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.
Marketing Channels
To reach a target market, the marketer uses three kinds of marketing channels. Communication channels send messages to and receive messages from target buyers. They include newspapers, magazines, radio, television, mail, telephone, billboards, posters, fliers, audio tapes, 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
period-to-period marketing-mix changes in the short run than the number of market-
ing-mix decision variables might suggest.

Robert Lauterborn suggested that the sellers' four Ps correspond to the cus-
tomers' four Cs.\textsuperscript{14}

<table>
<thead>
<tr>
<th>Four Ps</th>
<th>Four Cs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product</td>
<td>Customer solution</td>
</tr>
<tr>
<td>Price</td>
<td>Customer cost</td>
</tr>
<tr>
<td>Place</td>
<td>Convenience</td>
</tr>
<tr>
<td>Promotion</td>
<td>Communication</td>
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</tbody>
</table>

Winning companies are those that meet customer needs economically and conve-
niently and with effective communication.

COMPANY ORIERTATIONS 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 organi-
zation, customers, and society?

For example, one of Dexter Corporation’s most popular products was a pro-
fitable 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 com-
pany increased its market share while virtually eliminating hazardous waste.\textsuperscript{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 the 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 involves marketing people in the very beginning stages of design.

However, the product concept can lead to marketing myopia. 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;
tion 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 segments; and the societal marketing concept assumes that the firm must create customers more effectively and efficiently than competitors while still preserving the consumer's and the society's wellbeing. Keeping this concept in mind, smart companies add “higher order” image attributes to supply 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 these forces 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.

NOTES

9. From a lecture by Mohan Sawhney, faculty member at Kellogg Graduate School of Management, Northwestern University, June 4, 1998.


13. E. Jerome McCarthy, *Basic Marketing: A Managerial Approach*, 13th ed. (Homewood, IL: Irwin, 1999). Two alternative classifications are worth noting. Frey proposed that all marketing decision variables could be categorized into two factors: the offering (product, packaging, brand, price, and service) and methods and tools (distribution channels, personal selling, advertising, sales promotion, and publicity).


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-
➤ **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, 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...
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). 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.

Evaluating and Controlling the Marketing Process

To deal with the many surprises that occur during the implementation of marketing plans, the marketing department must 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...
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. 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, picking up about 8 pounds of dust each year and using 6 bags to do so. "We also have extensive information about consumption patterns in other countries. On an aggregate 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 Germans smoke the most cigarettes."

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 in-
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 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.\(^{30}\)
### Statistical Tools

*Multiple regression:*

*Example*

*Discriminant analysis:*

*Example*

*a*

*Factor analysis:*

*Example*

*b*

*Cluster analysis:*

*Example*

*Conjoint analysis:*

*Example:*

*Multidimensional scaling:*

*Example*

*Models:*

*Network process model:*

*Example*

*Queuing model:*

*Example*

*New-product pretest models:*

*c*

*Sales-response models:*

### Optimization Routines

*Differential calculus:*

*(continued)*
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.

### Estimating Current 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 of a nation, say 261 million people. The next step is to eliminate people 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:

\[
\text{Demand for the new light beer} = \text{Population} \times \text{personal discretionary income per capita} \times \text{average percentage of discretionary income spent on food} \times \text{average percentage of amount spent on food that is spent on beverages} \times \text{average percentage of amount spent on beverages that is spent on alcoholic beverages} \times \text{average percentage of amount spent on alcoholic beverages that is spent on beer} \times \text{expected percentage of amount spent on beer that will be spent on light beer}
\]

#### 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
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 several methods: surveys of buyer’s intentions, composites of sales force opinion, and expert opinion. Building a forecast on what people do involves another method, putting the product into a test market to measure buyer responses. 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?**

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 a current and prospective customer will buy of each of the company’s products.

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


3. From *Consumer Europe 1993*, a publication of Euromonitor, pnc. London: Tel +44 71 251 8021; U.S. offices: (312) 541-
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.

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.

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 a “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.

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.

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
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, we've never seen a greater polarization of income in the United States. The country is at its most unequal point since the end of World War II. This is leading to a two-tier consumer market, with affluent people buying expensive goods and working-class people buying 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 this trend by tailoring their products and pitches to these two very different Americas stand to gain a lot.26

At Gap’s Banana Republic stores, jeans sell for $58. Its Old Navy stores sell a version for $22. Both chains are thriving.
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 bedsheds, and animated videos. This downscaled Pooh sells at Wal-Mart and other discount stores.

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 TURAL ENVIRONMENT**

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
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. 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.

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 pres-
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:

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 emerged 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 of 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 now maintains 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.

**SOCIAL-CULTURAL ENVIRONMENT**

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.
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.

**Shifts of Secondary Cultural Values Through Time**

Although core values are fairly persistent, cultural shifts 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 yuppies and Gen-Xers’ influence 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.”

**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).
NOTES

Table 2.1

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<th>Stage</th>
<th>Number of Ideas</th>
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<th>Cost per Product Idea</th>
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Estimated Cost of Finding One Successful New Product (Starting with 64 New Ideas)

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

- **Product managers**: Many companies assign responsibility for new-product idea 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 technical 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, these product managers, not 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 approving 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. The innovation process is divided into several stages. At the end of each stage, 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
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 GENERATION

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. Hippe1 has shown that the highest percentage of ideas for new industrial products originate with customers. 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
Green and Wind have illustrated this approach in connection with developing a new spot-removing carpet-cleaning agent for home use. 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 packaging as the most important attributes followed by money-back guarantee, and last, a Good Housekeeping seal.

When preference data are collected from a sufficient sample of target consumers, it can be used to estimate the share any specific offer is likely to achieve, given any assumptions about competitive response. The company, however, may not launch the most customer-appealing offer if it is not also 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.

**MARKETING STRATEGIES**

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...
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<th>Year 0</th>
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<td>Row 4 shows anticipated development costs of $3.5 million, including product-development cost, marketing research costs, and manufacturing-development costs.</td>
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<td>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 people force coverage and marketing administration.</td>
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<td>Row 6 shows the allocated overhead to this new product over its share of the cost of executive salaries, heat, light, and so on.</td>
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<td>Row 7, the gross contribution, is found by subtracting the preceding three costs from the gross margin.</td>
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<td>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. Drastic revenue 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 caused from adding this product to the line. Table 2.3 assumes no supplementary contributions.</td>
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<td>Row 9 shows the net contribution, which in this case is the same as the gross contribution.</td>
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<td>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.</td>
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<td>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.</td>
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<td>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.</td>
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| 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.\textsuperscript{21}

\section*{Managing the Development Process: Development to Commercialization}

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 \textit{quality function deployment} (QFD). The methodology takes the list of desired \textit{customer attributes} (CAs) generated by market research and transforms them into a list of \textit{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). 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.\textsuperscript{22}

The R\&D department will develop one or more physical versions of the product concept. It must produce 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.

\begin{itemize}
  \item \textbf{Boeing}  
  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.\textsuperscript{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
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:

**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*.**

**When (Timing)**

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

1. **First entry:** The firm entering a market usually enjoys the “first mover advantages” of locking up key 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.

**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. 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.
Business marketers normally deal with far fewer buyers than do consumer marketers. Major companies are big customers in industries such as aircraft engines and defense weapons.

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.

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.

Demand for business goods is derived from demand for consumer goods, so business marketers must monitor the buying patterns of ultimate consumers.

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.

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.

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.

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.

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.
➤ *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. 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 communication to reach hidden buying influences and keep their current customers sold.

