager, who must call the customer within 48 hours and resolve the complaint.
- Maintain customer and product databases that let the company analyze types and sources of complaints and adjust its policies accordingly.

Satisfying Both Employees and Customers

Excellently managed service companies believe that employee relations will affect customer relations. In these firms, management carries out internal marketing and provides employee support and rewards for good performance. In addition, management regularly audits employee job satisfaction. Rosenbluth and Peters, in *The Customer Comes Second,* go so far as to say that the company's employees, not the company's customers, have to be made number one if the company hopes to truly satisfy its customers.[28]

The Safeway supermarket chain found this out when it instituted a customer-friendly policy that actually caused stress for many of its employees. Its Superior Service program mandates employee friendliness toward customers, with rules such as: Make eye contact with all customers, smile, and greet each customer. To ensure compliance, the store employs "mystery shoppers" who secretly grade workers. Those who are graded "poor" are sent to a training program to learn how to be friendlier. Although surveys show that customers are pleased with the program, many employees have admitted being stressed out and several have quit over the plan. Disgruntled workers complain that they must override their own instincts in favor of the corporate friendliness formula. For instance, employees are required to greet harried customers whose body language tells workers that they want to be left alone. The program has set off a spirited debate on the Internet over false-versus-real friendliness. At one Internet discussion group titled "Forced Smiles at Safeway," opinion ran 2-to-1 against the program.[29]

Managing Productivity

Service firms are under great pressure to keep costs down and increase productivity. There are seven approaches to improving service productivity:

1. Have service providers work more skillfully. Top service companies such as Starbucks go out of their way to hire and foster more skillful workers through better selection and training.
2. Increase the quantity of service by surrendering some quality. Doctors working for some HMOs have moved toward handling more patients and giving less time to each patient.
3. Industrialize the service by adding equipment and standardizing production. Levitt recommended that companies adopt a "manufacturing attitude" toward producing services as represented by McDonald's assembly-line approach to fast-food retailing, culminating in the "technological hamburger."[30]
4. Reduce or make obsolete the need for a service by inventing a product solution, the way carpet-cleaning services offer stain-removing products for consumers to use on their own.

5. Design a more effective service. For example, hiring paralegal workers reduces the need for more expensive legal professionals.
6. Present customers with incentives to substitute their own labor for company labor. Customers of iPrint (www.iprint.com) save at least 25 percent by designing, inputting, and proofreading the content of their printing jobs before submitting their orders through iPrint's Web site.[31]
7. Use technology to give better customer service and make service workers more productive. Companies, such as Cisco Systems, that use their Web sites to empower customers can lessen workloads, capture valuable customer data, and increase the value of their businesses. Cisco's on-line Knowledge Base of Frequently Asked Questions (FAQs) allows customers to quickly find answers to questions without talking to any employees. As a result, Cisco cut the number of customer calls by 70 percent or 50,000 calls a month, saving $10 million a month.[32]

MANAGING PRODUCT SUPPORT SERVICES

Although service industries are an important part of the economy, a growing number of product-based industries are also offering a service bundle. Manufacturers of equipment such as small appliances, computers, tractors, and airplanes generally have to provide product support services. In fact, product support service is becoming a major battleground for competitive advantage. Some equipment companies, such as Caterpillar Tractor and John Deere, make over 50 percent of their profits from these services. In the global marketplace, companies that make a good product but provide poor local service support are seriously disadvantaged. This is why Subaru contracted to use the Australian Volkswagen dealer network to provide parts and service when it began selling its autos in that market.

To design the best service support program, a manufacturer must identify and prioritize the services its customers value most. In general, customers worry about three things:[33]

- *Reliability and failure frequency.* Customers buy with an expectation of reliability. A farmer may tolerate a combine that breaks down once a year, but not more often. Similarly, eBay's on-line auction customers are concerned when the Web site is unavailable or experiencing problems.
- *Downtime duration.* The longer the downtime, the higher the cost, which is why customers count on the seller's ability to fix the product (laptop, minivan) quickly or at least provide a loaner.[34]
- *Out-of-pocket costs of maintenance and repair.* Customers are concerned with the amount they will have to spend on regular maintenance and repair costs (such as replacement batteries for laptops).

A buyer considers all of these factors when choosing a vendor. As part of the decision process, the buyer tries to estimate the *life-cycle cost,* which is the product's purchase cost plus the discounted cost of maintenance and repair less the discounted salvage value. Smart companies therefore consider the costs and the options for diffusing customer worries when designing presale and postsale support services.

Presale Service Strategy

Before any sale can be made, the marketer has to design an appealing and competitive service offer that will attract customers. In the case of expensive equipment, such as medical equipment, manufacturers offer *facilitating services* such as installation, repairs, and financing. They may also add *value-augmenting services*. Look at Herman Miller, a leading office-furniture company that works hard to understand and then deliver what its business customers value. Along with quality products, the company offers: (1) 5-year product warranties; (2) quality audits after installation; (3) guaranteed move-in dates; (4) trade-in allowances on furniture systems products; and (5) easy on-line ordering.

A manufacturer can offer and charge for enhanced product support services in different ways. One specialty organic chemical company provides a standard offering plus a basic level of services. If the customer wants additional services, it can pay extra or increase its annual purchases to a higher level, in which case additional services would be included. In a variation on this, Baxter Healthcare offers strategic customers bonus points (called "Baxter dollars") in proportion to how much they buy. They can use the bonus points to trade for different additional services. As another alternative, companies such as Compaq and IBM sell add-on service contracts in various lengths so customers can choose the service level they want beyond the basic service package.

Postsale Service Strategy

In providing postsale service, most companies progress through a series of stages. Manufacturers usually start out by running their own parts and service department, because they want to stay close to their products and learn about any problems right away. They also find it expensive and time-consuming to train others. Often, they discover that they can make good money running the parts-and-service business—and, if they are the only supplier of certain parts, they can charge a premium price. In fact, many equipment manufacturers price their equipment low and compensate by charging high prices for parts and service. This explains why competitors sometimes manufacture the same or similar parts and sell them to customers or intermediaries for less.

