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## MASTER OF BUSINESS ADMINISTRATION

### MARKETING MANAGEMENT

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## CHAPTER – I

### THE SCOPE OF MARKETING

Marketing is typically seen as the task of creating, promoting, and delivering goods and services to consumers and businesses. In fact, marketing people are involved in marketing 10 types of entities: goods, services, experiences, events, persons, places, properties, organizations, information, and ideas.

#### Goods

Physical goods constitute the bulk of most countries' production and marketing effort. The U.S. economy alone produces and markets each year 80 billion eggs, 3 billion chickens, 5 million hair dryers, 200 million tons of steel, and 4 billion tons of cotton. In developing nations, goods-particularly food, commodities, clothing, and housing-are the mainstay of the economy.

#### Services

As economies advance, a growing proportion of their activities are focused on the production of services. The U.S. economy today consists of a 70-30 services-to-goods mix. Services include the work of airlines, hotels, car rental firms, barbers and beauticians, maintenance and repair people, dog kennels and dog therapists, as well as professionals working within or for companies, such as accountants, lawyers, engineers, doctors, software programmers, and management consultants. Many market offerings consist of a variable mix of goods and services. At the pure service end would be a psychiatrist listening to a patient or a quartet performing Mozart; at another level would be the telephone call that is supported by a huge investment in plant and equipment; and at a more tangible level would be a fast-food establishment where the customer consumes both a good and a service.

#### Experiences

By orchestrating several services and goods, one can create, stage, and market experiences. Walt Disney World's Magic Kingdom is an experience, one of visiting a fairy kingdom, a pirate ship, or a haunted house. So are Hard Rock Cafe and Planet Hollywood. There is a market for different experiences, such as spending a week at a baseball camp playing with some retired baseball greats, paying to conduct the Chicago Symphony Orchestra for five minutes, or climbing Mount Everest.

#### Events

Marketers promote time-based events, such as the Olympics, company anniversaries, major trade shows, sports events, and artistic performances. There is a whole profession of meetings planners who work out the details of an event and stage it to come off perfectly.

#### Persons

Celebrity marketing has become a major business. Years ago, someone seeking fame would hire a press agent to plant stories in newspapers and magazines. Today every major film star has an agent, a personal manager, and ties to a public relations agency. Artists, musicians, CEOs, physicians, high-profile lawyers and financiers, and other professionals are drawing help from celebrity marketers.' In the art world, Andy Warhol clearly applied entrepreneurial marketing principles to build his own fame. Management consultant Tom Peters, himself a master at self-branding, has advised each person to become a "brand."

#### Places

Places-cities, states, regions, and whole nations-compete actively to attract tourists, factories, company headquarters, and new residents.' Stratford, Ontario, in Canada was a

fairly run-down city with one asset, its name and a river called Avon. This became the basis for an annual Shakespeare festival that put Stratford on the tourist map. Ireland has performed as an outstanding place marketer, having attracted more than 500 companies to locate their plants in Ireland. It operates the Irish Development Board, the Irish Tourist Board, and the Irish Export Board, responsible for inward investment, tourists, and exports, respectively. Place marketers include economic development specialists, real estate agents, commercial banks, local business associations, and advertising and public relations agencies.

### **Properties**

Properties are intangible rights of ownership of either real property (real estate) or financial property (stocks and bonds). Properties are bought and sold, and this occasions a marketing effort. Real estate agents work for property owners or seekers to sell or buy residential or commercial real estate. Investment companies and banks are involved in marketing securities to both institutional and individual investors.

### **Organizations**

Organizations actively work to build a strong, favorable image in the mind of their publics. We see corporate identity ads by companies seeking more public recognition. Philips, the Dutch electronics company, puts out ads with the tag line, "Let's Make Things Better." The Body Shop and Ben & Jerry's gain attention by promoting social causes. Other companies owe their visibility to a dramatic leader, such as Virgin's Richard Branson or Nike's Phil Knight. Universities, museums, and performing arts organizations all lay plans to boost their public image to compete more successfully for audiences and funds.

### **Information**

Information can be produced and marketed as a product. This is essentially what schools and universities produce and distribute at a price to parents, students, and communities. Encyclopedias and most nonfiction books market information. Magazines such as Road and Track and Byte supply considerable information about the car and computer worlds, respectively. We buy CDs and visit the Internet for information. The production, packaging, and distribution of information is one of society's major industries.<sup>6</sup>

### **Ideas**

Every market offering includes a basic idea at its core. Charley Revson of Revlon observed: "In the factory, we make cosmetics; in the store we sell hope." The buyer of a drill is really buying a hole. Products and services are platforms for delivering some idea or benefit. Marketers search hard for the core need they are trying to satisfy. A church, for example, must decide whether to market itself as a place of worship or a community center; the design of the church will be different depending on the choice.

## **MARKETING CONCEPTS AND TOOLS**

Marketing boasts a rich array of concepts and tools. We will start by defining marketing, and then describe its major concepts and tools.

### **DEFINING MARKETING**

Numerous definitions offered for marketing, we can distinguish between a social and a managerial definition. A social definition shows the role marketing plays in society. One marketer said that marketing's role is to "deliver a higher standard of living." A social definition that serves our purpose follows:

Marketing is a societal process by which individuals and groups obtain what they need and want through creating, offering, and freely exchanging products and services of value with others.)

For a managerial definition, marketing has often been described as "the art of selling products." But people are surprised when they hear that the most important part of marketing is not selling! Selling is only the tip of the marketing iceberg. Peter Drucker, a leading management theorist, puts it this way:

There will always, one can assume, be need for some selling. But the aim of marketing is to make selling superfluous. The aim of marketing is to know and understand the customer so well that the product or service fits him and sells itself Ideally, marketing should result in a customer who is ready to buy. All that should be needed then is to make the product or service available.'

When Sony designed its Walkman, when Nintendo designed a superior video game, and when Toyota introduced its Lexus automobile, these manufacturers were swamped with orders because they had designed the "right" product based on careful marketing homework.

**The American Marketing Association offers the following definition:**

Marketing (management) is the process of planning and executing the conception, pricing, promotion, and distribution of ideas, goods, services to create exchanges that satisfy individual and organizational goals.'

Coping with exchange processes calls for a considerable amount of work and skill. Marketing management takes place when at least one party to a potential exchange thinks about the means of achieving desired responses from other parties. We see marketing management as the art and science of choosing target markets and getting, keeping, and growing customers through creating, delivering, and communicating superior customer value.

### **CORE MARKETING CONCEPTS**

Marketing can be further understood by defining several of its core concepts.

#### **Target Markets and Segmentation**

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

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

Traditionally, a "market" was a physical place where buyers and sellers gathered to exchange goods. Economists now describe a market as a collection of buyers and sellers who transact over a particular product or product class (the housing market or grain market). But marketers view the sellers as constituting the industry and the buyers as constituting the market. The relationship between the industry and the market. Sellers and buyers are connected by four flows. The sellers send goods and services and communications (ads, direct mail) to the market; in return they receive money and information (attitudes, sales

data). The inner loop shows an exchange of money for goods and services; the outer loop shows an exchange of information.

Businesspeople often use the term markets to cover various groupings of customers. They talk about need markets (the diet-seeking market); product markets (the shoe market); demographic markets (the youth market); and geographic markets (the French market). Or they extend the concept to cover other markets, such as voter markets, labor markets, and donor markets.

Modern economies abound in markets. Manufacturers go to resource markets (raw-material markets, labor markets, money markets), buy resources and turn them into goods and services, and then sell finished products to intermediaries, who sell them to consumers. Consumers sell their labor and receive money with which they pay for goods and services. The government collects tax revenues to buy goods from resource, manufacturer, and intermediary markets and uses these goods and services to provide public services. Each nation's economy and the global economy consist of complex interacting sets of markets linked through exchange processes.

Today we can distinguish between a marketplace and marketpace. The marketplace is physical, as when one goes shopping in a store; marketpace is digital, as when one goes shopping on the Internet. Many observers believe that an increasing amount of purchasing will shift from the marketplace.' See the Marketing for the Millennium "E-Commerce: The Kitty Hawk Era.

Mohan Sawhney has proposed the concept of a metamarket to describe a cluster of complementary products and services that are closely related in the minds of consumers but are spread across a diverse set of industries. The automobile metamarket consists of automobile manufacturers, new car and used car dealers, financing companies, insurance companies, mechanics, spare parts dealers, service shops, auto magazines, classified auto ads in newspapers, and auto sites on the Internet. In planning to buy or buying a car, a buyer will get involved in many parts of this metamarket. This has created an opportunity for metamediaries to assist buyers to move seamlessly through these groups, although they are disconnected in physical space. One example is Edmund's ([www.edmunds.com](http://www.edmunds.com)), a Web site where a car buyer can find the stated prices of different automobiles and easily click to other sites to search for the lowest price dealer, for financing, for car accessories, and for used cars at bargain prices. Meta mediaries can also serve other metamarkets such as the home ownership market, the parenting and baby care market, and the wedding market.

### **Marketers and Prospects**

A marketer is someone seeking a response (attention, a purchase, a vote, a donation) from another party, called the prospect. If two parties are seeking to sell something to each other, we call them both marketers.

### **Needs, Wants, and Demands**

The marketer must try to understand the target market's needs, wants, and demands. Needs describe basic human requirements. People need food, air, water, clothing, and shelter to survive. 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. 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.

These distinctions shed light on the frequent criticism that "marketers create needs" or "marketers get people to buy things they don't want." 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. We mentioned earlier the major types of basic offerings: 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 brand strength—that is, a strong, favorable brand image.

### **Value and Satisfaction**

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. The benefits include functional benefits and emotional benefits. The costs include monetary costs, time costs, energy costs, and psychic costs. Thus value is given by:

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

The marketer can increase the value of the customer offering in several ways:

- Raise benefits
- Reduce costs
- Raise benefits and reduce costs
- Raise benefits by more than the raise in costs
- Lower benefits by less than the reduction in costs

The customer who is choosing between two value offerings, V1 and V2, will examine the ratio V1/V2. She will favor V1, if the ratio is larger than one; she will favor V2, if the ratio is smaller than one; and she will be indifferent if the ratio equals one.

### **Exchange and Transactions**

Exchange is only one of four ways in which a person can obtain a product. The person can self-produce the product or service, as when a person hunts, fishes, or gathers fruit. The person can use force to get a product, as in a holdup or burglary. The person can beg, as happens when a homeless person asks for food. Or the person can offer a product, a service, or money in exchange for something he or she desires.

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

1. There are at least two parties.
2. Each party has something that might be of value to the other party.
3. Each party is capable of communication and delivery.
4. Each party is free to accept or reject the exchange offer.
5. Each party believes it is appropriate or desirable to deal with the other party.

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

Exchange is a process rather than an event. Two parties are engaged in exchange if they are negotiating-trying to arrive at mutually agreeable terms. When an agreement is reached, we say that a transaction takes place. A transaction is a trade of values between two or more parties: A gives X to B and receives Y in return. Smith sells Jones a television set and Jones pays \$400 to Smith. This is a classic monetary transaction. But transactions do not require money as one of the traded values. A barter transaction involves trading goods or services for other goods or services, as when lawyer Jones writes a will for physician Smith in return for a medical examination.

A transaction involves several dimensions: at least two things of value, agreed upon conditions, a time of agreement, and a place of agreement. Usually a legal system exists to support and enforce compliance on the part of the transactors. Without a law of contracts, people would approach transactions with some distrust, and everyone would lose.

A transaction differs from a transfer. In a transfer, A gives X to B but does not receive anything tangible in return. Gifts, subsidies, and charitable contributions are all transfers. Transfer behavior can also be understood through the concept of exchange. Typically, the transferer expects to receive something in exchange for his or her gift for example, gratitude or seeing changed behavior in the recipient. Professional fundraisers provide benefits to donors, such as thank-you notes, donor magazines, and invitations to events. Marketers have broadened the concept of marketing to include the study of transfer behavior as well as transaction behavior.

In the most generic sense, marketers seek to elicit a behavioral response from another party. A business firm wants a purchase, a political candidate wants a vote, a church wants an active member, and a social-action group wants the passionate adoption of some cause. Marketing consists of actions undertaken to elicit desired responses from a target audience.

To effect successful exchanges, marketers analyze what each party expects from the transaction. Simple exchange situations can be mapped by showing the two actors and the wants and offerings flowing between them. Suppose Caterpillar, the world's largest manufacturer of earth-moving equipment, researches the benefits that a typical construction company wants when it buys earth-moving equipment. These benefits, listed at the top of the exchange map in Figure 1.3, include high-quality equipment, a fair price, on-time delivery, good financing terms, and good parts and service. The items on this want list are not equally important and may vary from buyer to buyer. One of Caterpillar's tasks is to discover the relative importance of these different wants to the buyer.

Caterpillar also has a want list. It wants a good price for the equipment, on-time payment, and good word of mouth. If there is a sufficient match or overlap in the want lists, a basis for a transaction exists. Caterpillar's task is to formulate an offer that motivates the construction company to buy Caterpillar equipment. The construction company might in turn

make a counteroffer. This process of negotiation leads to mutually acceptable terms or a decision not to transact.

### **Relationships and Networks**

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

The ultimate outcome of relationship marketing is the building of a unique company asset called a marketing network. A marketing network consists of the company and its supporting stakeholders (customers, employees, suppliers, distributors, retailers, ad agencies, university scientists, and others) with whom it has built mutually profitable business relationships. Increasingly, competition is not between companies but rather between marketing networks, with the prize going to the company that has built the better network. The operating principle is simple: Build an effective network of relationships with key stakeholders, and profits will follow.

### **Marketing Channels**

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

The marketer uses distribution channels to display or deliver the physical product or service(s) to the buyer or user. There are physical distribution channels and service distribution channels. They 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. The supply chain for women's purses starts with hides, tanning operations, cutting operations, manufacturing, and the marketing channels bringing products to customers. The 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 up-stream or downstream, its aim is to capture a higher percentage of supply chain value.

## Competition

Competition includes all 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. Figure 1.4 shows several levels of competitors. The car manufacturer can buy steel from U.S. Steel or other integrated steel mills in the United States or abroad; or go to a minimill such as Nucor to buy steel at a cost savings; or buy aluminum for certain parts of the car to lighten the cars' weight; or buy engineered plastics for bumpers instead of steel.

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

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

- 1. Brand competition:** A company sees its competitors as other companies offering a similar product and services to the same customers at similar prices. Volkswagen might see its major competitors as Toyota, Honda, Renault, and other manufacturers of medium-price automobiles. It would not see itself as competing with Mercedes or with Hyundai.
- 2. Industry competition:** A company sees its competitors as all companies making the same product or class of products. Volkswagen would see itself as competing against all other automobile manufacturers.
- 3. Form competition:** A company sees its competitors as all companies manufacturing products that supply the same service. Volkswagen would see itself competing against not only other automobile manufacturers but also against manufacturers of motorcycles, bicycles, and trucks.
- 4. Generic competition:** A company sees its competitors as all companies that compete for the same consumer dollars. Volkswagen would see itself competing with companies that sell major consumer durables, foreign vacations, and new homes.

## Marketing Environment

Competition represents only one force in the environment in which the marketer operates. The marketing environment consists of the task environment and the broad environment. The task environment includes the immediate actors involved in producing, distributing, and promoting the offering. The main actors are the company, suppliers, distributors, dealers, and the target customers. Included in the supplier group are material suppliers and service suppliers such as marketing research agencies, advertising agencies, banking and insurance companies, transportation and telecommunications companies. Included with distributors and dealers are agents, brokers, manufacturer representatives, and others who facilitate finding and selling to customers.

The broad environment consists of six components: demographic environment, economic environment, natural environment, technological environment, political-legal environment, and social-cultural environment. These environments contain forces that can have a major impact on the actors in the task environment. Market actors must pay close attention to the trends and developments in these environments and make timely adjustments to their marketing strategies.

## Marketing Mix

Marketers use numerous tools to elicit desired responses from their target markets. These tools constitute a marketing mix:

Marketing mix is the set of marketing tools that the firm uses to pursue its marketing objectives in the target market.

McCarthy classified these tools into four broad groups that he called the four Ps of marketing: product, price, place, and promotion. Marketing-mix decisions must be made for influencing the trade channels as well as the final consumers. Figure 1.6 shows the company preparing an offering mix of products, services, and prices, and utilizing a promotion mix of sales promotion, advertising, sales force, public relations, direct mail, telemarketing, and Internet to reach the trade channels and the target customers.

Typically, the firm can change its price, sales force size, and advertising expenditures in the short run. It can develop new products and modify its distribution channels only in the long run. Thus the firm typically makes fewer period-to-period marketing-mix changes in the short run than the number of marketing-mix decision variables might suggest.

Note that the four Ps represent the sellers' view of the marketing tools available for influencing buyers. From a buyer's point of view, each marketing tool is designed to deliver a customer benefit. Robert Lauterborn suggested that the sellers' four Ps correspond to the customers' four Cs.

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

Winning companies will be those who can meet customer needs economically and conveniently and with effective communication.

## CHAPTER – II

### **Profitability**

The ultimate purpose of the marketing concept is to help organizations achieve their objectives. In the case of private firms, the major objective is profit; in the case of nonprofit and public organizations, it is surviving and attracting enough funds to perform useful work. Private firms should not aim for profits as such but to achieve profits as a consequence of creating superior customer value. A company makes money by satisfying customer needs better than its competitors. Consider Frank Perdue's philosophy:

### **Perdue Chicken Farms**

Perdue Farms is a \$1.5 billion chicken business whose margins are substantially above the industry average and whose market shares in its major markets reach 50 percent. And the product is chicken a commodity if there ever was one! Yet its colorful founder, Frank Perdue, does not believe that "a chicken is a chicken is a chicken," nor do his customers. The company has always aimed to produce tender-tasting chickens for which discriminating customers will pay a price premium. Perdue controls the breeding operation to produce a quality bird with distinct characteristics. Its chickens are raised on a chemical-free and steroid-free diet. Since 1971, ads featuring founder Frank Perdue and the tag line "It takes a tough man to make a tender chicken" have become the company's signature line. In 1995, when Frank Perdue stepped down, his son Jim took the reins.

An advertising campaign introduced him to the country and emphasized the values, such as freshness and quality, which the company has promoted through the years. "After three generations, the Perdues know more about breeding chickens than chickens do," says one of the ads. In another, Jim Perdue says: "We've been working our tails off to make sure the Perdue chicken you buy today is every bit as tender, meaty, and delicious as the chicken you bought from my dad, or more so.

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

Most companies do not embrace the marketing concept until driven to it by circumstances. Various developments prod them to take the marketing concept to heart:

to Sales decline: When sales fall, companies panic and look for answers. Today, newspapers are experiencing declining circulation as more people rely on radio, TV, and the Internet for their news. Some publishers now realize that they know little about why people read newspapers. These publishers are commissioning consumer research and attempting to redesign newspapers to be contemporary, relevant, and interesting to readers. They are also starting Web pages.

Slow growth: Slow sales growth leads some companies to search for new markets. They realize they need marketing skill to identify and select new opportunities. Wanting new

sources of revenue, Dow Chemical entered consumer markets and invested heavily to acquire consumer marketing expertise to perform well in these markets.

**Changing buying patterns:** Many companies operate in markets characterized by rapidly changing customer wants. These companies need more marketing knowhow if they are to track buyers' changing values.

**Increasing competition:** Complacent companies may suddenly be attacked by powerful competitors. AT&T was a regulated, marketing-naive telephone company until the 1970s, when the government began allowing other companies to sell telecommunications equipment. AT&T plunged into the marketing waters and hired the best marketers it could find to help it compete. Companies in deregulated industries all find it necessary to build up marketing expertise.

**Increasing marketing expenditures:** Companies may find their expenditures for advertising, sales promotion, marketing research, and customer service to be poorly done. Management then decides it is time to undertake a serious marketing audit to improve its marketing.

In the course of converting to a marketing orientation, a company faces three hurdles: organized resistance, slow learning, and fast forgetting.

Some company departments (often manufacturing, finance, and R&D) believe a stronger marketing function threatens their power in the organization. The nature of the threat is illustrated in Figure 1.9(a) through (e). Initially, the marketing function is seen as one of several equally important functions in a check-and-balance relationship. Lack of demand leads marketers to argue that their function is more important. A few enthusiasts go further and say marketing is the major function of the enterprise, for without customers there would be no company. Enlightened marketers clarify the issue by putting the customer rather than marketing at the center of the company. They argue for a customer orientation in which all functions work together to respond to, serve, and satisfy the customer. Some marketers say that marketing still needs to command a central position if customers' needs are to be correctly interpreted and efficiently satisfied. See the Marketing Memo "Reasons to Embrace the Marketing Concept."

Resistance is especially strong in industries where marketing is being introduced for the first time—for instance, in law offices, colleges, deregulated industries, and government agencies. But in spite of resistance, many companies manage to introduce some marketing thinking into their organization. The company president establishes a marketing department; marketing talent is hired; key managers attend marketing seminars; the marketing budget is substantially increased; marketing planning and control systems are introduced. Even with these steps, however, learning comes slowly.

Even after marketing has been installed, management must fight a tendency to forget basic principles, especially in the wake of success. For example, many U.S. companies entered European markets in the 1950s and 1960s expecting to achieve outstanding success with their sophisticated products and marketing capabilities. A number of them failed because they forgot the basic marketing maxim: Know your target market and how to satisfy it. U.S. companies introduced their current products and advertising programs instead of adapting them. General Mills introduced its Betty Crocker cake mixes in Britain only to withdraw them a short time later: Angel food cake and devil's food cake sounded too exotic for British consumers. And many Britons felt that the perfect-looking cakes pictured on the packages must be too hard to make.

Companies face a particularly difficult task in adapting ad slogans to international markets. Perdue's slogan-"It takes a tough man to make a tender chicken"-was rendered into Spanish as "It takes a sexually excited man to make a chick affectionate." Even when the language is the same, words carry different meanings: Electrolux's British ad line for its vacuum cleaners-"Nothing sucks like an Electrolux"-would certainly not lure customers in the United States.

### **THE SOCIETAL MARKETING CONCEPT**

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

#### **Consider the following criticism:**

The fast-food hamburger industry offers tasty but unhealthy food. The hamburgers have a high fat content, and the restaurants promote fries and pies, two products high in starch and fat. The products are wrapped in convenient packaging, which leads to much waste. In satisfying consumer wants, these restaurants may be hurting consumer health and causing environmental problems.

Situations like this one call for a new term that enlarges the marketing concept. Among those suggested are "humanistic marketing" and "ecological marketing." We propose calling it the societal marketing concept.

The societal marketing concept holds that the organization's task is to determine the needs, wants, and interests of target markets and to deliver the desired satisfactions more effectively and efficiently than competitors in a way that preserves or enhances the consumer's and the society's well-being.

The societal marketing concept calls upon marketers to build social and ethical considerations into their marketing practices. They must balance and juggle the often conflicting criteria of company profits, consumer want satisfaction, and public interest. Yet a number of companies have achieved notable sales and profit gains by adopting and practicing the societal marketing concept. Two pioneers of the societal marketing concept are Ben & Jerry's and The Body Shop. But, as recent events show, even they encounter difficulties.

**Ben&lewey's** Twenty years after Ben & Jerry's Scoop Shop opened in Burlington, Vermont, sales have climbed to over \$190 million. The company has more than 600 employees and 10 franchisees. Why the appeal? For one thing, Ben & Jerry are masters at creating innovative flavors such as Cherry Garcia and Chocolate Chip Cookie Dough. For another, customers know that 7.5 percent of the company's pre-tax profits are donated to a variety of social and environmental causes. For a while it seemed the company could do no wrong. Then, in the mid-1990s, facing stiff competition in the superpremium ice cream category, the company suffered a series of losses. It began a highly publicized search for a new CEO to lead the company. The choice, a McKinsey consultant, was greeted with high hopes but lasted only two years. Current CEO Perry Odak, who arrived in 1997, has steered the company back on track to an impressive 12 percent growth in 1998. Odak has refined product lines, changed funky but confusing packaging, and tightened the company's loose and often chaotic business practices. And for those fearing a sellout from Mr. Odak-whose resume includes a stint at U.S. Repeating Arms rifle makersthey need only consider this:

Tightening the company's business practices is not only improving the bottom line but also seems to be promoting performance when it comes to worthy causes. Elizabeth A. Bankowski, the company's social mission director, said: "We now meet and identify social mission objectives by function, and it's taken as seriously as every other business objective." Since Odak took over the day-to-day management of the company, performance reviews even reflect how well employees identify and meet their social mission objectives."

**The Body Shop** In 1976, Anita Roddick opened The Body Shop in Brighton, England, as a tiny storefront selling body lotions. Today The Body Shop boasts 1,500 branches in 47 countries. The company manufactures and sells naturalingredient-based cosmetics in simple and appealing recyclable packaging. The ingredients are largely plant-based and often come from developing countries. All the products are formulated without animal testing. The company also helps developing countries through its Trade Not Aid mission, contributes to rain-forest preservation efforts, is active in women's and AIDS issues, and sets an example for recycling. Yet, like many businesses striving to be socially responsible and profitable, The Body Shop has faced intense scrutiny and suspicions about its ethics. It has also been the victim of its own success and has been edged out by younger, fresher proteges whom it inspired. Competitors, such as Bath & Body Works, Aveda, and Origins, are all unhampered by an expensive social mission. Declining store sales, particularly in the United States, have jolted The Body Shop into some new management and marketing moves. Outspoken Anita Roddick has stepped down as CEO, although she is still actively involved in crafting the social agenda and developing new products. One of her initiatives, Hemp, a line of hempseed-oil body care products, promises to put The Body Shop in the spotlight again and rev up sales. Advocates of industrial hemp, a nonnarcotic relative of marijuana, say the fast-growing crop provides an environmentally friendly alternative to trees used in paper, fabric, and other products. The product line is both attractively packaged and consistent with The Body Shop's environmentally conscious philosophy."

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

#### **HOW BUSINESS AND MARKETING ARE CHANGING**

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

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

6(b)

## LEVELS OF MARKET SEGMENTATION

Market segmentation is an effort to increase a company's precision marketing. The starting point of any segmentation discussion is mass marketing. In mass marketing, the seller engages in the mass production, mass distribution, and mass promotion of one product for all buyers. Henry Ford epitomized this marketing strategy when he offered the Model T-Ford "in any color, as long as it is black." Coca-Cola also practiced mass marketing when it sold only one kind of Coke in a 6.5-ounce bottle.

The argument for mass marketing is that it creates the largest potential market, which leads to the lowest costs, which in turn can lead to lower prices or higher margins. However, many critics point to the increasing splintering of the market, which makes mass marketing more difficult. According to Regis McKenna,

Consumers have more ways to shop: at giant malls, specialty shops, and superstores; through mail-order catalogs, home shopping networks, and virtual stores on the Internet. And they are bombarded with messages pitched through a growing number of channels: broadcast and narrow-cast television, radio, on-line computer networks, the Internet, telephone services such as fax and telemarketing; and niche magazines and other print media.'

The proliferation of advertising media and distribution channels is making it difficult to practice "one size fits all" marketing. Some claim that mass marketing is dying. Not surprisingly, many companies are turning to micromarketing at one of four levels: segments, niches, local areas, and individuals.

### Segment Marketing

A market segment consists of a large identifiable group within a market with similar wants, purchasing power, geographical location, buying attitudes, or buying habits. For example, an auto company may identify four broad segments: car buyers who are primarily seeking basic transportation or high performance or luxury or safety.

Segmentation is an approach midway between mass marketing and individual marketing. Each segment's buyers are assumed to be quite similar in wants and needs, yet no two buyers are really alike. Anderson and Narus urge marketers to present flexible market offerings instead of a standard offering to all members within a segment.' A flexible market offering consists of two parts: a naked solution consisting of product and service elements that all segment members value-and options that some segment members value. Each option carries an additional charge. For example, Delta Airlines offers all economy passengers a seat, food, and soft drinks. It charges extra for alcoholic beverages and earphones to those economy passengers wanting them. Siemens sells metal-clad boxes whose price includes free delivery and a warranty but also offers installation, tests, and communication peripherals as extra-cost options

Segment marketing offers several benefits over mass marketing. The company can create a more fine-tuned product or service offering and price it appropriately for the target audience. The choice of distribution channels and communications channels becomes much easier. The company also may face fewer competitors in the particular segment.

### Niche Marketing

A niche is a more narrowly defined group, typically a small market whose needs are not well served. Marketers usually identify niches by dividing a segment into subsegments or by defining a group seeking a distinctive mix of benefits. For example, the segment of heavy smokers includes those who are trying to stop smoking and those who don't care.

Whereas segments are fairly large and normally attract several competitors, niches are fairly small and normally attract only one or two. Larger companies, such as IBM, lose pieces of their market to nichers: Dalgic labeled this confrontation "guerrillas against gorillas."; Some larger companies have therefore turned to niche marketing, which has required more decentralization and some changes in the way they do business. Johnson & Johnson, for example, consists of 170 affiliates (business units), many of which pursue niche markets.