Furthermore, the buying center can change rapidly, 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 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. 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.”
als, when a machine breaks down and needs new parts, when purchased material turns out to be unsatisfactory, 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.
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, brand ratings, product usage patterns, attitudes toward the product category, and respondents' demographics, geographics, psychographics, and mediographics.

2. **Analysis stage.** The researcher applies factor analysis to the data to remove highly correlated attributes and 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: 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 mediographics to be analyzed and addressed through marketing programs.

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.
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. 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.

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**Table 3.6 Major Segmentation Variables for Business Markets**

<table>
<thead>
<tr>
<th>Demographic</th>
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<tbody>
<tr>
<td>1. <strong>Industry:</strong> Which industries should we serve?</td>
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<tr>
<td>2. <strong>Company size:</strong> What size companies should we serve?</td>
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<tr>
<td>3. <strong>Location:</strong> What geographical areas should we serve?</td>
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<tr>
<th>Operating Variables</th>
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<tr>
<td>4. <strong>Technology:</strong> What customer technologies should we focus on?</td>
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<tr>
<td>5. <strong>User or nonuser status:</strong> Should we serve heavy users, medium users, light users, or nonusers?</td>
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<td>6. <strong>Customer capabilities:</strong> Should we serve customers needing many or fewer services?</td>
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<th>Purchasing Approaches</th>
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<tr>
<td>7. <strong>Purchasing-function organization:</strong> Should we serve companies with highly centralized or decentralized purchasing organizations?</td>
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<tr>
<td>8. <strong>Power structure:</strong> Should we serve companies that are engineering dominated, financially dominated, and so on?</td>
</tr>
<tr>
<td>9. <strong>Nature of existing relationships:</strong> Should we serve companies with which we have strong relationships or simply go after the most profitable companies?</td>
</tr>
<tr>
<td>10. <strong>General purchase policies:</strong> Should we serve companies that prefer leasing? Service contracts? Systems purchase? Sealed bidding?</td>
</tr>
<tr>
<td>11. <strong>Purchasing criteria:</strong> Should we serve companies that are seeking quality? Service? Price?</td>
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<tr>
<th>Situational Factors</th>
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<tr>
<td>12. <strong>Urgency:</strong> Should we serve companies that need quick and sudden delivery or service?</td>
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<tr>
<td>13. <strong>Specific application:</strong> Should we focus on certain applications of our product rather than all applications?</td>
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<tr>
<td>14. <strong>Size of order:</strong> Should we focus on large or small orders?</td>
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<th>Personal Characteristics</th>
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<tr>
<td>15. <strong>Buyer–seller similarity:</strong> Should we serve companies whose people and values are similar to ours?</td>
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<tr>
<td>16. <strong>Attitudes toward risk:</strong> Should we serve risk-taking or risk-avoiding customers?</td>
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<tr>
<td>17. <strong>Loyalty:</strong> Should we serve companies that show high loyalty to their suppliers?</td>
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**Source:** Adapted from Thomas V. Bonoma and Benson P. Shapiro, *Segmenting the Industrial Market* (Lexington, MA: Lexington Books, 1983).
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 sends 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 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 see 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-
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.
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 place 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
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 stagnate 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](image)

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**Figure 3-11** Sales and Profit Life Cycles
Differentiation and Positioning Strategy

➤ 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. 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. 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 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.

➤ Maintenance and repair describes the service program for helping customers keep purchased products in good working order, an important consideration for many products.
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 process, 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. The major risk of this two-way stretch is that some customers 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: *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.
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. 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 high 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. Therefore, the fundamental asset underlying brand equity is customer equity. This suggests that the proper focus of marketing planning is that of customer equity 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.

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,
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 flavors of 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. On the downside, extensions may lead to the brand name losing its specific meaning; Ries and Trout call this the “line-extension trap.” 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.
Marketing Strategies for Service Firms

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
service providers must deliver services that are “high touch” as well as “high tech.”

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.

In some cases, customers cannot judge the technical quality of a service even after they have received it, as shown in Figure 4-6. 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.

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 4-5 Three Types of Marketing in Service Industries
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 services when they could save money by trading online. 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 Gibraltar 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:
the market; even A will consider leaving. Then TI will pick up the business that would have gone to B (and possibly A). For example, 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, cutting its profits even further to a price of $9. TI has used this aggressive pricing 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.
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).

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 an instant price comparison on specific products, while Web sites such as Priceline 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.

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 more 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-line 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.
Reactions to Price Changes

Any price change can provoke a response from the firm’s stakeholders. Savvy marketers pay close attention to customers’ reactions, because customers often question the motivation behind price changes. Customers are most price sensitive to products that cost a lot or are bought frequently; they hardly notice higher prices on low-cost items that they buy infrequently. Some buyers are less concerned with price than with the total costs of obtaining, operating, and servicing the product over its lifetime. So a seller can charge more and maintain sales if customers are convinced that total lifetime costs are lower.

Competitors are most likely to react to a price change when there are few firms offering the product, the product is homogeneous, and buyers are highly informed. Anticipating competitive reaction is complicated because each rival may have different interpretations of a company’s price cut: One may think the company is trying to steal the market, while another may believe that the company wants the entire industry to reduce prices to stimulate total demand. Still, a firm will be unable to interpret competitors’ price changes or other marketing-mix adjustments unless it continuously monitors and analyzes its rivals’ activities.

Responding to Competitors’ Price Changes

How should a firm respond to a price cut initiated by a competitor? In markets characterized by high product homogeneity, the firm should search for ways to enhance its augmented product; if it cannot find any, it will have to meet the price reduction. If the company raises its price in a homogeneous product market, the other firms will often not match it, unless the price increase will benefit the industry as a whole. If not matching, the leader will have to rescind the increase.

In nonhomogeneous product markets, a firm has more latitude to consider the following questions: (1) Why did the competitor change the price? Is it to steal the market, to use excess capacity, to meet changing cost conditions, or to lead an industrywide price change? (2) Does the competitor plan to make the price change temporary or permanent? (3) What will happen to the company’s market share and profits if it does not respond? Are other companies going to respond? (4) What are the competitor’s and other firms’ responses likely to be to each possible reaction?

Market leaders often face aggressive price cutting by smaller competitors trying to build market share, the way Amazon.com has attacked Barnes and Noble. The brand leader can respond by:

- **Maintaining price and profit margin**, believing that (1) it would lose too much profit if it reduced its price, (2) it would not lose much market share, and (3) it could regain market share when necessary. However, the risk is that the attacker may get more confident, the leader’s sales force may get demoralized, and the leader can lose more share than expected. Then the leader may panic, lower price to regain share, and find that regaining market share is more difficult and costly than expected.

- **Maintaining price while adding value** to its product, services, and communications. This may be less expensive than cutting price and operating at a lower margin.

- **Reducing price** to match the competitor’s price, because (1) its costs fall with volume, (2) it would lose market share in a price-sensitive market, and (3) it would be hard to rebuild market share once it is lost, even though this will cut short-term profits.

- **Increasing price and improving quality** by introducing a new product to bracket the attacking brand.
Adding or dropping an individual channel member requires an incremental analysis to determine what the firm's profits would be with and without this intermediary. Sometimes a producer considers dropping all intermediaries whose sales are below a certain amount. For example, Navistar noted at one time that 5 percent of its dealers sold fewer than 10 to 15 trucks a year. It cost the company more to service these dealers than their sales were worth. But dropping these dealers could have system-wide repercussions. The unit costs of producing trucks would be higher because the overhead would be spread over fewer trucks, some employees and equipment would be idled, some business in these markets would go to competitors, and other dealers might become insecure. All of these factors have to be taken into account when changing channel arrangements.