Over time, manufacturers—especially those who expand into international markets—switch more maintenance and repair services to authorized distributors and dealers. These intermediaries are closer to customers, operate in more locations, and can offer quicker service. Manufacturers still make a profit on the parts but leave the servicing profit to their intermediaries. Still later, independent service firms emerge. Over 40 percent of auto-service work is now done outside franchised automobile dealerships, by independent garages and chains such as Midas Muffler and Sears. Independent service organizations have sprung up to service computers, telecommunications products, and other items, typically offering lower price or faster service than offered by the manufacturer or authorized intermediaries.

Ultimately, some large business customers may prefer to handle their own maintenance and repair services. A company with several hundred personal computers, printers, and related equipment might find it cheaper to have its own service personnel on site. These companies typically press the manufacturer for a lower product price because they are providing their own services.

Major Trends in Customer Service

Service remains a critical component for product marketers in today's dynamic, interconnected global marketplace. Lele has noted the following major trends in the customer service area:[35]

1. Equipment manufacturers are building more reliable and more easily fixable equipment. One reason is the shift from electromechanical equipment to electronic equipment, which has fewer breakdowns and is more repairable. Companies are adding modularity and disposability to facilitate self-servicing by customers.

2. Customers are becoming more sophisticated about buying product support services and are pressing for "services unbundling." They want separate prices for each service element and the right to select just the elements they want.
3. Customers increasingly dislike having to deal with a multitude of service providers that handle different types of equipment. In response, some third-party service organizations have begun servicing a greater range of equipment.[36]
4. *Service contracts* (also called *extended warranties*), in which sellers agree to provide free maintenance and repair services for a specified period of time at a specified contract price, may diminish in importance. Some new car warranties now cover 100,000 miles before servicing. The increase in disposable or never-fail equipment makes customers less inclined to pay from 2 percent to 10 percent of the purchase price every year for a service.
5. Customer service choices are increasing rapidly, and this is holding down prices and profits on service. Equipment manufacturers increasingly have to figure out how to make money on their equipment independent of service contracts.

Add to these trends the now commonplace use of the Internet to deliver service, advice, and maintenance or repair information at any hour to any customer at any location—and it is clear that the most successful companies will be those that marry high-tech capabilities with customizable, high-touch customer service. Such top-quality customer service comes at a price, of course; pricing strategies and programs for goods and services will be discussed in the next chapter.

EXECUTIVE SUMMARY

A service is any act or performance that one party offers to another that is essentially intangible and does not result in the ownership of anything. Its production may or may not be tied to a tangible product. As the United States has moved increasingly toward a service economy, marketers have become more interested in the special challenges involved in marketing services.

Services are intangible, inseparable, variable, and perishable. Each characteristic poses challenges and requires certain strategies. Marketers must find ways to give tangibility to intangibles, to increase the productivity of service providers, to increase and standardize the quality of the service provided, and to match the supply of services during peak and nonpeak periods with market demand.

Service marketing strategy covers three additional Ps: people, physical evidence, and process. Successful services marketing calls not only for external marketing, but also for internal marketing to motivate employees and interactive marketing to emphasize both "high-tech" and "high-touch" elements.

Because services are generally high in experience and credence qualities, there is more risk in their purchase. The service organization therefore faces three tasks in marketing: (1) It must differentiate its offer, delivery, or image; (2) it must manage service quality in order to meet or exceed customers' expectations; and (3) it must manage worker productivity by getting its employees to work more skillfully, increasing the quantity of service by surrendering some quality, industrializing the service, inventing new product solutions, designing more effective services, presenting customers with incentives to substitute their own labor for company labor, or using technology to save time and money.

Even product-based companies must provide support services for their customers. To provide the best support, a manufacturer must identify and prioritize the services that customers value most. The service mix includes both presale services

(such as facilitating services and value-augmenting services) and postsale services (customer service departments, repair and maintenance services).

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11. Keaveney has identified more than 800 critical behaviors of service firms that cause customers to switch services. These behaviors fit into eight categories ranging from price, inconvenience, and core service failure to service encounter failure, failed employee response to service failures, and ethical problems. See Susan M. Keaveney, "Customer Switching Behavior in Service Industries: An Exploratory Study," *Journal of Marketing,* April 1995, pp. 71–82. See also Michael D. Hartline and O. C. Ferrell, "The Management of Customer-Contact Service Employees: An Empirical Investigation," *Journal of Marketing,* October 1996, pp. 52–70; Lois A. Mohr, Mary Jo Bitner, and Bernard H. Booms, "Critical Service Encounters: The Employee's Viewpoint," *Journal of Marketing,* October 1994, pp. 95–106; Linda L. Price, Eric J. Arnould, and Patrick Tierney, "Going to Extremes: Managing Service Encounters and Assessing Provider Performance," *Journal of Marketing,* April 1995, pp. 83–97.
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13. Leonard Berry, "Big Ideas in Services Marketing," *Journal of Consumer Marketing,* Spring 1986, pp. 47–51. See also Walter E. Greene, Gary D. Walls, and Larry J. Schrest, "Internal Marketing: The Key to External Marketing Success," *Journal of Services Marketing* 8, no. 4

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Designing Pricing Strategies and Programs

We will address the following questions:

- How should a company price a new good or service?
- How should the price be adapted to meet varying circumstances and opportunities?
- When should the company initiate a price change, and how should it respond to competitive price changes?

All for-profit organizations and many nonprofit organizations set prices on their goods or services. Whether the price is called *rent* (for an apartment), *tuition* (for education), *fare* (for travel), or *interest* (for borrowed money), the concept is the same. Throughout most of history, prices were set by negotiation between buyers and sellers. Setting one price for all buyers arose with the development of large-scale retailing at the end of the nineteenth century, when Woolworth's and other stores followed a "strictly one-price policy" because they carried so many items and had so many employees.