The prevalence of niche-and even "microniche"-marketing can be seen in the media. Witness the proliferation of new magazines (in 1998 there were 1,000 first-edition magazines launched) targeting specific niches, divided and subdivided along lines of ethnicity, gender, or sexual orientation: B1G2 (meaning "black first, gay second") is a New York-based lifestyle magazine for black gay men. There's Aqua, a bimonthly for divers and snorkelers, and Miami-based Quince, a magazine just for Hispanic teenage girls. As the media's gaze turns ever inward, there is Stephen Brill's Content, a consumer magazine about the media.

Niche marketers presumably understand their customers' needs so well that the customers willingly pay a premium. Ferrari gets a high price for its cars because loyal buyers feel no other automobile comes close to offering the product-service-membership benefit bundle that Ferrari does.

An attractive niche is characterized as follows: The customers in the niche have a distinct set of needs; they will pay a premium to the firm that best satisfies their needs; the niche is not likely to attract other competitors; the nicher gains certain economies through specialization; and the niche has size, profit, and growth potential.

Both small and large companies can practice niche marketing. Here are some examples of large companies that have moved into niche marketing:

Linneman and Stanton claim that there are riches in niches and believe that companies will have to niche or risk being niched. Blattberg and Deighton claim that "niches too small to be served profitably today will become viable as marketing efficiency improves." The low cost of setting up shop on the Internet is a key factor making it more profitable to serve even seemingly minuscule niches. Small businesses, in particular, are realizing riches from serving small niches on the World Wide Web. Fifteen percent of the commercial Web sites with fewer than 10 employees take in more than \$100,000, and 2 percent even ring up more than \$1 million. The recipe for Internet niching success: Choose a hard-to-find product that customers don't need to see and touch. These two "Webpreneurs" followed this recipe with astonishing results: In many markets today, niches are the norm. See the Marketing Insight "Hidden Champions: German Midsize Companies Grow Prosperous Through Niching."

### **Local Marketing**

Target marketing is leading to marketing programs being tailored to the needs and wants of local customer groups (trading areas, neighborhoods, even individual stores). Citibank provides different mixes of banking services in its branches depending on neighborhood demographics. Kraft helps supermarket chains identify the cheese assortment and shelf positioning that will optimize cheese sales in low-, middle-, and high-income stores, and in different ethnic neighborhoods.

Those favoring localizing a company's marketing see national advertising as wasteful because it fails to address local needs. Those against local marketing argue that it drives up manufacturing and marketing costs by reducing economies of scale. Logistical problems become magnified when companies try to meet varying local requirements. A brand's overall image might be diluted if the product and message differ in different localities.

## Individual Marketing

The ultimate level of segmentation leads to "segments of one," "customized marketing," or "one-to-one marketing."<sup>9</sup> For centuries, consumers were served as individuals: The tailor made the suit and the cobbler designed shoes for the individual. Much business-to-business marketing today is customized, in that a manufacturer will customize the offer, logistics, communications, and financial terms for each major account. New technologies-computers, databases, robotic production, e-mail, and fax-permit companies to return to customized marketing, or what is called "mass customization." Mass customization is the ability to prepare on a mass basis individually designed products and communications to meet each customer's requirements.

For more detailed information on how mass customization is being used in consumer and business-to-business marketing, and its prospects for the future, see the Marketing for the Millennium box, "A Segment of One: Mass Customization Comes of Age."

According to Arnold OstIE, chief designer for Mazda, "Customers will want to express their individuality with the products they buy." The Opportunities Offered by these technologies promise to turn marketing from "a broadcast medium to a dialog inedium," where the customer participates actively in the design of the product and offer.

Today customers are taking more individual initiative in determining what and how to buy. They log onto the Internet; look up information and evaluations of product or service offers; dialogue with suppliers, users, and product critics; and make up their own minds about the best offer.

Marketers will still influence the process but in new ways. They will need to set up toll-free phone numbers and e-mail addresses to enable buyers to reach them with questions, suggestions, and complaints. They will involve customers more in the product-specification process. They will sponsor an Internet home page that provides full information about the company's products, guarantees, and locations.

## PATTERNS OF MARKET SEGMENTATION

Market segments can be built up in many ways. One way is to identify preference segments. Suppose ice cream buyers are asked how much they value sweetness and creaminess as two product attributes. Three different patterns can emerge.

**Homogeneous preferences:** Figure 9.1(a) shows a market where all the consumers have roughly the same preference. The market shows no natural segments. We would predict that existing brands would be similar and cluster around the middle of the scale in both sweetness and creaminess.

**Diffused preferences:** At the other extreme, consumer preferences may be scattered throughout the space (Figure 9.1 [b]), indicating that consumers vary greatly in their preferences. The first brand to enter the market is likely to position in the center to appeal to the most people. A brand in the center minimizes the sum of total consumer dissatisfaction. A second competitor could locate next to the first brand and fight for market share. Or it could locate in a corner to attract a customer group that was not satisfied with the center brand. If several brands are in the market, they are likely to position throughout the space and show real differences to match consumer-preference differences.

**Clustered preferences:** The market might reveal distinct preference clusters, called natural market segments. The first firm in this market has three options. It might position in the center, hoping to appeal to all groups. It might position in the largest market segment (concentrated marketing). It might develop several brands, each positioned in a different

segment. If the first firm developed only one brand, competitors would enter and introduce brands in the other segments.

## **MARKET-SEGMENTATION PROCEDURE**

Here is a three-step procedure for identifying market segments: survey, analysis, and profiling.

### **Step One: Survey Stage**

The researcher conducts exploratory interviews and focus groups to gain insight into consumer motivations, attitudes, and behavior. Then the researcher prepares a questionnaire and collects data on attributes and their importance ratings; brand awareness and brand ratings; product-usage patterns; attitudes toward the product category; and demographics, geographics, psychographics, and mediagraphics of the respondents.

### **Step Two: Analysis Stage**

The researcher applies factor analysis to the data to remove highly correlated variables, then applies cluster analysis to create a specified number of maximally different segments.

### **Step Three: Profiling Stage**

Each cluster is profiled in terms of its distinguishing attitudes, behavior, demographics, psychographics, and media patterns. Each segment is given a name based on its dominant characteristic. In a study of the leisure market, Andreassen and Belk found six segments: 13 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 and socially active people.

Market segmentation must be redone periodically because market segments change. At one time the personal computer industry segmented its products purely on speed and power, thus appealing to two broad swathes, high-end users and low-end users, but missing out on the prosperous middle. Later PC marketers recognized an emerging "SoHo" market, named for "small office and home office." Mail-order companies such as Dell and Gateway appealed to this market's requirement for high performance coupled with low price and user-friendliness. Shortly thereafter PC makers began to see SoHo as comprised of smaller segments. "Small-office needs might be very different from home-office needs," says one Dell executive.

One way to discover new segments is to investigate the hierarchy of attributes that consumers examine in choosing a brand. This process is called market partitioning. Years ago, most car buyers first decided on the manufacturer and then on one of its car divisions (brand-dominant hierarchy). A buyer might favor General Motors cars and, within this set, Pontiac. Today, many buyers decide first on the nation from which they want to buy a car (nation-dominant hierarchy). Buyers may first decide they want to buy a Japanese car, then Toyota, and then the Corolla model of Toyota. Companies must monitor potential shifts in the consumers' hierarchy of attributes and adjust to changing priorities.

The hierarchy of attributes can reveal customer segments. Buyers who first decide on price are price dominant; those who first decide on the type of car (e.g., sports, passenger, station wagon) are type dominant; those who first decide on the car brand are brand dominant. One can identify those who are type then price then brand dominant as making up a segment; those who are quality then service then type dominant as making up another segment. Each segment may have distinct demographics, psychographics, and mediagraphics.'s

## **SEGMENTING CONSUMER AND BUSINESS MARKETS**

Two broad groups of variables are used to segment consumer markets. Some researchers try to form segments by looking at consumer characteristics: geographic, demographic, and psychographic. Then they examine whether these customer segments exhibit different needs or product responses. For example, they might examine the differing attitudes of "professionals," "blue collars," and other groups toward, say, "safety" as a car benefit.

Other researchers try to form segments by looking at consumer responses to benefits sought, use occasions, or brands. Once the segments are formed, the researcher sees whether different characteristics are associated with each consumer-response segment. For example, the researcher might examine whether people who want "quality" versus "low price" in buying an automobile differ in their geographic, demographic, and psychographic makeup.

The major segmentation variables-geographic, demographic, psychographic, and behavioral segmentation.

### **Geographic Segmentation**

Geographic segmentation calls for dividing the market into different geographical units such as nations, states, regions, counties, cities, or neighborhoods. The company can operate in one or a few geographic areas or operate in all but pay attention to local variations. For example, Hilton Hotels customizes rooms and lobbies according to the location of its hotels. Northeastern hotels are sleeker and more cosmopolitan. Southwestern hotels are more rustic. Or, how about Campbell Soup, an experienced regional marketer? Since 1994, the company has marketed its Pace Picante sauce regionally. People in the Southwest don't need to be told that "picante" is a cooking ingredient, whereas northerners confuse it with salsa. The packaging, communication, and marketing effort are more educational in the North. More and more regional marketing means marketing right down to a specific zip code:

Blockbuster Entertainment Blockbuster has invested in complex databases to track the video preferences of its 85 million members and buys additional demographic data from outside companies. It then stocks each of its stores accordingly. San Francisco stores may carry more videos portraying gay relationships, reflecting the city's large gay population. Chicago stores are big on family pictures and dramas. Blockbuster can even measure the difference between patterns of East Dallas and South Dallas.

### **Demographic Segmentation**

In demographic segmentation, the market is divided into groups on the basis of variables such as age, family size, family life cycle, gender, income, occupation, education, religion, race, generation, nationality, social class. Demographic variables are the most popular bases for distinguishing customer groups. One reason is that consumer wants, preferences, and usage rates are often associated with demographic variables. Another is that demographic variables are easier to measure. Even when the target market is described in nondemographic terms (say, a personality type), the link back to demographic characteristics is needed in order to estimate the size of the target market and the media that should be used to reach it efficiently.

**Geographic**

Region

Pacific, Mountain, West North Central, West South Central, East North Central, East South Central, South Atlantic, Middle Atlantic, New England

City or metro size

Under 4,999, 5,000-19,999, 20,000-49,999, 50,000-99,999, 100,000-249,999; 250,000-499,999; 500,000-999,999; 1,000,000-3,999,999, 4,000,000 or over

Density

Urban, suburban, rural

Climate

Northern, southern

**Demographic**

Age

Under 6, 6-11, 12-19, 20-34, 35 -49, 50 -64, h5+

Family size

1-2,3-4,5+

Family life cycle

Young, single; young, married, no children, young, married, youngest child under 6; young, married, youngest child 6 or over; older, married, with children, older, married, no children under 18; older, single; other

Gender

Male, female

Income

Under \$9,999; \$10,000-\$14,999; \$15,000-\$19,999; \$20,000-\$29,999; \$30,000-\$49,999; \$50,000-\$99,999; \$100,000 and over

Occupation

Professional and technical; managers, officials, and proprietors; clerical, sales; craftspeople; forepersons; operatives; farmers; retired, students; homemakers; unemployed

Education

Grade school or less, some high school; high school graduate; some college, college graduate

Religion

Catholic, Protestant, Jewish, Muslim, Hindu, other

Race

White, Black, Asian, Hispanic

Generation

Baby boomers, Generation Xers

Nationality

North American, South American, British, French, German, Italian, Japanese

Social class

Lower lowers, upper lowers, working class, middle class, upper middles, lower lower uppers, upper uppers

**Psychographic**

Lifestyle

Straights, swingers, longhairs

Personality

Compulsive, gregarious, authoritarian, ambitious

**Behavioral**

Occasions

Regular occasion, special occasion

Benefits

Quality, service, economy, speed

User status

Nonuser, ex-user, potential user, first-time user, regular user

Usage rate

Light user, medium user, heavy user

Loyalty status

None, medium, strong, absolute

Readiness stage

Unaware, aware, informed, interested, desirous, intending to buy

Attitude toward product

Enthusiastic, positive, indifferent, negative, hostile

Here is how certain demographic variables have been used to segment markets.

**Age and Life-Cycle Stage**

Consumer wants and abilities change with age. Gerber realized this and began expanding beyond its traditional baby foods line. Its new "Graduates" line is geared for the 1-

to 3-year-old. One of the reasons for Gerber's expansion into this new segment is that the baby food category's growth is declining, due to factors including the declining birthrate, babies staying on formula longer, and children moving to solid foods sooner. The company is hoping that the parents who buy Gerber's baby food will be receptive to Gerber's Graduates line as their baby grows." Sega, the computer games giant, has a similar goal of retaining the loyalty of its main market segment. Sega is launching a range of associated goods for adults, including clothes and sports equipment, under its Sega Sports brand. Sega's core market lies in the 10 to 18 age range. Says a Sega licensing executive, "They sit in their bedrooms playing games for hours, then they turn 18 and discover girls . . . and the computer gets locked away." Clothing and other products are, a way of taking the brand to a more mature market. Sega watches will be available, too; as will Sega shoes and Sega Sports-branded footballs and basketballs.

Photo companies are now applying age and life-cycle segmentation to the film market. With film sales down, photo companies are working hard to exploit promising niche markets: moms, kids, and older people:

Nevertheless, age and life cycle can be tricky variables. For example, the Ford Motor Company designed its Mustang automobile to appeal to young people who wanted an inexpensive sport car. But Ford found that the car was being purchased by all age groups. It then realized that its target market was not the chronologically young but the psychologically young.

The Neugartens' research indicates that age stereotypes need to be guarded against: Age has become a poor predictor of the timing of life events, as well as a poor predictor of a person's health, work status, family status, and therefore, also, of a person's interests, preoccupations, and needs. We have multiple images of persons of the same age: there is the 70-year-old in a wheelchair and the 70-year-old on tile tennis court. Likewise, there are 35-year-olds sending children off to college and 35-year-olds flogging the nursery for newborns, producing in turn, first-time grandparenthood for persons who range in age from 35 to 75.

### **Gender.**

Gender segmentation has long been applied in clothing, hairstyling, cosmetics, and magazines. Occasionally other marketers notice an opportunity for gender segmentation. Consider the cigarette market, where brands like Virginia Slims have been introduced, accompanied by appropriate flavor, packaging, and advertising cues to reinforce a female image.

The automobile industry is beginning to recognize gender segmentation. With more women car owners, some manufacturers are designing certain features to appeal to women, although stopping short of advertising the cars as women's cars.

### **Income:**

Income segmentation is a long-standing practice in such product and service categories as automobiles, boats, clothing, cosmetics, and travel. However, income does not always predict the best customers for a given product. Blue-collar workers were among the first purchasers of color television sets; it was cheaper for them to buy these sets than to go to movies and restaurants. The most economical cars are not bought by the really poor, but rather by those who think of themselves as poor relative to their status aspirations. Medium-price and expensive cars tend to be purchased by the overprivileged segments of each social class.

**Generation:**

Many researchers are now turning to generation segmentation. Each generation is profoundly influenced by the times in which it grows up—the music, movies, politics, and events of that period. Some marketers target baby boomers (those born between 1946 and 1964) using communications and symbols that appeal to the optimism of that generation. Other marketers are targeting Generation X (those born between 1964 and 1984), aware that the members of this generation grew up distrustful of society, politicians, and slick advertising and merchandising. Generation Xers are more sophisticated in evaluating products. Many are turned off by advertising that has too much hype or takes itself too seriously." Meredith and Schewe have proposed a more focused concept of generation segmentation that they call cohort segmentation.' Cohorts are groups of people who share experiences of major external events that have deeply affected their attitudes and preferences. There is a cohort group that experienced the Great Depression, another that experienced World War II, another that experienced the Vietnam War, and so on. Members of a cohort group feel a bonding with each other for having shared the same major experiences. Marketers often advertise to a cohort group by using the icons and images prominent in their experience.

**Social Class:**

Social class has a strong influence on preference in cars, clothing, home furnishings, leisure activities, reading habits, and retailers. Many companies design products and services for specific social classes. The tastes of social classes can change with the years. The 1980s were about greed and ostentation for the upper classes, but the nineties were more about values and self-fulfillment. Affluent tastes now run more toward the utilitarian, a Range Rover or Ford Explorer rather than a Mercedes."

**Psychographic Segmentation**

In psychographic segmentation, buyers are divided into different groups on the basis of lifestyle or personality and values. People within the same demographic group can exhibit very different psychographic profiles.

**Lifestyle**

People exhibit many more lifestyles than are suggested by the seven social classes. The goods they consume express their lifestyles. For example: Companies making cosmetics, alcoholic beverages, and furniture are always seeking opportunities in lifestyle segmentation. But lifestyle segmentation does not always work. Nestle introduced a special brand of decaffeinated coffee for "late nighters," and it failed

**Personality**

Marketers have used personality variables to segment markets. They endow their products with human personalities that correspond to consumer personalities. In the late 1950s, Fords and Chevrolets were promoted as having different personalities. Ford buyers were identified as independent, impulsive, masculine, alert to change, and self-confident. Chevrolet owners were conservative, thrifty, prestige-conscious, less masculine, and seeking to avoid extremes.

**Values**

Some marketers segment by core values, the belief systems that underlie consumer attitudes and behaviors. Core values go much deeper than behavior or attitude, and determine, at a basic level, people's choices and desires over the long term. Marketers that segment by values believe that by appealing to people's inner selves it is possible to influence their outer selves—their purchase behavior. A marketing research firm's Roper Reports Worldwide Global

Consumer Survey has developed a values segmentation scheme for global markets (see the 'Marketing Memo "Tapping into Core Values Around the Globe"')

### Behavioral Segmentation

In behavioral segmentation, buyers are divided into groups on the basis of their knowledge of, attitude toward, use of, or response to a product. Many marketers believe that behavioral variables--occasions, benefits, user status, usage rate, loyalty status, buyer readiness stage, and attitude--are the best starting points for constructing market segments. Occasions. Buyers can be distinguished according to the occasions they develop a need, purchase a product, or use a product. For example, air travel is triggered by occasions related to business, vacation, or family. An airline can specialize in serving people for whom one of these occasions dominates. Thus charter airlines serve groups of people who fly to a vacation destination.

Occasion segmentation can help firms expand product usage. For example, orange juice is usually consumed at breakfast. An orange juice company can try to promote drinking orange juice on other occasions--lunch, dinner, midday. Certain holidays--Mother's Day and Father's Day, for example--were established partly to increase the sale of candy and flowers. The Curtis Candy Company promoted the trick-or-treat custom at Halloween, with every home ready to dispense candy to eager little callers knocking at its door.

A company can consider critical life events to see whether they are accompanied by certain needs. This kind of analysis has led to service providers such as marriage, employment, and bereavement counselors.

### Benefits

Buyers can be classified according to the benefits they seek. One study of travelers uncovered three benefit segments: those who travel to be with their family, those who travel for adventure or educational purposes, and people who enjoy the "gambling" and "fun" aspects of travel.

Haley reported a successful benefit segmentation of the toothpaste market. He found four benefit segments: economy, medicinal, cosmetic, and taste. Each benefit-seeking group had particular demographic, behavioral, and psychographic characteristics. For example, decay-prevention seekers had large families, were heavy toothpaste users, and were conservative. Each segment favored certain brands. Toothpaste can use these findings to focus its brand better and to launch new brands.

Benefit Segments	Demographics	Behavioristics	Psychographics	Favored Brands
Economy (low price)	Men	Heavy users	High autonomy, value oriented	Brands on sale
Medicinal prevention)	Large families	Heavy users	Hypochondriac, conservative	Crest (decay
Cosmetic (bright teeth)	Teens, young adults	Smokers	High sociability, active	Maclean's, Ultra Brite
Taste good tasting	Children	Spearmint lovers	High self-involvement, hedonistic	Colgate, Aim

**User Status.** Markets can be segmented into nonusers, ex-users, potential users, first-time users, and regular users of a product. Thus blood banks must not rely only on regular donors to supply blood. They must recruit new first-time donors and contact ex-donors, and each will require a different marketing strategy. The company's market position will also influence its focus. Market-share leaders will focus on attracting potential users, whereas smaller firms will try to attract current users away from the market leader.

**Usage Rate.** Markets can be segmented into light, medium, and heavy product users. Heavy users are often a small percentage of the market but account for a high percentage of total consumption. Marketers usually prefer to attract one heavy user rather than several light users, and they vary their promotional efforts accordingly.

Usage rates for some popular consumer products. For example, 41 percent of the sampled households buy beer. But heavy users accounted for 87 percent of the beer consumed-almost seven times as much as the light users. Thus, most beer companies target heavy beer drinkers, using appeals such as Miller Lite's "tastes great, less filling." Heavy beer drinkers have the following profile: working class; age 25 to 50; heavy viewers of television, particularly sports programs. These profiles can assist marketers in developing price, message, and media strategies.

Social marketing agencies face a heavy-user dilemma. A family planning agency would normally target poor families who have many children, but these families are usually the most resistant to birth control messages. The National Safety Council would target unsafe drivers, but these drivers are the most resistant to safe-driving appeals. The agencies must decide whether to go after a few highly resistant heavy offenders or many less-resistant light offenders.

**Loyal Status.** Consumers have varying degrees of loyalty to specific brands, stores, and other entities. Buyers can be divided into four groups according to brand loyalty status:

- Hard-core loyals : Consumers who buy one brand all the time.
- Split loyals : Consumers who are loyal to two or three brands.
- Shifting loyals : Consumers who shift from one brand to another.
- Switchers : Consumers who show no loyalty to any brand.

Each market consists of different numbers of the four types of buyers. A brandloyal market is one with a high percentage of hard-core brand-loyal buyers. The tooth-` paste market and the beer market are fairly high brand-loyal markets. Companies selling in a brand-loyal market have a hard time gaining more market share, and companies that enter such a market have a hard time getting in.

A company can learn a great deal by analyzing the degrees of brand loyalty: By studying its hard-core loyals, the company can identify its products' strengths. By studying its split loyals, the company can pinpoint which brands are most competitive with its own. By looking at customers who are shifting away from its brand, the company can learn about its marketing weaknesses and attempt to correct them.

One caution: What appear to be brand-loyal purchase patterns may reflect habit, indifference, a low price, a high switching cost, or the nonavailability of other brands. Thus a company must carefully interpret what is behind the observed purchase patterns.

**Buyer-Readiness Stage.** A market consists of people in different stages of readiness to buy a product. Some are unaware of the product, some are aware, some are informed, some are

interested, some desire the product, and some intend to buy. The relative numbers make a big difference in designing the marketing program.

Suppose a health agency wants to encourage women to have an annual Pap test to detect possible cervical cancer. At the beginning, most women may be unaware of the Pap test. The marketing effort should go into high-awareness-building advertising using a simple message. Later, to move more women into desiring the test, the advertising should dramatize the benefits of the Pap test and the risks of not taking it. A special offer of a free health examination might be made to motivate women into actually signing up for the test.

Attitude. Five attitude groups can be found in a market: enthusiastic, positive, indifferent, negative, and hostile. Door-to-door workers in a political campaign use the voter's attitude to determine how much time to spend with that voter. They thank enthusiastic voters and remind them to vote; they reinforce those who are positively disposed; they try to win the votes of indifferent voters; they spend no time trying to change the attitudes of negative and hostile voters. To the extent that attitudes are correlated with demographic descriptors, the political party can more efficiently locate the best prospects.

### **Multi-Attribute Segmentation (Geocustering)**

Marketers no longer talk about the average consumer or even limit their analysis to only a few market segments. Rather, they are increasingly combining several variables in an effort to identify smaller, better-defined target groups. Thus a bank may not only identify a group of wealthy retired adults, but within that group distinguish several segments depending on current income, assets, savings, and risk preferences.

One of the most promising developments in multi-attribute segmentation is called geocustering. Geocustering yields richer descriptions of consumers and neighborhoods than traditional demographics. Claritas Inc. has developed a geocustering approach called PRIZM (Potential Rating Index by Zip Markets) that classifies over half a million U.S. residential neighborhoods into 62 distinct lifestyle groupings called PRIZM Clusters." The groupings take into consideration 39 factors in 5 broad categories: (1) education and affluence, (2) family life cycle, (3) urbanization, (4) race and ethnicity, and (5) mobility. The neighborhoods are broken down by zip code, zip + 4, or census tract and block group. The clusters have descriptive titles such as Blue Blood Estates, Winners Circle, Hometown Retired, Latino America, Shotguns and Pickups, and Back

Country Folks. The inhabitants in a cluster tend to lead similar lives, drive similar cars, have similar jobs, and read similar magazines. Here are three PRIZM clusters: Other PRIZM clusters include Kids & Cul-de-Sacs, which covers the baby boomer migration to the suburbs; Young Literati, which taps Generation X; and New Ecotopia, which focuses on the country's aging hippies.

Marketers can use PRIZM to answer such questions as these: Which clusters (neighborhoods or zip codes) contain our most valuable customers? How deeply have we already penetrated these segments? Which markets, performance sites, and promotional media provide us with the best opportunities for growth? Spiegel, a direct marketer, uses geocustering information to search for where to mail its catalogs. In marketing its Suave shampoo, Helene Curtis, now part of Unilever, used PRIZM to identify neighborhoods with high concentrations of young working women. These women responded best to advertising messages that Suave is inexpensive, yet will make their hair "look like a million."

Geocustering's importance as a segmentation tool is growing. It captures the increasing diversity of the American population, and marketing to microsegments has

become accessible even to small organizations as database costs decline, PCs proliferate, software becomes easier to use, data integration increases, and as the Internet grows."

### **Targeting Multiple Segments**

Very often, companies start marketing to one segment, then expand to others. Consider the experiences of one small technology company: Many shoppers cannot be neatly pigeonholed into one segment. Many consumers are cross-shoppers. Consider the "cross-shopper" who buys an expensive Bill Blass suit but shops at Wal-Mart for underwear. Or the "cross-eater" who eats a Healthy Choice frozen dinner followed by Ben & Jerry's ice cream for dessert. It is dangerous to interpret segment membership by observing only one purchase. Segmentation ignores the whole customer profile, which becomes clear only with individual customer profiling.

### **BASES FOR SEGMENTING BUSINESS MARKETS**

Business markets can be segmented with some variables employed in consumer market segmentation, such as geography, benefits sought, and usage rate. Yet business marketers can also use several other variables. Bonoma and Shapiro proposed segmenting the business market with the variables shown in Table 9.3. The demographic tables are the most important, followed by the operating variables-down to the personal characteristics of the buyer.

The table lists major questions that business marketers should ask in determining which segments and customers to serve. A rubber-tire company should first decide which industries it wants to serve. It can sell tires to manufacturers of automobiles, trucks, farm tractors, forklift trucks, or aircraft. Within a chosen target industry, a company can further segment by company size. The company might set up separate operations for selling to large and small customers. Consider how Dell is organized: Small businesses, in particular, have become a Holy Grail for business marketers." In the United States small businesses are now responsible for 50 percent of the gross national product, according to the U.S. Small Business Administration, and this segment is growing at 11 percent annually, three percentage points higher than the growth of large companies. IBM is one company that is going after this segment with almost religious zeal:

#### **Demographic**

1. Industry. Which industries should we serve?
2. Company size: What size companies should we serve?
3. Location. What geographical areas should we serve?

#### **Operating Variables**

4. Technology: What customer technologies should we focus on?
5. User or nonuser status: Should we serve heavy users, medium users, light users, or nonusers?
6. Customer capabilities: Should we serve customers needing many or few services?

#### **Purchasing Approaches**

7. Purchasing-function organizations: Should we serve companies with highly centralized or decentralized purchasing organizations?
8. Power structure: Should we serve companies that are engineering dominated, financially dominated, and so on?
9. Nature of existing relationships: Should we serve companies with which we have strong relationships or simply go after the most desirable companies?

10. General purchase policies Should we serve companies that prefer leasing? Service contracts? Systems purchases? Sealed bidding?

11. Purchasing criteria: Should we serve companies that are seeking quality? Service? Price? Situational Factors

12. Urgency: Should we serve companies that need quick and sudden delivery or service? 13. Specific application: Should we focus on certain applications of our product rather than all applications?

14. Size of order should we focus on large or small orders?

Personal Characteristics

15. Buyer-seller similarity: Should we serve companies whose people and values are similar to ours?

16. Attitudes toward risk: Should we serve risk-taking or risk-avoiding customers? 17. Loyalty should we serve companies that show high loyalty to their suppliers?

Service businesses are appealing small business customers as well. BB&T, a Raleigh, North Carolina, bank, is positioning itself as a powerful local bank with a down-home approach, particularly to entrepreneurs. It launched a business-to-business advertising campaign depicting various Carolina businesses and their owners. Each entrepreneur is a BB&T small business customer, and the ads reinforce the bank's commitment to small business.