The most difficult decision involves revising the overall channel strategy. Distribution channels can become outmoded over time, as a gap arises between the existing distribution system and the ideal system that would satisfy target customers' (and producers') requirements. Examples abound: Avon's door-to-door system for selling cosmetics had to be modified as more women entered the workforce, and IBM's exclusive reliance on a field sales force had to be modified with the introduction of low-priced personal computers. Dell Computer started out selling PCs by mail to consumers and businesses, briefly added retail stores as part of an expansion strategy, then cut out store distribution in favor of the Internet (www.dell.com), a direct channel where customers could more easily order customized PCs.

CHANNEL DYNAMICS

In the ever-changing marketing environment, distribution channels do not stand still. New wholesaling and retailing institutions emerge, and new channel systems evolve. We look next at the recent growth of vertical, horizontal, and multichannel marketing systems and see how these systems cooperate, conflict, and compete.
We will address the following questions:

- What are the major steps in developing effective marketing communications?
- What steps are involved in developing an advertising program?
- What explains the growth in use of sales promotion, and how are sales-promotion decisions made?
- How can companies exploit the marketing potential of public relations and publicity?

Modern marketing calls for more than developing a good product, pricing it attractively, and making it accessible. Companies must also communicate with present and potential stakeholders as well as the general public. For most companies, the question is not whether to communicate but rather what to say, to whom, and how often.

The marketing communications mix consists of advertising, sales promotion, public relations and publicity, personal selling, and direct marketing, although savvy marketers know that communication goes beyond these five methods. The product’s styling and price, the package’s shape and color, the salesperson’s manner and dress, the place’s decor—all communicate something to buyers. In fact, every brand contact delivers an impression that can affect a customer’s view of the company. Therefore, the entire marketing mix must be integrated to deliver a consistent message and strategic positioning.

We first explore effective marketing communications and the communications mix, and then look more closely at advertising, sales promotion, and public relations.
Promotional Tools
Each promotional tool has its own unique characteristics and costs.12

➤ Advertising. Advertising can be used to build up a long-term image for a product (Coca-Cola ads) or trigger quick sales (a Sears ad for a weekend sale). Advertising can reach geographically dispersed buyers efficiently. Certain forms of advertising (TV advertising) typically require a large budget, whereas other forms (newspaper advertising) can be done on a small budget. We discuss advertising in more detail later in this chapter.

➤ Sales promotion. Although sales-promotion tools—coupons, contests, premiums, and the like—are highly diverse, they offer three distinctive benefits: (1) communication (they gain attention and usually provide information that may lead the consumer to the product); (2) incentive (they incorporate some concession or inducement that gives value to the consumer); and (3) invitation (they include a distinct invitation to engage in the transaction now). Sales promotion can be used for short-run effects such as dramatizing product offers and boosting sales. Later in this chapter we discuss sales promotion in more detail.

➤ Public relations and publicity. The appeal of public relations and publicity is based on three distinctive qualities: (1) high credibility (news stories and features are more authentic and credible than ads); (2) surprise (they put buyers off guard (reach prospects who prefer to avoid salespeople and advertisements); and (3) dramatization (the potential for dramatizing a company or product). This underused technique is examined later in this chapter.

➤ Personal selling. Personal selling has three distinctive qualities: (1) personal confrontation (it involves an immediate and interactive relationship between two or more people); (2) cultivation (it permits all kinds of relationships to spring up, ranging from a matter-of-fact selling relationship to a deep personal friendship); and (3) response (it makes the buyer feel under some obligation for having listened to the sales talk).

➤ Direct marketing. All forms of direct marketing—direct mail, telemarketing, Internet marketing—share four distinctive characteristics: They are (1) nonpublic (the message is normally addressed to a specific person); (2) customized (the message can be prepared to appeal to the addressed individual); (3) up-to-date (a message can be prepared very quickly); and (4) interactive (the message can be changed depending on the person’s response).

Factors in Setting the Marketing Communications Mix
Companies must consider several factors in developing their promotion mix:

➤ Type of product market. As Figure 5-6 shows, promotional allocations vary between consumer and business markets. Although advertising is used less than sales calls in business markets, it still plays a significant role in building awareness and comprehension, serving as an efficient reminder of the product, generating leads, legitimizing the company and products, and reassuring customers about their purchases. Personal selling can also make a strong contribution in consumer-goods marketing by helping to persuade dealers to take more stock and display more of the product, build dealer enthusiasm, sign up more dealers, and grow sales at existing accounts.

➤ Push-versus-pull strategy. A push strategy involves the manufacturer using sales force and trade promotion to induce intermediaries to carry, promote, and sell the product to end users. This is especially appropriate where there is low brand loyalty.
Developing Effective Marketing Communications

in a category; brand choice is made in the store; the product is an impulse item; and product benefits are well understood. A **pull strategy** involves the manufacturer using advertising and consumer promotion to induce consumers to ask intermediaries for the product; thus, making the intermediaries to order it. This is especially appropriate when there is high brand loyalty and high involvement in the category; people perceive differences between brands, and people choose the brand before they go to the store.

**Buyer-readiness stage.** Promotional tools vary in cost effectiveness at different stages of buyer readiness, as shown in Figure 5-7. Advertising and publicity play the most important roles in the awareness-building stage. Customer comprehension is affected primarily by advertising and personal selling, while customer conviction is influenced mostly by personal selling. Closing the sale is influenced mostly by personal selling and sales promotion. Reordering is also affected mostly by personal selling and sales promotion, and somewhat by reminder advertising.

**Product-life cycle stage.** Promotional tools also vary in cost effectiveness at different stages of the product life cycle. Advertising and publicity are most cost effective in the introduction stage; then all the tools can be toned down in the growth stage because demand is building word of mouth. Sales promotion, advertising, and personal selling grow more important in the maturity stage. In the decline stage, sales promotion continues strong, advertising and publicity are reduced, and salespeople give the product only minimal attention.

**Company market rank.** Market leaders derive more benefit from advertising than from sales promotion. Conversely, smaller competitors gain more by using sales promotion in their marketing communications mix.

**Step 7: Measuring Results**

After implementing the promotional plan, the communicator must measure its impact. Members of the target audience are asked whether they recognize or recall the message, how many times they saw it, what points they recall, how they felt about the message, and their previous and current attitudes toward the product.
the message. Any message can be presented in a number of execution styles: slice of life, lifestyle, fantasy, mood or image, musical, personality symbol, technical expertise, scientific evidence, and testimonial. For example, testimonial advertising is used by Rogaine extra-strength for men, which promises to grow back more hair than does its predecessor. Rogaine television ads feature noted sports figures such as Utah Jazz basketball star Karl Malone delivering testimonials; in the ads, Malone says he got good results after using the product for 5 months.22

The actual words in an ad must be memorable and attention-getting to make an impression on the audience. The following ad themes (column on left) would have had much less impact without the creative phrasing (column on right):

<table>
<thead>
<tr>
<th>Theme</th>
<th>Creative Copy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Milk is good for you.</td>
<td>Got milk? (Milk industry)</td>
</tr>
<tr>
<td>Our technology can help you do almost anything.</td>
<td>Where do you want to go today?</td>
</tr>
<tr>
<td>No hard sell, just a good car.</td>
<td>Drivers wanted (Volkswagen)</td>
</tr>
<tr>
<td>You set the price instead of paying the regular price.</td>
<td>Name your own price. (Priceline.com)</td>
</tr>
</tbody>
</table>

Format elements such as ad size, color, and illustration can affect an ad’s impact as well as its cost. Yet a minor rearrangement of mechanical elements can improve attention-getting power. Larger-size ads get more attention, though not necessarily by as much as their difference in cost. Four-color illustrations increase ad effectiveness as well as ad cost. Still, carefully planning the relative dominance of different elements can help clients achieve better message delivery.