Now, 100 years later, technology is taking us back to an era of negotiated pricing. The Internet, corporate networks, and wireless setups are linking people, machines, and companies around the globe, connecting sellers and buyers as never before. Web sites like Compare.Net and PriceScan.com allow buyers to compare products and prices quickly and easily. On-line auction sites like eBay.com and Onsale.com make it easy for buyers and sellers to negotiate prices on thousands of items. At the same time, new technologies are allowing sellers to collect detailed data about customers' buying habits, preferences—even spending limits—so they can tailor their products and prices.[1]

In the entire marketing mix, price is the one element that produces revenue; the others produce costs. Price is also one of the most flexible elements: It can be changed quickly, unlike product features and channel commitments. Although price competition is a major problem facing companies, many do not handle pricing well. The most common mistakes are these: Pricing is too cost-oriented; price is not revised often enough to capitalize on market changes; price is set independent of the rest of the marketing mix rather than as an intrinsic element of market-positioning strategy; and price is not varied enough for different product items, market segments, and purchase occasions.

Figure 4-8 Nine Price-Quality Strategies

Product Quality	Price: High	Price: Medium	Price: Low
High	1. Premium strategy	2. High-value strategy	3. Super-value strategy
Medium	4. Overcharging strategy	5. Medium-value strategy	6. Good-value strategy
Low	7. Rip-off strategy	8. False economy strategy	9. Economy strategy

SETTING THE PRICE

A firm must set a price for the first time when it develops a new product, introduces its regular product into a new distribution channel or geographical area, and enters bids on new contract work. Price is also a key element used to support a product's quality positioning, as described in Chapter 9. Because a firm, in developing its strategy, must decide where to position its product on price and quality, there can be competition between price-quality segments (see Figure 4-8).

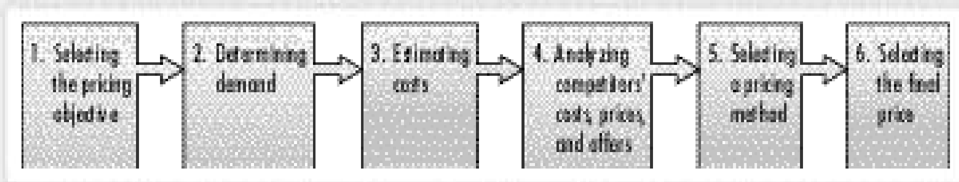
In setting a product's price, marketers follow a six-step procedure: (1) selecting the pricing objective; (2) determining demand; (3) estimating costs; (4) analyzing competitors' costs, prices, and offers; (5) selecting a pricing method; and (6) selecting the final price (see Figure 4-9).

Step 1: Selecting the Pricing Objective

A company can pursue any of five major objectives through pricing:

- *Survival.* This is a short-term objective that is appropriate only for companies that are plagued with overcapacity, intense competition, or changing consumer wants. As long as prices cover variable costs and some fixed costs, the company will be able to remain in business.
- *Maximum current profit.* To maximize current profits, companies estimate the demand and costs associated with alternative prices and then choose the price that produces maximum current profit, cash flow, or return on investment. However, by emphasizing current profits, the company may sacrifice long-run performance by

Figure 4-9 Setting Pricing Policy



ignoring the effects of other marketing-mix variables, competitors' reactions, and legal restraints on price.

- *Maximum market share.* Firms such as Texas Instruments choose this objective because they believe that higher sales volume will lead to lower unit costs and higher long-run profit. With this *market-penetration pricing,* the firms set the lowest price, assuming the market is price sensitive. This is appropriate when (1) the market is highly price sensitive, so a low price stimulates market growth; (2) production and distribution costs fall with accumulated production experience; and (3) a low price discourages competition.
- *Maximum market skimming.* Many companies favor setting high prices to "skim" the market. This objective makes sense under the following conditions: (1) A sufficient number of buyers have a high current demand; (2) the unit costs of producing a small volume are not so high that they cancel the advantage of charging what the traffic will bear; (3) the high initial price does not attract more competitors to the market; and (4) the high price communicates the image of a superior product.
- *Product-quality leadership.* Companies such as Maytag that aim to be product-quality leaders will offer premium products at premium prices. Because they offer top quality plus innovative features that deliver wanted benefits, these firms can charge more. Maytag can charge $800 for its European-style washers—double what most other washers cost—because, as its ads point out, the appliances use less water and electricity and prolong the life of clothing by being less abrasive. Here, Maytag's strategy is to encourage buyers to trade up to new models before their existing appliances wear out.[2]

Nonprofit and public organizations may adopt other pricing objectives. A university aims for partial cost recovery, knowing that it must rely on private gifts and public grants to cover the remaining costs, while a nonprofit theater company prices its productions to fill the maximum number of seats. As another example, a social services agency may set prices geared to the varying incomes of clients.

Step 2: Determining Demand

Each price will lead to a different level of demand and, therefore, will have a different impact on a company's marketing objectives. The relationship between alternative prices and the resulting current demand is captured in a *demand curve.* Normally, demand and price are inversely related: The higher the price, the lower the demand. In the case of prestige goods, however, the demand curve sometimes slopes upward because some consumers take the higher price to signify a better product. Still, if the price is too high, the level of demand may fall.

Price Sensitivity

The demand curve shows the market's probable purchase quantity at alternative prices, summing the reactions of many individuals who have different price sensitivities. The first step in estimating demand is to understand what affects price sensitivity. Nagle says there is less price sensitivity when:

- The product is more distinctive,
- Buyers are less aware of substitutes,
- Buyers cannot easily compare the quality of substitutes,
- The expenditure is a lower part of buyer's total income,
- The expenditure is small compared to the total cost of the end product,

- Part of the cost is borne by another party,
- The product is used in conjunction with assets previously bought,
- The product is assumed to have more quality, prestige, or exclusiveness, and
- Buyers cannot store the product.[3]

A number of forces, such as deregulation and instant price comparisons that are available over the Internet, have turned products into commodities in the eyes of consumers and increased their price sensitivity. More than ever, companies need to understand the price sensitivity of their target market and the trade-offs that people are willing to make between price and product characteristics. Even in the energy marketplace, where you would think that a kilowatt is a kilowatt is a kilowatt, some utility companies are buying power, branding it, marketing it, and providing unique services to customers.