Within a given target industry and customer size, the company can segment by purchase criteria. For example, government laboratories, in buying scientific equipment, need low prices and service contracts; university laboratories need equipment that requires little service; and industrial laboratories need equipment that is highly reliable and accurate.

Business marketers generally identify segments through a sequential segmentation process. Consider an aluminum company: The aluminum company first undertook macrosegmentation consisting of three steps. It looked at which end-use market to serve: automobile, residential, or beverage containers. Choosing the residential market, it needed to determine the most attractive product application: semfinished material, building components, or aluminum mobile homes. Deciding to focus on building components, it considered the best customer size and chose large customers. The second stage consisted of microsegmentation. The company distinguished among customers buying on price, service, or quality. Because the aluminum company had a high-service profile, it decided to concentrate on the service-motivated segment of the market.

Business buyers seek different benefit bundles based on their stage in the purchase decision process:

1. First-time prospects: Customers who have not yet purchased want to buy from a vendor who understands their business, who explains things well, and whom they can trust.
2. Notices: Customers who are starting their purchasing relationship want easy-to-read manuals, hot lines, a high level of training, and knowledgeable sales reps.
3. Sophisticates: Established customers want speed in maintenance and repair, product customization, and high technical support.

These segments may also have different channel preferences. First-time prospects would prefer to deal with a company salesperson instead of a catalog or direct-mail channel, because the latter provides too little information. Sophisticates, on the other hand, may want to conduct more of their buying over electronic channels. Rangan, Moriarty, and Swartz studied a mature commodity market, steel strapping, and found four business segments:

1. Programmed buyers: Buyers who view the product as not very important to their operation. They buy it as a routine purchase item, usually paying full price and receiving below-average service. Clearly this is a highly profitable segment for the vendor.
2. Relationship buyers: Buyers who regard the product as moderately important and are knowledgeable about competitive offerings. They get a small discount and a modest amount of service and prefer the vendor as long as the price is not far out of line. They are the second most profitable group.
3. Transaction buyers: Buyers who see the product as very important to their operations. They are price and service sensitive. They receive about a 10 percent discount and above-average service. They are knowledgeable about competitive offerings and are ready to switch for a better price, even at the sacrifice of some service.
4. Bargain hunters: Buyers who see the product as very important and demand the deepest discount and the highest service. They know the alternative suppliers, bargain hard, and are ready to switch at the slightest dissatisfaction. The company needs these buyers for volume purposes, but they are not very profitable. This segmentation scheme can help a company in a mature commodity industry do a better job of figuring out where to apply price and service increases and decreases, because each segment would react differently.

### EFFECTIVE SEGMENTATION

Not all segmentations are useful. For example, table salt buyers could be divided into blond and brunet customers, but hair color is not relevant to the purchase of salt. Furthermore, if all salt buyers buy the same amount of salt each month, believe all salt is the same, and would pay only one price for salt, this market would be minimally segmentable from a marketing point of view.

To be useful, market segments must be:

**Measurable:** The size, purchasing power, and characteristics of the segments can be measured.

**Substantial:** The segments are large and profitable enough to serve. A segment should be the largest possible homogeneous group worth going after with a tailored marketing program. It would not pay, for example, for an automobile manufacturer to develop cars for people who are shorter than four feet.

**Accessible:** The segments can be effectively reached and served.

**Differentiable:** The segments are conceptually distinguishable and respond differently to different marketing-mix elements and programs. If married and unmarried women respond similarly to a sale on perfume, they do not constitute separate segments.

**Actionable:** Effective programs can be formulated for attracting and serving the segments.

### MARKET TARGETING

Once the firm has identified its market-segment opportunities, it has to decide how many and which ones to target.

### EVALUATING THE MARKET SEGMENTS

In evaluating different market segments, the firm must look at two factors: the segment's overall attractiveness and the company's objectives and resources. First, the firm must ask whether a potential segment has the characteristics that make it generally attractive, such as size, growth, profitability, scale economies, and low risk. Second, the firm must consider whether investing in the segment makes sense given the firm's objectives and resources. Some attractive segments could be dismissed because they do not mesh with the

company's long-run objectives, or the segment should be dismissed if the company lacks one or more necessary competences to offer superior value.

#### **SELECTING THE MARKET SEGMENTS**

Having evaluated different segments, the company can consider five patterns of target market selection shown in Figure.

##### **Single-Segment Concentration**

The company may select a single segment. Volkswagen concentrates on the small-car market and Porsche on the sports car market. Through concentrated marketing, the firm gains a strong knowledge of the segment's needs and achieves a strong market presence. Furthermore, the firm enjoys operating economies through specializing its production, distribution, and promotion. If it captures segment leadership, the firm can earn a high return on its investment.

However, concentrated marketing involves higher than normal risks. A particular market segment can turn sour. When young women suddenly stopped buying sportswear, Bobbie Brooks's earnings fell sharply. Or a competitor may invade the segment. For these reasons, many companies prefer to operate in more than one segment.

##### **Selective Specialization**

Here the firm selects a number of segments, each objectively attractive and appropriate. There may be little or no synergy among the segments, but each segment 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. Emmis Broadcasting owns New York's KISS-FM, which describes itself as "smooth R&B [rhythm and blues] and classic soul" and appeals to older listeners, and WQHT-FM ("Hot 97"), which plays hip-hop (urban street music) for listeners in the under-25 crowd.

##### **Product Specialization**

Here the firm specializes in making a certain product that it sells to several segments. An example would be a microscope manufacturer that sells microscopes to university laboratories, government laboratories, and commercial laboratories. The firm makes different microscopes for different customer groups but does not manufacture other instruments that laboratories might use. Through a product specialization strategy, the firm builds a strong reputation in the specific product area. The downside risk is that the product may be supplanted by an entirely new technology.

##### **Market Specialization**

Here 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, Bunsen burners, and chemical flasks. The firm gains a strong reputation in serving this customer group and becomes a channel for further products that the customer group could use. The downside risk is that the customer group may have its budgets cut.

##### **Full Market Coverage**

Here a firm attempts to serve all customer groups with all 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 un-differentiated marketing or differentiated marketing.

In undifferentiated marketing, the firm ignores market-segment differences and goes after the whole market with one market offer. It focuses on a basic buyer need rather than on differences among buyers. It designs a product and a marketing program that will appeal to the broadest number of buyers. It relies on mass distribution and mass advertising. It aims to endow the product with a superior image in people's minds. Undifferentiated marketing is "the marketing counterpart to standardization and mass production in manufacturing." 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 when it says that it produces a car for every "purse, purpose, and personality." IBM offers many hardware and software packages for different segments in the computer market. Consider the case of American Drug:

Their purchasing preferences and motivations can be very different from another urban market.... Our stores are now beginning to reflect those differences," says the chain's director of sales and marketing."

Differentiated marketing typically creates more total sales than undifferentiated marketing. However, it also increases the costs of doing business. The following costs are likely to be higher:

**Product modification costs:** Modifying a product to meet different market-segment requirements usually involves some R&D, engineering, and special tooling costs.

**Manufacturing costs:** It is usually more expensive to produce 10 units of 10 different products than 100 units of one product. The longer the production setup time and the smaller the sales volume of each product, the more expensive the product becomes. However, if each model is sold in sufficiently large volume, the higher costs of setup time may be quite small per unit.

**Administrative costs:** The company has to develop separate marketing plans for each market segment. This requires extra marketing research, forecasting, sales analysis, promotion, planning, and channel management.

**Inventory costs:** It is more costly to manage inventories containing many products.

**Promotion costs:** The company has to reach different market segments with different promotion programs. The result is increased promotion-planning costs and media costs.

Because differentiated marketing leads to both higher sales and higher costs, nothing general can be said regarding this strategy's profitability. Companies should be cautious about oversegmenting their market. If this happens, they may want to turn to countersegmentation to broaden the customer base. Johnson & Johnson, for example, broadened its target market for its baby shampoo to include adults. Smith Kline Beecham launched its Aquafresh toothpaste to attract three benefit segments simultaneously: those seeking fresh breath, whiter teeth, and cavity protection.

## CHAPTER – III

The starting point for understanding buyer behavior is the stimulus-response model shown in Figure. Marketing and environmental stimuli enter the buyer's consciousness. The buyer's characteristics and decision process lead to certain purchase decisions. The marketer's task is to understand what happens in the buyer's consciousness between the arrival of outside stimuli and the buyer's purchase decisions.

### **THE MAJOR FACTORS INFLUENCING BUYING BEHAVIOUR**

A consumer's buying behavior is influenced by cultural, social, personal, and psychological factors. Cultural factors exert the broadest and deepest influence.

#### **CULTURAL FACTORS**

Culture, subculture, and social class are particularly important in buying behavior.

##### **Culture**

Culture is the most fundamental determinant of a person's wants and behavior. The growing child acquires a set of values, perceptions, preferences, and behaviors through his or her family and other key institutions. A child growing up in the United States is exposed to the following values: achievement and success, activity, efficiency and practicality, progress, material comfort, individualism, freedom, external comfort, humanitarianism, and youthfulness.

##### **Sub culture**

Each culture consists of smaller subcultures that provide more specific identification and socialization for their members. Subcultures include nationalities, religions, racial groups, and geographic regions. Many subcultures make up important market segments, and marketers often design products and marketing programs tailored to their needs. (See the Marketing Insight "Marketing to Latinos, African Americans, and seniors.")

##### **Social Class**

Virtually all-human societies exhibit social stratification. Stratification sometimes takes the form of a caste system where the members of different castes are reared for certain roles and cannot change their caste membership. More frequently, stratification takes the form of social classes.

Social classes are relatively homogeneous and enduring divisions in a society, which are hierarchically ordered and whose members share similar values, interests, and behavior.

Social classes do not reflect income alone, but also other indicators such as occupation, education, and area of residence. Social classes differ in dress, speech patterns, recreational preferences, and many other characteristics. Table 6.1 describes the seven U.S. social classes identified by social scientists.

Social classes have several characteristics. First, those within each social class tend to behave more alike than persons from two different social classes. Second, persons are perceived as occupying inferior or superior positions according to social class. Third, social class is indicated by a cluster of variables—for example, occupation, income, wealth, education, and value orientation—rather than by any single variable. Fourth, individuals can move from one social class to another—up or down—during their lifetime. The extent of this mobility varies according to the rigidity of social stratification in a given society.

Social classes show distinct product and brand preferences in many areas, including clothing, home furnishings, leisure activities, and automobiles. Some marketers focus their efforts on one social class. Thus the Four Seasons restaurant in midtown Manhattan focuses on upper-class customers, whereas Joe's Diner in Brooklyn focuses on lower-class customers. Social classes differ in media preferences, with upper-class part two consumers preferring magazines and books and lower-class consumers preferring tele. Analyzing vision. Even within a media category such as TV, upper-class consumers prefer news Marketing and drama, and lower-class consumers prefer soap operas and sports programs. There Opportunities are also language differences among the social classes. The advertiser has to compose copy and dialogue that ring true to the targeted social class.

## **SOCIAL FACTORS**

In addition to cultural factors, a consumer's behavior is influenced by such social factors as reference groups, family, and social roles and statuses.

### **Reference Groups**

A person's reference groups consist of all the groups that have a direct (face-to-face) or indirect influence on the person's attitudes or behavior. Groups having a direct influence on a person are called membership groups.

Some membership groups are primary groups, such as family, friends, neighbors, and co-workers, with whom the person interacts fairly continuously and informally.

1. Upper Uppers: The social elite who live on inherited wealth. They give large (less than 1 percent) sums to charity, run the debutante balls, maintain more than one home, send their children to the finest schools. They are a market for jewelry, antiques, homes, and vacations. They often buy and dress conservatively. Although small as a group, they serve as a reference group to the extent that their consumption decisions are imitated by the other social classes.
2. Lower Uppers (2 percent): Persons who have earned high income or wealth through exceptional ability in the professions or business. They usually come from the middle class. They tend to be active in social and civic affairs and seek to buy the symbols of status for themselves and their children. They include the nouveau riche, whose pattern of conspicuous consumption is designed to impress those below them. The ambition of lower uppers is to be accepted in the upper-upper stratum.
3. Upper Middles (12 percent): Possess neither family status nor unusual wealth. They are primarily concerned with "career." They have attained positions as professionals, independent businesspersons, and corporate managers. They believe in education and want their children to develop professional or administrative skills. Members of this class like to deal in ideas and are highly civic minded. They are home-oriented and are the quality market for good homes, clothes, furniture, and appliances.
4. Middle Class (32 percent): Average-pay white- and blue-collar workers who live on "the right side of town." Often, they buy products that are popular to keep up with trends. Twenty-five percent own imported cars, and most are concerned with fashion. The middle class believes in spending more money on "worthwhile experiences" for their children and aiming them toward a college education.
5. Working Class (38 percent): Average-pay blue-collar workers and those who lead a working-class lifestyle, whatever their income, school background, or job. The working class depends heavily on relatives for economic and emotional support, for tips on job

opportunities, for advice, and for assistance. A working-class vacation means staying in town, and "going away" means to a lake or resort no more than two hours away. The working class tends to maintain sharp sex-role divisions and stereotyping.

6. Upper Lower (9 percent): Upper lowers are working, although their living standard is just above poverty. They perform unskilled work and are very poorly paid. Often, upper lowers are educationally deficient.

7. Lower Lower (7 percent): Lower lowers are on welfare, visibly poverty stricken, and usually out of work. Some are not interested in finding a permanent job, and most are dependent on public aid or charity for income.

People also belong to secondary groups, such as religious, professional, and trade union groups, which tend to be more formal and require less continuous interaction.

People are significantly influenced by their reference groups in at least three ways. Reference groups expose an individual to new behaviors and lifestyles. They influence attitudes and self-concept. And they create pressures for conformity that may affect actual product and brand choices.

People are also influenced by groups to which they do not belong. Aspirational groups are those the person hopes to join; dissociative groups are those whose values or behavior an individual rejects.

Marketers try to identify target customers' reference groups. However, the level of reference-group influence varies among products and brands. Reference groups appear to influence both product and brand choice strongly only in the case of automobiles and color televisions; mainly brand choice in such items as furniture and clothing; and mainly product choice in such items as beer and cigarettes.

Manufacturers of products and brands where group influence is strong must determine how to reach and influence the opinion leaders in these reference groups. An opinion leader is the person in informal product-related communications who offers advice or information about a specific product or product category, such as which of several brands is best or how a particular product may be used. Opinion leaders are found in all strata of society, and a person can be an opinion leader in certain product areas and an opinion follower in other areas. Marketers try to reach opinion leaders by identifying demographic and psychographic characteristics associated with opinion leadership, identifying the media read by opinion leaders, and directing messages at the opinion leaders. The hottest trends in teenage music, language, and fashion start in America's inner cities, then quickly spread to more mainstream youth in the suburbs. Clothing companies that hope to appeal to the fickle and fashion-conscious youth market are making a concerted effort to monitor urban opinion leaders' style and behavior:

### **Family**

The family is the most important consumer-buying organization in society, and it has been researched extensively. Family members constitute the most influential primary reference group. We can distinguish between two families in the buyer's life. The family of orientation consists of one's parents and siblings. From parents a person acquires an orientation toward religion, politics, and economics and a sense of personal ambition, self-worth, and love. Even if the buyer no longer interacts very much with his or her parents, their influence on the buyer's behavior can be significant. In countries where parents live with their grown children, their influence can be substantial. A more direct influence on everyday buying behavior is one's family of procreation—namely, one's spouse and children.

Marketers are interested in the roles and relative influence of the husband, wife, and children in the purchase of a large variety of products and services. These roles vary widely in different countries and social classes. Vietnamese Americans, for example, are more likely to adhere to the traditional model in which the man makes the decisions for any large purchase. Similarly, successful ads for Korean Americans usually will feature a man in his thirties or forties unless the ad is for a specifically female product, such as jewelry.

In the United States, husband-wife involvement has traditionally varied widely by product category. The wife has traditionally acted as the family's main purchasing agent, especially for food, sundries, and staple-clothing items. In the case of expensive products and services like vacations or housing, husbands and wives have engaged in more joint decision making. Marketers need to determine which member normally has the greater influence in choosing various products. Often it is a matter of who has more power or expertise.

Women are rapidly gaining power in the household-purchasing power, to be exact. Business guru Tom Peters cites women as the number-one business marketing opportunity, and says:

The market research is clear: Women make or greatly influence most purchasing decisions. Homes... Medical care. Cars. Vacations. And hammers and nails in the huge IY (do-it-yourself) industry: One (rare) female DIY-chain exec remarked to me about her male colleagues' amazement that 60% of their customers were women. ... Women are where the real bucks are. Now close to 8 million women own enterprises in America, up from about 400,000 in 1970. They employ about 18.5 million of us ... 40% more than old Forbes 500 industrials. About 22% of working wives outearn their hubbies, and women constitute about half the population of those with \$500,000 or more in net worth.

Given women's great strides in the workplace, especially in nontraditional jobs, traditional household purchasing patterns are gradually changing. Shifts in social values regarding the division of domestic labor have also weakened such standard conceptions as "women buy all the household goods." Recent research has shown that although traditional buying patterns still hold, baby boomer husbands and wives are more willing to shop jointly for products traditionally thought to be under the separate control of one spouse or the other.<sup>10</sup> Hence, convenience-goods marketers are making a mistake if they think of women as the main or only purchasers of their products. Similarly, marketers of products traditionally purchased by men may need to start thinking of women as possible purchasers.

**This is already happening in the car business:**

Another shift in buying patterns is an increase in the amount of dollars spent and influence wielded by children and teens.<sup>12</sup> This is now an era where children not only are seen and heard but also are catered to as never before. The numbers show it. Children age 4 to 12 spent an estimated \$24.4 billion—three times the value of the ready-to-eat cereal market. Kids' power over their own money is precisely what induced Ty, Inc., to introduce Beanie Babies, the fabulously successful line of about 100 different small stuffed creatures. Beanie Babies sell for about \$6, just the right amount for a kid's weekly allowance. The indirect influence on parental spending of kids age 2 to 14 accounted for \$300 billion of household purchases in 1997. Indirect influence means that parents know the brands, product choices, and preferences of their children without hints or outright requests. Direct influence describes children's hints, requests, and demands—"I want to go to McDonald's." Direct influence peaked around \$188 billion in 1997. Nontraditional marketers are now figuring out that the fastest route to Mom and Dad's wallets may be through Junior.

## Roles and Statuses

A person participates in many groups-family, clubs, and organizations. The person's position in each group can be defined in terms of role and status. A role consists of the activities that a person is expected to perform. Each role carries a status. A Supreme Court justice has more status than a sales manager, and a sales manager has more status than an office clerk. People choose products that communicate their role and status in society. Thus company presidents often drive Mercedes, wear expensive suits, and drink Chivas Regal scotch. Marketers are aware of the status symbol potential of products and brands.

## PERSONAL FACTORS

A buyer's decisions are also influenced by personal characteristics. These include the buyer's age and stage in the life style, occupation, economic circumstances, lifestyle, and personality and self-concept.

### Age and Stage in the Life Cycle

People buy different goods and services over a lifetime. They eat baby food in the early years, most foods in the growing and mature years, and special diets in the later years. Taste in clothes, furniture, and recreation is also age related.

Consumption is shaped by the family life cycle. Nine stages of the family life cycle are listed in Table 6.2, along with the financial situation and typical product interests of each group. Marketers often choose life-cycle groups as their target market. Yet target households are not always family based: There are also single households, gay households, and cohabitor households.

Some recent work has identified psychological life-cycle stages. Adults experience certain "passages" or "transformations" as they go through life.<sup>15</sup> Marketers pay close attention to changing life circumstances-divorce, widowhood, remarriage-and their effect on consumption behavior.

### (Occupation and Economic Circumstances

Occupation also influences a person's consumption pattern. A blue-collar worker will buy work clothes, work shoes, and lunchboxes. A company president will buy expensive suits, air travel, country club membership, and a large sailboat. Marketers try to identify the occupational groups that have above-average interest in their products and services. A company can even specialize its products for certain occupational groups: Computer software companies design different products for brand managers, engineers, lawyers, and physicians.

**1. Bachelor stage:** young, single, not living at home.

Few financial burdens. Fashion opinion leaders. Recreation oriented. Buy: basic home equipment, furniture, cars, equipment for the mating game; vacations.

**2. Newly married couples:** Young, no children.

Highest purchase rate and highest average purchase of durables: cars, appliances, furniture, vacations.

**3. Full nest I:** youngest child under six.

Home purchasing at peak. Liquid assets low. Interested in new products, advertised products. Buy: washers, dryers, TV, baby food, chest rubs and cough medicines, vitamins, dolls, wagons, sleds, skates.

**4. Full nest II:** youngest child six or over.

Financial position better. Less influenced by advertising. Buy larger-size packages, multiple-unit deals. Buy: many foods, cleaning materials, bicycles, music lessons, pianos.

**5. Full nest III:** older married couples with dependent children.

Financial position still better. Some children get jobs. Hard to influence with advertising. High average purchase of durables: new, more tasteful furniture, auto travel, unnecessary appliances, boat"s, dental services, magazines.

**6. Empty nest I:** older married couples, no children living with them, head of household in labor force. Home ownership at peak. Most satisfied with financial position and money saved. Interested in travel, recreation, self-education. Make gifts and contributions. Not interested in new products. Buy: vacations, luxuries, home improvements.

**7. Empty nest II:** older married. No children living at home, head of household retired. Drastic cut in income. Keep home. Buy: medical appliances, medical-care products.

**8. Solitary survivorI in labor force:** Income still good but likely to sell home.

**9. Solitary survivor, retired:** Same medical and product needs as other retired group; drastic cut in income. Special need for attention, affection, and security.

Product choice is greatly affected by economic circumstances: spendable income (level, stability, and time pattern), savings and assets (including the percentage that is liquid), debts, borrowing power, and attitude toward spending versus saving. Marketers of income-sensitive goods pay constant attention to trends in personal income, savings, and interest rates. If economic indicators point to a recession, marketers can take steps to redesign, reposition, and reprice their products so they continue to offer value to target customers.

### Lifestyle

People from the same subculture, social class, and occupation may lead quite different lifestyles. A lifestyle is the person's pattern of living in the world as expressed in activities, interests, and opinions. Lifestyle portrays the "whole person" interacting with his or her environment.

Marketers search for relationships between their products and lifestyle groups. For example, a computer manufacturer might find that most computer buyers are achievement-oriented. The marketer may then aim the brand more clearly at the achiever lifestyle.

Psychographics is the science of measuring and categorizing consumer lifestyles. One of the most popular classifications based on psychographic measurements is the VALS 2 framework. SRI International's Values and Lifestyles (VALS) framework has been the only commercially available psychographic segmentation system to gain widespread acceptance. The VALS 2 system is continually updated to serve the business world better. VALS 2 classifies all U.S. adults into 8 groups based on psychological attributes. The segmentation system is based on responses to a questionnaire featuring 5 demographics and 42 attitudinal questions as well as questions about use of on-line services and Web sites.

The VALS 2 questionnaire asks respondents to agree or disagree with statements such as "I like my life to be pretty much the same from week to week," "I often crave excitement," and "I would rather make something than buy it.

The major tendencies of the four groups with greater resources are:

**Actualizers:** Successful, sophisticated, active, "take-charge" people. Purchases often reflect cultivated tastes for relatively upscale, niche-oriented products.

**Ful filleds:** Mature, satisfied, comfortable, reflective. Favor durability, functionality, and value in products.

**Achievers:** Successful, career- and work-oriented. Favor established, prestige products that demonstrate success to their peers.

**Experiencers:** Young, vital, enthusiastic, impulsive, and rebellious. Spend a comparatively high proportion of their income on clothing, fast food, music, movies, and video.

The major tendencies of the four groups with fewer resources are:

**Believers:** Conservative, conventional, and traditional. Favor familiar products and established brands.

**Strivers:** Uncertain, insecure, approval-seeking, resource constrained. Favor stylish products that emulate the purchases of those with greater material wealth.

**Makers:** Practical, self-sufficient, traditional, family-oriented. Favor only products with a practical or functional purpose such as tools, utility vehicles, fishing equipment.

**Strugglers:** Elderly, resigned, passive, concerned, resource constrained. Cautious consumers who are loyal to favorite brands.

If you want to find out which VALS 2 type you are or to find out about the VALS 2 segments in general, go to SRI's Web site ([www.future.sri.com](http://www.future.sri.com)). You can complete the VALS 2 and other lifestyle questionnaires and get results back in real time.

Although psychographics continues to be a valid and valued methodology for many marketers, it may become less valid in the information economy. Social scientists are realizing that old tools for predicting consumer behavior don't always work when it comes to use of the Internet or on-line services and purchases of technology products. See the Marketing for the Millennium box "Are You a Mouse Potato or a Techno-Striver? New Research Focuses on What Makes Technology Buyers Click."

Lifestyle segmentation schemes are by no means universal. McCann-Erickson London, for example, identified the following British lifestyles: Avant-Gardians (interested in change); Pontificators (traditionalists, very British); Chameleons (follow the crowd); and Sleepwalkers (contented underachievers). In 1992 the advertising agency D'Arcy, Masius, Benton & Bowles published *The Russian Consumer: A New Perspective and a Marketing Approach*, which revealed five categories of Russian consumers: "Kuptsi" (merchants), "Cossacks," "Students," "Business Executives," and "Russian Souls." Cossacks are characterized as ambitious, independent, and status seeking, whereas Russian Souls are passive, fearful of choices, and hopeful. Cossacks would drive a BMW, smoke Dunhill cigarettes, and drink Remy Martin; Russian Souls would drive a Lada, smoke Marlboros, and drink Smirnoff."

### **Personality and Self-Concept**

Each person has a distinct personality that influences buying behavior.

By personality, we mean distinguishing psychological characteristics that lead to relatively consistent and enduring responses to environment.

Women giving birth to millennium Personality is usually described in terms of such traits as self-confidence, dominance, autonomy, deference, sociability, defensiveness, and adaptability." Personality cause maternal and infant deaths are can be a useful variable in analyzing consumer behavior, provided that personality expected to decrease dramatically types can be classified accurately and that strong correlations exist between certain personality types and product or brand choices. For example, a computer company might discover that many prospects show high self-confidence, dominance, and autonomy. This suggests designing computer advertisements to appeal to these traits. Related to personality is self-concept (or self-image). Marketers try to develop brand images that match the target market's self-image. It is possible that a person's actual self-concept (how she views herself) differs from her ideal self-concept (how she would like to view herself) and from her others-self-concept (how she thinks others see her).

## PSYCHOLOGICAL FACTORS

A person's buying choices are influenced by four major psychological factors—motivation, perception, learning, and beliefs and attitudes.

### Motivation

A person has many needs at any given time. Some needs are biogenic; they arise from physiological states of tension such as hunger, thirst, discomfort. Other needs are psychogenic; they arise from psychological states of tension such as the need for recognition, esteem, or belonging. A need becomes a motive when it is aroused to a sufficient level of intensity. A motive is a need that is sufficiently pressing to drive the person to act.

Psychologists have developed theories of human motivation. Three of the best known—the theories of Sigmund Freud, Abraham Maslow, and Frederick Herzberg—carry quite different implications for consumer analysis and marketing strategy.

**Freud's Theory.** Sigmund Freud assumed that the psychological forces shaping people's behavior are largely unconscious, and that a person cannot fully understand his or her own motivations. A technique called laddering can be used to trace a person's motivations from the stated instrumental ones to the more terminal ones. Then the marketer can decide at what level to develop the message and appeal.

When a person examines specific brands, he or she will react not only to their stated capabilities but also to other, less conscious cues. Shape, size, weight, material, color, and brand name can all trigger certain associations and emotions.

Motivation researchers often collect "in-depth interviews" with a few dozen consumers to uncover deeper motives triggered by a product. They use various "projective techniques" such as word association, sentence completion, picture interpretation, and role playing. Their research has produced interesting and occasionally bizarre hypotheses: Consumers resist prunes because prunes are wrinkled looking and remind people of old age, men smoke cigars as an adult version of thumb sucking, and women prefer vegetable shortening to animal fats because the latter arouse a sense of guilt over killing animals.

More recent research holds that each product is capable of arousing a unique set of motives in consumers. For example, whisky can attract someone who seeks social relaxation, status, or fun. Therefore, different whisky brands have specialized in one of these three different appeals. Jan Callebaut calls this approach "motivational positioning."

**Maslow's Theory.** Abraham Maslow sought to explain why people are driven by particular needs at particular times. Why does one person spend considerable time and energy on personal safety and another on pursuing the high opinion of others? Maslow's answer is that human needs are arranged in a hierarchy, from the most pressing to the least pressing. In their order of importance, they are physiological needs, safety needs, social needs, esteem needs, and self-actualization needs (Figure 6.2). People will try to satisfy their most important needs first. When a person succeeds in satisfying an important need, that need will cease being a current motivator, and the person will try to satisfy the next-most-important need. For example, a starving man (need 1) will not take an interest in the latest happenings in the art world (need 5), nor in how he is viewed by others (need 3 or 4), nor even in whether he is breathing clean air (need 2). But when he has enough food and water, the next-most-important need will become salient. Maslow's theory helps marketers understand how various products fit into the plans, goals, and lives of consumers.