Social Responsibility Review

Advertisers and their agencies must be sure their “creative” advertising does not overstep social and legal norms. Most marketers work hard to communicate openly and honestly with consumers. Still, abuses occur, and public policymakers have developed a substantial body of laws and regulations to govern advertising. Under U.S. law, for example, companies must avoid false or deceptive advertising. Also, sellers are legally obligated to avoid bait-and-switch advertising that attracts buyers under false pretenses.23 And, to be socially responsible, advertisers must be careful not to offend ethnic groups, racial minorities, or special-interest groups. For instance, a commercial for Black Flag insecticide was altered after a veterans group protested the playing of Taps over dead bugs.24

Some companies have begun building ad campaigns on a platform of social responsibility. Look at Ethical Funds, a Canadian mutual fund firm that will not invest in corporations that are involved in the production of military weapons, tobacco, nuclear power, and those with unfair employment practices, poor environmental records, or companies that support reactionary political regimes. One Ethical Funds ad shows scenes of child labor and people dying from cancer, presumably caused by smoking, then asks, “Do you know where your money goes?” Ethical Funds has grown from $100 million in assets to more than $2 billion over the last decade.25

Developing Media Strategies

After choosing the message, the next task is to choose media to carry it. The steps here are deciding on desired reach, frequency, and impact; choosing among major media types; selecting specific media vehicles; deciding on media timing; and deciding on geographical media allocation.
10. Michael Cafferky has identified four kinds of people that companies try to reach to stimulate word-of-mouth referrals: opinion leaders, marketing mavens, influential, and product enthusiasts. For more, see *Let Your Customers Do the Talking* (Chicago: Dearborn Financial Publishing, 1995), pp. 30–33.
15. The definitions of advertising, sales promotion, and public relations are adapted from Peter D. Bennett, ed., *Dictionary of Marketing Terms* (Chicago: American Marketing Association, 1995).
23. For further reading, see Dorothy Cohen, *Legal Issues in Marketing Decision Making* (Cincinnati, OH: South-Western, 1995).
25. Adapted from Sandra Cordon, “Where High Road Meets Bottom Line: Ethical Mutual Funds Avoid Companies Deemed Socially Irresponsible,” *The London Free Press*, October 9,
Theme

7-Up is not a cola.
Let us drive you in our bus instead of driving your car.
Shop by turning the pages of the telephone directory.
We don’t rent as many cars, so we have to do more for our customers.
Red Roof Inns offer inexpensive lodging.

Creativity is especially required for headlines. There are six basic types of headlines: news (“New Boom and More Inflation Ahead . . . and What You Can Do About It”); question (“Have You Had It Lately?”); narrative (“They Laughed When I Sat Down at the Piano, but Then I Started to Play!”); command (“Don’t Buy Until You Try All Three”); 1-2-3 ways (“12 Ways to Save on Your Income Tax”); and how-what-why (“Why They Can’t Stop Buying”).

Creative Copy

“The Un-Cola.”
“Take the bus, and leave the driving to us.”
“Let your fingers do the walking.”
“We try harder.”
“Sleep cheap at Red Roof Inns.”

Format elements such as ad size, color, and illustration will affect an ad’s impact as well as its cost. A minor rearrangement of mechanical elements can improve attention-getting power. Larger-size ads gain more attention, though not necessarily by as much as their difference in cost. Four-color illustrations increase ad effectiveness and ad cost. By planning the relative dominance of different elements, better delivery can be achieved. New electronic eye movement studies show that consumers can be led through an ad by strategic placement of dominant elements.

A number of researchers into print advertisements report that the picture, headline, and copy are important, in that order. The reader first notices the picture, and it must be strong enough to draw attention. Then the headline must propel the person to read the copy. The copy itself must be well composed. Even then, a really outstand-
For Print Ads.

For Broadcast Ads. In-home tests:

Trailer tests:

Theatre tests:

On-air tests:

![Table 5.8](image)

Advertising Research Techniques

| noted, |
| seen or associated, |
| read most, |

blood pressure, pupil dilation, perspiration — to an ad. These tests measure attention-getting power but reveal little about impact on beliefs, attitudes, or intentions. Table 5.8 describes some specific advertising research techniques.

Haley, Carlin, and Fox argue that current copy-testing methods have become overly linear and well-established. It is easy to overlook their sizable limitations. These methods are not excessively rational and verbal, and to rely primarily on respondents’ playback in one form or another. They argue that marketers need to take more account of ads’ nonverbal elements, which can be very strong influences on behavior.33

Advertisers are also interested in posttesting the overall communication impact of a completed campaign. If a company hoped to increase brand awareness from 20 percent to 50 percent and succeeded in increasing it to only 30 percent, then the company is not spending enough, its ads are poor, or some other factor has been ignored.

Sales-Effect Research

What sales are generated by an ad that increases brand awareness by 20 percent and brand preference by 10 percent? Advertising’s sales effect is generally harder to measure than its communication effect. Sales are influenced by many factors, such as the product’s features, price, and availability, as well as competitors’ actions. The fewer or more controllable these other factors are, the easier it is to measure effect on sales. The sales impact is easiest to measure in direct-marketing situations and hardest to measure in brand or corporate-image-building advertising.

Companies are generally interested in finding out whether they are overspending or underspending on advertising. One approach to answering this question is to work with the formulation shown in Figure 5-14.

A company’s share of advertising expenditures produces a share of voice that earns a share of consumers’ minds and hearts and ultimately a share of market. Peckham studied the relationship between share of voice and share of market for several consumer products over a number of years and found a 1-to-1 ratio for established
information and communications to build goodwill. When negative publicity happens, the PR department acts as a troubleshooter. The best PR departments spend time counseling top management to adopt positive programs and to eliminate questionable practices so that negative publicity does not arise in the first place. They perform the following five functions:

1. **Press relations**: Presenting news and information about the organization in the most positive light.
2. **Product publicity**: Sponsoring efforts to publicize specific products.
3. **Corporate communication**: Promoting understanding of the organization through internal and external communications.
4. **Lobbying**: Dealing with legislators and government officials to promote or defeat legislation and regulation.
5. **Counseling**: Advising management about public issues and company positions and image. This includes advising in the event of a product mishap.

**MARKETING PUBLIC RELATIONS**

Marketing managers and PR specialists do not always talk the same language. Marketing managers are much more bottom-line oriented, whereas PR practitioners see their job as preparing and disseminating communications. But these differences are disappearing. Many companies are turning to *marketing public relations* (MPR) to directly support corporate or product promotion and image making. Thus MPR, like financial PR and community PR, serves a special constituency, namely the marketing department.