Vermont-based GreenMountain.com for example, is working hard to differentiate its energy products. Through extensive marketing research, the energy firm uncovered a large market of prospects who not only were concerned with the environment, but also were willing to pay more to protect it. Because GreenMountain.com is a "green" power provider—a large percentage of its power is hydroelectric—customers can help ease the environmental burden by purchasing its power. This differentiation helps the firm compete against "cheaper" brands that focus on price-sensitive consumers.[4]

Estimating Demand Curves

Companies can use one of three basic methods to estimate their demand curves. The first involves statistically analyzing past prices, quantities sold, and other factors to estimate their relationships. However, building a model and fitting the data with the proper techniques calls for considerable skill.

The second approach is to conduct price experiments, as when Bennett and Wilkinson systematically varied the prices of several products sold in a discount store and observed the results.[5] An alternative here is to charge different prices in similar territories to see how sales are affected.

The third approach is to ask buyers to state how many units they would buy at different proposed prices.[6] One problem with this method is that buyers might understate their purchase intentions at higher prices to discourage the company from setting higher prices.

In measuring the price-demand relationship, the marketer must control for various factors that will influence demand, such as competitive response. Also, if the company changes other marketing-mix factors besides price, the effect of the price change itself will be hard to isolate.[7]

Price Elasticity of Demand

Marketers need to know how responsive, or elastic, demand would be to a change in price. If demand hardly changes with a small change in price, we say the demand is *inelastic*. If demand changes considerably, demand is *elastic*.

Demand is likely to be less elastic when (1) there are few or no substitutes or competitors; (2) buyers do not readily notice the higher price; (3) buyers are slow to change their buying habits and search for lower prices; and (4) buyers think the higher prices are justified by quality differences, normal inflation, and so on. If demand is elastic, sellers will consider lowering the price to produce more total revenue. This makes sense as long as the costs of producing and selling more units do not increase disproportionately.[8]

Price elasticity depends on the magnitude and direction of the contemplated price change. It may be negligible with a small price change and substantial with a large price change; it may differ for a price cut versus a price increase. Finally, long-run price elasticity may differ from short-run elasticity. Buyers may continue to buy from their current supplier after a price increase because they do not notice the increase, or the increase is small, or they are distracted by other concerns, or they find that choosing a new supplier takes time. But they may eventually switch suppliers. The distinction between short-run and long-run elasticity means that sellers will not know the total effect of a price change until time passes.

Step 3: Estimating Costs

While demand sets a ceiling on the price the company can charge for its product, costs set the floor. Every company should charge a price that covers its cost of producing, distributing, and selling the product and provides a fair return for its effort and risk.

Types of Costs and Levels of Production

A company's costs take two forms—fixed and variable. *Fixed costs* (also known as *overhead*) are costs that do not vary with production or sales revenue, such as payments for rent, heat, interest, salaries, and other bills that must be paid regardless of output.

In contrast, *variable costs* vary directly with the level of production. For example, each calculator produced by Texas Instruments (TI) involves a cost of plastic, microprocessing chips, packaging, and the like. These costs tend to be constant per unit produced, but they are called variable because their total varies with the number of units produced.

Total costs consist of the sum of the fixed and variable costs for any given level of production. *Average cost* is the cost per unit at that level of production; it is equal to total costs divided by production. Management wants to charge a price that will at least cover the total production costs at a given level of production.

To price intelligently, management needs to know how its costs vary with different levels of production. A firm's cost per unit is high if only a few units are produced every day, but as production increases, fixed costs are spread over a higher level of production results in each unit, bringing the average cost down. At some point, however, higher production will lead to higher average cost because the plant becomes inefficient (due to problems such as machines breaking down more often). By calculating costs for different-sized plants, a company can identify the optimal plant size and production level to achieve economies of scale and bring down the average cost.

Accumulated Production

Suppose TI runs a plant that produces 3,000 calculators per day. As TI gains experience producing calculators, its methods improve. Workers learn shortcuts, materials flow more smoothly, and procurement costs fall. The result, as Figure 4-10 shows, is that average cost falls with accumulated production experience. Thus, the average cost of producing the first 100,000 hand calculators is $10 per calculator. When the company has produced the first 200,000 calculators, the average cost has fallen to $9. After its accumulated production experience doubles again to 400,000, the average cost is $8. This decline in the average cost with accumulated production experience is called the *experience curve* or *learning curve.*

Now suppose TI competes against two other firms (A and B) in this industry. TI is the lowest-cost producer at $8, having produced 400,000 units in the past. If all three firms sell the calculator for $10, TI makes $2 profit per unit, A makes $1 per unit, and B breaks even. The smart move for TI would be to lower its price to $9 to drive B out of

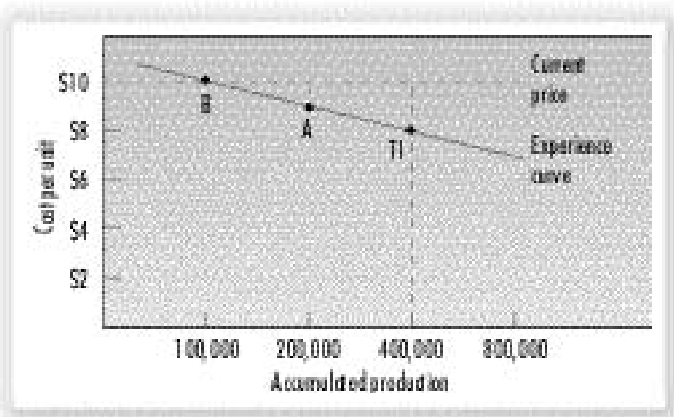


Figure 4-10 The Experience Curve

the market; even A will consider leaving. Then TI will pick up the business that would have gone to B (and possibly A). Furthermore, price-sensitive customers will enter the market at the lower price. As production increases beyond 400,000 units, TI's costs will drop even more, restoring its profits even at a price of $9. TI has used this aggressive pricing strategy repeatedly to gain market share and drive others out of the industry.

Experience-curve pricing is risky because aggressive pricing may give the product a cheap image. This strategy also assumes that the competitors are weak and not willing to fight. Finally, the strategy may lead the firm into building more plants to meet demand while a competitor innovates a lower-cost technology and enjoys lower costs, leaving the leader stuck with old technology.