**Herzberg's Theory.** Frederick Herzberg developed a two-factor theory that distinguishes dissatisfiers (factors that cause dissatisfaction) and satisfiers (factors that cause

satisfaction). The absence of dissatisfiers is not enough; satisfiers must be actively present to motivate a purchase. For example, a computer that does not come with a warranty would be a dissatisfier. Yet the presence of a product warranty would not act as a satisfier or motivator of a purchase, because it is not a source of intrinsic satisfaction with the computer. Ease of use would be a satisfier.

Herzberg's theory has two implications. First, sellers should do their best to avoid dissatisfiers (for example, a poor training manual or a poor service policy). Although these things will not sell a product, they might easily unsell it. Second, the manufacturer should identify the major satisfiers or motivators of purchase in the market and then supply them. These satisfiers will make the major difference as to which brand the customer buys.

### **Perception**

A motivated person is ready to act. How the motivated person actually acts is influenced by his or her perception of the situation. Perception is the process by which an individual selects, organizes, and interprets information inputs to create a meaningful picture of the world." Perception depends not only on the physical stimuli but also on the stimuli's relation to the surrounding field and on conditions within the individual.

The key word in the definition of perception is individual. One person might perceive a fast-talking salesperson as aggressive and insincere; another, as intelligent and helpful. People can emerge with different perceptions of the same object because of three perceptual processes: selective attention, selective distortion, and selective retention.

**Selective Attention.** People are exposed to a tremendous amount of daily stimuli: The average person may be exposed to over 1,500 ads a day. Because a person cannot possibly attend to all of these, most stimuli will be screened out—a process called selective attention. Selective attention means that marketers have to work hard to attract consumers' notice. The real challenge is to explain which stimuli people will notice. Here are some findings:

People are more likely to notice stimuli that relate to a current need. A person who is motivated to buy a computer will notice computer ads; he or she will probably not notice stereo-equipment ads.

People are more likely to notice stimuli that they anticipate. You are more likely to notice computers than radios in a computer store because you do not expect the store to carry radios.

People are more likely to notice stimuli whose deviations (are large in relation to the normal size of the stimuli). You are more likely to notice an ad offering \$100 off the list price of a computer than one offering \$5 off.

**Selective Distortion.** Even noticed stimuli do not always come across in the way the senders intended. Selective distortion is the tendency to twist information into personal meanings and interpret information in a way that will fit our preconceptions. Unfortunately, there is not much that marketers can do about selective distortion.

**Selective Retention.** People will forget much that they learn but will tend to retain information that supports their attitudes and beliefs. Because of selective retention, we are likely to remember good points mentioned about a product we like and forget good points mentioned about competing products. Selective retention explains why marketers use drama and repetition in sending messages to their target market.

## **Learning**

When people act, they learn. Learning involves changes in an individual's behavior arising from experience. Most human behavior is learned. A drive is a strong internal stimulus impelling action. Cues are minor stimuli that determine when, where, and how a person responds.

Suppose you buy an IBM computer. If your experience is rewarding, your response to computers and IBM will be positively reinforced. Later on, when you want to buy a printer, you may assume that because IBM makes good computers, IBM also makes good printers. In other words, you generalize your response to similar stimuli. A countertendency to generalization is discrimination. Discrimination means that the person has learned to recognize differences in sets of similar stimuli and can adjust responses accordingly.

Learning theory teaches marketers that they can build up demand for a product by associating it with strong drives, using motivating cues, and providing positive reinforcement. A new company can enter the market by appealing to the same drives that competitors use and providing similar cue configurations because buyers are more likely to transfer loyalty to similar brands (generalization). Or the company might design its brand to appeal to a different set of drives and offer strong cue inducements to switch (discrimination).

## **Beliefs and Attitudes**

Through doing and learning, people acquire beliefs and attitudes. These in turn influence buying behavior. A belief is a descriptive thought that a person holds about something.

Beliefs may be based on knowledge, opinion, or faith. They may or may not carry an emotional charge. Of course, manufacturers are very interested in the beliefs people carry in their heads about their products and services. These beliefs make up product and brand images, and people act on their images. If some beliefs are wrong and inhibit purchase, the manufacturer will want to launch a campaign to correct these beliefs.

Particularly important to global marketers is the fact that buyers often hold distinct beliefs about brands or products based on their country of origin. Several country-of-origin studies have found the following:

The impact of country of origin varies with the type of product. Consumers would want to know where a car was made but not where the lubricating oil came from. Certain countries enjoy a reputation for certain goods: Japan for automobiles and consumer electronics; the United States for high-tech innovations, soft drinks, toys, cigarettes, and jeans; and France for wine, perfume, and luxury goods.

Sometimes the country-of-origin perception can extend beyond certain products and encompass an entire country's products. In a recent study, Chinese consumers in Hong Kong perceived American products as prestigious, Japanese products as innovative, and Chinese products as cheap." The more favorable a country's image, the more prominently the "Made in ..." label should be displayed in promoting the brand.

Attitudes toward country of origin can change over time. Japan had a poor quality image before World War II. A company has several options when its products are competitively priced but their place of origin turns off consumers. The company can consider co-production with a foreign company that has a better name: South Korea could make a fine leather jacket that it sends to Italy for finishing. Or the company can adopt a strategy to achieve world-class quality in the local industry, as is the case with Belgian chocolates, Polish ham, and Colombian coffee. This is what South African wineries are attempting to do.

Finally, the company can hire a well-known celebrity to endorse the product. Nike has had a great deal of success using basketball star Michael Jordan to promote its *Air Max* shoes in Europe.

Just as important as beliefs are attitudes. An attitude is a person's enduring favorable or unfavorable evaluations, emotional feelings, and action tendencies toward some object or idea. People have attitudes toward almost everything: religion, politics, clothes, music, and food. Attitudes put them into a frame of mind of liking or disliking an object, moving toward or away from it. Attitudes lead people to behave in a fairly consistent way toward similar objects. People do not have to interpret and react to every object in a fresh way. Because attitudes economize on energy and thought, they are very difficult to change. A person's attitudes settle into a consistent pattern. To change a single attitude may require major adjustments in other attitudes.

Thus a company would be well advised to fit its product into existing attitudes rather than to try to change people's attitudes. Of course, there are exceptions where the cost of trying to change attitudes might pay off. Here are two examples of food organizations that used ad campaigns to change consumer attitudes, with handsome results:

Marketers have to go beyond the various influences on buyers and develop an understanding of how consumers actually make their buying decisions. Specifically, marketers must identify who makes the buying decision, the types of buying decisions, and the steps in the buying process.

#### **BUYING ROLES**

It is easy to identify the buyer for many products. In the United States, men normally choose their shaving equipment, and women choose their pantyhose. But even here marketers must be careful in making their targeting decisions, because buying roles change. ICI, the giant British chemical company, discovered to its surprise that women made 60 percent of the decisions on the brand of household paint. ICI therefore decided to advertise its DeLux brand to women. We can distinguish five roles people might play in a buying decision:

- Initiator** : A person who first suggests the idea of buying the product or service
- Influencer** : A person whose view or advice influences the decision
- Decider** : A person who decides on any component of a buying decision, whether to buy, what to buy, how to buy, or where to buy
- User** : A person who consumes or uses the product or service.

#### **BUYING BEHAVIOR**

Consumer decision-making varies with the type of buying decision. The decisions to buy toothpaste, a tennis racket, a personal computer, and a new car are all very different. Complex and expensive purchases are likely to involve more buyer deliberation and more participants. As such, distinguished four types of consumer buying behavior based on the degree of buyer involvement and the degree of differences among brands.

##### **Complex Buying Behavior**

Complex buying behavior involves a three-step process. First, the buyer develops beliefs about the product. Second, he or she develops attitudes about the product. Third, he or she makes a thoughtful choice. Consumers engage in complex buying behavior when they are highly involved in a purchase and aware of significant differences among brands. This is usually the case when the product is expensive, bought infrequently, risky, and highly self-

expressive. Typically the consumer does not know much about the product category. For example, a person buying a personal computer may not know what attributes to look for. Many product features carry no meaning unless the buyer has done some research.

The marketer of a high-involvement product must understand consumers' information-gathering and evaluation behavior. The marketer needs to develop strategies that assist the buyer in learning about the product's attributes and their relative importance, and that call attention to the high standing of the company's brand on the more important attributes. The marketer needs to differentiate the brand's features, use print media to describe the brand's benefits, and motivate store sales personnel and the buyer's acquaintances to influence the final brand choice.

### **Dissonance-Reducing Buyer Behavior**

Sometimes the consumer is highly involved in a purchase but sees little difference in brands. The high involvement is based on the fact that the purchase is expensive, infrequent, and risky. In this case, the buyer will shop around to learn what is available but will buy fairly quickly, perhaps responding primarily to a good price or to purchase convenience. For example, carpet buying is a high-involvement decision because carpeting is expensive and self-expressive, yet the buyer may consider most carpet brands in a given price range to be the same.

After the purchase, the consumer might experience dissonance that stems from noticing certain disquieting features or hearing favorable things about other brands. The consumer will be alert to information that supports his or her decision. In this example, the consumer first acted, then acquired new beliefs, then ended up with a set of attitudes. Marketing communications should supply beliefs and evaluations that help the consumer feel good about his or her brand choice.

### **Habitual Buying Behavior**

Many products are bought under conditions of low involvement and the absence of significant brand differences. Consider salt. Consumers have little involvement in this product category. They go to the store and reach for the brand. If they keep reaching for the same brand, it is out of habit, not strong brand loyalty. There is good evidence that consumers have low involvement with most low-cost, frequently purchased products.

With these products, consumer behavior does not pass through the normal sequence of belief, attitude, and behavior. Consumers do not search extensively for information, evaluate characteristics, and make a decision on which brand to buy. Instead, they are passive recipients of information in television or print ads. Ad repetition creates brand familiarity rather than brand conviction. After purchase, they may not even evaluate the choice because they are not highly involved with the product. For low-involvement products, the buying process begins with brand beliefs formed by passive learning and is followed by purchase behavior, which may be followed by evaluation.

Marketers of such products find it effective to use price and sales promotions to stimulate product trial. Television advertising is more effective than print because it is a low-involvement medium that is suitable for passive learning.

Marketers use four techniques to try to convert a low-involvement product into one of higher involvement. First, they can link the product to some involving issue, as when Crest toothpaste is linked to avoiding cavities. Second, they can link the product to some involving personal situation—for instance, by advertising a coffee brand early in the morning v.,hen the

consumer wants to shake off sleepiness. Third, they might design advertising to trigger strong emotions related to personal values or ego defense. Fourth, they might add an important feature (for example, fortifying a plain drink with vitamins). These strategies at best raise consumer involvement from a low to a moderate level; they do not propel the consumer into highly involved buying behavior.

### **Variety-Seeking Buying Behavior**

Some buying situations are characterized by low involvement but significant brand differences. Here consumers often do a lot of brand switching. Think about cookies. The consumer has some beliefs about cookies, chooses a brand of cookies without much evaluation, and evaluates the product during consumption. Next time, the consumer may reach for another brand out of a wish for a different taste. Brand switching occurs for the sake of variety rather than dissatisfaction.

The market leader and the minor brands in this product category have different marketing strategies. The market leader will try to encourage habitual buying behavior by dominating the shelf space, avoiding out-of-stock conditions, and sponsoring frequent reminder advertising. Challenger firms will encourage variety seeking by offering lower prices, deals, coupons, free samples, and advertising that presents reasons for trying something new.

Smart companies research the buying decision process involved in their product category. They ask consumers when they first became acquainted with the product category and brands, what their brand beliefs are, how involved they are with the product, how they make their brand choices, and how satisfied they are after purchase.

How can marketers learn about the stages in the buying process for their product? "They can think about how they themselves would act (introspective method). They can interview a small number of recent purchasers, asking them to recall the events leading to their purchase (retrospective method). They can locate consumers who plan to buy the product and ask them to think out loud about going through the buying process (prospective method). Or they can ask consumers to describe the ideal way to buy the product (prescriptive method). Each method yields a picture of the steps in the consumer buying process.

"Stage model" of the typical buying process. The consumer passes through five stages: problem recognition, information search, evaluation of alternatives, purchase decision, and postpurchase behavior. Clearly the buying process starts long before the actual purchase and has consequences long afterward."

Consumers pass sequentially through all five stages in buying a product. But this is not the case: Consumers may skip or reverse some stages. A woman buying her regular brand of toothpaste goes directly from the need for toothpaste to the purchase decision, skipping information search and evaluation. Because it captures the full range of considerations that arise when a consumer faces a highly involving new purchase."

### **PROBLEM RECOGNITION**

The buying process starts when the buyer recognizes a problem or need. The need can be triggered by internal or external stimuli. In the former case, one of the person's normal needs-hunger, thirst, sex-rises to a threshold level and becomes a drive. In the latter case, a need is aroused by an external stimulus. A person passes a bakery and sees freshly baked

bread that stimulates her hunger; she admires a neighbor's new car; or she watches a television ad for a Hawaiian vacation.

Marketers need to identify the circumstances that trigger a particular need. By gathering information from a number of consumers, marketers can identify the most frequent stimuli that spark an interest in a product category. They can then develop marketing strategies that trigger consumer interest.

### **INFORMATION SEARCH**

An aroused consumer will be inclined to search for more information. We can distinguish between two levels of arousal. The milder search state is called heightened attention. At this level a person simply becomes more receptive to information about a product. At the next level, the person may enter active information search: looking for reading material, phoning friends, and visiting stores to learn about the product. Of key interest to the marketer are the major information sources to which the consumer will turn and the relative influence each will have on the subsequent purchase decision. Consumer information sources fall into four groups:

**Personal sources:** Family, friends, neighbors, and acquaintances

**Commercial sources:** Advertising, salespersons, dealers, packaging, displays

**Public sources:** Mass media, consumer-rating organizations

**Experiential sources:** Handling, examining, using the product

The relative amount and influence of these information sources vary with the product category and the buyer's characteristics. Generally speaking, the consumer receives the most information about a product from commercial sources—that is, marketer-dominated sources. But the most effective information comes from personal sources. Each information source performs a different function in influencing the buying decision. Commercial information normally performs an informing function, and personal sources perform a legitimizing or evaluation function. For example, physicians often learn of new drugs from commercial sources but turn to other doctors for evaluative information.

Through gathering information, the consumer learns about competing brands and their features. The total set of brands available to the consumer. The individual consumer will come to know only a subset of these brands (awareness set). Some brands will meet initial buying criteria (consideration set). As the person gathers more information, only a few will remain as strong contenders (choice set). The brands in the choice set might all be acceptable. The person makes a final choice from this set.

Makes it clear that a company must strategize to get its brand into the prospect's awareness set, consideration set, and choice set. The company must also identify the other brands in the consumer's choice set so that it can plan competitive appeals. In addition, the company should identify the consumer's information sources and evaluate their relative importance. Consumers should be asked how they first heard about the brand, what information came in later, and the relative importance of the different information sources. The answers will help the company prepare effective communications for the target market.

### **EVALUATION OF ALTERNATIVES**

How does the consumer process competitive brand information and make a final value judgment? There is no single evaluation process used by all consumers or by one consumer in all buying situations. There are several decision evaluation processes, the most

current models of which see the process as cognitively oriented. That is, they see the consumer as forming judgments largely on a conscious and rational basis.

Some basic concepts will help us understand consumer evaluation processes: First, the consumer is trying to satisfy a need. Second, the consumer is looking for certain benefits from the product solution. Third, the consumer sees each product as a bundle of attributes with varying abilities of delivering the benefits sought to satisfy this need. The attributes of interest to buyers vary by product:

**Cameras:** Picture sharpness, camera speeds, camera size, price

**Hotels:** Location, cleanliness, atmosphere, price

**Mouthwash:** Color, effectiveness, germ-killing capacity, price, taste/flavor

**Tires:** Safety, tread life, ride quality, price

Consumers vary as to which product attributes they see as most relevant and the importance they attach to each attribute. They will pay the most attention to attributes that deliver the sought benefits. The market for a product can often be segmented according to attributes that are salient to different consumer groups.

The consumer develops a set of brand beliefs about where each brand stands on each attribute. The set of beliefs about a brand make up the brand image. The consumer's brand image will vary with his or her experiences as filtered by the effects of selective perception, selective distortion, and selective retention.

The consumer arrives at attitudes (judgments, preferences) toward the various brands through an attribute evaluation procedure." Suppose that Linda Brown has narrowed her choice set to four computers (A, B, C, D). Assume that she is interested in four attributes: memory capacity, graphics capability, size and weight, and price. Table 6.4 shows her beliefs about how each brand rates on the four attributes. If one computer dominated the others on all the criteria, we could predict that Linda would choose it. But her choice set consists of brands that vary in their appeal. If Linda wants the best memory capacity, she should buy A; if she wants the best graphics capability, she should buy B; and so on.

Most buyers consider several attributes in their purchase decision. If we knew the weights that Linda Brown attaches to the four attributes, we could more reliably predict her computer choice. Suppose Linda assigned 40 percent of the importance to the computer's memory capacity, 30 percent to its graphics capability, 20 percent to its size and weight, and 10 percent to its price. To find Linda's perceived value for each computer, we multiply her weights by her beliefs about each computer's attributes. This computation leads to the following perceived values:

$$\text{Computer A} = 0.4(10) + 0.3(8) + 0.2(6) + 0.1(4) = 8.0$$

$$\text{Computer B} = 0.4(8) + 0.3(9) + 0.2(8) + 0.1(3) = 7.8$$

$$\text{Computer C} = 0.4(6) + 0.3(8) + 0.2(10) + 0.1(5) = 7.3$$

$$\text{Computer D} = 0.4(4) + 0.3(3) + 0.2(7) + 0.1(8) = 4.7$$

We would predict that Linda would favor computer A, which (at 8.0) has the highest perceived value. Suppose most computer buyers form their preferences the same way. Knowing this, a computer manufacturer can do a number of things to influence buyer decisions. The marketer of computer C, for example, could apply the following strategies to stimulate greater interest in brand C.

**Redesign the computer:** This technique is called real repositioning.

**Alter beliefs about the brand:** Attempting to alter beliefs about the brand is called psychological repositioning.

**Alter beliefs about competitors' brands:** This strategy, called competitive depositioning, makes sense when buyers mistakenly believe a competitor's brand has more quality than it actually has.

**Alter the importance weights:** The marketer could try to persuade buyers to attach more importance to the attributes in which the brand excels.

**Call attention to neglected attributes:** The marketer could draw buyers' attention to neglected attributes, such as styling or processing speed.

**Shift the buyer's ideals:** The marketer could try to persuade buyers to change their ideal levels for one or more attributes.

## **PURCHASE DECISION**

In the evaluation stage, the consumer forms preferences among the brands in the choice set. The consumer may also form an intention to buy the most preferred brand. However, two factors can intervene between the purchase intention and the purchase decision.

The first factor is the attitudes of others. The extent to which another person's attitude reduces one's preferred alternative depends on two things: (1) the intensity of the other person's negative attitude toward the consumer's preferred alternative and (2) the consumer's motivation to comply with the other person's wishes." The more intense the other person's negativism and the closer the other person is to the consumer, the more the consumer will adjust his or her purchase intention. The converse is also true: A buyer's preference for a brand will increase if someone he or she respects favors the same brand strongly. The influence of others becomes complex when several people close to the buyer hold contradictory opinions and the buyer would like to please them all.

The second factor is unanticipated situational factors that may erupt to change the purchase intention. Jack Hamilton might lose his job, some other purchase might become more urgent, or a store salesperson may turn him off. Preferences and even purchase intentions are not completely reliable predictors of purchase behavior.

A consumer's decision to modify, postpone, or avoid a purchase decision is heavily influenced by perceived risk." The amount of perceived risk varies with the amount of money at stake, the amount of attribute uncertainty, and the amount of consumer self-confidence. Consumers develop routines for reducing risk, such as decision avoidance, information gathering from friends, and preference for national brand names and warranties. Marketers must understand the factors that provoke a feeling of risk in consumers and provide information and support to reduce the perceived risk.

In executing a purchase intention, the consumer may make up to five purchase subdecisions: a brand decision (brand A), vendor, decision (dealer 2), quantity decision (one computer), timing decision (weekend), and payment-method decision (credit card). Purchases of everyday products involve fewer decisions and less deliberation. For example, in buying sugar, a consumer gives little thought to the vendor or payment method.

## **POSTPURCHASE BEHAVIOR**

After purchasing the product, the consumer will experience some level of satisfaction or dissatisfaction. The marketer's job does not end when the product is bought. Marketers must monitor postpurchase satisfaction, postpurchase actions, and postpurchase product uses.

### **Postpurchase Satisfaction**

What determines whether the buyer will be highly satisfied, somewhat satisfied, or dissatisfied with a purchase? The buyer's satisfaction is a function of the closeness between the buyer's expectations and the product's perceived performance." If performance falls short of expectations, the customer is disappointed; if it meets expectations, the customer is satisfied, if it exceeds expectations, the customer is delighted. These feelings make a difference in whether the customer buys the product again and talks favorably or unfavorably about the product to others.

Consumers form their expectations on the basis of messages received from sellers, friends, and other information sources. The larger the gap between expectations and performance, the greater the consumer's dissatisfaction. Here the consumer's coping style comes into play. Some consumers magnify the gap when the product is not perfect, and they are highly dissatisfied. Other consumers minimize the gap and are less dissatisfied.

The importance of postpurchase satisfaction suggests that product claims must truthfully represent the product's likely performance. Some sellers might even understate performance levels so that consumers experience higher-than-expected satisfaction with the product.

### **Postpurchase Actions**

The consumer's satisfaction or dissatisfaction with the product will influence subsequent behavior. If the consumer is satisfied, he or she will exhibit a higher probability of purchasing the product again. For example, data on automobile brand choice show a high correlation between being highly satisfied with the last brand bought and intention to rebuy the brand. One survey showed that 75 percent of Toyota buyers were highly satisfied and about 75 percent intended to buy a Toyota again; 35 percent of Chevrolet buyers were highly satisfied and about 35 percent intended to buy a Chevrolet again. The satisfied customer will also tend to say good things about the brand to others. Marketers say: "Our best advertisement is a satisfied customer.

Dissatisfied consumers may abandon or return the product. They may seek information that confirms its high value. They may take public action by complaining to the company, going to a lawyer, or complaining to other groups (such as business, private, or government agencies). Private actions include making a decision to stop buying the product (exit option) or warning friends (voice option). In all these cases, the seller has done a poor job of satisfying the customer.

Postpurchase communications to buyers have been shown to result in fewer product returns and order cancellations. Computer companies, for example, can send a letter to new computer owners congratulating them on having selected a fine computer. They can place ads showing satisfied brand owners. They can solicit customer suggestions for improvements and list the location of available services. They can write instruction booklets that are intelligible. They can send owners a magazine containing articles describing new computer applications. In addition, they can provide good channels for speedy redress of customer grievances.

### PRODUCT LIFE-CYCLE MARKETING STRATEGIES

A company's differentiating and positioning strategy must change as the product, market, and competitors change over time. Here we will describe the concept of the product life cycle and the changes that are normally made 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, each posing different challenges, opportunities, and problems to the seller.
3. Profits rise and fall at different stages of the product life cycle.
4. Products require different marketing, financial, manufacturing, purchasing, and human resource strategies in each stage of their life cycle.

Most product life-cycle curves are portrayed as bell-shaped. This curve is typically divided into four stages: introduction, growth, maturity, and decline.

1. **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.
2. **Growth:** A period of rapid market acceptance and substantial profit improvement.
3. **Maturity:** A period of a slowdown in sales growth because the product has achieved acceptance by most potential buyers. Profits stabilize or decline because of increased competition.
4. **Decline:** The period when sales show a downward drift and profits erode.

The PLC concept can be used to analyze a product category (liquor), a product form (white liquor), a product (vodka), or a brand (Smirnoff).

Product categories have the longest life cycles. Many product categories stay in the mature stage indefinitely and grow only at the population growth rate. Some major product categories-typewriters newspapers-seem to have entered the decline stage of the PLC. Some others-fax machines, cellular telephones, bottled water-are clearly in the growth stage.

Product forms follow the standard PLC more faithfully. Manual typewriters passed through the stages of introduction, growth, maturity, and decline; their successors-electric typewriters and electronic typewriters-passed through these same stages. Products follow either the standard PLC or one of several variant shapes.

Branded products can have a short or long PLC. Although many new brands die an early death, some brand names-such as Ivory, Jell-O, Hershey's-have a very long PLC and are used to name and launch new products. Hershey's has successfully introduced Hershey's Hugs, Hershey's Kisses with Almonds, and Hershey's Cookies & Mint candy bar. Hershey believes it can keep its strong brand name going forever.

#### Other Shapes of the Product Life Cycle

Not all products exhibit a bell-shaped PLC. Researchers have identified from six to seventeen different PLC patterns.<sup>3</sup> Three common alternate pattern shows a growth-slump-maturity pattern, often characteristic of small kitchen appliances. Some years ago, the sales of electric knives grew rapidly when the product was first introduced and then fell to a

"petrified" level. The petrified level is sustained by late adopters buying the product for the first time and early adopters replacing the product.

The cycle-recycle describes the sales of new drugs. The pharmaceutical company aggressively promotes its new drug, and this produces the first cycle. Later, sales start declining and the company give the drug another promotion push, which produces a second cycle (usually of smaller magnitude and duration).

Another common pattern is the scalloped PLC. Here sales pass through a succession of life cycles based on the discovery of new-product characteristics, uses, or users. Nylon's sales, for example, show a scalloped pattern because of many new uses-parachutes, hosiery, shirts, carpeting, boat sails, automobile tires-that continue to be discovered over time.

### **Style, Fashion, and Fad Life Cycles**

Three special categories of product life cycles should be distinguished-styles, fashions, and fads. A style is a basic and distinctive mode of expression appearing in a field of human endeavor. Styles appear in homes (colonial, ranch, Cape Cod); clothing (formal, casual, funky); and art (realistic, surrealist, abstract). A style .an last for generations, going in and out of vogue. A fashion is a currently accepted or popular style in a given field. Fashions pass through four stages: distinctiveness, emulation, mass fashion, and decline.

The length of a fashion cycle is hard to predict. Wasson believes that fashions end because they represent a purchase compromise, and consumers start looking for missing attributes. For example, as automobiles become smaller, they become less comfortable, and then a growing number of buyers start wanting larger cars. Furthermore, too many consumers adopt the fashion, thus turning others away. Reynolds suggests that the length of a particular fashion cycle depends on the extent to which the fashion meets a genuine need, is consistent with other trends in the society, satisfies societal norms and values, and does not exceed technological limits as it develops.

Fads are fashions that come quickly into public view, are adopted with great zeal, peak early, and decline very fast. Their acceptance cycle is short, and they tend to attract only a limited following of those who are searching for excitement or want to distinguish themselves from others. They often have a novel or capricious aspect, such as body piercing and tattooing. Fads do not survive because they do not normally satisfy a strong need.

The marketing winners are those who recognize fads early and leverage them into products with staying power. Here are two success stories of companies that managed to extend a fad's life span.

### **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: delays in the expansion of production capacity; technical problems ("working out the bugs"; delays in obtaining adequate distribution through retail outlets; and customer reluctance to change established behaviors." Sales of expensive new products such as high-definition TV are retarded by additional factors such as product complexity and fewer buyers.

Profits are negative or low in the introduction stage because of low sales and heavy distribution and promotion expenses. Much money is needed to attract distributors. Promotional expenditures are at their highest ratio to sales because of the need to (1) inform potential consumers, (2) induce product trial, and (3) secure distribution in retail outlets. Firms focus their selling on those buyers who are the readiest to buy, usually higher-income

groups. Prices tend to be high because costs are high due to relatively low output rates, technological problems in production, and high required margins to support the heavy promotional expenditures.

In launching a new product, marketing management can set a high or a low level for each marketing variable (price, promotion, distribution, product quality). Considering only price and promotion, management can pursue one of four strategies.

1. Rapid skimming: Launching the new product at a high price and a high promotion level. This strategy makes sense when a large part of the potential market is unaware of the product; those who become aware of the product are eager to have it and can pay the asking price; and the firm faces potential competition and wants to build brand preference.
2. Slow skimming: Launching the new product at a high price and low promotion. This strategy makes sense when the market is limited in size; most of the market is aware of the product; buyers are willing to pay a high price; and potential competition is not imminent.
3. Rapid penetration: Launching the product at a low price and spending heavily on promotion. This strategy makes sense when the market is large, the market is unaware of the product, most buyers are price sensitive, there is strong potential competition, and the unit manufacturing costs fall with the company's scale of production and accumulated manufacturing experience.
4. Slow penetration: Launching the new product at a low price and low level of promotion. This strategy makes sense when the market is large, is highly aware of the product, is price sensitive, and there is some potential competition.