The old name for MPR was *publicity*, which was seen as the task of securing editorial space—as opposed to paid space—in print and broadcast media to promote or “hype” a product, service, or person, or organization. But MPR goes beyond simple publicity and plays an important role in the following tasks:

- **Assisting in the launch of new products**: The amazing commercial success of toys such as Teenage Mutant Ninja Turtles, Mighty Morphin’ Power Rangers, and Beanie Babies owes a great deal to clever publicity.
- **Assisting in repositioning a mature product**: New York City had extremely bad press in the 1970s until the “I Love New York” campaign began.
- **Building interest in a product category**: Companies and trade associations have used MPR to rebuild interest in declining commodities such as eggs, milk, beef, and potatoes and to expand consumption of such products as tea, pork, and orange juice.
- **Influencing specific target groups**: McDonald’s sponsors special neighborhood events in Latino and African American communities to build goodwill.
- **Defending products that have encountered public problems**: Johnson & Johnson’s masterly use of MPR was a major factor in saving Tylenol from extinction following two incidents in which poison-tainted Tylenol capsules were found.
- **Building the corporate image in a way that reflects favorably on its products**: Iacocca’s speeches and his autobiography created a whole new winning image for the Chrysler Corporation.

As the power of mass advertising weakens, marketing managers are turning more to MPR. In a survey of 286 U.S. marketing managers, three-fourths reported that their companies used MPR. They found it particularly effective in building awareness and brand knowledge, for both new and established products. MPR is also effective in blanketing local communities and reaching specific ethnic and other groups. In several cases, MPR proved more cost effective than advertising. Nevertheless, it must be planned jointly with advertising. MPR needs a larger budget, and the money might have to come from advertising. In addition, marketing managers need to acquire more skill in using PR resources. Gillette is a trendsetter here: Each brand manager is required to have a budget line for MPR and to justify not using it.
which has 105 global staff members, has emerged as the first truly global sports league. NBA games are televised everywhere, global sponsors have signed up, and the league and its partners have sold nearly $500 million of NBA-licensed basketballs, backboards, T-shirts, and caps outside the United States.\(^4\)

**DECIDING WHETHER TO GO ABROAD**

Most companies would prefer to remain domestic if their domestic market were large enough. Managers would not need to learn other languages and laws, deal with volatile currencies, face political and legal uncertainties, or redesign their products to suit different customer needs and expectations. Business would be easier and safer.

Yet several factors are drawing more and more companies into the international arena:

- Global firms offering better products or lower prices can attack the company’s domestic market. The company might want to counterattack these competitors in their home markets.
- The company discovers that some foreign markets present higher profit opportunities than the domestic market.
- The company needs a larger customer base to achieve economies of scale.
- The company wants to reduce its dependence on any one market.
- The company’s customers are going abroad and require international services.

Before making a decision to go abroad, the company must weigh these risks:

- The company might not understand foreign customer preferences and fail to offer a competitively attractive product. (Figure 6.1 lists some famous blunders in this arena).
- The company might not understand the foreign country’s business culture or know how to deal effectively with local nationals. Table 6.1 lists some of the many challenges.

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**Figure 6-1**

Major Decisions in International Marketing

**Table 6.1**

Blunders in International Marketing

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Because of the competing advantages and risks, companies often do not act until some event thrusts them into the international arena. Someone—a domestic exporter, a foreign importer, a foreign government—solicits the company to sell abroad. Or the company is saddled with overcapacity and must find additional markets for its goods.

DECIDING WHICH MARKETS TO ENTER

In deciding to go abroad, the company needs to define its international marketing objectives and policies. What proportion of foreign to total sales will it seek? Most companies start small when they venture abroad. Some plan to stay small. Others have bigger plans, believing that their foreign business will eventually be equal to, or even more important than, their domestic business. “Going abroad” on the Internet poses special challenges; see the Marketing for the Millennium box, “WWW.TheWorldIsYourOyster.com: The Ins and Outs of Global E-Commerce.”

The company must decide whether to market in a few countries or many countries and determine how fast to expand. Consider Tyco:

- Tyco Toys Inc. began expanding into Europe in 1990, a slew of acquisitions and best-sellers at home had propelled the company to fourth place among U.S. toy makers, from twenty-second place only four years before. Yet non-U.S. sales still accounted for only 13 percent of total sales, and the company’s rivals had significant overseas sales. Tyco wanted to close the gap quickly and better serve global-minded retailers such as Toys “R” Us. The initial plan was to open one European subsidiary a year, with each expected to turn a profit 12 months later. But the company then speeded up the pace by starting subsidiaries in Italy, Spain, Germany, and Belgium all in one year. Tyco also bought Universal Matchbox Group Ltd., a major Hong Kong producer of die-cast toy vehicles. Tyco’s unusual push abroad, coupled with a domestic sales slump, soon strained the limits of its senior executives, who knew little about running a far-flung empire. In its 1995 annual report, the company reported its third consecutive year of net losses, mainly from Europe. To cut its losses, Tyco ended up liquidating the Italian subsidiary, merging operations in three other countries, and dismissing one-third of its European staff.

In contrast, consider Amway’s experience:

- Known for its neighbor-to-neighbor direct-selling networks, consumer-product company Amway expanded into Australia in 1971, a country far away from but similar to the U.S. market. In the 1980s, Amway expanded into 10 more countries, and the pace increased rapidly from then on. By 1997, Amway had evolved into a multinational juggernaut with a sales force of 2.5 million hauling in $6.8 billion on doorsteps from Hungary to Malaysia to Brazil. Today, Amway sells products in 43 countries. Its goal: to have overseas markets account for 80 percent of its sales during the next decade. This is not an unrealistic or overly ambitious goal considering that Amway already gains 70 percent of its $6.8 billion from foreign markets.

Generally speaking, it makes sense to operate in fewer countries with a deeper commitment and penetration in each. Ayal and Zif have argued that a company should enter fewer countries when

- Market entry and market control costs are high.
- Product and communication adaptation costs are high.
- Population and income size and growth are high in the initial countries chosen.
- Dominant foreign firms can establish high barriers to entry.

...
channels broadcast by four separate MTV stations: MTV UK, and Northern, Central, and Southern Europe. Each of the four channels shows programs tailored to music tastes of its local market, along with more traditional pan-European pop selections and, of course, a healthy serving of Beavis and Butthead.

Pummeled by dozens of local music channels in Europe, such as Germany's Holland's and Scandinavia's MTV Europe has had to drop its pan-European programming, which featured a large amount of American and British pop along with European favorites. In its place, the division's programming best resembles that of a local music channel.


The front desk was parallel to the doors and road, and this was thought to lead to wealth flowing out. Furthermore, the doors were facing northwest, which easily let undesirable spirits in. The geomancer recommended design alterations so that wealth could be retained and undesirable spirits kept out.23

Product invention consists of creating something new. It can take two forms, Backward invention is reintroducing earlier product forms that are well adapted to a foreign country's needs. The National Cash Register Company reintroduced its crank-operated cash register at half the price of a modern cash register and sold substantial numbers in Latin America and Africa. (This illustrates a good understanding of the international product life cycle, where countries stand at different stages of readiness to adopt a particular product.) Forward invention is creating a new product to meet a need in another country. There is an enormous need in less developed countries for low-cost, high-protein foods. Companies such as Quaker Oats, Swift, and Monsanto are researching these countries' nutrition needs, formulating new foods, and developing advertising campaigns to gain product trial and acceptance. Toyota produces vehicles, such as the Soluna in Thailand and the Toyota Utility Vehicle in Indonesia, the Philippines, and Taiwan, which were specifically designed with the help of local employees to suit the tastes of these markets.24 In globalization's latest
When companies sell their goods abroad, they face a *price escalation* problem. A Gucci handbag may sell for $120 in Italy and $240 in the United States. Why? Gucci has to add the cost of transportation, tariffs, importer margin, wholesaler margin, and retailer margin to its factory price. Depending on these added costs, as well as the currency-fluctuation risk, the product might have to sell for two to five times as much in another country to make the same profit for the manufacturer. Because the cost escalation varies from country to country, the question is how to set the prices in different countries. Companies have three choices:

1. **Setting a uniform price everywhere**: Coca-Cola might want to charge 60 cents for Coke everywhere in the world. But then Coca-Cola would earn quite different profit rates in different countries because of varying escalation costs. Also, this strategy would result in the price being too high in poor countries and not high enough in rich countries.