Differentiated Marketing Offers

Today's companies try to adapt their offers and terms to different buyers. Thus, a manufacturer will negotiate different terms with different retail chains, meaning the costs and profits will differ with each chain. To estimate the real profitability of dealing with different retailers, the manufacturer needs to use *activity-based cost (ABC) accounting* instead of *standard cost accounting*.[9]

ABC accounting tries to identify the real costs associated with serving different customers. Both the variable costs and the overhead costs must be tagged back to each customer. Companies that fail to measure their costs correctly are not measuring their profit correctly, and they are likely to misallocate their marketing effort. Identifying the true costs arising in a customer relationship also enables a company to explain its charges better to the customer.

Target Costing

We have seen that costs change with production scale and experience. They can also change as a result of a concentrated effort by the company's designers, engineers, and purchasing agents to reduce them. Many Japanese firms use a method called *target costing*.[10] First, they use market research to establish a new product's desired functions, then they determine the price at which the product will sell given its appeal and competitors' prices. They deduct the desired profit margin from this price, and this leaves the target cost they must achieve.

Next, the firms examine each cost element—design, engineering, manufacturing, sales—and break them down into further components, looking for ways to reengineer components, eliminate functions, and bring down supplier costs. The objective is to bring the final cost projections into the target cost range. If they cannot succeed, they may decide against developing the product because it could not sell for the target price and make the target profit. When they can succeed, profits are likely to follow.

Step 4: Analyzing Competitors' Costs, Prices, and Offers

Within the range of possible prices determined by market demand and company costs, the firm must take into account its competitors' costs, prices, and possible price reactions. If the firm's offer is similar to a major competitor's offer, then the firm will have to price close to the competitor or lose sales. If the firm's offer is inferior, it will not be able to charge more than the competitor charges. If the firm's offer is superior, it can charge more than does the competitor—remembering, however, that competitors might change their prices in response at any time.

Step 5: Selecting a Pricing Method

The three Cs—the customers' demand schedule, the cost function, and competitors' prices—are major considerations in setting price (see Figure 4-11). First, costs set a floor to the price. Second, competitors' prices and the price of substitutes provide an orienting point. Third, customers' assessment of unique product features establishes the ceiling price. Companies must therefore select a pricing method that includes one or more of these considerations. We will examine six price-setting methods: markup pricing, target-return pricing, perceived-value pricing, value pricing, going-rate pricing, and sealed-bid pricing.

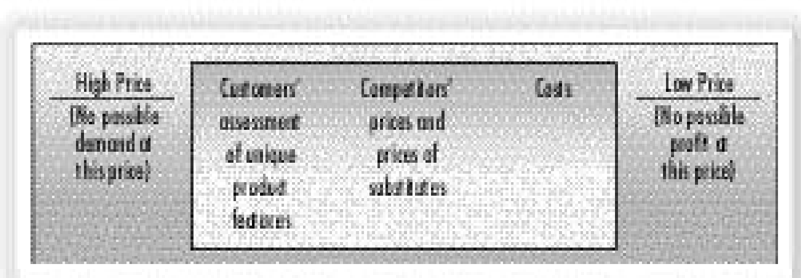
Markup Pricing

The most elementary pricing method is to add a standard markup to the product's cost. Construction companies do this when they submit job bids by estimating the total project cost and adding a standard markup for profit. Similarly, lawyers and accountants typically price by adding a standard markup on their time and costs.

Suppose a toaster manufacturer has the following costs and sales expectations:

Variable cost per unit	$ 10
Fixed cost	300,000
Expected unit sales	50,000

Figure 4-11 The Three Cs Model for Price Setting



The manufacturer's unit cost is given by:

$$\text{Unit cost} = \text{variable cost} + \frac{\text{fixed costs}}{\text{unit sales}} = \$10 + \frac{\$300{,}000}{50{,}000} = \$16$$

If the manufacturer wants to earn a 20 percent markup on sales, its markup price is given by:

$$\text{Markup price} = \frac{\text{unit cost}}{(1 - \text{desired return on sales})} = \frac{\$16}{1 - 0.2} = \$20$$

Here, the manufacturer charges dealers \$20 per toaster and makes a profit of \$4 per unit. If the dealers want to earn 50 percent on their selling price, they will mark up the toaster to \$40. This is equivalent to a cost markup of 100 percent.

Does the use of standard markups make logical sense? Generally, no. Any pricing method that ignores current demand, perceived value, and competition is not likely to lead to the optimal price. Markup pricing works only if the marked-up price actually brings in the expected level of sales.

Companies that introduce a new product often price it high, hoping to recover their costs as rapidly as possible. But a high-markup strategy could be fatal if a competitor is pricing low. This happened to Philips, the Dutch electronics manufacturer, in pricing its videodisc players. Philips wanted to make a profit on each videodisc player. Meanwhile, Japanese competitors priced low and succeeded in building their market share rapidly, which in turn pushed down their costs substantially.

Markup pricing remains popular for a number of reasons. First, sellers can determine costs much more easily than they can estimate demand. By tying the price to cost, sellers simplify the pricing task. Second, when all firms in the industry use this pricing method, prices tend to be similar, which minimizes price competition. Third, many people feel that cost-plus pricing is fairer to both buyers and sellers: Sellers do not take advantage of buyers when demand becomes acute, and sellers earn a fair return on investment.

Target-Return Pricing

In *target-return pricing,* the firm determines the price that would yield its target rate of return on investment (ROI). Target pricing is used by many firms, including General Motors, which prices its automobiles to achieve a 15–20 percent ROI.

Suppose the toaster manufacturer in the previous example has invested \$1 million and wants to earn a 20 percent return on its invested capital. The target-return price is given by the following formula:

$$\text{Target-return price} = \frac{\text{unit cost} + \text{desired return} \times \text{invested capital}}{\text{unit sales}}$$

$$= \$16 + \frac{.20 \times \$1{,}000{,}000}{50{,}000} = \$20$$

The manufacturer will realize this 20 percent ROI provided its costs and estimated sales turn out to be accurate. But what if sales do not reach 50,000 units? The manufacturer can prepare a *break-even chart* to learn what would happen at other sales levels (Figure 4-12). Note that fixed costs remain the same regardless of sales volume, while variable costs, which are not shown in the figure, rise with volume. Total costs equal the sum of fixed costs and variable costs; the total revenue curve rises with each unit sold.