### **The Pioneer Advantage**

Companies that plan to introduce a new product must decide when to enter the market. To be first can be highly rewarding, but risky and expensive. To come in later makes sense if the firm can bring superior technology, quality, or brand strength.

Speeding up innovation time is essential in an age of shortening product life cycles. Competitors in many industries learn about new technologies and new market opportunities at about the same time. Those companies that first reach practical solutions will enjoy "first-mover" advantages in the market. Being early rather than late pays off. One study found that products that came out six months late but on budget earned an average of 33 percent less profit in their first five years; products that came out on time but 50 percent over budget cut their profits by only 4 percent.

Most studies indicate that the market pioneer gains the most advantage. Such pioneering companies as Amazon.com, Campbell, Coca-Cola, Eastman Kodak, Hallmark, Peapod.com, and Xerox developed sustained market dominance. Robinson and Fornell studied a broad range of mature consumer- and industrial-goods businesses, and found that market pioneers generally enjoy a substantially higher market share than do early followers and late entrants. Urban's study also found a pioneer advantage: It appears that the second entrant obtained only 71 percent of the pioneer's market share, and the third entrant obtained only 58 percent.<sup>41</sup> Carpenter and Nakamoto found that 19 out of 25 companies who were market leaders in 1923 were still the market leaders in 1983, 60 years later.

What are the sources of the pioneer's advantage? Research has shown that consumers often prefer pioneering brands. Early users will favor the pioneer's brand if they try it and it satisfies them. The pioneer's brand also establishes the attributes the product class should possess. The pioneer's brand normally aims at the middle of the market and so captures more

users. There are also producer advantages: economies of scale, technological leadership, ownership of scarce assets, and other barriers to entry.

However, the pioneer advantage is not inevitable. One only has to reflect on the fate of Bowmar (hand calculators), Reynolds (ballpoint pens), and Osborne (portable computers), market pioneers who were overtaken by later entrants. Schnaars studied 28 industries where the imitators surpassed the innovators. He found several weaknesses among the failing pioneers, including new products that were too crude, were improperly positioned, or appeared before there was strong demand; product-development costs that exhausted the innovator's resources; a lack of resources to compete against entering larger firms; and managerial incompetence or unhealthy complacency. Successful imitators thrived by offering lower prices, improving the product more continuously, or using brute market power to overtake the pioneer.

Golder and Tellis raise further doubts about the pioneer advantage." They distinguish between an inventor (first to develop patents in a new-product category), product pioneer (first to develop a working model), and a market pioneer (first to sell in the new-product category). They also include nonsurviving pioneers in their sample. They conclude that although pioneers may still have an advantage, it is less pronounced than claimed. A larger number of market pioneers fail than has been reported and a larger number of early market leaders (though not pioneers) succeed, especially if they enter decisively and commit substantial resources. Examples of later entrants overtaking market pioneers are IBM over Sperry in mainframe computers, Matsushita over Sony in VCRs, Texas Instruments over Bowmar in hand calculators, and GE over EMI in CAT scan equipment. Under the right circumstances, the late entrant can overcome the pioneer advantage. Yet an alert pioneer, according to Robertson and Gatignon, can pursue various strategies to prevent later entrants from wresting away leadership.

The pioneer should visualize the various product markets it could initially enter, knowing that it cannot enter all of them at once. Suppose market-segmentation analysis reveals the product market segments. The pioneer should analyze the profit potential of each product market singly and in combination and decide on a market expansion path. It plans first to enter product market PiMi, then move the product into a second market (PiMz), then surprise competition by developing a second product for the second market (P2M2), then take the second product back into the first market (PzM), and then launch a third product for the first market (P3M). If this game plan works, the pioneer firm will own a good part of the first two segments and serve them with two or three products.

### **The Competitive Cycle**

The pioneer knows that competition will eventually enter and cause prices and its market share to fall. When will this happen? What should the pioneer do at each stage? Frey describes five stages of the competitive cycle that the pioneer has to anticipate.

Initially the pioneer is the sole supplier, with 100 percent of production capacity and sales. Competitive penetration starts when a new competitor has built production capacity and begins commercial sales. The leader's share of production capacity and share of sales falls. As more competitors enter the market and charge a lower price, the perceived relative value of the leaders offer declines, forcing a reduction in the leader's price premium.

Capacity tends to be overbuilt during rapid growth. When a cyclical slowdown occurs, industry overcapacity drives down margins to lower levels. New competitors decide

not to enter, and existing competitors try to solidify their positions. This leads to share stability.

Stability is followed by commodity competition. The product is viewed as a commodity, buyers no longer pay a price premium, and the suppliers earn only an average rate of return. At this point, withdrawal begins. The pioneer might decide to build share further as other firms withdraw.

### **MARKETING STRATEGIES: GROWTH STAGE**

The growth stage is marked by a rapid climb in sales. Early adopters like the product, and additional consumers start buying it. New competitors enter, attracted by the opportunities. They introduce new product features and expand distribution.

Prices remain where they are or fall slightly, depending on how fast demand increases. Companies maintain their promotional expenditures at the same or at a slightly increased level to meet competition and to continue to educate the market. Sales rise much faster than promotional expenditures, causing a welcome decline in the promotion-sales ratio.

Profits increase during this stage as promotion costs are spread over a larger volume and unit manufacturing costs fall faster than price declines owing to the producer learning effect. Firms have to watch for a change from an accelerating to a decelerating rate of growth in order to prepare new strategies.

During this stage, the firm uses several strategies to sustain rapid market growth as long as possible:

- \* It improves product quality and adds new product features and improved styling.
- \* It adds new models and flanker products (i.e., products of different sizes, flavors, and so forth that protect the main product).
- \* It enters new market segments.
- \* It increases its distribution coverage and enters new distribution channels.
- \* It shifts from product-awareness advertising to product-preference advertising.
- \* It lowers prices to attract the next layer of price-sensitive buyers.

These market expansion strategies strengthen the firm's competitive position. Consider the case of Yahoo!" The firm in the growth stage faces a trade-off between high market share and high current profit. By spending money on product improvement, promotion, and distribution, it can capture a dominant position. It forgoes maximum current profit in the hope of making even greater profits in the next stage.

### **MARKETING STRATEGIES: MATURITY STAGE**

At some point, the rate of sales growth will slow, and the product will enter a stage of relative maturity. This stage normally lasts longer than the previous stages, and poses formidable challenges to marketing management. Most products are in the maturity stage of the life cycle, and most marketing managers cope with the problem of marketing the mature product.

The maturity stage divides into three phases: growth, stable, and decaying maturity. In the first phase, the sales growth rate starts to decline. There are no new distribution channels to fill. In the second phase, sales flatten on a per capita basis because of market saturation. Most potential consumers have tried the product, and future sales are governed by population growth and replacement demand. In the third phase, decaying maturity, the absolute level of sales starts to decline, and customers begin switching to other products and substitutes.

The sales slowdown creates overcapacity in the industry, which leads to intensified competition. Competitors scramble to find niches. They engage in frequent markdowns. They increase advertising and trade and consumer promotion. They increase R&D budgets to develop product improvements and line extensions. They make deals to supply private brands. A shakeout begins, and weaker competitors withdraw. The industry eventually consists of well-entrenched competitors whose basic drive is to gain or maintain market share.

Dominating the industry are a few giant firms-perhaps a quality leader, a service leader, and a cost leader-that serve the whole market and make their profits mainly through high volume and lower costs. Surrounding these dominant firms are a multitude of market nichers, including market specialists, product specialists, and customizing firms. The issue facing a firm in a mature market is whether to struggle to become one of the "big three" and achieve profits through high volume and low cost or to pursue a niching strategy and achieve profits through low volume and a high margin.

In the maturity stage, some companies abandon weaker products and concentrate on more profitable products and on new products. Yet they may be ignoring the high potential many mature markets and old products still have. Many industries widely thought to be mature-autos, motorcycles, television, watches, cameras-were proved otherwise by the Japanese, who found ways to offer new values to customers. Seemingly moribund brands like Jell-O, Ovaltine, and Arm & Hammer baking soda have achieved major sales revivals several times, through the exercise of marketing imagination.<sup>49</sup> The resurgence in Hush Puppies' popularity in the footwear category is a case study in reviving old, nearly forgotten brands.

### **Market Modification**

The company might try to expand the market for its mature brand by working with the two factors that make up sales volume:

Volume = number of brand users \* usage rate per user

The company can try to expand the number of brand users in three ways:

1. Convert nonusers: The key to the growth of air freight service is the constant search for new users to whom air carriers can demonstrate the benefits of using air freight rather than ground transportation.
2. Enter new market segments: Johnson & Johnson successfully promoted its baby shampoo to adult users.
3. Win competitors' customers: Pepsi-Cola is constantly tempting Coca-Cola users to switch.

Volume can also be increased by convincing current brand users to increase their usage of the brand. Here are three strategies:

(1) The company can try to get customers to use the product more frequently: Orange juice marketers try to get people to drink orange juice at occasions other than breakfast time.

(2) The company can try to interest users in using more of the product on each occasion: A shampoo manufacturer might indicate that the shampoo is more effective with two applications than one.

(3) The company can try to discover new product uses and convince people to use the product in more varied ways: Food manufacturers list several recipes on their packages to broaden consumers' uses of the product.

## **Product Modification**

Managers also try to stimulate sales by modifying the product's characteristics through quality improvement, feature improvement, or style improvement.

Quality improvement aims at increasing the product's functional performance—its durability, reliability, speed, taste. A manufacturer can often overtake its competition by launching a "new and improved" product. Grocery manufacturers call this a "plus launch" and promote a new additive or advertise something as "stronger," "bigger," or "better." This strategy is effective to the extent that the quality is improved, buyers accept the claim of improved quality, and a sufficient number of buyers will pay for higher quality. But customers are not always willing to accept an "improved" product, as the classic tale of New Coke illustrates:

Feature improvement aims at adding new features (for example, size, weight, materials, additives, accessories) that expand the product's versatility, safety, or convenience. For instance, you wouldn't think one could do much to change a sliced pickle, but Vlasic R&D people worked for years to modify its core product:

This strategy has several advantages. New features build the company's image as an innovator and win the loyalty of market segments that value these features. They provide an opportunity for free publicity and they generate sales force and distributor enthusiasm. The chief disadvantage is that feature improvements are easily imitated; unless there is a permanent gain from being first, the feature improvement might not pay off in the long run.

A strategy of style improvement aims at increasing the product's aesthetic appeal. The periodic introduction of new car models amounts to style competition rather than quality or feature competition. In the case of packaged-food and household products, companies introduce color and texture variations and restyle the package. A style strategy might give the product a unique market identity. Yet style competition has problems. First, it is difficult to predict whether people—and which people—will like a new style. Second, a style change usually requires discontinuing the old style, and the company risks losing customers. Consumers may become attached to something as seemingly insignificant as a peanut shell. In the United States, eating unshelled peanuts at baseball games is a time-honored tradition. During the 1986 major league baseball season at New York's Shea Stadium, the concessionaire began selling preshelled peanuts in cellophane packages. Sales fell 15 percent and consumers complained strongly.

## **Marketing-Mix Modification**

Product managers might also try to stimulate sales by modifying other marketing-mix elements. They should ask the following questions:

**Prices:** Would a price cut attract new buyers? If so, should the list price be lowered, or should prices be lowered through price specials, volume or early purchase discounts, freight cost absorption, or easier credit terms? Or would it be better to raise the price to signal higher quality?

**Distribution:** Can the company obtain more product support and display in existing outlets? Can more outlets be penetrated? Can the company introduce the product into new distribution channels? When Goodyear decided to sell its tires via Wal-Mart, Sears, and Discount Tire, it boosted market share from 14 percent to 16 percent in the first year."

Advertising: Should advertising expenditures be increased? Should the message or copy be changed? Should the media mix be changed? Should the timing, frequency, or size of ads be changed?

Sales promotion: Should the company step up sales promotion-trade deals, centsoff coupons, rebates, warranties, gifts, and contests?

Personal selling: Should the number or quality of salespeople be increased? Should the basis for sales force specialization be changed? Should sales territories be revised? Should sales force incentives be revised? Can sales-call planning be improved?

Services: Can the company speed up delivery? Can it extend more technical assistance to customers? Can it extend more credit?

Marketers often debate which tools are most effective in the mature stage. For example, would the company gain more by increasing its advertising or its salespromotion budget? Sales promotion has more impact at this stage because consumers have reached equilibrium in their buying habits and preferences, and psychological persuasion (advertising) is not as effective as financial persuasion (sales-promotion deals). Many consumer-packaged-goods companies now spend over 60 percent of their total promotion budget on sales promotion to support mature products. Other marketers argue that brands should be managed as capital assets and supported by advertising. Advertising expenditures should be treated as a capital investment, not a current expense. Brand managers, however, use sales promotion because its effects are quicker and more visible to their superiors. But excessive sales-promotion activity can hurt the brand's image and long-run profit performance.

A major problem with marketing-mix modifications, especially price reductions and additional services, is that they are easily imitated. The firm may not gain as much as expected, and all firms might experience profit erosion as they step up their marketing attacks on each other. See the Marketing Memo "Breaking Through the Mature-Product Syndrome."

### **MARKETING STRATEGIES: DECLINE STAGE**

The sales of most product forms and brands eventually decline. The decline might be slow, as in the case of oatmeal; or rapid, as in the case of the Edsel automobile. Sales may plunge to zero, or they may petrify at a low level.

Sales decline for a number of reasons, including technological advances, shifts in consumer tastes, and increased domestic and foreign competition. All lead to overcapacity, increased price-cutting, and profit erosion.

As sales and profits decline, some firms withdraw from the market. Those remaining may reduce the number of products they offer. They may withdraw from smaller market segments and weaker trade channels, and they may cut their promotion budget and reduce their prices further.

Unfortunately, most companies have not developed a well-thought-out policy for handling their aging products. Sentiment often plays a role:

Putting products to death--or letting them die--is a drab business, and often engenders much of the sadness of a final parting with old and tried friends. The portable, six-sided pretzel was the first product The Company ever made. Our line will no longer be our line without it."

Logic may also play a role. Management believes that product sales will improve when the economy improves, or when the marketing strategy is revised, or when the product

is improved. Or the weak product may be retained because of its alleged contribution to the sales of the company's other products. Or its revenue may cover out-of-pocket costs, even if it is not turning a profit.

Unless strong reasons for retention exist, carrying a weak product is very costly to the firm. The cost is not just the amount of uncovered overhead and profit: There are many hidden costs. Weak products often consume a disproportionate amount of management's time, require frequent price and inventory adjustments, generally involve short production runs in spite of expensive setup times, require both advertising and sales force attention that might be better used to make the healthy products more profitable, and can cause customer misgivings and cast a shadow on the company's image. The biggest cost might well lie in the future. Failing to eliminate weak products delays the aggressive search for replacement products. The weak products create a lopsided product mix, long on yesterday's breadwinners and short on tomorrow's.

In handling its aging products, a company faces a number of tasks and decisions. The first task is to establish a system for identifying weak products. Many companies appoint a product-review committee with representatives from marketing, R&D, manufacturing, and finance, which develops a system for identifying weak products. The controller's office supplies data for each product showing trends in market size, market share, prices, costs, and profits. A computer program then analyzes this information. The managers responsible for dubious products fill out rating forms showing where they think sales and profits will go, with and without any changes in marketing strategy. The product-review committee makes a recommendation for each dubious product—leave it alone, modify its marketing strategy, or drop it."

Some firms will abandon declining markets earlier than others. Much depends on the presence and height of exit barriers in the industry." The lower the exit barriers, the easier it is for firms to leave the industry, and the more tempting it is for the remaining firms to stay and attract the withdrawing firms' customers. For example, Procter & Gamble stayed in the declining liquid-soap business and improved its profits as others withdrew.

In a study of company strategies in declining industries, Harrigan identified five decline strategies available to the firm:

1. Increasing the firm's investment (to dominate the market or strengthen its competitive position)
2. Maintaining the firm's investment level until the uncertainties about the industry are resolved
3. Decreasing the firm's investment level selectively, by dropping unprofitable customer groups, while simultaneously strengthening the firm's investment in lucrative niches
4. Harvesting ("milking") the firm's investment to recover cash quickly
5. Divesting the business quickly by disposing of its assets as advantageously as possible."

The appropriate decline strategy depends on the industry's relative attractiveness and the company's competitive strength in that industry. A company that is in an unattractive industry but possesses competitive strength should consider shrinking selectively. A company that is in an attractive industry and has competitive strength should consider strengthening its investment. Procter & Gamble on a number of occasions has taken disappointing brands that were in strong markets and restaged them.

## **CHALLENGES IN NEW-PRODUCT DEVELOPMENT**

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

At the same time, new-product development is risky. Texas instruments lost \$600 million before withdrawing from the home computer business, RCA lost \$500 million on its videodisc players, Federal Express lost \$340 million on its Zap mail, Ford lost \$250 million on its Edsel, DuPont lost an estimated \$100 million on a synthetic leather called Corfam, and the British-French Concorde aircraft will never recover its investment .2

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

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

### **Why do new products fail?**

A high-level executive pushes a favorite idea through in spite of negative market research findings. The idea is good, but the market size is overestimated. The product is not well designed. The product is incorrectly positioned in the market, not advertised effectively, or overpriced. Development costs are higher than expected. Competitors fight back harder than expected. Several other factors hinder new-product development: Shortage of important ideas in certain areas: There may be few ways left to improve some basic products (such as steel, detergents).

Fragmented markets: Keen competition is leading to market fragmentation. Companies have to aim their new products at smaller market segments, and this can mean lower sales and profits for each product.

Social and governmental constraints: New products have to satisfy consumer safety and environmental concerns. Government requirements slow down innovation in drugs, toys, and some other industries.

Costliness of the development process: A company typically has to generate many ideas to find just one worthy of development. Furthermore, the company often faces high R&D, manufacturing, and marketing costs.

Capital shortages: Some companies with good ideas cannot raise the funds needed to research and launch them.

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

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

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

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

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

#### **EFFECTIVE ORGANIZATIONAL ARRANGEMENTS**

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

The product can be introduced within five years.

The product has a market potential of at least \$50 million and a 15 percent growth rate.

The product would provide at least 30 percent return on sales and 40 percent on investment.

The product would achieve technical or market leadership.

#### **BUDGETING FOR NEW PRODUCT DEVELOPMENT**

Senior management must decide how much to budget for new-product development. R&D outcomes are so uncertain that it is difficult to use normal investment criteria. Some

companies solve this problem by financing as many projects as possible, hoping to achieve a few winners. Other companies set their budget by applying a conventional percentage of sales figures or by spending what the competition spends. Still other companies decide how many successful new products they need and work backward to estimate the required investment.

The U.S. company best known for its commitment to new-product research and development is Minneapolis-based 3M Company: 3M encourages everyone, not just engineers, to become "product champions." The company's 15 percent rule allows all employees to spend up to 15 percent of their time working on projects of personal interest. Products such as Post-it notes, masking tape, and 3M's microreplication technology grew from 15 percent-rule activities.

Each promising new idea is assigned to a multidisciplinary venture team headed by an "executive champion." 3M expects some failures and learns from them. Its slogan is "You have to kiss a lot of frogs to find a prince." 3M hands out its Golden Step awards each year to the venture teams whose new product earned more than \$2 million in U.S. sales or \$4 million in worldwide sales within three years of its commercial introduction.

The new-products manager at a large consumer packaged-goods company reviewed the results of 64 new-product ideas. Only one in four ideas, or 16, passed the screening stage. It cost \$1,000 to review each idea at this stage. Half of these ideas, or eight, survived the concept-testing stage, at a cost of \$20,000 each. Half of these, or four, survived the product-development stage, at a cost of \$200,000 each. Half of these, or two, did well in the test market, at a cost of \$500,000 each. When these two ideas were launched, at a cost of \$5 million each, only one was highly successful. Thus the one successful idea had cost the company \$5,721,000 to develop. In the process, 63 other ideas fell by the wayside. The total cost for developing one successful new product was \$13,984,400. Unless the company can improve the pass ratios and reduce the costs at each stage, it will have to budget nearly \$14 million for each successful new idea it hopes to find. If top management wants four successful new products in the next few years, it will have to budget at least \$56 million (4 X 14 million) for new-product development.

## **ORGANIZING NEW-PRODUCT DEVELOPMENT**

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 ideas to product managers. In practice, this system has several faults. Product managers are so busy managing existing lines that they give little thought to new products other than line extensions. They also lack the specific skills and knowledge needed to develop and critique new products.

**New-product managers:** Kraft and Johnson & Johnson have new-product managers who report to category managers. This position professionalizes the new-product function. However, like product managers, new-product managers tend to think in terms of modifications and line extensions limited to their product market.

**New-product committees:** Many companies have a high-level management committee charged with reviewing and approving proposals.

**New-product departments:** Large companies often establish a department headed by a manager who has substantial authority and access to top management. The department's major responsibilities include generating and screening new ideas, working with the R&D department, and carrying out field testing and commercialization.

New product venture teams: 3M, Dow, Westinghouse, and General Mills often assign new-product development work to venture teams. A venture team is a group brought together from various operating departments and charged with developing a specific product or business. They are "intrapreneurs" relieved of their other duties and given a budget, a time frame, and a "skunkworks" setting. Skunkworks are informal workplaces, sometimes garages, where intrapreneurial teams attempt to develop new products. See the Marketing Insight box, "NewProduct 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.<sup>9</sup> The innovation process is divided into several stages. At the end of each stage is a gate or checkpoint. The project leader, working with a cross-functional team, must bring a set of known deliverables to each gate before the project can pass to the next stage. To move from the business plan stage into product development requires a convincing market research study of consumer needs and interest, a competitive analysis, and a technical appraisal. Senior managers review the criteria at each gate to judge whether the project deserves to move to the next stage. The gatekeepers make one of four decisions: go, kill, hold, or recycle.

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

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.

## **CHANGING 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. Hippel 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

Scotch-Brite Never Scratch soap pad. Sales of the new soap pad have now exceeded 3M's expectations by 25 percent. Successful companies have established a company culture that encourages every employee to seek new ways of improving production, products, and services. Toyota claims its employees submit 2 million ideas annually (about 35 suggestions per employee), over 85 percent of which are implemented. Kodak and other firms give monetary, holiday, or recognition awards to employees who submit the best ideas.

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

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

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

## **IDEA SCREENING**

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

In screening ideas, the company must avoid two types of errors. A DROP-error occurs when the company dismisses an otherwise good idea. It is extremely easy to find fault with other people's ideas (Figure 11.2). Some companies shudder when they look back at ideas they dismissed: Xerox saw the novel promise of Chester Carlson's copying machine, but IBM and Eastman Kodak did not. IBM thought the market for personal computers was minuscule. RCA saw the opportunity of radio; the Victor Talking Machine Company did not. Marshall Field understood the unique market-development possibilities of installment buying; Endicott

Johnson did not. Sears dismissed the importance of discounting; Wal-Mart and Kmart did not." If a company makes too many DROP-errors, its standards are too conservative.

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

The purpose of screening is to drop poor ideas as early as possible. The rationale is that product-development costs rise substantially with each successive development stage. Most companies require new-product ideas to be described on a standard form that can be reviewed by a new-product committee. The description states the product idea, the target market, and the competition, and roughly estimates market size, product price, development time and costs, manufacturing costs, and rate of return.

The executive committee then reviews each idea against a set of criteria. Does the product meet a need? Would it offer superior value? Can it be distinctively advertised? Does the company have the necessary know-how and capital? Will the new product deliver the expected sales volume, sales growth, and profit? The surviving ideas can be rated using a weighted-index method like that in Table 11.2. The first column lists factors required for successful product launches, and the second column assigns importance weights. The third column scores the product idea on a scale from 0 to 1.0, with 1.0 the highest score. The final step multiplies each factor's importance by the product score to obtain an overall rating. In this example, the product idea scores .69, which places it in the "good idea" level. The purpose of this basic rating device is to promote systematic product-idea evaluation and discussion. It is not supposed to make the decision for management.

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

$$\text{Overall probability of success} = \text{Probability of technical completion} \times \text{Probability of commercialization given technical completion} \times \text{Probability of economic success given commercialization}$$

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

## MANAGING THE DEVELOPMENT PROCESS: CONCEPT TO STRATEGY

### CONCEPT DEVELOPMENT AND TESTING

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

#### Concept Development

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

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

Concept 1: An instant breakfast drink for adults who want a quick nutritious breakfast without preparing a breakfast.

Concept 2: A tasty snack drink for children to drink as a midday refreshment.

Concept 3: A health supplement for older adults to drink in the late evening before they go to bed.

Each concept represents a category concept that defines the product's competition. An instant breakfast drink would compete against bacon and eggs, breakfast cereals, coffee and pastry, and other breakfast alternatives. A tasty snack drink would compete against soft drinks, fruit juices, and other thirst quenchers.

Suppose the instant-breakfast-drink concept looks best. The next task is to show where this powdered product would stand in relation to other breakfast products. Figure 11.3(a) uses the two dimensions of cost and preparation time to create a productpositioning map for the breakfast drink. An instant breakfast drink offers low cost and quick preparation. Its nearest competitor is cold cereal; its most distant competitor is bacon and eggs. These contrasts can be utilized in communicating and promoting the concept to the market.

Next, the product concept has to be turned into a brand concept. Figure 11.3(b) is a brand positioning map showing the current positions of three existing brands of instant breakfast drinks. The company needs to decide how much to charge and how calorific to make its drink. The new brand would be distinctive in the medium-price, medium-calorie market or in the high-price, high-calorie market. The company would not want to position it next to an existing brand, where it would have to fight for market share.

### **Concept Testing**

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

Companies are also using virtual reality to test product concepts. Virtual reality programs use computers and sensory devices (such as gloves or goggles) to simulate reality. Gadd International has developed a research tool called Simul-Shop, a CDROM virtual reality approach that re-creates shopping situations in which researchers can test consumer reactions to factors such as product positioning, store layouts, and package designs. Suppose a cereal marketer wants to test reactions to a new package design and store shelf positioning. Using Simul-Shop on a standard desktop PC, test shoppers begin their shopping spree with a screen showing the outside of a grocery store. They click to enter the virtual store and are guided to the appropriate store section. Once there, they can scan the shelf, pick up various cereal packages, rotate them, study the labels-even look around to see what is on the shelf

behind them. A Gadd's research director explains: "Once users move toward the item we want to test, [they] can look at different packaging, shelf layouts, and package colors. Depending on the activity, we can even ask users why they did what they did.

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

Concept testing entails presenting consumers with an elaborated version of the concept. Here is the elaboration of concept I in our milk example: Our product is a powdered mixture that is added to milk to make an instant breakfast that gives the person all the needed nutrition along with good taste and high convenience. The product would be offered in three flavors (chocolate, vanilla, and strawberry) and would come in individual packets, six to a box, at \$2.49 a box.

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

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

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

### Conjoint Analysis

Consumer preferences for alternative product concepts can be measured through conjoint is a method for deriving the utility values that consumers attach to varying levels of a product's attributes. Respondents are shown different hypothetical offers formed by combining varying levels of the attributes, then asked to rank the various offers. Management

can identify the most appealing offer and the estimated market share and profit the company might realize.

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)

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 i.e. (3 x 3 x 3 x 2 x 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. 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 by the difference between the highest and lowest utility level for that attribute. The greater the difference, the more important the attribute. Clearly, this consumer sees price and package design as the most important attributes followed by money-back guarantee, brand name, and last, a Good Housekeeping seal.

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

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

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

## MARKETING-STRATEGY DEVELOPMENT

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

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

The third part of the marketing-strategy plan describes the long-run sales and profit goals and marketing-mix strategy over time: The company intends to win a 25 percent market share and realize an after-tax return on investment of 12 percent. To achieve this return, product quality will start high and be improved over time through technical research. Price will initially be set at a high level and lowered gradually to expand the market and meet competition. The total promotion budget will be boosted each year about 20 percent, with the initial advertising-sales promotion split of 65:35 evolving eventually to 50:50. Marketing research will be reduced to \$60,000 per year after the first year.

## BUSINESS ANALYSIS

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

### Estimating Total Sales

Management needs to estimate whether sales will be high enough to yield a satisfactory profit. Total estimated sales are the sum of estimated first-time sales, replacement sales, and repeat sales. Sales-estimation methods depend on whether the product is a one-time purchase (such as an engagement ring or retirement home), an infrequently purchased product, or a frequently purchased product. For one-time purchased products, sales rise at the

beginning, peak, and later approach zero as the number of potential buyers is exhausted. If new buyers keep entering the market, the curve will not go down to zero.

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

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

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

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

### **Estimating Costs and Profits**

After preparing the sales forecast, management should estimate expected costs and profits. Costs are estimated by the R&D, manufacturing, marketing, and finance departments.