2. **Setting a market-based price in each country**: Here Coca-Cola would charge what each country could afford. But this strategy ignores differences in the actual cost from country to country. Also, it could lead to a situation in which intermediaries in low-price countries reship their Coca-Cola to high-price countries.

3. **Setting a cost-based price in each country**: Here Coca-Cola would use a standard markup of its costs everywhere. But this strategy might price Coca-Cola out of the market in countries where its costs are high.

Another problem arises when a company sets a *transfer price* (i.e., the price that it charges to another unit in the company) for goods that it ships to its foreign subsidiaries. Consider the following:

Several years ago, the Swiss pharmaceutical company Hoffman-LaRoche charged its Italian subsidiary only $22 a kilo for Librium so that it could report high profits in Italy, where corporate taxes were lower. It charged its British subsidiary more than $100 per kilo for the same Librium so that it could make high profits at home instead of in Britain, where corporate taxes were higher. The British Monopoly Commission sued Hoffman-LaRoche for back taxes and won.

If the company charges too high a price to a subsidiary, it may end up paying higher tariff duties, although it may pay lower income taxes in the foreign country. If the company charges too low a price to its subsidiary, it can be charged with *dumping*. Dumping occurs when a company charges either less than its costs or less than it charges in its home market, in order to enter or win a market. Zenith accused Japanese television manufacturers of dumping their TV sets on the U.S. market. When the U.S. Customs Bureau finds evidence of dumping, it can levy a dumping tariff on the guilty company. Various governments are watching for abuses and often force companies to charge the *arm’s-length price*—that is, the price charged by other competitors for the same or a similar product.

Many multinationals are plagued by the gray-market problem. A *gray market* occurs when the same product sells at different prices geographically. Dealers in the low-price country find ways to sell some of their products in higher-price countries, thus earning more. For example:

Because of lower transportation costs and tariffs, Minolta sold its cameras to dealers in Hong Kong for a lower price than it sold the same cameras to dealers in Germany. The Hong Kong dealers worked on smaller margins than the German retailers, who preferred high markups to high volume. Minolta’s cameras ended up selling at retail for $174 in Hong Kong and $270 in Germany. Some Hong Kong wholesalers noticed this price difference and shipped Minolta cameras to German dealers for less than they were paying the German distributor. The German distributor couldn’t sell his stock and complained to Minolta.
is headed by Goeran Lindahl. The company’s motto is “ABB is a global company local everywhere.” It established English—or “broken English,” as Lindahl says—as the company’s official language (all ABB managers must be conversant in English), and all financial results must be reported in dollars. ABB aims to reconcile three contradictions: to be global and local; to be big and small; and to be radically decentralized with centralized reporting and control. ABB has only 170 staff people at headquarters (with about 19 nationalities among them), compared to the 3,000 who populate Siemens headquarters. The company’s many product lines are organized into 8 business segments, 65 business areas, 1,300 companies, and 5,000 profit centers, with the average employee belonging to a profit center of around 50 employees. Managers are regularly rotated among countries and mixed-nationality teams are encouraged. Depending on the type of business, some are treated as superlocal businesses with lots of autonomy and others as global businesses with major central control.

**SUMMARY**

1. Companies cannot simply stay domestic and expect to maintain their markets. Despite the many challenges in the international arena (shifting borders, unstable governments, foreign-exchange problems, corruption, and technological pirating), companies selling in global industries need to internationalize their operations.

2. In deciding to go abroad, a company needs to define its international marketing objectives and policies. The company must determine whether to market in a few countries or many countries. Then it must decide on which types of countries to consider. In general, the candidate countries should be rated on three criteria: market attractiveness, risk, and competitive advantage.

3. Once a company decides on a particular country, it must determine the best mode of entry. Its broad choices are indirect exporting, direct exporting, licensing, joint ventures, and direct investment. Each succeeding strategy involves more commitment, risk, control, and potential profit. Companies generally begin with indirect exporting, then proceed through later stages as they gain more experience in the international arena.

4. In deciding on the marketing program, a company must decide how much to adapt its marketing mix (product, promotion, price, and place) to local conditions. At the two ends of the spectrum are standardized and adapted marketing mixes, with many steps in between. At the product level, firms can pursue a strategy of straight extension, product adaptation, or product invention. At the promotion level, firms may choose communication adaptation or dual adaptation. At the price level, firms may encounter price escalation and gray markets, and it may be very difficult to set standard prices. At the distribution level, firms need to take a whole-channel view of the challenge of distributing its products to the final users. In creating all elements of the marketing mix, firms must be aware of the cultural, social, political, technological, environmental, and legal limitations they face in other countries.

5. Depending on the level of international involvement, companies manage their international marketing activity in three ways: through export departments, international divisions, or a global organization. Most firms start with an export department and graduate to an international division. A few become global companies in which the top management plans and organizes on a global basis.

**APPLICATIONS**

**CONCEPTS**

1. Because of shrinking domestic markets due to competition, a moderate-size company in the salad-dressing industry is trying to decide “whether to go abroad.”
Global consumers in Asia and Europe are also catching on to the catalog craze. A full 90 percent of L.L. Bean’s international sales, for instance, come from Japan. One reason why Bean and other American catalog firms have flourished in Japan is that they offer high-quality merchandise aimed at specific groups. Consumer catalog companies such as Tiffany & Co., Patagonia, and Eddie Bauer are also entering Europe, as are business catalog firms such as Viking Office Products.10

Of course, by putting their catalogs on the Internet, catalog companies have better access to global consumers than ever before. They also save considerable printing and mailing costs while being able to offer unique services. In its latest attempt to
stores, airports, and other locations. For example, the Florsheim Shoe Company includes a machine in selected stores to allow the customer to indicate the type of shoe he or she wants (dress, sport), along with the color and size. Pictures of Florsheim shoes that meet the criteria appear on the screen. If the particular shoes are not available in that store, the customer can order by dialing an attached phone and typing in a credit-card number and an address where the shoes should be delivered.

MANAGING ELECTRONIC COMMERCE AND ON-LINE MARKETING

Technology is expanding direct marketing into new electronic arenas. Electronic commerce (e-commerce) describes a wide variety of electronic platforms, such as the sending of purchase orders to suppliers via electronic data interchange (EDI); the use of fax and e-mail to conduct transactions; the use of ATMs, electronic point-of-sale terminals, and smart cards to facilitate payment and obtain digital cash; and the use of the Internet and on-line services. All of these involve doing business in a “marketspace” as compared to a physical “marketplace.” Although consumer buying over the Internet is growing rapidly—driven by purchases of computers and related products, books, CDs, and videos—the volume of business Internet transactions is growing even faster: By 2003, U.S. business-to-business e-commerce is projected to reach $1 trillion.

Commercial on-line services offer on-line information and marketing services to paid subscribers. The largest and best known is America Online (AOL), which has 19 million subscribers and holds 50 percent of the market.15 Other on-line services offer proprietary services featuring information (news, libraries, education, travel, sports, reference), entertainment (movies, games), shopping services, dialogue opportunities (bulletin boards, forums, chat rooms), and e-mail capabilities.