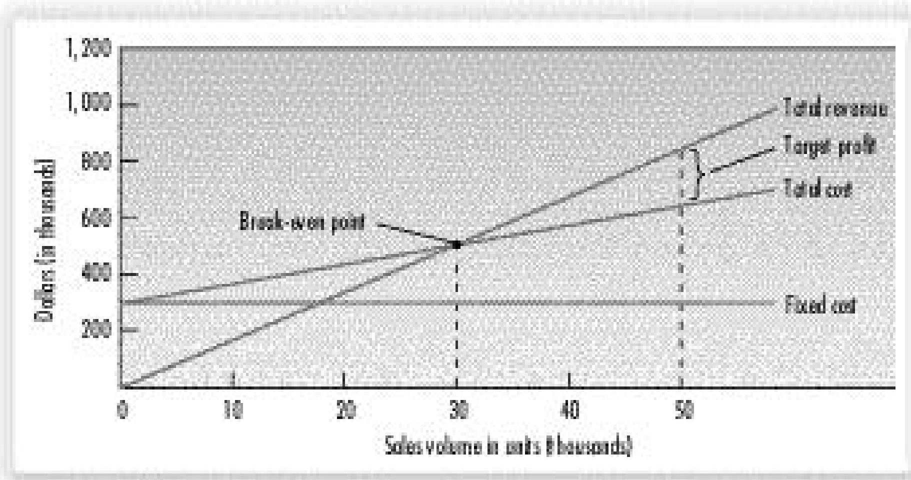


Figure 4-12 Break-Even Chart

According to this break-even chart, the total revenue and total cost curves cross at 30,000 units. This is the *break-even volume.* It can be verified by the following formula:

$$\text{Break-even volume} = \frac{\text{fixed cost}}{\text{price} - \text{variable cost}} = \frac{\$300{,}000}{\$20-10} = 30{,}000$$

If the manufacturer sells 50,000 units at $20, it earns a $200,000 profit on its $1 million investment. But much depends on price elasticity and competitors' prices, two elements that are ignored by target-return pricing. In practice, the manufacturer needs to consider different prices and estimate their probable impacts on sales volume and profits. The manufacturer should also search for ways to lower its fixed or variable costs, because lower costs will decrease its required break-even volume.

Perceived-Value Pricing

An increasing number of companies base price on customers' *perceived value.* They see the buyers' perceptions of value, not the seller's cost, as the key to pricing. Then they use the other marketing-mix elements, such as advertising, to build up perceived value in buyers' minds.[11]

For example, when DuPont developed a new synthetic fiber for carpets, it demonstrated to carpet manufacturers that they could afford to pay DuPont as much as $1.40 per pound for the new fiber and still make their target profit. DuPont calls the $1.40 the *value-in-use price.* But pricing the new material at $1.40 per pound would leave the carpet manufacturers indifferent. So DuPont set the price lower than $1.40 to induce carpet manufacturers to adopt the new fiber. In this situation, DuPont used its manufacturing cost only to judge whether there was enough profit to go ahead with the new product.

The key to perceived-value pricing is to determine the market's perception of the offer's value accurately. Sellers with an inflated view of their offer's value will overprice their product, while sellers with an underestimated view will charge less than they could. Market research is therefore needed to establish the market's perception of value as a guide to effective pricing.[12]

Value Pricing

Value pricing is a method in which the company charges a fairly low price for a high-quality offering. Value pricing says that the price should represent a high-value offer to consumers. This is a major trend in the computer industry, which has shifted from charging top dollar for cutting-edge computers to offering basic computers at lower prices. For instance, Monorail Computer started selling PCs in 1996 for as little as $999 to woo price-sensitive buyers. Compaq and others quickly followed suit. More recently, eMachines began selling its PCs for less than $500 without a monitor, targeting the 55 percent of computerless households with annual incomes of $25,000 to $30,000.[13]

Value pricing is not a matter of simply setting lower prices on one's products compared to those of competitors. It is a matter of reengineering the company's operations to become a low-cost producer without sacrificing quality, and lowering prices significantly to attract a large number of value-conscious customers. An important type of value pricing is *everyday low pricing (EDLP),* which takes place at the retail level. Retailers such as Wal-Mart and Amazon.com use EDLP pricing, posting a constant, everyday low price with few or no temporary price discounts. These constant prices eliminate week-to-week price uncertainty and can be contrasted to the "high-low" pricing of promotion-oriented competitors. In *high-low pricing,* the retailer charges higher prices on an everyday basis but then runs frequent promotions in which prices are temporarily lowered below the EDLP level.[14]

Retailers adopt EDLP for a number of reasons, the most important of which is that constant sales and promotions are costly and erode consumer confidence in the credibility of everyday prices. Consumers also have less time and patience for such time-honored traditions as watching for specials and clipping coupons. Yet promotions are an excellent way to create excitement and draw shoppers. For this reason, EDLP is not a guarantee of success. As supermarkets face heightened competition from store rivals and alternative channels, many are drawing shoppers using a combination of high-low and EDLP strategies, with increased advertising and promotions.[15]

Going-Rate Pricing

In *going-rate pricing,* the firm bases its price largely on competitors' prices. The firm might charge the same, more, or less than its major competitor(s) charges. In oligopolistic industries that sell a commodity such as steel, paper, or fertilizer, firms normally charge the same price. The smaller firms "follow the leader," changing their prices when the market leader's prices change rather than when their own demand or costs change. Some firms may charge a slight premium or slight discount, but they typically preserve the amount of difference. When costs are difficult to measure or competitive response is uncertain, firms feel that the going price represents a good solution, since it seems to reflect the industry's collective wisdom as to the price that will yield a fair return and not jeopardize industrial harmony.

Sealed-Bid Pricing

Competitive-oriented pricing is common when firms submit sealed bids for jobs. In bidding, each firm bases its price on expectations of how competitors will price rather than on a rigid relationship to the firm's own costs or demand. Sealed-bid pricing involves two opposite pulls. The firm wants to win the contract—which means submitting the lowest price—yet it cannot set its price below cost.