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

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

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

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

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

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

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

Row 8, supplementary contribution, lists any change in income from other company products caused by the introduction of the new product. It has two components. Dragalong income is additional income on other company products resulting from adding this product to the line. Cannibalized income is the reduced income on other company products resulting from adding this product to the line." Table 11.3 assumes no supplementary contributions.

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

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

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

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

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

## **MANAGING THE DEVELOPMENT PROCESS DEVELOPMENT TO COMMUNICATION**

### **PRODUCT DEVELOPMENT**

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 invokes a large jump in investment that drawing 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 actual project costs will except for any useful information gained in the process.

The job of translating target customer requirements into a working prototype is helped by a set of methods known as quality function development (QFD). The methodology takes the list of desired customer attributes (CAs) generated by market research and turns them into a list of engineering attributes (EAs) that the engineers can use. For example, customers of a proposed truck may want a certain acceleration rate (CA). Engineers can turn this into the

required horsepower and other engineering equivalents (EAs). The methodology permits measuring the trade-offs and costs of providing the customer requirements. A major contribution of QFD is that it improves communication between marketers, engineers and the manufacturing people.

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

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

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

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

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

Consumer testing can take a variety of forms, from bringing consumers into a laboratory to giving them samples to use in their homes. In-home placement tests are

common with products ranging from ice cream flavors to new appliances. When DuPont developed its new synthetic carpeting, it installed free carpeting in several homes in exchange for the homeowners' willingness to report their likes and dislikes about the carpeting.

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

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

The rank-order method asks the consumer to rank the three items in order of preference. The consumer might respond with  $A > B > C$ . Although this method has the advantage of simplicity, it does not reveal how intensely the consumer feels about each item or whether the consumer likes any item very much. It is also difficult to use this method when there are many objects to be ranked.

The paired-comparison method calls for presenting pairs of items and asking the consumer which one is preferred in each pair. Thus the consumer could be presented with the pairs AB, AC, and BC and say that she prefers A to B, A to C, and B to C. Then we could conclude that  $A > B > C$ . People find it easy to state their preference between two items, and this method allows the consumer to focus on the two items, noting their differences and similarities.

The monadic-rating method asks the consumer to rate liking of each product on a scale. Suppose a seven-point scale is used, where 1 signifies intense dislike, 4 indifference, and 7, intense like. Suppose the consumer returns the following ratings:  $A = 6, B = 5, C = 3$ . We can derive the individual's preference order (i.e.,  $A > B > C$ ) and even know the qualitative levels of the person's preference for each and the rough distance between preferences.

## MARKET TESTING

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

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

The amount of market testing is influenced by the investment cost and risk on the one hand, and the time pressure and research cost on the other. High investment-high risk products, where the chance of failure is high, must be market tested; the cost of the market tests will be an insignificant percentage of the total project cost. High-risk products—those that

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

### **Consumer-Goods Market Testing**

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

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

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

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

This method has several advantages. It gives fairly accurate results on advertising effectiveness and trial rates (and repeat rates if extended) in a much shorter time and at a fraction of the cost of using real test markets. Pretests often take only three months and may cost \$250,000.30 the results are incorporated into new-product forecasting models to project ultimate sales levels. Marketing research firms report surprisingly accurate predictions of sales levels of products that are subsequently launched in the market."

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

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

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

Management faces several questions:

1. How many test cities? Most tests use between two and six cities. The greater the maximum possible loss, the greater the number of connecting marketing strategies, the greater the regional differences, and the greater the chance of test-market interference by competitors, the greater the number of cities that should be used.
2. Which cities? Each company must develop test-city selection criteria. One company looks for test cities that have diversified industry, good media coverage, cooperative chain stores, average competitive activity, and no evidence of being overtested.
3. Length of test? Market tests last anywhere from a few months to a year. The longer the product's average repurchase period, the longer the test period necessary to observe repeat-purchase rates. This period should be cut down if competitors are rushing to the market.
4. What information? Warehouse shipment data will show gross inventory buying but will not indicate weekly sales at the retail level. Store audits will show retail sales and competitors' market shares but will not reveal buyer characteristics. Consumer panels will indicate which people are buying which brands and their loyalty and switching rates. Buyer will yield in-depth information about consumer attitudes, usage, and satisfaction.
5. What action to take? If the test markets show high trial and repurchase rates, the product should be launched nationally. If the test markets show a high trial rate and a low repurchase rate, customers are not satisfied and the product should be redesigned or dropped. If the test markets show a low trial rate and a high repurchase rate, the product is satisfying but more

people have to try it. This means increasing advertising and sales promotion. If trial and repurchase rates are both low, the product should be abandoned.

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

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

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

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

### **Business-Goods Market Testing**

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

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

A second common test method for business goods is to introduce the new product at trade shows. Trade shows draw a large number of buyers, who view many new products in a few concentrated days. The vendor can observe how much interest buyers show in the new product, how they react to various features and terms, and how many express purchase intentions or place orders. Book publishers, for instance, regularly launch their fall titles at

the American Booksellers Association convention each spring. There they display page proofs wrapped in dummy book covers. If a large bookstore chain objects to a cover design or title of a promising new book, the publisher will consider changing the cover or title. The disadvantage of trade shows is that they reveal the product to competitors; therefore, the vendor should be ready to launch the product soon after the trade show.

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

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

## **COMMERCIALIZATION**

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

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

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

### **When (Timing)**

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

1. First entry: The first firm entering a market usually enjoys the "first mover advantages" of locking up key distributors and customers and gaining reputational leadership. But, if the product is rushed to market before it is thoroughly debugged, the product can acquire a flawed image.

2. Parallel entry: The firm might time its entry to coincide with the competitor's entry. The market may pay more attention when two companies are advertising the new product.

3. Late entry: The firm might delay its launch until after the competitor has entered. The competitor will have borne the cost of educating the market. The competitor's product may reveal faults the late entrant can avoid. The company can also learn the size of the market.

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

### **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.

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

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

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

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

concentration. Coordinating an international launch also requires very deep pockets, as was the case with the launch of Iridium's "world phone.

### **To Whom (Target-Market Prospects)**

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

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

### **How (Introductory Market Strategy)**

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

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

## **BRAND DECISIONS**

Branding is a major issue in product strategy. On the one hand, developing a branded product requires a great deal of long-term investment, especially for advertising, promotion, and packaging. Many brand-oriented companies subcontract manufacturing to other companies. Taiwanese manufacturers make a great amount of the world's clothing and consumer electronics, but not under Taiwanese brand names.

On the other hand, manufacturers eventually learn market power lies with building their own brands. Japanese and South Korean companies spent liberally to build up brand names such as Sony, Toyota, Goldstar, and Samsung. Even when these companies can no longer afford to manufacture their products in their homelands, the brand names continue to command customer loyalty.

## **WHAT IS A BRAND?**

Perhaps the most distinctive skill of professional marketers is their ability to create, maintain, protect, and enhance brands. Marketers say that "branding is the art and cornerstone of marketing." The American Marketing Association defines a brand as follows:

A brand is a name, term, sign, symbol, or design, or a combination of them, intended to identify the goods or services of one seller or group of sellers and to differentiate them from those of competitors.

In essence, a brand identifies the seller or maker. It can be a name, trademark, logo, or other symbol. Under trademark law, the seller is granted exclusive rights to the use of the brand name in perpetuity. Brands differ from other assets such as patents and copyrights, which have expiration dates.

A brand is essentially a seller's promise to deliver a specific set of features, benefits, and services consistently to the buyers. The best brands convey a warranty of quality. But a brand is an even more complex symbol.' It can convey up to six levels of meaning:

1. **Attributes:** A brand brings to mind certain attributes. Mercedes suggests expensive, well-built, well-engineered, durable, high-prestige automobiles.
2. **Benefits:** Attributes must be translated into functional and emotional benefits. The attribute "durable" could translate into the functional benefit "I won't have to buy another car for several years." The attribute "expensive" translates into the emotional benefit "The car makes me feel important and admired."
3. **Values:** The brand also says something about the producer's values. Mercedes stands for high performance, safety, and prestige.
4. **Culture:** The brand may represent a certain culture. The Mercedes represents German culture: organized, efficient, high quality.
5. **Personality:** The brand can project a certain personality. Mercedes may suggest a no-nonsense boss (person), a reigning lion (animal), or an austere palace (object).
6. **User:** The brand suggests the kind of consumer who buys or uses the product. We would expect to see a 55-year-old top executive behind the wheel of a Mercedes, not a 20-year-old secretary.

If a company treats a brand only as a name, it misses the point. The branding challenge is to develop a deep set of positive associations for the brand. Marketers must decide at which level(s) to anchor the brand's identity. One mistake would be to promote only attributes. First, the buyer is not as interested in attributes as in benefits. Second, competitors can easily copy attributes. Third, the current attributes may become less desirable later.

Promoting the brand only on one benefit can also be risky. Suppose Mercedes touts - its main benefit as "high performance." Then several competitive brands emerge with high or higher performance. Or suppose car buyers start placing less importance on high performance as compared to other benefits. Mercedes needs the freedom to ma- -neuver into a new benefit positioning.

The most enduring meanings of a brand are its values, culture, and personality. They define the brand's essence. The Mercedes stands for high technology, performance, and success. Mercedes must project this in its brand strategy. Mercedes must resist marketing an inexpensive car bearing the name; doing so would dilute the value and personality Mercedes has built up over the years.

### **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 acceptance. Then there are brands that enjoy a high degree of brand preference. Finally there are brands that command a high degree of brand loyalty. Tony O'Reilly, former CEO of H. J. Heinz, proposed this test of brand loyalty: "My acid test ... is whether a housewife, intending to buy Heinz tomato ketchup in a store, finding it to be out of stock, will walk out of the store to buy it elsewhere.

Few customers are as brand-loyal as O'Reilly hopes Heinz's customers will be. Aaker distinguished five levels of customer attitude toward his or her brand, from lowest to highest:

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.

Certain companies base their growth on acquiring and building rich brand portfolios. Grand Metropolitan acquired various Pillsbury brands, Green Giant vegetables, Haagen-Dazs ice cream, and Burger King. Nestle acquired Rowntree (U.K.), Carnation (U.S.), Stouffer (U.S.), Buitoni-Perugina (Italy), and Perrier (France), making it the world's largest food company. Nestle paid \$4.5 billion to buy Rowntree, five times its book value. Companies do not normally list brand equity on their balance sheets because of the arbitrariness of the estimate. But clearly brand equity relates to the price premium the brand commands times the extra volume it moves over an average brand.

The world's 10 most valuable brands in 1997 were (in rank order): Coca-Cola, Marlboro, IBM, McDonald's, Disney, Sony, Kodak, Intel, Gillette, and Budweiser. Coca-Cola's brand equity was \$48 billion, Marlboro's \$47 billion, and IBM's \$24 billion.

**High brand equity provides a number of competitive advantages:**

- The company will enjoy reduced marketing costs because of consumer brand awareness and loyalty.
- The company will have more trade leverage in bargaining with distributors and retailers because customers expect them to carry the brand.
- The company can charge a higher price than its competitors because the brand has higher perceived quality.
- The company can more easily launch extensions because the brand name carries high credibility.
- The brand offers the company some defense against price competition.

A brand name needs to be carefully managed so that its equity doesn't depreciate. This requires maintaining or improving brand awareness, perceived quality and functionality, and positive associations. These tasks require continuous R&D investment, skillful advertising, and excellent trade and consumer service. Canada Dry and Colgate-Palmolive have appointed "brand equity managers" to guard the brand's image, associations, and quality and prevent short-term tactical actions by overzealous brand managers from hurting the brand. That's why some companies put their branding in the hands of an entirely different company that can focus only on brand management and nothing else. Henry Silverman of Cendant Corporation has made a business of managing-not owning-brands.

P&G believes that well-managed brands are not subject to a brand life cycle. Many brand leaders of 70 years ago are still today's brand leaders: Kodak, Wrigley's, Gillette, Coca-Cola, Heinz, and Campbell Soup.

Some analysts see brands as outlasting a company's specific products and facilities. They see brands as the company's major enduring asset. Yet every powerful brand really represents

a set of loyal customers. Therefore, the fundamental asset underlying brand equity is customer equity. This suggests that the proper focus of marketing planning is that of extending loyal customer lifetime value, with brand management serving as a major marketing tool.

Unfortunately, many companies have mismanaged their greatest asset-their brands. In the quest for ever increasing profits, it's easy for a brand to lose its focus. This is what befell Snapple Beverage Corporation almost as soon as Quaker Oats bought it for \$1.7 billion in 1994.

In Kuczmarski's nationwide study of companies in a wide range of industries, only 43 percent of companies indicated that they even measured brand equity. Whereas 72 percent of companies were confident enough in their brand equity to project that it would last two years with no financial support, over two-thirds of the respondents had no formal long-term brand strategy." Also, while we normally think of brand equity as something accruing to the products of manufacturers, service companies also prize it. As Wall Street competition intensifies, financial service companies are spending millions on their brand names in order to attract investors. Just as Coke wants you to reach for a soda when you're thirsty, Merrill Lynch and Chase want you to call them when you need financial know-how. For financial services companies, total ad spending has jumped 127 percent since 1991.

## **BRANDING CHALLENGES**

Branding poses several challenges to the marketer. The key decisions are discussed in the following sections.

### **Branding Decision: To Brand or Not to Brand?**

The first decision is whether the company should develop a brand name for its product. In the past, most products went unbranded. Producers and intermediaries sold their goods out of barrels, bins, and cases, without any supplier identification. Buyers depended on the seller's integrity. The earliest signs of branding were the medieval guilds' efforts to require craftspeople to put trademarks on their products to protect themselves and consumers against inferior quality. In the fine arts, too, branding began with artists signing their works.

Today, branding is such a strong force that hardly anything goes unbranded. Salt is packaged in distinctive manufacturers' containers, oranges are stamped with growers' names, nuts and bolts are packaged in cellophane with a distributor's label, and automobile components-spark plugs, tires, filters-bear separate brand names from the automakers. Fresh food products-such as chicken, turkey, and salmon-are increasingly being sold under strongly advertised brand names.

In some cases, there has been a return to "no branding" of certain staple consumer goods and pharmaceuticals. Carrefours, the originator of the French hypermarket, introduced a line of "no brands" or generics in its stores in the early 1970s. Generics are unbranded, plainly packaged, less expensive versions of common products such as spaghetti, paper towels, and canned peaches. They offer standard or lower quality at a price that may be as much as 20 percent to 40 percent lower than nationally advertised brands and 10 percent to 20 percent lower than retailer private-label brands. The lower price is made possible by lower-quality ingredients, lower-cost labeling and packaging, and minimal advertising.

National brands have fought generics in a number of ways. Ralston-Purina increased its quality and targeted pet owners who identified strongly with their pets and cared most about quality. Procter & Gamble introduced its Banner paper products, a line offering lower

quality than its higher lines but greater quality than generics and at a competitive price. Other companies simply have cut their prices to compete with generics. Branding gives the seller several advantages:

- The brand name makes it easier for the seller to process orders and track down problems.
- The seller's brand name and trademark provide legal protection of unique product features.
- Branding gives the seller the opportunity to attract a loyal and profitable set of customers. Brand loyalty gives sellers some protection from competition.
- Branding helps the seller segment markets. Instead of P&G's selling a simple detergent, it can offer eight detergent brands, each formulated differently and aimed at specific benefit-seeking segments.
- Strong brands help build the corporate image, making it easier to launch new brands and gain acceptance by distributors and consumers.
- Distributors and retailers want brand names because brands make the product easier to handle, hold production to certain quality standards, strengthen buyer preferences, and make it easier to identify suppliers. Consumers want brand names to help them identify, quality differences and shop more efficiently.

### **Brand-Sponsor Decision**

A manufacturer has several options with respect to brand sponsorship. The product may be launched as a manufacturer brand (sometimes called a national brand), a distributor brand (also called reseller, store, house, or private brand), or a licensed brand name. Another alternative is for the manufacturer to produce some output under its own name and some under reseller labels. Kellogg, John Deere & Company, and IBM sell virtually all of their output under their own brand names. Hart Schaffner & Marx sells some of its manufactured clothes under licensed names such as Christian Dior, Pierre Cardin, and Johnny Carson. Whirlpool produces both under its own name and under distributors' names (Sears Kenmore appliances).

Although manufacturers' brands dominate, large retailers and wholesalers have been developing their own brands by contracting production from willing manufacturers. Sears has created several names-Diehard batteries, Craftsman tools, Kenmore appliances-that command brand preference and even brand loyalty. Retailers such as The Limited, Benetton, The Body Shop, Gap, and Marks & Spencer carry mostly own-brand merchandise. In Britain, two large supermarket chains have developed popular store-brand colas-Sainsbury Cola (from Sainsbury) and Classic Cola (from Tesco). Sainsbury, Britain's largest food chain, sells 50 percent store-label goods; its operating margins are six times that of U.S. retailer operating margins. U.S. supermarkets average 19.7 percent private-brand sales. Some experts believe that 50 percent is the natural limit for carrying private brands because (1) consumers prefer certain national brands, and (2) many product categories are not feasible or attractive on a privatebrand basis.

Why do middlemen bother to sponsor their own brands? They have to hunt down qualified suppliers who can deliver consistent quality, order large quantities and tie up their capital in inventories, and spend money promoting a private label. Nevertheless, private brands offer two advantages. First, they are more profitable. Intermediaries search for manufacturers with excess capacity who will produce the private label at a low cost. Other

costs, such as research and development, advertising, sales promotion, and physical distribution are also much lower. This means that the private brander can charge a lower price and yet make a higher profit margin. Second, retailers develop exclusive store brands to differentiate themselves from competitors. Many consumers don't distinguish between national and store brands.

In the conformation between manufacturers and private brands, retailers have many advantages and increasing market power. Because shelf space is scarce, many supermarkets now charge a slotting fee for accepting a new brand to cover the cost of listing and stocking it. Safeway, the giant supermarket chain, required a payment of \$25,000 from a small pizza-roll manufacturer to stock its product. Retailers also charge for special display space and in-store advertising space. They typically give more prominent display to their own brands and make sure they are well stocked. Retailers are now building better quality in their store brands. Consider the following case:

Manufacturers of national brands are frustrated by the growing power of retailer brands. Kevin Price put it well: "A decade ago, the retailer was a chihuahua nipping at the manufacturer's heels—a nuisance, yes, but only a minor irritant; you fed it and it went away. Today it's a pit bull and it wants to rip your arms and legs off. You'd like to see it roll over, but you're too busy defending yourself to even try. Some marketing commentators predict that private brands will eventually knock out all but the strongest manufacturers' brands.

In years past, consumers viewed the brands in a category arranged in a brand ladder, with their favorite brand at the top and remaining brands in descending order of preference. There are now signs that this ladder is being replaced with a consumer perception of brand parity—that many brands are equivalent.<sup>21</sup> Instead of a strongly preferred brand, consumers buy from a set of acceptable brands, choosing whichever is on sale that day. As Joel D. Weiner, a former Kraft executive, said: "People don't think the world will come to a screeching halt if they use Tide instead of Cheer." A study by DDB Needham Worldwide reported that the percentage of packaged-goods consumers saying that they bought only well-known brands fell from 77 percent to 62 percent between 1975 and 1990. A Grey Advertising Inc. study reported that 66 percent of consumers said they were trading down to lower-priced brands, particularly store brands.

The growing power of store brands is not the only factor weakening national brands. Consumers are more price sensitive. They are noting more quality equivalence as competing manufacturers and national retailers copy and duplicate the qualities of the best brands. The continuous barrage of coupons and price specials has trained a generation of shoppers to buy on price. The fact that companies have reduced advertising to 30 percent of their total promotion budget has weakened their brand equity. The endless stream of brand extensions and line extensions has blurred brand identity and led to a confusing amount of product proliferation. Of course, one of the newest factors that is not necessarily weakening national brands but changing the entire branding landscape is the Internet. While some "born digital" companies, like Netscape and America Online, have used the Internet to gain brand recognition seemingly overnight, other companies have poured millions of dollars into on-line advertising with no significant effect on brand awareness. See the Marketing for the Millennium box, "The Elusive Goal of Branding on the World Wide Web.

Manufacturers have reacted by spending substantial amounts of money on consumer-directed advertising and promotion to maintain strong brand preference. Their price has to be somewhat higher to cover the higher promotion cost. At the same time, mass distributors

pressure manufacturers to put more promotional money into trade allowances and deals if they want adequate shelf space. Once manufacturers start giving in, they have less to spend on advertising and consumer promotion, and their brand leadership starts spiraling down. This is the national brand manufacturers' dilemma.

To maintain their power vis-a-vis the trade, leading brand marketers need to invest in heavy and continuous R&D to bring out new brands, line extensions, features, and quality improvements. They must sustain a strong "pull" advertising program to maintain high consumer brand recognition and preference. They must find ways to "partner" with major mass distributors in a joint search for logistical economies and competitive strategies that produce savings.

But what if a company is small or just starting out and can't pump millions into expensive advertising campaigns? Technology companies in particular have been adept at achieving levels of brand recognition through less conventional marketing approaches. Here are two examples:

### **BRAND-NAME DECISION**

Manufacturers and service companies who brand their products must choose which brand names to use. Four strategies are available:

1. Individual names: This policy is followed by General Mills (Bisquick, Gold Medal, Betty Crocker, Nature Valley). A major advantage of an individual names strategy is that the company does not tie its reputation to the product's. If the product fails or appears to have low quality, the company's name or image is not hurt. A manufacturer of good-quality watches, such as Seiko, can introduce a lower-quality line of watches (called Pulsar) without diluting the Seiko name. The strategy permits the firm to search for the best name for each new product.
2. Blanket family names: This policy is followed by Heinz and General Electric. A blanket family name also has advantages. Development cost is less because there is no need for "name" research or heavy advertising expenditures to create brand-name recognition. Furthermore, sales of the new product are likely to be strong if the manufacturer's name is good. Campbell's introduces new soups under its brand name with extreme simplicity and achieves instant recognition.
3. Separate family names for all products: This policy is followed by Sears (Kenmore for appliances, Craftsman for tools, and Homart for major home installations). Where a company produces quite different products, it is not desirable to use one blanket family name. Swift and Company developed separate family names for its hams (Premium) and fertilizers (Vigoro). When Mead Johnson developed a diet supplement for gaining weight, it created a new family name, Nutriment, to avoid confusion with its weight-reducing products, Metrecal. Companies often invent different family names for different quality lines within the same product class. Thus A&P food stores sold a first-grade, second-grade, and third-grade set of brands—Ann Page, Sultana, and Iona, respectively.
4. Company trade name combined with individual product names: This policy is followed by Kellogg (Kellogg's Rice Krispies, Kellogg's Raisin Bran, and Kellogg's Corn Flakes). Some manufacturers tie their company name to an individual brand name for each product. The company name legitimizes, and the individual name individualizes, the new product.

Once a company decides on its brand-name strategy, it faces the task of choosing a specific brand name. The company could choose the name of a person (Honda, Estee Lauder), location (American Airlines, Kentucky Fried Chicken), quality (Safeway, Duracell),

lifestyle (Weight Watchers, Healthy Choice), or an artificial name (Exxon, Kodak). Among the desirable qualities for a brand name are the following:

- It should suggest something about the products benefits: Examples: Beauty-rest, Craftsman, Accutron.
- It should suggest product qualities such (is action or color: Examples: Sunkist, Spic and Span, Firebird.
- It should be easy to pronounce, recognize, and remember : short names, help. Examples: Tide, Crest, Puffs.
- It should be distinctive: Examples : Mustang, Kodak, Exxon.
- It should not carry poor meanings in other countries and languages: Example: Nova is a poor name for a car to be sold in Spanish-speaking countries; it means "doesn't go."

Normally, companies choose brand names by generating a list of possible names, debating their merits, eliminating all but a few, testing them with target consumers, and making a final choice. Today many companies hire a marketing research firm to develop and test names. These companies use human brainstorming sessions and vast computer databases, catalogued by association, sounds, and other qualities. Name research procedures include association tests (What images come to mind?), learning tests (How easily is the name pronounced?), memory tests (How well is the name remembered?), and preference tests (Which names are preferred?). Of course, the firm must also conduct searches through other databases to make sure the chosen name hasn't already been registered. The whole process, however, isn't cheap. One of the best-known specialists in the "name game" is San Francisco-based Namelab Inc., which says its jobs run about \$60,000 on average. Namelab is responsible for such brand names as Arura and Compaq. Another prominent naming firm is Landor Associates, also based in San Francisco. Its fees run from 525,000 to \$60,000."

Many firms strive to build a unique brand name that eventually will become intimately identified with the product category. Examples are Frigidaire, Kleenex, Kitty Litter, Levis, Jell-O, Popsicle, Scotch Tape, Xerox, and Fiberglas. In 1994 Federal Express officially shortened its marketing identity to FedEx, a term that has become a synonym for "to ship overnight." Yet identifying a brand name with a product category may threaten the company's exclusive rights to that name. Cellophane and shredded wheat are now in the public domain and available for any manufacturer to use.

Given the rapid growth of the global marketplace, companies should choose brand names that work globally. These names should be meaningful 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 makes one immediately think of an "Impresario," the magical master of the whirl and fantasy of a stage production. Companies also should not change names owned by someone in another country. For example, Anheuser-Busch cannot use the name "Budweiser" in Germany.

### **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 cobrands (brands bearing two or more well-known brand names).

**Line Extensions.** Line extensions consist of introducing additional items in the same product category under the same brand name, such as new flavors, forms, colors, added ingredients, and package sizes. Dannon introduced several Dannon yogurt line extensions, including fat-free "light" yogurt and dessert flavors such as "mint chocolate cream pie" and "caramel apple crunch." The vast majority of new-product introductions consist of line extensions.

Many companies are now introducing branded variants, which are specific brand lines, supplied to specific retailers or distribution channels. They result from the pressure retailers put on manufacturers to enable the retailers to provide distinctive offerings. A camera company may supply its low-end cameras to mass merchandisers while limiting its higher-priced items to specialty camera shops. Or Valentino may design and supply different lines of its suits and jackets to different department stores.

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." When a person asked for a Coke in the past, she received a 6.5-ounce bottle. Today the seller will have to ask: New, Classic, or Cherry Coke? Regular or diet? Caffeine or caffeine-free? Bottle or can? Sometimes the original brand identity is so strong that its line extensions serve only to confuse and don't sell enough to cover development and promotion costs. A-1 poultry sauce flopped because people identify A-1 with beef, and Clorox detergent was doomed because Clorox means, "bleach" and people don't want their clothes to come out colorless. However, line extensions can and often do have a positive side. They have a much higher chance of survival than brand-new products. 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 lotion-impregnated tissues, boxes with nursery-rhyme drawings for children's rooms, and a "man-sized" box with tissues 60 percent larger than regular Kleenex.

Line extensions are also fueled by fierce competition in the marketplace, calling for matching competitors' new offerings. Nabisco has had such success with its Snackwell Fat Free cookies that every competitor has had to extend its product line in defense. One study, by Reddy, Holak, and Bhat, examined what makes a line extension succeed or fail. Data on 75 line extensions of 34 cigarette brands over a 20-year period yielded these findings: Line extensions of strong brands, symbolic brands, brands given strong advertising and promotion support, and those entering earlier into a project subcategory are more successful. The size of the company and its marketing competence also play a role.

**Brand Extensions:** A company may use its existing brand name to launch new products in other categories. Honda uses its company name to cover such different products as automobiles, motorcycles, snowblowers, lawn mowers, marine engines, and snowmobiles. This allows Honda to advertise that it can fit "six Hondas in a twocar garage." Gap stores now feature its name on soap, lotion, shampoo, conditioner, shower gel, bath salts, and perfume spray. A new trend in corporate brand building is that corporations are licensing their names to manufacturers of a wide range of products—from bedding to shoes. See the

Marketing Insight box, "From Harley-Davidson Armchairs to Coca-Cola Fishing Lures: The Rise of Corporate Branding," for a closer look at the new trend in corporate image branding.

Brand-extension strategy offers many of the same advantages as line extensions. Sony puts its name on most of its new electronic products and instantly establishes the new product's high quality. Like line extension, brand extension also involves risks. The new product might disappoint buyers and damage their respect for the company's other products. The brand name may be inappropriate to the new product—consider buying Standard Oil ketchup, Drano milk, or Boeing cologne. The brand name may lose its special positioning in the consumer's mind through overextension. Brand dilution occurs when consumers no longer associate a brand with a specific product or highly similar products. A brand is stronger the more narrow its focus. Richard Branson, the flamboyant CEO and founder of London-based Virgin Group, is ambitiously putting the Virgin name on a host of diverse products. Yet naysayers think he is diluting the Virgin brand:

Companies that are tempted to transfer their brand name must research how well the brand's associations fit the new product. The best result would occur when the brand name builds the sales of both the new product and the existing product. An acceptable result would be one in which the new product sells well without affecting the sales of the existing product. The worst result would be one in which the new product fails and hurts the sales of the existing product.