The Internet is an international web of computer networks that has made instantaneous and decentralized global communication possible. Internet usage has surged with the development of the user-friendly World Wide Web and browser programs such as Netscape Navigator and Microsoft Internet Explorer. Internet users can now experience fully integrated text, graphics, images, and sound; send e-mail and visit chat rooms to exchange views; shop for products; and find information of all kinds.

To target and reach these Internet users, marketers need to understand the characteristics and behavior of the on-line consumer.

The On-Line Consumer

As a whole, the Internet population is younger, more affluent, and better educated than the general population, with an almost equal number of men and women. But as more people find their way onto the Internet, the cyberspace population is becoming more mainstream and diverse. Internet users in general place greater value on information and tend to respond negatively to messages aimed only at selling. They want to decide what marketing information they will receive about which products and services and under what conditions. In on-line marketing, it is the consumer, not the marketer, who gives permission and controls the interaction.

Internet consumers have around-the-clock access to varied information sources, making them better informed and more discerning shoppers. They can (1) get objective information about multiple brands, including costs, prices, features, and quality, without relying on manufacturers or retailers; (2) initiate requests for advertising and information from manufacturers and retailers; (3) design the offerings they want; and (4) use shopping agents to search for and invite offers from multiple sellers.
Despite the ubiquity of banner ads, the “click-through rate” (the number of users who click on an ad to get more information) has plummeted below 1 percent. However, users who don’t click may still see and absorb the banner ad message, notes Christopher Escher of Talk City (www.talkcity.com), an on-line community site: “Our focus groups tell us that people see our banner ads. Sometimes they click. Sometimes they don’t. But the banner ads make them more likely to visit at another time.”

Accustomed to measurement techniques for traditional media, advertisers want better measures of on-line advertising impact. For now, Web advertising is playing a supporting role in the promotion mixes of most advertisers.

Forums, Newsgroups, Bulletin Boards, and Web Communities
On-line buyers increasingly create product information, not just consume it. They participate in Internet interest groups to share product-related information, with the result that “word of Web” is joining “word of mouth” as an important buying influence. To benefit from this trend, companies may participate in or sponsor Internet forums, newsgroups, and bulletin boards that appeal to special interest groups.

Forums are discussion groups that are usually located on commercial on-line services. A forum may operate a library, a “chat room” for real-time message exchanges, and even a classified ad directory. Some firms are creating proprietary chat rooms where visitors can go to discuss that company’s offerings or interact with customer service reps. IGoGolf.com (www.igogolf.com), for example, made a $12,000 sale after a customer (who logged onto the U.S. site from Egypt) chatted with a customer service rep who recommended the right golf equipment.

Newsgroups, the Internet version of forums, are limited to people who post and read messages on a specified topic. Thousands of newsgroups deal with every imaginable topic: healthy eating, caring for Bonsai trees, exchanging views about the latest soap opera happenings.

Bulletin board systems (BBSs) are specialized on-line services that center on a specific topic or group. Over 60,000 BBSs deal with numerous topics, such as vacations and hobbies. Marketers that participate in newsgroups and BBSs must take care to avoid a commercial tone in their messages.

Web communities are commercially sponsored Web sites where members congregate on-line and exchange views on issues of common interest. One such community is Agriculture Online (www.agriculture.com), where farmers and others can find commodity prices, recent farm news, and chat rooms of all types.

E-mail
The most targeted method a company can use to communicate directly with prospects and customers is via e-mail. Using inbound e-mail, the firm can invite people to e-mail the firm with questions, suggestions, and even complaints so customer service reps can respond and cultivate the relationship. E-savvy companies also develop Internet-based electronic mailing lists for outbound e-mail, sending out customer newsletters, special product or promotion offers based on purchasing histories, reminders of service requirements or warranty renewals, and announcements of special events.

However, in using e-mail as a direct-marketing vehicle, companies must be extra careful not to develop a reputation as a “spammer.” Spam is the term for unsolicited e-mail. Consumers who are accustomed to receiving junk mail in their real mailboxes are often enraged to find unsolicited marketing pitches in their e-mail boxes. In fact, several states, as well as the federal government, have proposed legislation to limit or prohibit spam broadcasting.
Despite the possibility of being perceived as a spammer, savvy marketers are racing to take advantage of the potential of e-mail marketing. One effective approach is permission-based marketing, a term coined by Seth Godin to describe the e-mail marketing model in which marketers ask for the customer's permission before sending e-mail offers. Amazon.com, for instance, invites customers to receive free newsletters with editors' recommendations for books in specific categories such as business and cooking. Targeted “opt-in marketing messages” are an increasingly important part of online marketing strategy because they can yield impressive response rates of 18–25 percent, compared with the average banner ad’s response rate of 1 percent (or less).

The Promise and Challenges of On-Line Marketing

On-line marketing is bringing profound changes to various sectors of the economy. Consumers’ ability to order direct threatens to seriously hurt certain groups, particularly travel agents, stockbrokers, insurance salespeople, car dealers, and bookstore owners. These middlemen will be disintermediated by on-line services. At the same time, some reintermediation will take place in the form of new on-line intermediaries, called infomediaries, which help consumers shop more easily and obtain lower prices.

Consider mySimon (www.mysimon.com), which acts as an intelligent shopping agent for consumers looking for the best buys in categories such as electronics and computers. A shopper seeking a digital camera can go to mySimon, click on cameras, then digital cameras, scan the listing of makes and models, and locate the merchant offering a particular camera at the lowest price. DealPilot (www.dealpilot.com) helps buyers compare prices of books, videos, DVDs, and CDs, while Point.com (www.point.com) helps buyers compare cellular phone service offerings.

Among other changes, Quelch and Klein believe that the Internet will lead to the more rapid internationalization of small- to medium-size enterprises. The advantages of scale economies will be reduced, global advertising costs will be less, and smaller enterprises offering specialized products will be able to reach a much larger world market.

At the same time, on-line marketers continue to face a number of challenges:

- **Encouraging more buying:** The major on-line buyers today are businesses rather than individual consumers. Web marketers such as Priceline.com (www.priceline.com) are among the many sites using techniques such as special pricing to encourage more consumers to buy on-line. At auction sites such as eBay (www.ebay.com), many buyers return because they like bidding for what they want and getting a bargain.

- **Skewed user demographics and psychographics:** On-line users are more upscale, younger, and more Web-savvy than the general population, making them ideal prospects for computers, electronics, and financial services. The challenge now is to expand the on-line market and find ways of reaching diverse targeted segments. Eyeing the assets of younger, wealthier investors who frequent on-line brokerage firms, for example, Charles Schwab (www.schwab.com) acquired U.S. Trust so it could offer a wider range of services, such as private banking, to this attractive segment.

- **Chaos and clutter:** The Internet offers millions of Web sites and a staggering volume of information. Navigating the Web can be frustrating. Many sites go unnoticed and even visited sites must capture visitors’ attention within 8 seconds or lose them to another site.

- **Security:** Consumers worry about the security of credit-card numbers and other data sent to Internet sites, while companies worry about systems espionage or sabotage. The Internet is becoming more secure, but the race continues between new security
Managing the Total Marketing Effort

The marketing organization will have to redefine its role from managing customer interactions to integrating all the company's customer-facing processes.

We will answer the following questions:

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characterized by deep rivalries and distrust. Some interdepartmental conflict stems from differences of opinion as to what is in the company’s best interests, some from real trade-offs between departmental well-being and company well-being, and some from unfortunate stereotypes and prejudices.

In the typical organization, each business function has a potential impact on customer satisfaction. Under the marketing concept, all departments need to “think customer” and work together to satisfy customer needs and expectations. The marketing department must drive this point home. The marketing vice president has two tasks: (1) to coordinate the company’s internal marketing activities and (2) to coordinate marketing with finance, operations, and other company functions to serve the customer.