To solve this dilemma, the company would estimate the profit and the probability of winning with each price bid. By multiplying the profit by the probability of winning the bid on the basis of that price, the company can calculate the expected profit for each bid. For a firm that makes many bids, this method is a way of playing the odds to achieve maximum profits in the long run. However, firms that bid only occasionally or that badly want to win certain contracts will not find it advantageous to use the expected-profit criterion.

Step 6: Selecting the Final Price

The previous pricing methods narrow the range from which the company selects its final price. In selecting that price, the company must consider additional factors: psychological pricing, the influence of other marketing-mix elements on price, company pricing policies, and the impact of price on other parties.

Psychological Pricing

Many consumers use price as an indicator of quality. Image pricing is especially effective with ego-sensitive products such as perfumes and expensive cars. A $100 bottle of perfume might contain $10 worth of scent, but gift givers pay $100 to communicate their high regard for the receiver. Similarly, price and quality perceptions of cars interact:[16] Higher-priced cars are perceived to possess high quality; higher-quality cars are likewise perceived to be higher priced than they actually are. In general, when information about true quality is unavailable, price acts as a signal of quality.

When looking at a particular product, buyers carry in their minds a *reference price* formed by noticing current prices, past prices, or the buying context. Sellers often manipulate these reference prices. For example, a seller can situate its product among expensive products to imply that it belongs in the same class. Reference-price thinking is also created by stating a high manufacturer's suggested price, by indicating that the product was priced much higher originally, or by pointing to a rival's high price.[17]

Often sellers set prices that end in an odd number, believing that customers who see a television priced at $299 instead of $300 will perceive the price as being in the $200 range rather than the $300 range. Another explanation is that odd endings convey the notion of a discount or bargain, which is why both toysrus.com and etoys.com set prices ending in 99. But if a company wants a high-price image instead of a low-price image, it should avoid the odd-ending tactic.

The Influence of Other Marketing-Mix Elements

The final price must take into account the brand's quality and advertising relative to competition. When Farris and Reibstein examined the relationships among relative price, relative quality, and relative advertising for 227 consumer businesses, they found that brands with average relative quality but high relative advertising budgets were able to charge premium prices. Consumers apparently were willing to pay higher prices for known products than for unknown products. They also found that brands with high relative quality and high relative advertising obtained the highest prices, while brands with low quality and advertising charged the lowest prices. Finally, the positive relationship between high prices and high advertising held most strongly in the later stages of the product life cycle for market leaders.[18] Smart marketers therefore ensure that their prices fit with other marketing-mix elements.

Company Pricing Policies

The price must be consistent with company pricing policies. To accomplish this, many firms set up a pricing department to develop policies and establish or approve decisions. The aim is to ensure that the salespeople quote prices that are reasonable to customers and profitable to the company.

Impact of Price on Other Parties

Management must also consider the reactions of other parties to the contemplated price. How will distributors and dealers feel about it? Will the sales force be willing to sell at that price? How will competitors react? Will suppliers raise their prices when they see the company's price? Will the government intervene and prevent this price from being charged?

In the last case, marketers need to know the laws regulating pricing. U.S. legislation outlaws price-fixing, so sellers must set prices without talking to competitors. Many federal, state, and local laws also protect consumers against deceptive pricing practices. For example, it is illegal for a company to set artificially high "regular" prices, then announce a "sale" at prices close to previous everyday prices.

ADAPTING THE PRICE

Companies usually do not set a single price, but rather a pricing structure that reflects variations in geographical demand and costs, market-segment requirements, purchase timing, order levels, delivery frequency, guarantees, service contracts, and other factors. As a result of discounts, allowances, and promotional support, a company rarely realizes the same profit from each unit of a product that it sells. Here we will examine several price-adaptation strategies: geographical pricing, price discounts and allowances, promotional pricing, discriminatory pricing, and product-mix pricing.

Geographical Pricing

In geographical pricing, the company decides how to price its products to different customers in different locations and countries. For example, should the company charge distant customers more to cover higher shipping costs, or set a lower price to win additional business? Another issue is how to get paid. This is particularly critical when foreign buyers lack sufficient hard currency to pay for their purchases. Many buyers want to offer other items in payment in a practice known as *countertrade,* which accounts for 15–25 percent of world trade and takes several forms:[19]

- *Barter:* The direct exchange of goods, with no money and no third party involved. For example, Eminence S.A., a major clothing maker in France, bartered $25 million worth of U.S.-produced underwear and sportswear to customers in eastern Europe in exchange for transportation, magazine advertising space, and other goods and services.
- *Compensation deal:* The seller is paid partly in cash and partly in products. A British aircraft manufacturer used this approach to sell planes to Brazil for 70 percent cash and the rest in coffee.
- *Buyback arrangement:* The seller sells a plant, equipment, or technology to another country and agrees to accept as partial payment products manufactured with the supplied equipment. As one example, a U.S. chemical firm built a plant for an Indian company and accepted partial payment in cash and the remainder in chemicals manufactured at the plant.
- *Offset:* The seller receives full payment in cash but agrees to spend a substantial amount of that money in that country within a stated time period. For example, PepsiCo sells its cola syrup to Russia for rubles and agrees to buy Russian vodka at a certain rate for sale in the United States.

Price Discounts and Allowances

Most companies will adjust their list price and give discounts and allowances for early payment, volume purchases, and off-season buying, as shown in Table 4.4. However, companies must do this carefully or they will find that their profits are much less than planned.[20]

Table 4.4 Price Discounts and Allowances

Cash Discounts:	A *cash discount* is a price reduction to buyers who pay their bills promptly. A typical example is "2/10, net 20," which means that payment is due within 30 days and that the buyer can deduct 2 percent by paying the bill within 10 days. Such discounts are customary in many industries.
Quantity Discounts:	A *quantity discount* is a price reduction to those buyers who buy large volumes. A typical example is "$10 per unit for less than 100 units; $9 per unit for 100 or more units." Quantity discounts must be offered equally to all customers and must not exceed the cost savings to the seller associated with selling large quantities. They can be offered on a noncumulative basis (on each order placed) or a cumulative basis (on the number of units ordered over a given period).
Functional Discounts:	*Functional discounts* (also called *trade discounts*) are offered by a manufacturer to trade-channel members if they will perform certain functions, such as selling, storing, and record keeping. Manufacturers may offer different functional discounts to different trade channels but must offer the same functional discounts within each channel.
Seasonal Discounts:	A *seasonal discount* is a price reduction to buyers who buy merchandise or services out of season. Ski manufacturers will offer seasonal discounts to retailers in the spring and summer to encourage early ordering. Hotels, motels, and airlines will offer seasonal discounts in slow selling periods.
Allowances:	*Allowances* are extra payments designed to gain reseller participation in special programs. *Trade-in allowances* are price reductions granted for turning in an old item when buying a new one. Trade-in allowances are most common in durable-goods categories. *Promotional allowances* are payments or price reductions to reward dealers for participating in advertising and sales support programs.