**Multibrands:** A company will often introduce additional brands in the same product category. Sometimes the company is trying to establish different features or appeal to different buying motives. Thus, P&G produces nine different brands of detergents. A multibranding strategy also enables the company to lock up more distributor shelf space and to protect its major brand by setting up flanker brands. Seiko establishes different brand names for its higher-priced (Seiko Lasalle) and lower-priced watches (Pulsar) to protect its flanks. Sometimes the company inherits different brand names in the process of acquiring competitors. Electrolux, the Swedish multinational, owns a stable of acquired brand names (Frigidaire, Kelvinator, Westinghouse, Zanussi, White, Gibson) for its appliance lines.

A major pitfall in introducing multibrand entries is that each might obtain only a small market share, and none may be particularly profitable. The company will have dissipated its resources over several brands instead of building a few highly profitable brands. Ideally, a company's brands within a category should cannibalize the competitors' brands and not each other. At the very least, the net profits with multibrands should be larger even if some cannibalism occurs.

**New Brands:** When a company launches products in a new category, it may find that none of its current brand names are appropriate. If Timex decides to make toothbrushes, it is not likely to call them Timex toothbrushes. Yet establishing a new brand name in the U.S. marketplace for a mass-consumer-packaged good can cost anywhere from \$50 million to \$100 million.

**Cobrands:** A rising phenomenon is the emergence of cobranding (also called dual branding), in which two or more well-known brands are combined in an offer. Each brand sponsor expects that the other brand name will strengthen preference or purchase intention. In the case of copackaged products, each brand hopes it might be reaching a new audience by associating with the other brand.

Cobranding takes a variety of forms. One is ingredient cobranding, as when Volvo advertises that it uses Michelin tires or Betty Crocker's brownie mix includes Hershey's

chocolate syrup. Another form is same-company cobranding, as when General Mills advertises Trix and Yoplait yogurt. Still another form is joint venture cobranding, as in the case of General Electric and Hitachi lightbulbs in Japan and the Citibank AAdvantage credit card. Finally, there is multiple-sponsor cobranding, as in the case of Taligent, a technological alliance of Apple, IBM, and Motorola.

Many manufacturers make components-motors, computer chips, carpet fibers that enter into final branded products, and whose individual identity normally gets lost. These manufacturers hope their brand will be featured as part of the final product. Among the few component branders that have succeeded in building a separate identity are Intel, Nutrasweet, and Gortex. Intel's consumer-directed brand campaign convinced many personal computer buyers to buy only computer brands with "Intel Inside." As a result, major PC manufacturers-IBM, Dell, Compaq-purchase their chips from Intel at a premium price rather than buy equivalent chips from an unknown supplier. Searle has convinced many beverage consumers to look for Nutrasweet as an ingredient. Manufacturers of outerwear can charge a higher price if their garments include Gortex. Despite these success stories, most component manufacturers find it hard to convince buyers to insist on a certain component, material, or ingredient in the final product. A consumer is not likely to choose a car because it features Champion spark plugs or Stainmaster upholstery.

### **BRAND REPOSITIONING**

However well a brand is currently positioned, the company may have to reposition it later when facing new competitors or changing customer preferences. Consider the following repositioning story:

### **PACKAGING AND LABELING**

Most physical products have to be packaged and labeled. Some packages-such as the Coke bottle and the L'eggs container-are world famous. Many marketers have called packaging a fifth P, along with price, product, place, and promotion. Most marketers, however, treat packaging and labeling as an element of product strategy.

### **PACKAGING**

We define packaging as follows:

Packaging includes the activities of designing and producing the container for a product. The container is called the package, and it might include up to three levels of material. Old Spice aftershave lotion is in a bottle (primary package) that is in a cardboard box (secondary package) that is in a corrugated box (shipping package) containing six dozen boxes of Old Spice.

Packaging has become a potent marketing tool. Well-designed packages can create convenience and promotional value. Various factors have contributed to packaging's growing use as a marketing tool:

**Self-service:** An increasing number of products are sold on a self-service basis. In an average supermarket, which stocks 15,000 items, the typical shopper passes 4 by some 300 items per minute. Given that 53 percent of all purchases are made on impulse, the effective package operates as a five-second commercial." The package must perform many of the sales tasks: attract attention, describe the product's features, create consumer confidence, and make a favorable overall impression.

**Consumer affluence:** Rising consumer affluence means consumers are willing to pay a little more for the convenience, appearance, dependability, and prestige of better packages.

Company and brand image: Packages contribute to instant recognition of the company or brand. The Campbell Soup Company estimates that the average shopper sees its familiar red and white can 76 times a year, creating the equivalent of \$26 million worth of advertising.

Innovation opportunity: Innovative packaging can bring large benefits to consumers and profits to producers. Softsoap cornered the market on pumps for dispensing soap. Toothpaste pump dispensers have captured 12 percent of the toothpaste market because they are more convenient and less messy. Chesebrough-Pond's increased its overall nail-polish sales by 22 percent after introducing its novel Aziza Polishing Pen for fingernails.

Developing an effective package for a new product requires several decisions. The first task is to establish the packaging concept: defining what the package should basically be or do for the particular product. Decisions must now be made on additional elements-size, shape, materials, color, text, and brand mark. Decisions must be made - on the amount of text, on cellophane or other transparent films, on a plastic or a laminate tray, and so on. Decisions must be made on "tamperproof" devices. The various packaging elements must be harmonized. The packaging elements must also be harmonized with decisions on pricing, advertising, and other marketing elements.

After the packaging is designed, it must be tested. Engineering tests are conducted to ensure that the package stands up under normal conditions; visual tests, to ensure that the script is legible and the colors harmonious; dealer tests, to ensure that dealers find the packages attractive and easy to handle; and consumer tests, to ensure favorable consumer response.

In spite of these precautions, a packaging design occasionally gets through with some basic flaw:

Developing effective packaging may cost several hundred thousand dollars and take several months to complete. Companies must pay attention to growing environmental and safety concerns about packaging. Shortages of paper, aluminum, and other materials suggest that marketers should try to reduce packaging. Many packages end up as broken bottles and crumpled cans littering the streets and countryside. All of this packaging creates a major problem in solid waste disposal, requiring huge amounts of labor and energy. Fortunately, many companies have gone "green": S. C. Johnson repackaged Agree Plus shampoo in a stand-up pouch using 80 percent less plastic. P&G eliminated outer cartons from its Secret and Sure deodorants, saving 3.4 million pounds of paper board per year.

## **LABELING**

Sellers must label products. The label may be a simple tag attached to the product or an elaborately designed graphic that is part of the package. The label might carry only the brand name or a great deal of information. Even if the seller prefers a simple label, the law may require additional information.

Labels perform several functions. First, the label identifies the product or brand for instance, the name Sunkist stamped on oranges. The label might also grade the product; canned peaches are grade labeled A, B, and C. The label might describe the product: who made it, where it was made, when it was made, what it contains, how it is to be used, and how to use it safely. Finally, the label might promote the product through its attractive graphics.

Labels eventually become outmoded and need freshening up. The label on Ivory soap has been redone 18 times since the 1890s, with gradual changes in the size and design of the letters. The label on Orange Crush soft drink was substantially changed when competitors'

labels began to picture fresh fruits, thereby pulling in more sales. In response, Orange Crush developed a label with new symbols to suggest freshness and with much stronger and deeper colors.

There is a long history of legal concerns surrounding labels, as well as packaging. In 1914, the Federal Trade Commission Act held that false, misleading, or deceptive labels or packages constitute unfair competition. The Fair Packaging and Labeling Act, passed by Congress in 1967, set mandatory labeling requirements, encouraged voluntary industry packaging standards, and allowed federal agencies to set packaging regulations in specific industries. The Food and Drug Administration (FDA) has required processed-food producers to include nutritional labeling that clearly states the amounts of protein, fat, carbohydrates, and calories contained in products, as well as their vitamin and mineral content as a percentage of the recommended daily allowance. The FDA recently launched a drive to control health claims in food labeling by taking action against the potentially misleading use of such descriptions as "light," "high fiber," and "low fat." Consumerists have lobbied for additional labeling laws to require open dating (to describe product freshness), unit pricing (to state the product cost in standard measurement units), grade labeling (to rate the quality level), and percentage labeling (to show the percentage of each important ingredient).

## CHAPTER -V

### SETTING THE PRICE

A firm must set a price for the first time when it develops a new product, when it introduces its regular product into a new distribution channel or geographical area, and when it enters bids on new contract work.

The firm must decide where to position its product on quality and price. In some markets, such as the auto market, as many as eight price points can be found.

Segment	Example (Automobiles)
Ultimate	Rolls-Royce
Gold Standard	Mercedes-Benz
Luxury	Audi
Special Needs	Volvo
Middle	Buick
Ease/Convenience	Ford Escort
Me Too, but Cheaper	Hyundai
Price Alone	Kia

There can be competition between price-quality segments. Figure 15.1 shows nine price-quality strategies. The diagonal strategies 1, 5, and 9 can all coexist in the same market: that is, one firm offers a high-quality product at a high price, another offers an average-quality product at an average price, and still another offers a low-quality product at a low price. All three competitors can coexist as long as the market consists of three groups of buyers: those who insist on quality, those who insist on price, and those who balance the two considerations.

Strategies 2, 3, and 6 are ways to attack the diagonal positions. Strategy 2 says, "Our product has the same high quality as product I but we charge less." Strategy 3 says the same thing and offers an even greater saving. If quality-sensitive customers believe these competitors, they will sensibly buy from them and save money (unless firm 1's product has acquired snob appeal).

Positioning strategies 4, 7, and 8 amount to overpricing the product in relation to its quality. The customers will feel "taken" and will probably complain or spread bad word of mouth about the company.

The firm has to consider many factors in setting its pricing policy. We will describe a six-step procedure: (1) selecting the pricing objective; (2) determining demand; (3) estimating costs; (4) analyzing competitors' costs, prices, and offers; (5) selecting a pricing method; and (6) selecting the final price.

### SELECTING THE PRICING OBJECTIVE

The company first decides where it wants to position its market offering. The clearer a firm's objectives, the easier it is to set price. A company can pursue any of five major objectives through pricing: survival, maximum current profit, maximum market share, maximum market skimming, or product-quality leadership.

Companies pursue survival as their major objective if they are plagued with overcapacity, intense competition, or changing consumer wants. Profits are less important than survival. As long as prices cover variable costs and some fixed costs, the company stays

in business. However, survival is a short-run objective; in the long run, the firm must learn how to add value or face extinction.

Many companies try to set a price that will maximize current profits. They estimate the demand and costs associated with alternative prices and choose the price that produces maximum current profit, cash flow, or rate of return on investment. This strategy assumes that the firm has knowledge of its demand and cost functions; in reality, these are difficult to estimate. By emphasizing current financial performance, the company may sacrifice long-run performance by ignoring the effects of other marketing-mix variables, competitors' reactions, and legal restraints on price.

Some companies want to maximize their market share. They believe that a higher sales volume will lead to lower unit costs and higher long-run profit. They set the lowest price, assuming the market is price sensitive. Texas Instruments (TI) practices this market-penetration pricing. TI will build a large plant, set its price as low as possible, win a large market share, experience falling costs, and cut its price further as costs fall. The following conditions favor setting a low price: (1) The market is highly price sensitive, and a low price stimulates market growth; (2) production and distribution costs fall with accumulated production experience; and (3) a low price discourages actual and potential competition.

Many companies favor setting high prices to "skim" the market. Intel is a prime practitioner of market-skimming pricing. Market skimming makes sense under the following conditions: (1) A sufficient number of buyers have a high current demand; (2) the unit costs of producing a small volume are not so high that they cancel the advantage of charging what the traffic will bear; (3) the high initial price does not attract more competitors to the market; (4) the high price communicates the image of a superior product.

A company might aim to be the product-quality leader in the market. Consider Maytag: Maytag has long built high-quality washing machines and priced them higher than competitors' products (Maytag used the slogan "Built to last longer," and its ads featured the Maytag repairman asleep at the phone because no one ever calls him for service). Now, in a change of strategy, Maytag still capitalizes on its premium-brand strengths but emphasizes innovative features and benefits. The company is trying to change the purchase cycle from "wear out" to "want in." The objective is to get consumers to buy Maytag appliances with whizbang features at a premium price, even though their old machines are still working. To lure the price-sensitive consumer, Maytag's new ads point out that washers are custodians of what is often a \$300 to \$400 load of clothes, making them worth the higher price tag. For instance, at \$800 Maytag's new European-style washers sell for double what most other washers cost, yet the company's marketers argue that they use less water and electricity and prolong the life of clothing by being less abrasive.'

Nonprofit and public organizations may adopt other pricing objectives. A university aims for partial cost recovery, knowing that it must rely on private gifts and public grants to cover the remaining costs. A nonprofit hospital may aim for full cost recovery in its pricing. A nonprofit theater company may price its productions to fill the maximum number of theater seats. A social service agency may set a social price geared to the varying incomes of clients.

Whatever their specific objective, businesses that use price as a strategic tool will profit more than those who simply let costs or the market determine their pricing. For a further discussion of how businesses accomplish their objectives with pricing, see the Marketing Insight "Power Pricers: How Smart Companies Use Price to Achieve Business Strategies."

## **DETERMINING DEMAND**

Each price will lead to a different level of demand and therefore have a different impact on a company's marketing objectives. The relation between alternative prices and the resulting current demand is captured in a demand curve (Figure 15.3[a]). In the normal case, demand and price are inversely related: the higher the price, the lower the demand. In the case of prestige goods, the demand curve sometimes slopes upward. A perfume company raised its price and sold more perfume rather than less! Some consumers take the higher price to signify a better product. However, if too high a price is charged, the level of demand may fall.

### **Price Sensitivity**

The demand curve shows the market's probable purchase quantity at alternative prices. It sums the reactions of many individuals who have different price sensitivities. The first step in estimating demand is to understand what affects price sensitivity. Nagle has identified nine factors:

1. Unique-value effect: Buyers are less price sensitive when the product is more distinctive.
2. Substitute-awareness effect: Buyers are less price sensitive when they are less aware of substitutes.
3. Difficult-comparison effect: Buyers are less price sensitive when they cannot easily compare the quality of substitutes.
4. Total-expenditure effect: Buyers are less price sensitive the lower the expenditure is as a part of their total income.
5. End-benefit effect: Buyers are less price sensitive the smaller the expenditure is to the total cost of the end product.
6. Shared-cost effect: Buyers are less price sensitive when part of the cost is borne by another party.
7. Sunk-investment effect: Buyers are less price sensitive when the product is used in conjunction with assets previously bought.
8. Price-quality effect: Buyers are less price sensitive when the product is assumed to have more quality, prestige, or exclusiveness.
9. Inventory effect: Buyers are less price sensitive when they cannot store the product.

A number of forces, such as deregulation and the instant price comparison technology available over the Internet, have turned products into commodities in the eyes of consumers and increased their price sensitivity. Marketers need to work harder than ever to differentiate their offerings when a dozen competitors are selling virtually the same product at a comparable or lower price. More than ever, companies need to understand the price sensitivity of their customers and prospects and the trade-offs people are willing to make between price and product characteristics. In the words of marketing consultant Kevin Clancy, those who target only the price sensitive are "leaving money on the table." Even in the energy marketplace, where you would think that a kilowatt is a kilowatt is a kilowatt, some utility companies are beginning to wake up to this fact. They are buying power, branding it, marketing it, and providing unique services to customers. Consider Green Mountain Power.

### **Estimating Demand Curves**

Most companies make some attempt to measure their demand curves. They can use different methods.

First, statistically analyzing past prices, quantities sold, and other factors to estimate their relationships. The data can be longitudinal (over time) or cross-sectional (different locations at the same time). Building the appropriate model and fitting the data with the proper statistical techniques calls for considerable skill.

The second approach is to conduct price experiments. Bennett and Wilkinson systematically varied the prices of several products sold in a discount store and observed the results. An alternative approach is to charge different prices in similar territories to see how sales are affected.

The third approach is to ask buyers to state how many units they would buy at different proposed prices. But buyers might understate their purchase intentions at higher prices to discourage the company from setting higher prices.

In measuring the price-demand relationship, the market researcher must control for various factors that will influence demand. The competitor's response will make a difference. Also, if the company changes other marketing-mix factors besides its price, the effect of the price change itself will be hard to isolate. Nagle has presented an excellent summary of the various methods for estimating price sensitivity and demand."

### **Price Elasticity of Demand**

Marketers need to know how responsive, or elastic, demand would be to a change in price. Consider the two demand curves in Figure 15.3. With demand curve (a), a price increase from \$10 to \$15 leads to a relatively small decline in demand from 150 to 133. With demand curve (b), the same price increase leads to a substantial drop in demand from 150 to 50. If demand hardly changes with a small change in price, we say the demand is inelastic. If demand changes considerably, demand is elastic.

Demand is likely to be less elastic under the following conditions: (1) There are few or no substitutes or competitors; (2) buyers do not readily notice the higher price; (3) buyers are slow to change their buying habits and search for lower prices; (4) buyers think the higher prices are justified by quality differences, normal inflation, and so on. If demand is elastic, sellers will consider lowering the price. A lower price will produce more total revenue. This makes sense as long as the costs of producing and selling more units does not increase disproportionately.

The effects of not considering the needs of customers for whom demand is most elastic is illustrated by the subway fare changes made by New York's Metropolitan Transit Authority. In 1997, the governor of New York announced that in the following year New York City subway riders would be able to purchase daily, weekly, or monthly passes and avoid having to pay on a per-ride basis. By purchasing passes, riders would also benefit from a discounted fare; for users of the monthly pass, the benefit kicked in if the pass was used at least 47 times. Yet a Barron's journalist pointed out that the special fare did not benefit those whose demand was most elastic, suburban off-peak riders who use the subway the least. Here is how he segmented New York City's subway riders in terms of price elasticity: Commuters' demand curve is perfectly inelastic: No matter what happens to the fare, these people must get to work and get back home. The somewhat elastic demand curve for "all riders" includes commuters who live in the city and who might use the subway for other activities if the fare were lowered. The demand curve for off-peak riders, however, is the most price elastic, because this is the group that might use the subway much more with lower fares.

Price elasticity depends on the magnitude and direction of the contemplated price change. It may be negligible with a small price change and substantial with a large price change. It may differ for a price cut versus a price increase. Finally, long-run price elasticity may differ from short-run elasticity. Buyers may continue to buy from their current supplier after a price increase, because they do not notice the increase, or the increase is small, or they are distracted by other concerns, or they find choosing a new supplier takes time. But they may eventually switch suppliers. Here demand is more elastic in the long run than in the short run. Or the reverse may happen:

Buyers drop a supplier after being notified of a price increase but return later. The distinction between short-run and long-run elasticity means that sellers will not know the total effect of a price change until time passes.

## **ESTIMATING COSTS**

Demand sets a ceiling on the price the company can charge for its product. Costs set the floor. The company wants to charge a price that covers its cost of producing, distributing, and selling the product, including a fair return for its effort and risk.

### **Types of Costs and Levels of Production**

A company's costs take two forms, fixed and variable. Fixed costs (also known as over head) are costs that do not vary with production or sales revenue. A company must pay bills each month for rent, heat, interest, salaries, and so on, regardless of output.

Variable costs vary directly with the level of production. For example, each hand calculator produced by Texas Instruments involves a cost of plastic, microprocessing chips, packaging, and the like. These costs tend to be constant per unit produced. They are called variable because their total varies with the number of units produced.

Total costs consist of the sum of the fixed and variable costs for any given level of production. Average cost is the cost per unit at that level of production; it is equal to total costs divided by production. Management wants to charge a price that will at least cover the total production costs at a given level of production. To price intelligently, management needs to know how its costs vary with different levels of production.

Take the case in which a company such as TI has built a fixed-size plant to produce 1,000 hand calculators a day. The cost per unit is high if few units are produced per day. As production approaches 1,000 units per day, average cost falls. The reason is that the fixed costs are spread over more units, with each one bearing a smaller fixed cost. Average cost increases after 1,000 units, because the plant becomes inefficient: workers have to queue for machines, machines break down more often, and workers get in each other's way (Figure).

If TI believes that it could sell 2,000 units per day, it should consider building a larger plant. The plant will use more efficient machinery and work arrangements, and the unit cost of producing 2,000 units per day will be less than the unit cost of producing 1,000 units per day. This is shown in the long-run average cost curve in Figure 15.4(b). In fact, a 3,000-capacity plant would be even more efficient according to Figure 15.4(b). But a 1,000-daily production plant would be less efficient because of increasing diseconomies of scale: There are too many workers to manage, and paperwork slows things down. Figure 15.4(b) indicates that a 3,000-

daily production plant is the optimal size to build, if demand is strong enough to support this level of production.

### **Accumulated Production**

Suppose TI runs a plant that produces 3,000 hand calculators per day. As TI gains experience producing hand calculators, its methods improve. Workers learn shortcuts, materials flow more smoothly, and procurement costs fall. The result, as Figure 15.5 shows, is that average cost falls with accumulated production experience. Thus the average cost of producing the first 100,000 hand calculators is \$10 per calculator. When the company has produced the first 200,000 calculators, the average cost has fallen to \$9. After its accumulated production experience doubles again to 400,000, the average cost is \$8. This decline in the average cost with accumulated production experience is called the experience curve or learning curve.

Now suppose three firms compete in this industry, TI, A, and B. TI is the lowest-cost producer at \$8, having produced 400,000 units in the past. If all three firms sell the calculator for \$10, TI makes \$2 profit per unit, A makes \$1 per unit, and B breaks even. The smart move for TI would be to lower its price to \$9. This will drive B out of the market, and even A will consider leaving. TI will pick up the business that would have gone to B (and possibly A). Furthermore, price-sensitive customers will enter the market at the lower price. As production increases beyond 400,000 units, TI's costs will drop still further and faster and more than restore its profits, even at a price of \$9. TI has used this aggressive pricing strategy repeatedly to gain market share and drive others out of the industry.

Experience-curve pricing nevertheless carries major risks. Aggressive pricing might give the product a cheap image. The strategy also assumes that the competitors are weak and not willing to fight. Finally, the strategy leads the company into building more plants to meet demand while a competitor innovates a lower-cost technology and obtains lower costs than the market leader, who is now stuck with the old technology.

Most experience-curve pricing has focused on manufacturing costs. But all costs, including marketing costs, are subject to learning improvements. If three firms are each investing a large sum of money trying telemarketing, the firm that has used it the longest might achieve the lowest telemarketing costs. This firm can charge a little less for its product and still earn the same return, all other costs being equal."

### **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. One retailer may want daily delivery (to keep stock lower) while another retailer may accept twice-a-week delivery in order to get a lower price. As a result, the manufacturer's costs will differ with each chain, and its profits will differ. 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.

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. 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. The Japanese use a method called target costing." 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. They then examine each cost element—design, engineering, manufacturing, sales—and break them down into further components. They consider ways to reengineer components, eliminate functions, and bring down supplier costs. The objective is to bring the final cost projections into the target cost range. If they can't succeed, they may decide against developing the product because it couldn't sell for the target price and make the target profit. When they can succeed, profits are likely to follow.

## ANALYZING COMPETITORS' COSTS, PRICES, AND OFFERS

Within the range of possible prices determined by market demand and company costs, the firm must take the competitors' costs, prices, and possible price reactions into account. If the firm's offer is similar to a major competitor's offer, then the firm will have to price close to the competitor or lose sales. If the firm's offer is inferior, the firm will not be able to charge more than the competitor. If the firm's offer is superior, the firm can charge more than the competitor. The firm must be aware, however, that competitors might change their prices in response.

## SELECTING A PRICING METHOD

Given the three Cs—the customers' demand schedule, the cost function, and competitors' prices—the company is now ready to select a price. Figure 15.6 summarizes the three major considerations in price setting. Costs set a floor to the price. Competitors' prices and the price of substitutes provide an orienting point. Customers' assessment of unique product features establishes the ceiling price.

Companies select a pricing method that includes one or more of these three considerations. We will examine six price-setting methods: markup pricing, target-return pricing, perceived-value pricing, value pricing, going-rate pricing, and sealed-bid pricing.

### Markup Pricing

The most elementary pricing method is to add a standard markup to the product's cost. Construction companies submit job bids by estimating the total project cost and adding a standard markup for profit. Lawyers and accountants typically price by adding a standard markup on their time and costs. Defense contractors charge their cost plus a standard markup. Suppose a toaster manufacturer has the following costs and sales expectations:

Variable cost per unit	\$ 10
Fixed cost	300,000
Expected unit sales	50,000

The manufacturer's unit cost is given by:

$$\text{Unit cost} = \text{variable cost} + \frac{\text{fixed costs} = \$10}{\text{unit sales}} + \frac{\$300,000}{50,000} = \$16$$

Now assume the manufacturer wants to earn a 20 percent markup on sales. The manufacturer's markup price is given by:

$$\text{Markup price} = \frac{\text{Unit cost}}{(1 - \text{desired return on sales})} = \frac{\$16}{1 - 0.2} = \$20$$

The manufacturer would charge dealers \$20 per toaster and make a profit of \$4 per unit. The dealers in turn will mark up the toaster. If dealers want to earn 50 percent on their selling price, they will mark up the toaster to \$40. This is equivalent to a cost markup of 100 percent.

Markups are generally higher on seasonal items (to cover the risk of not selling), specialty items, slower moving items, items with high storage and handling costs, and demand-inelastic items, such as prescription drugs. Unfortunately, those least able to pay for prescription drugs are often those most burdened by the markups: uninsured individual customers and the elderly on Medicare. In the case of prescription drugs, generic (non-brand-name) drugs command an extraordinarily high markup:

Does the use of standard markups make logical sense? Generally no. Any pricing method that ignores current demand, perceived value, and competition is not likely to lead to the optimal price. Markup pricing works only if the marked-up price actually brings in the expected level of sales.

Companies introducing a new product often price it high hoping to recover their costs as rapidly as possible. But a high-markup strategy could be fatal if a competitor is pricing low. This happened to Philips, the Dutch electronics manufacturer, in pricing its videodisc players. Philips wanted to make a profit on each videodisc player. Meanwhile, Japanese competitors priced low and succeeded in building their market share rapidly, which in turn pushed down their costs substantially.

Still, (markup pricing remains popular for a number of reasons. First, sellers can determine costs much more easily than they can estimate demand. By tying the price to cost, sellers simplify the pricing task. Second, where all firms in the industry use this pricing method, prices tend to be similar. Price competition is therefore minimized, which would not be the case if firms paid attention to demand variations when they priced. Third, many people feel that cost-plus pricing is fairer to both buyers and sellers. Sellers do not take advantage of buyers when the latter's demand becomes acute, and sellers earn a fair return on investment.

### Target-Return Pricing

In target-return pricing, the firm determines the price that would yield its target rate of return on investment (ROI). Target pricing is used by General Motors, which prices its automobiles to achieve a 15 to 20 percent ROI. This pricing method is also used by public utilities, which need to make a fair return on their investment.

Suppose the toaster manufacturer has invested \$1 million in the business and wants to set price to earn a 20 percent ROI, specifically \$200,000. The target-return price is given by the following formula:

$$\text{Target-return price} = \frac{\text{unit cost} + \text{desired return} \times \text{invested capital}}{\text{unit sales}}$$

$$= \$16 + \frac{0.20 \times \$1,000,000}{50,000} = \$20$$

The manufacturer will realize this 20 percent ROI provided its costs and estimated sales turn out to be accurate. But what if sales do not reach 50,000 units? The manufacturer can prepare a break-even chart to learn what would happen at other sales levels (Figure 15.7). Fixed costs are \$300,000 regardless of sales volume. Variable costs, not shown in the figure, rise with volume. Total costs equal the sum of fixed costs and variable costs. The total revenue curve starts at zero and rises with each unit sold.

The total revenue and total cost curves cross at 30,000 units. This is the break-even volume. It can be verified by the following formula:

$$\text{Break-even volume} = \frac{\text{fixed cost}}{\text{price} - \text{variable cost}} = \frac{\$300,000}{\$20 - \$10} = 30,000$$

The manufacturer, of course, is hoping that the market will buy 50,000 units at \$20, in which case it earns \$200,000 on its \$1 million investment. But much depends on price elasticity and competitors' prices. Unfortunately, target-return pricing tends to ignore these considerations. The manufacturer needs to consider different prices and estimate their probable impacts on sales volume and profits. The manufacturer should also search for ways to lower its fixed or variable costs, because lower costs will decrease its required break-even volume.

### Perceived-Value Pricing

An increasing number of companies base price on the customer's perceived value. They see the buyers' perceptions of value, not the seller's cost, as the key to pricing. They use the other marketing-mix elements, such as advertising and sales force, to build up perceived value in buyers' minds.