Yet there is little agreement on how much influence and authority marketing should have over other departments. Typically, the marketing vice president must work through persuasion rather than authority. Other departments often resist bending their efforts to meet the customers’ interests. Inevitably, departments define company problems and goals from their viewpoint. As a result, conflicts of interest are unavoidable. We will briefly examine the typical concerns of each department.

**R&D**

The company’s drive for successful new products is often thwarted by weak working relations between R&D and marketing. In many ways, these groups have different cultures. R&D is staffed with scientists and technicians who pride themselves on scientific curiosity and detachment, like to work on challenging technical problems without much concern for immediate sales payoffs, and prefer to work without much supervision or accountability. The marketing—sales department is staffed with business-oriented people who pride themselves on a practical understanding of the marketplace, like to see many new products with promotable sales features, and feel compelled to pay attention to their costs. Marketers see the R&D people as maximizing technical quality at the expense of designing for customer requirements. R&D people see marketers as gimmick-oriented shucksters who are more interested in sales than in the product’s technical feasibility.

A balanced company is one in which R&D and marketing share responsibility for successful market-oriented innovation. The R&D staff must take responsibility not only for innovation but also for a successful product launch. The marketing staff must take responsibility not only for new sales features but also for correctly identifying customer needs and preferences.

Gupta, Raj, and Wilemon concluded that a balanced R&D—marketing coordination is strongly correlated with innovation success. R&D—marketing cooperation can be facilitated in several ways:

- Sponsor joint seminars to build understanding and respect for each other’s goals, working styles, and problems.
- Assign each new project to functional teams including an R&D person and a marketing person, who work together through the project’s life. R&D and marketing jointly establish the development goals and marketing plan.
- Encourage R&D participation into the selling period, including involvement in preparing technical manuals, participating in trade shows, carrying out post-introduction marketing research with customers, and even doing some selling.
- Work out conflicts by going to higher management, following a clear procedure. In one company, R&D and marketing both report to the same vice president.

Merck is a company that recognizes the strong connection between marketing and R&D:

- **Merck** The description on its Web site reveals the close relationship of Merck’s departments: “Merck is a worldwide research-intensive company that discovers and develops, manufactures and markets human and animal health products and services.” The research focus at Merck is on the development of prescription drugs—Merck is the world’s largest seller of these products—
Sales Analysis

Sales analysis consists of measuring and evaluating actual sales in relation to sales goals. Two specific tools are used in sales analysis.

Sales-variance analysis measures the relative contribution of different factors to a gap in sales performance. Suppose the annual plan called for selling 4,000 widgets in the first quarter at $1 per widget, for total revenue of $4,000. At quarter’s end, only 3,000 widgets were sold at $.80 per widget, for total revenue of $2,400. The sales performance variance is $1,600, or 40 percent of expected sales. How much of this underperformance is due to the price decline and how much to the volume decline? The following calculation answers this question:

\[
\text{Variance due to price decline} = \frac{1,000}{4,000 - 3,000} = \$600 \quad 37.5\% \\
\text{Variance due to volume decline} = \frac{1,000}{4,000 - 3,000} = \$1,000 \quad 62.5\% \\
\text{Total Variance} = \$1,600 \quad 100.0\%
\]

Almost two-thirds of the variance is due to failure to achieve the volume target. The company should look closely at why it failed to achieve expected sales volume.

Microsales analysis looks at specific products, territories, and so forth that failed to produce expected sales. Suppose the company sells in three territories and expected sales were 1,500 units, 500 units, and 2,000 units, respectively. The actual sales volume was 1,400 units, 525 units, and 1,075 units, respectively. Thus territory 1 showed a 7 percent shortfall in terms of expected sales; territory 2, a 5 percent improvement over expectations; and territory 3, a 46 percent shortfall! Territory 3 is causing most of the trouble. The sales vice president can check into territory 3 to see what explains the poor performance: Territory 3’s sales representative is loafing or has a personal problem; a major competitor has entered this territory; or business is in a recession in this territory.

Market-Share Analysis

Company sales do not reveal how well the company is performing relative to competitors. For this purpose, management needs to track its market share. Market share can be measured in two ways: Overall market share is the company’s sales expressed as a percentage of total market sales. For market share is its sales expressed as a percentage of the total sales to its served market. Its served market is all the buyers who are able and willing to buy its product. Served market share is always larger than overall market share. A company could capture 100 percent of its served market and yet have a relatively small share of the total market. Relative market share can be expressed as market share in relation to its largest competitor. A relative market share over 100 percent indicates a market leader. A relative market share of exactly 100 percent means that the company is tied for the lead. A rise in relative market share means a company is gaining on its leading competitor.

Conclusions from market-share analysis, however, are subject to certain qualifications:

- The assumption that outside forces affect all companies in the same way is often not true: The U.S. Surgeon General’s Report on the harmful consequences of cigarette smoking caused total cigarette sales to falter, but not equally for all companies.
- The assumption that a company’s performance should be judged against the average performance of all companies is not always valid: A company’s performance should be judged against the performance of its closest competitors.
- If a new firm enters the industry, then every existing firm’s market share might fall: A decline in market share might not mean that the company is performing any worse than other companies. Share loss depends on the degree to which the new firm hits the company’s specific markets.
- Sometimes a market-share decline is deliberately engineered to improve profits: For example, management might drop unprofitable customers or products to improve its profits.
Each division of Hewlett-Packard evaluates its performance on a customer-based scorecard that monitors 18 to 20 “business fundamentals.” Some, such as customer satisfaction and on-time delivery, are rated for all divisions; other indicators are tracked according to the nature of the division’s business. The company is thus able to gauge the effects of its marketing strategies on sales and profits and to identify areas where improvements in performance can lead to improved quantitative results.

Focusing on customer-based criteria for evaluating the company’s success was what led to the development of HP’s global account management (GAM) program in the 1990s. As the largest international corporations redirected their purchases of computer-related products and services from the most powerful hardware to the most productive software, and then to the quest for electronic solutions to problems affecting their global business, HP responded by becoming a partner and adviser in problem solving. The GAM system develops a relationship between HP’s top managers and the client corporation. A senior sales executive is assigned as global account manager, providing on-site service at the corporate headquarters of the global account. The customer’s chief information officer provides a broad overview of the company’s needs, and the global account manager helps to develop solutions.

P OFI ABILI CON OL

Here are some disconcerting findings from a bank profitability study:

We have found that anywhere from 20 to 40 percent of an individual institution’s products are unprofitable, and up to 60 percent of their accounts generate losses.

Our research has shown that, in most firms, more than half of all customer relationships are not profitable, and 30 to 40 percent are actually losing money. It is frequently a mere 10 to 15 percent of a firm’s customers that generate the bulk of its profits.

Our profitability research for the branch system of a major U.S. bank produced some surprising results. Only 20 percent of the bank’s branches were unprofitable.

Clearly, it makes sense to measure the profitability of their products, territories, customer groups, segments, types of channels, and order sizes. This information will help management determine whether any products or marketing activities should be expanded, reduced, or eliminated.

**Marketing-Profitability Analysis**

We will illustrate the steps in marketing-profitability analysis with the following example:

The marketing vice president of a lawnmower company wants to determine the profitability of selling its lawnmower through three types of retail channels: hardware stores, garden supply shops, and department stores. The company’s profit-and-loss statement is shown in Table 6.7.

| Table 6.7 |
| A Simplified Profit-and-Loss Statement |
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