Promotional Pricing

Companies can use any of seven promotional pricing techniques to stimulate early purchase (see Table 4.5). However, smart marketers recognize that promotional-pricing strategies are often a zero-sum game. If they work, competitors copy them and they lose their effectiveness. If they do not work, they waste company money that could have been put into longer impact marketing tools, such as building up product quality and service or strengthening product image through advertising.

Table 4.5 Promotional Pricing Techniques

Technique	Description	Example
Loss-leader pricing	Stores drop the price on well-known brands to stimulate additional store traffic.	Kmart cuts the price of selected toys to attract shoppers before Christmas.
Special-event pricing	Sellers establish special prices in certain seasons to draw in more customers.	Staples offers special prices on stationery items during a back-to-school sale.
Cash rebates	Manufacturers offer cash rebates to encourage purchase of their products within a specified period; this helps clear inventories without cutting the stated price.	Mazda advertises cash rebates on the purchase of selected previous-year models to clear these vehicles out of dealer inventory.
Low-interest financing	Instead of cutting its price, the company can offer customers low-interest financing.	Ford offers low- or no-interest financing to encourage the purchase of selected vehicles.
Longer payment terms	Sellers stretch loans over longer periods and thus lower the monthly payments that customers pay.	Auto companies and mortgage banks use this approach because consumers are more concerned with affordable payments than with the interest rate.
Warranties and service contracts	Companies can promote sales by adding a free or low-cost warranty or service contract.	Real estate brokers offer special warranties on selected homes to expedite sales.
Psychological discounting	Used legitimately, this involves offering the item at substantial savings from the normal price.	A jewelry store lowers the price of a diamond ring and advertises "Was $359, now $299."

Discriminatory Pricing

Companies often adjust their basic price to accommodate differences in customers, products, locations, and so on. *Discriminatory pricing* occurs when a company sells a product or service at two or more prices that do not reflect a proportional difference in costs. Discriminatory pricing takes several forms:

- *Customer-segment pricing:* Different customer groups pay different prices for the same good or service. For example, museums often charge a lower admission fee to students and senior citizens.
- *Product-form pricing:* Different versions of the product are priced differently but not proportionately to their respective costs. Evian, for instance, prices a 48-ounce bottle of its mineral water at $2, while its 1.7 ounce moisturizer spray sells for $6.
- *Image pricing:* Some companies price the same product at two different levels based on image differences. For instance, a perfume manufacturer can put its perfume in one bottle with a certain name and image priced at $10 an ounce; the same perfume in another bottle with a different name and image could be priced at $30 an ounce.

- *Location pricing:* The same product is priced differently at different locations even though the costs are the same; for example, theaters often vary seat prices according to audience preferences for different locations.
- *Time pricing:* Prices are varied by season, day, or hour. Public utilities use time pricing, varying energy rates to commercial users by time of day and weekend versus weekday. A special form of time pricing is *yield pricing*, which is often used by airlines to fill as many seats as possible.

Price discrimination works when (1) the market is segmentable and the segments show different intensities of demand; (2) members in the lower-price segment cannot resell the product to the higher-price segment; (3) competitors cannot undersell the firm in the higher-price segment; (4) the cost of segmenting and policing the market does not exceed the extra revenue derived from price discrimination; (5) the practice does not breed customer resentment and ill will; and (6) the particular form of price discrimination is not illegal (practices such as *predatory pricing*—selling below cost with the intention of destroying competition—are against the law).[21]

Today's Internet technology helps sellers discriminate between buyers as well as helping buyers discriminate between sellers. For example, Personify software allows companies to examine the "clickstream" of an on-line shopper, looking at the way that individual navigates through a Web site. Based on that behavior, the software can instantaneously target shoppers for specific products and prices. At the same time, Web sites such as MySimon are giving buyers instant price comparisons on specific products, while Web sites such as Priceline.com allow buyers to name their own price for airline tickets, long-distance phone service, hotel rooms, mortgages, groceries, and other goods and services—including an electronic yard sale for personal items.[22] These and other Internet innovations clearly signal the return to fluid pricing rather than the fixed pricing approach that came into acceptance a century ago.

Product-Mix Pricing

Price-setting logic must be modified when the product is part of a product mix. In this case, the firm searches for a set of prices that maximizes profits on the total mix. Pricing a product line is difficult because the various products have demand and cost interrelationships and are subject to different degrees of competition. We can distinguish six situations involving product-mix pricing:

- *Product-line pricing.* Many sellers use well-established price points (such as $200, $350, and $500 for suits) to distinguish the products in their line. The seller's task is to establish perceived-quality differences that justify the price differences.
- *Optional-feature pricing.* Automakers and many other firms offer optional products, features, and services along with their main product. Pricing these options is a sticky problem because companies must decide which items to include in the standard price and which to offer as options.
- *Captive-product pricing.* Some products require the use of ancillary, or *captive,* products. In the razor industry, manufacturers often price their razors low and set high markups on their blades. However, there is a danger in pricing the captive product too high in the *aftermarket* (the market for ancillary supplies to the main product). Caterpillar, for example, makes high profits in the aftermarket by pricing its parts and service high. This practice has given rise to "pirates," who counterfeit the parts and sell them to "shady tree" mechanics who install them, sometimes without passing on the cost savings to customers. Meanwhile, Caterpillar loses sales.[23]