DuPont is a major practitioner of perceived-value pricing. When DuPont developed its new synthetic fiber for carpets, it demonstrated to carpet manufacturers that they could afford to pay DuPont as much as \$1.40 per pound for the new fiber and still make their target profit. DuPont calls the \$1.40 the value-in-use price. But pricing the new material at \$1.40 per pound would leave the carpet manufacturers indifferent. So it set the price lower than \$1.40 to induce carpet manufacturers to adopt the new fiber. DuPont did not use its manufacturing cost to set the price but only to judge whether there was enough profit to go ahead in the first place.

DuPont also embeds each chemical into a larger offering so that it is not seen as a commodity but rather as a solution to a customer's problem. Consider the following:

Attribute	Standard Offer	Premium Offer	Added Value
Quality	Impurities less than ten parts	Impurities less than one part	\$1.40
Delivery	Within two weeks	Within one week	0.15
System	Supply chemical only	Supply total system	0.80
Innovation	Little R&D support	High level R&D support	2.00

Retraining	Train initially	Retrain on request	0.40
Service	Through home Officepurchase	Locally available	0.25
Price	\$100/pound	\$105/pound	\$5.00

The chemical is part of a standard offer or a premium offer. The customer who wants the premium offer pays \$105 instead of \$100 a pound. The customer may end up requesting fewer added values. DuPont is willing to unbundle the premium offer and charge only for the chosen added values.

Caterpillar also uses perceived value to set prices on its construction equipment. It might price its tractor at \$100,000, although a similar competitor's tractor might be priced at \$90,000. When a prospective customer asks a Caterpillar dealer why he should pay \$10,000 more for the Caterpillar tractor, the dealer answers:

\$ 901,000 is the tractor's price if it is only equivalent to the competitor's tractor  
 \$7,000 is the price premium for Caterpillar's superior durability  
 \$6,000 is the price premium for Caterpillar's superior reliability  
 \$5,000 is the price premium for Caterpillar's superior service  
 \$2,000 is the price premium for Caterpillar's longer warranty on parts  
 \$110,000 is the normal price to cover Caterpillar's superior value  
 -\$10,000 discount

-----  
 \$100,000 final price

The Caterpillar dealer is able to indicate why Caterpillar's tractor delivers more value than the competitor's. Although the customer is asked to pay a \$10,000 premium, he is actually getting \$20,000 extra value! He chooses the Caterpillar tractor because he is convinced that its lifetime operating costs will be lower.

The key to perceived-value pricing is to determine the market's perception of the offer's value accurately. Sellers with an inflated view of their offer's value will overprice their product. Sellers with an underestimated view will charge less than they could. Market research is needed to establish the market's perception of value as a guide to effective pricing."

### Value Pricing

In recent years, several companies have adopted value pricing, in which they charge a fairly low price for a high-quality offering. Value pricing says that the price should represent a high-value offer to consumers.

The computer industry has gone from seeking top dollar for computers with the most technology to putting out computers with basic features for lower prices. Recently Procter & Gamble created quite a stir by reducing its price on Pampers and Luvs diapers, liquid Tide detergent, and Folger's coffee to value price them. In the past, a brand-loyal family had to pay what amounted to a \$725 premium for a year's worth of P&G products versus private-label or low-priced brands. To offer value prices, P&G underwent a major overhaul. It redesigned the way it develops, manufactures, distributes, prices, markets, and sells products to deliver better value at every point in the supply chain." Value pricing is not a matter of simply

setting lower prices on one's products compared to competitors. It is a matter of reengineering the company's operations to become a low-cost producer without sacrificing quality, and lowering prices significantly to attract a large number of value-conscious customers.

An important type of value pricing is everyday low pricing (EDLP), which takes place at the retail level. A retailer who holds to an EDLP pricing policy charges a constant, everyday low price with no temporary price discounts. These constant prices eliminate week-to-week price uncertainty and can be contrasted to the "high-low" pricing of promotion-oriented competitors. In high-low pricing the retailer charges higher prices on an everyday basis but then runs frequent promotions in which prices are temporarily lowered below the EDLP level.

In recent years, high-low pricing has given way to EDLP at such widely different venues as General Motors' Saturn car dealerships and upscale department stores such as Nordstrom. But the king of EDLP is surely Wal-Mart, which practically defined the term. Except for a few sale items every month, Wal-Mart promises everyday low prices on major brands. "It's not a short-term strategy," says one Wal-Mart executive. "You have to be willing to make a commitment to it, and you have to be able to operate with ratios of expense than everybody else.

Retailers adopt EDLP for a number of reasons, the most important of which is that constant sales and promotions are costly and have eroded consumer confidence in the credibility of everyday shelf prices. Consumers also have less time and patience for such time-honored traditions as watching for supermarket specials and clipping coupons. Yet, there is no denying that promotions create excitement and draw shoppers. For this reason, EDLP is not a guarantee of success. As supermarkets face heightened competition from their counterparts and from alternative channels, many find that the key to drawing shoppers is using a combination of high-low and everyday low pricing strategies, with increased advertising and promotions.

### **Going-Rate Pricing**

In going-rate pricing, the firm bases its price largely on competitors' prices. The firm might charge the same, more, or less than major competitor(s). In oligopolistic industries that sell a commodity such as steel, paper, or fertilizer, firms normally charge the same price. The smaller firm, "follow the leader," changing their prices when the market leader's price change rather than when their own demand or costs change. Some firms may charge a slight premium or slight discount, but they preserve the amount of difference. Thus, minor gasoline retailers usually charge a few cents less per gallon than the major oil companies, without letting the difference increase or decrease.

Going-rate pricing is quite popular. Where costs are difficult to measure or competitive response is uncertain, firms feel that the going price represents a good solution. It is thought to reflect the industry's collective wisdom as to the price that will yield a fair return and not jeopardize industrial harmony.

### **Sealed-Bid Pricing**

Competitive-oriented pricing is common where firms submit sealed bids for jobs. The firm bases its price on expectations of how competitors will price rather than on a rigid relation to the firm's costs or demand. The firm wants to win the contract, and winning normally requires submitting a lower price bid. At the same time, the firm cannot set its price below cost.

The net effect of these two opposite pulls can be described in terms of the bid's expected profit. Suppose a bid of 59,500 would yield a high chance of getting the contract (say 81 percent) but only a low profit, say \$100. The expected profit is calculated by multiplying the company's profit by the probability of winning the bid. Thus the expected profit of this bid is 581. If the firm bid \$11,000, its profit would be \$1,600, but its chance of getting the contract might be reduced, say to 1%. The expected profit would thus be only \$16. One logical bidding criterion, might be to bid the price that would maximize the expected profit. According to Table, the best bid would be \$10,000, for which the expected profit is \$216.

Using expected profit for setting price makes sense for the firm that makes many bids. In playing the odds, the firm will achieve maximum profits in the long run. The firm that bids only occasionally or that needs a particular contract badly will not find it advantageous to use the expected-profit criterion. This criterion, for example, does not distinguish between a \$1,000 profit with a 0.10 probability and a \$125 profit with an 0.80 probability. Yet the firm that wants to keep production going would prefer in the second contract to the first.

### **SELECTING THE FINAL PRICE**

Pricing methods narrow the range from which the company must select its final price. In selecting that price, the company must consider additional factors, including psychological pricing, the influence of other marketing-mix elements on price, company pricing policies, and the impact of price on other parties.

#### **Psychological Pricing**

Many consumers use price as an indicator of quality. When Fleischmann raised the price of its gin from \$4.50 to \$5.50 a bottle, its liquor sales went up, not down. Image pricing is especially effective with ego-sensitive products such as perfumes and expensive cars. A \$100 bottle of perfume might contain \$10 worth of scent, but gift givers pay \$100 to communicate their high regard for the receiver.

Price and quality perceptions of cars interact. Higher-priced cars are perceived to possess high quality. Higher-quality cars are likewise perceived to be higher priced than they actually are. When alternative information about true quality is available, price becomes a less significant indicator of quality. When this information is not available, price acts as a signal of quality.

When looking at a particular product, buyers carry in their minds a reference price formed by noticing current prices, past prices, or the buying context. Sellers often manipulate these reference prices. For example, a seller can situate its product among expensive products to imply that it belongs in the same class. Department stores will display women's apparel in separate departments differentiated by price; dresses found in the more expensive department are assumed to be of better quality. Reference-price thinking is also created by stating a high manufacturer's suggested price, or by indicating that the product was priced much higher originally, or by pointing to a competitor's high price.

Many sellers believe that prices should end in an odd number. Many customers see a stereo amplifier priced at \$299 instead of \$300 as a price in the \$200 range rather than \$300 range. Another explanation is that odd endings convey the notion of a discount or bargain. But if a company wants a high-price image instead of a low-price image, it should avoid the odd-ending tactic.

### **The Influence of Other Marketing-Mix Elements**

The final price must take into account the brand's quality and advertising relative to competition. Farris and Reibstein examined the relationships among relative price, relative quality, and relative advertising for 227 consumer businesses and found the following:

Brands with average relative quality but high relative advertising budgets were able to charge premium prices. Consumers apparently were willing to pay higher prices for known products than for unknown products.

Brands with high relative quality and high relative advertising obtained the highest prices. Conversely, brands with low quality and low advertising charged the lowest prices. The positive relationship between high prices and high advertising held most strongly in the later stages of the product life cycle for market leaders.

### **Company Pricing Policies**

The price must be consistent with company pricing policies. Many companies set up a pricing department to develop policies and establish or approve decisions. The aim is to ensure that the salespeople quote prices that are reasonable to customers and profitable to the company.

### **Impact of Price on Other Parties**

Management must also consider the reactions of other parties to the contemplated price. How will distributors and dealers feel about it? Will the sales force be willing to sell at that price? How will competitors react? Will suppliers raise their prices when they see the company's price? Will the government intervene and prevent this price from being charged?

In the last case, marketers need to know the laws regulating pricing. U.S. legislation states that sellers must set prices without talking to competitors: Price-fixing is illegal. Many federal and state statutes protect consumers against deceptive pricing practices. For example, it is illegal for a company to set artificially high "regular" prices, and then announce a "sale" at prices close to previous everyday prices.

## **ADAPTING THE PRICE**

Companies usually do not set a single price but rather a pricing structure that reflects variations in geographical demand and costs, market-segment requirements, purchase timing, order levels, delivery frequency, guarantees, service contracts, and other factors. As a result of discounts, allowances, and promotional support, a company rarely realizes the same profit from each unit of a product that it sells. Here we will examine several price-adaptation strategies: geographical pricing, price discounts and allowances, promotional pricing, discriminatory pricing, and product-mix pricing.

### **GEOGRAPHICAL PRICING (CASH, COUNTERTRADE, BARTER)**

Geographical pricing involves the company in deciding how to price its products to different customers in different locations and countries. For example, should the company charge higher prices to distant customers to cover the higher shipping costs or a lower price to win additional business? Another issue is how to get paid. This issue is critical when buyers lack sufficient hard currency to pay for their purchases. Many buyers want to offer other items in payment, a practice known as countertrade. American companies are often forced to engage in countertrade if they want the business. Countertrade may account for 15 to 25 percent of world trade and takes several forms: barter, compensation deals, buyback agreements, and offset.

**Barter:** The direct exchange of goods, with no money and no third party involved. In 1993, Eminence 5.A., one of France's major clothing makers, launched a five-year deal to barter \$25 million worth of U.S.-produced underwear and sportswear to customers in eastern Europe in exchange for a variety of goods and services, including global transportation and advertising space in eastern European magazines.

**Compensation deal:** The seller receives some percentage of the payment in cash and the rest in products. A British aircraft manufacturer sold planes to Brazil for 70 percent cash and the rest in coffee.

**Buyback arrangement:** The seller sells a plant, equipment, or technology to another country and agrees to accept as partial payment products manufactured with the supplied equipment. A U.S. chemical company built a plant for an Indian company and accepted partial payment in cash and the remainder in chemicals manufactured at the plant.

**Offset:** The seller receives full payment in cash but agrees to spend a substantial amount of that money in that country within a stated time period. For example, PepsiCo sells its cola syrup to Russia for rubles and agrees to buy Russian vodka at a certain rate for sale in the United States.

More complex countertrade deals involve more than two parties. For example, Daimler-Benz agreed to sell 30 trucks to Romania and accept in exchange 150 Romanian-made jeeps, which it sold in Ecuador for bananas, which in turn were sold to a German supermarket chain for deutsche marks. Through this circuitous transaction, Daimler-Benz finally achieved payment in German currency. Deals such as this are carried on by a separate countertrade department within the company. Other companies rely on barter houses and countertrade specialists to assist them.

## **PRICE DISCOUNTS AND ALLOWANCES**

Most companies will adjust their list price and give discounts and allowances for early payment, volume purchases, and off-season buying. Companies must do this carefully or find that their profits are much less than planned.

Jack Trout, author of *Positioning* and several other marketing guidebooks, cautions that some categories tend to self-destruct by always being on sale. Mink coats and mattresses, says Trout, never seem to be sold at anything near list price, and when automakers get rebate happy, the market just sits back and waits for a deal. Discount pricing has become the modus operandi of a surprising number of companies offering both products and services. Even Pepsi and Coke, two of the most popular brands in the world, engaged in a price war, which ultimately tarnished their brand equity. See the Marketing Memo, "Commandments of Discounting," for Jack Trout's discounting directives.

### **Cash Discounts:**

A cash discount is a price reduction to buyers who pay their bills promptly. A typical example is "2/10, net 30," which means that payment is due within 30 days and that the buyer can deduct 2 percent by paying the bill within 10 days. Such discounts are customary in many industries.

### **Quantity Discounts :**

A quantity discount is a price reduction to those buyers who buy large volumes. A typical example is "\$10 per unit for less than 100 units; \$9 per unit for 100 or more units." Quantity discounts must be offered equally to all customers and must not exceed the cost savings to the seller associated with selling large quantities. They can be offered on a

noncumulative basis (on each order placed) or a cumulative basis (on the number of units ordered over a given period).

**Functional Discounts:**

Functional discounts (also called trade discounts) are offered by a manufacturer to trade-channel members if they will perform certain functions, such as selling, storing, and record keeping. Manufacturers may offer different functional discounts to different trade channels but must offer the same functional discounts within each channel.

**Seasonal Discounts:**

A seasonal discount is a price reduction to buyers who buy merchandise or services out of season. Ski manufacturers will offer seasonal discounts to retailers in the spring and summer to encourage early ordering. Hotels, motels, and airlines will offer seasonal discounts in slow selling periods.

**Allowances :**

Allowances are extra payments designed to gain reseller participation in special programs. Trade-in allowances are price reductions granted for turning in an old item when buying a new one. Trade-in allowances are most common in durable-goods categories. Promotional allowances are payments or price reductions to reward dealers for participating in advertising and sales support programs.

**PROMOTIONAL PRICING**

Companies can use several pricing techniques to stimulate early purchase. Loss-leader pricing: Supermarkets and department stores often drop the price on well-known brands to stimulate additional store traffic. The manufacturers of these brands typically disapprove of their products being used as loss leaders because this practice can dilute the brand image and bring complaints from other retailers who charge the list price. Manufacturers have tried to restrain intermediaries from loss leader pricing through lobbying for retail-price-maintenance laws, but these laws have been revoked.

Special-event pricing: Sellers will establish special prices in certain seasons to draw in more customers. Every August, there are back-to-school sales.

Cash rebates: Auto companies and other consumer-goods companies offer cash rebates to encourage purchase of the manufacturers' products within a specified time period. Rebates can help clear inventories without cutting the stated list price.

Low-interest financing: Instead of cutting its price, the company can offer customers low-interest financing. Automakers have announced 3 percent financing and in some cases no-interest financing to attract customers.

Longer payment terms: Sellers, especially mortgage banks and auto companies, stretch loans over longer periods and thus lower the monthly payments. Consumers often worry less about the cost (i.e., the interest rate) of a loan and more about whether they can afford the monthly payment.

Warranties and service contracts: Companies can promote sales by adding a free or low-cost warranty or service contract.

Psychological discounting: This strategy involves setting an artificially high price and then offering the product at substantial savings; for example, "Was \$359, now \$299." Illegitimate discount tactics are fought by the Federal Trade Commission and Better Business Bureaus. However, discounts from normal prices are a legitimate form of promotional pricing.

Promotional-pricing strategies are often a zero-sum game. If they work, competitors join them and they lose their effectiveness. If they do not work, they waste company money that could have been put into longer impact marketing tools, such as building up product quality and service or strengthening product image through advertising.

### **DISCRIMINATORY PRICING**

Companies often adjust their basic price to accommodate differences in customers, products, locations, and so on. Discriminatory pricing occurs when a company sells a product or service at two or more prices that do not reflect a proportional difference in costs. Discriminatory pricing takes several forms:

**Customer-segment pricing:** Different customer groups are charged different prices for the same product or service. For example, museums often charge a lower admission fee to students and senior citizens.

**Product-form pricing:** Different versions of the product are priced differently but not proportionately to their respective costs. Evian prices a 48-ounce bottle of its mineral water at \$2.00. It takes the same water and packages 1.7 ounces in a moisturizer spray for \$6.00. Through product-form pricing, Evian manages to charge \$3.00 an ounce in one form and about \$.04 an ounce in another.

**Image pricing:** Some companies price the same product at two different levels based on image differences. A perfume manufacturer can put the perfume in one bottle, give it a name and image, and price it at \$10 an ounce. It can put the same perfume in another bottle with a different name and image and price it at \$110 an ounce.

**Location pricing:** The same product is priced differently at different locations even though the cost of offering at each location is the same. A theater varies its seat prices according to audience preferences for different locations.

**Time pricing:** Prices are varied by season, day, or hour. Public utilities vary 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 hotels and airlines to ensure high occupancy. To ensure that all its berths are full, for example, a cruise ship may lower the price of the cruise two days before sailing.

For price discrimination to work, certain conditions must exist. First, the market must be segmentable and the segments must show different intensities of demand. Second, members in the lower-price segment must not be able to resell the product to the higher-price segment. Third, competitors must not be able to undersell the firm in the higher-price segment. Fourth, the cost of segmenting and policing the market must not exceed the extra revenue derived from price discrimination. Fifth, the practice must not breed customer resentment and ill will. Sixth, the particular form of price discrimination must not be illegal.

As a result of deregulation in several industries, competitors have increased their use of discriminatory pricing. Airlines charge different fares to passengers on the same flight depending on the seating class; the time of day (morning or night coach); the day of the week (workday or weekend); the season; the person's company, past business, or status (youth, military, senior citizen); and so on. Airlines are using yield pricing to capture as much revenue as possible.

Most consumers are probably not even aware of the degree to which they are the targets of discriminatory pricing. For instance, catalog retailers like Victoria's Secret routinely send out catalogs that sell identical goods except at different prices. Consumers who

live in a more free-spending zip code may see only the higher prices. Office product superstore staples also sends out office supply catalogs with different prices.

Computer technology is making it easier for sellers to practice discriminatory pricing. For instance, they can use software that monitors customers' movements over the web and allows them to customize offers and prices to each customer. New software applications, however, are also allowing buyers to discriminate between sellers by comparing prices instantaneously. For more on the topic, see the marketing for the Millennium, "Digital Discrimination: How the Internet is Revolutionizing pricing – for Sellers and Buyers".

Some forms of price discrimination (in which sellers offer different price terms to different people within the same trade group) are illegal. However, price discrimination is legal if the seller can prove that its costs are different when selling different volumes or different qualities of the same product to different retailers. Predatory pricing – selling below cost with the intention of destroying competition – is against the law.

But although predatory pricing is thought to be against the law, courts regard it as a legal function: theoretically against the law but almost impossible to prove. A new generation of economists, however, is arguing it is wrong and illegal, especially where software is concerned. Economist Brian Arthur holds that once a company gains a decisive lead in an industry, such as computing, where there is a strong tendency for consumers to band around one standard, it is almost impossible for rivals to unseat it (even when the predator raises its prices). The U.S. government's antitrust lawsuit against Microsoft could well bring attention to what many perceive as its predatory pricing tactics, even though the suit focuses on other grievances:

### **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 is difficult because the various products have demand and cost interrelationships and are subject to different degrees of competition. We can distinguish six situations involving product-mix pricing: product-line pricing, optional-feature pricing, captive-product pricing, two-part pricing, by-product pricing, and product-bundling pricing.

#### **Product-Line Pricing**

Companies normally develop product lines rather than single products and introduce price steps. In many lines of trade, sellers use well-established price points for the products in their line. A men's clothing store might carry men's suits at three price levels: \$200, \$350 and \$500. Customers will associate low, average and high-quality suits with the three price points. The seller's task is to establish perceived-quality differences that justify the price differences.

#### **Optional features pricing**

Many companies offer optional products, features and services along with their main product. The automobile buyer can order electric window controls, defoggers, light dimmers, and an extended warranty. 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. For many years U.S. auto companies advertised a stripped-down model for \$10,000 to pull people into showrooms. The economy model was stripped of so many features that most buyers left the showroom spending \$13,000.

Restaurants face a similar pricing problem. Restaurant customers can often order liquor in addition to the meal. Many restaurants price their liquor high and their food low. The food revenue covers costs, and the liquor produces the profit. This explains why server often presses hard to get customers to order drinks. Other restaurants price their liquor low and food high to draw in a drinking crowd.

### **Captive-Product Pricing**

Some products require the use of ancillary, or captive, products. Manufacturers of razors and cameras often price them low and set high markups on razor blades and film, respectively

'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.

### **Two-Part Pricing**

Service firms often engage in two-part pricing, consisting of a fixed fee plus a variable usage fee. Telephone users pay a minimum monthly fee plus charges for calls beyond a certain area. Amusement parks charge an admission fee plus fees for rides over a certain minimum. The service firm faces a problem similar to captive-product pricing—namely, how much to charge for the basic service and how much for the variable usage. The fixed fee should be low enough to induce purchase of the service; the profit can then be made on the usage fees.

### **By-product Pricing**

The production of certain goods—meats, petroleum products, and other chemicals—often results in by-products. If the by-products have value to a customer group, they should be priced on their value. Any income earned on the by-products will make it easier for the company to charge a lower price on its main product if competition forces it to do so.

Sometimes companies don't realize how valuable their by-products are. Until Zoo Doo Compost Company came along, many zoos did not realize that one of their by-products—their occupants' manure—could be an excellent source of additional revenue.

### **Product-Bundling Pricing**

Sellers often bundle their products and features at a set price. An auto manufacturer might offer an option package at less than the cost of buying all the options separately. A theater company will price a season subscription at less than the cost of buying all the performances separately. Because customers may not have planned to buy all the components, the savings on the price bundle must be substantial enough to induce them to buy the bundle.

Some customers will want less than the whole bundle. Suppose a medical equipment supplier's offer includes free delivery and training. A particular customer might ask to forgo the free delivery and training in exchange for a lower price. The customer is asking the seller to "unbundle" or "rebundle" its offer. If a supplier saves \$100 by not supplying delivery and reduces the customer's price by \$80, the supplier has kept the customer happy while increasing its profit by \$20.

## **DEVELOPING AND MANAGING AN ADVERTISING PROGRAM**

We define advertising as follows:

Advertising is any paid form of nonpersonal presentation and promotion of ideas, goods, or services by an identified sponsor.

Advertisers include not only business firms but also museums, charitable organizations, and government agencies that direct messages to target publics. Ads are a cost-effective way to disseminate messages, whether to build brand preference for Coca-Cola or to educate people to avoid hard drugs.

Organizations handle their advertising in different ways. In small companies, advertising is handled by someone in the sales or marketing department, who works with an advertising agency. A large company will often set up its own advertising department, whose manager reports to the vice president of marketing. The advertising department's job is to propose a budget; develop advertising strategy; approve advertising campaigns; and handle direct-mail advertising, dealer displays, and other forms of advertising. Most companies use an outside agency to help create advertising campaigns and to select and purchase media.

In developing a program, marketing managers must always start by identifying the target market and buyer motives. Then they can make the five major decisions in developing an advertising program, known as the five Ms: Mission: What are the advertising objectives? Money: How much can be spent? Message: What message should be sent? Media: What media should be used? Measurement: How should the results be evaluated? These decisions are summarized in Figure 19.1 and described in the following sections.

### **SETTING THE ADVERTISING OBJECTIVES**

The advertising objectives must flow from prior decisions on target market, market positioning, and marketing mix.

Many specific communication and sales objectives can be assigned to advertising. Colley lists 52 possible advertising objectives in his *Defining Advertising Goals for Measured Advertising Results*. He outlines a method called DAGMAR (after the book's title) for turning objectives into specific measurable goals. An advertising goal (or objective) is a specific communication task and achievement level to be accomplished with a specific audience in a specific period of time. Colley provides an example:

To increase among 30 million homemakers who own automatic washers the number who identify brand X as a low-sudsing detergent and who are persuaded that it gets clothes cleaner—from 10 percent to 40 percent in one year.

Advertising objectives can be classified according to whether their aim is to inform, persuade, or remind.

Informative advertising figures heavily in the pioneering stage of a product category, where the objective is to build primary demand. Thus the yogurt industry initially had to inform consumers of yogurt's nutritional benefits.

Persuasive advertising becomes important in the competitive stage, where a company's objective is to build selective demand for a particular brand. For example, Chivas Regal attempts to persuade consumers that it delivers more taste and status than other brands of Scotch whiskey. Some persuasive advertising uses comparative advertising, which makes an explicit comparison of the attributes of two or more brands. The Burger King Corporation used comparative advertising for its attack on McDonald's (Burger King's burgers are flame-broiled; McDonald's are fried). Schering-Plough claimed that "New OcuClear relieves three times longer than Visine." A company should make sure it can prove its claim of superiority.

and cannot be counterattacked in a vulnerable area. Comparative advertising works best when it elicits cognitive and affective motivations simultaneously.'

Reminder advertising is important with mature products. Expensive four-color Coca-Cola ads in magazines are intended to remind people to purchase Coca-Cola. A related form of advertising is reinforcement advertising, which seeks to assure current purchasers that they have made the right choice. Automobile ads often depict satisfied customers enjoying special features of their new car.

The advertising objective should emerge from a thorough analysis of the current marketing situation. If the product class is mature, the company is the market leader, W, and brand usage is low, the proper objective should be to stimulate more usage. If the product class is new, the company is not the market leader, but the brand is superior (A to the leader, then the proper objective is to convince the market of the brand's superiority.

### **DECIDING ON THE ADVERTISING BUDGET**

How does a company know if it will be spending the right amount? If it spends too little, the effect will be negligible. If it spends too much, then some of the money could have been put to better use. Some critics charge that large consumer-packaged goods firms tend to overspend on advertising as a form of insurance against not spending enough, and that industrial companies underestimate the power of company and product image building and tend to underspend on advertising.

Advertising has a carryover effect that lasts beyond the current period. Although advertising is treated as a current expense, part of it is really an investment that builds up an intangible asset called brand equity. When \$5 million is spent on capital equipment, the equipment may be treated as a five-year depreciable asset and only one-fifth of the cost is written off in the first year. When \$5 million is spent on advertising to launch a new product, the entire cost must be written off in the first year. This treatment of advertising reduces the company's reported profit and therefore limits the number of new-product launches a company can undertake in any one year.

There are five specific factors to consider when setting the advertising budget:  
Stage in the product life cycle: New products typically receive large advertising budgets to build awareness and to gain consumer trial. Established brands usually are supported with lower advertising budgets as a ratio to sales.

Market share and consumer base: High-market-share brands usually require less advertising expenditure as a percentage of sales to maintain their share. To build share by increasing market size requires larger advertising expenditures. On a cost-per-impression basis, it is less expensive to reach consumers of a widely used brand than to reach consumers of low-share brands.

Competitor and clutter: In a market with a large number of competitors and high advertising spending, a brand must advertise more heavily to be heard. Even simple clutter from advertisements not directly competitive to the brand creates a need for heavier advertising.

Advertising frequency: The number of repetitions needed to put across the brand's message to consumers has an important impact on the advertising budget.

Product substitutability: Brands in a commodity class (cigarettes, beer, soft drinks) require heavy advertising to establish a differential image. Advertising is also important when a brand can offer unique physical benefits or features.

Marketing scientists have built a number of advertising-expenditure models that take these factors into account. Vidale and Wolfe's model called for a larger advertising budget, the higher the sales-response rate, the higher the sales-decay rate (the rate at which customers forget the advertising and brand), and the higher the untapped sales potential. Unfortunately, this model leaves out other important factors, such as the rate of competitive advertising and the effectiveness of the company's ads.

John Little proposed an adaptive-control method for setting the advertising budget. Suppose the company has set an advertising-expenditure rate based on its most current information. It spends this rate in all markets except in a Subset of  $2n$  markets randomly drawn. In  $n$  test markets the company spends at a lower rate, and the other  $n$  it spends at a higher rate. This procedure will yield information on the average sales created by low, medium, and high rates of advertising that can be used to update the parameters of the sales-response function. The updated function can be used to determine the best advertising-expenditure rate for the next period. If this experiment is conducted each period, advertising expenditures will closely track optimal advertising expenditures.

### **CHOOSING THE ADVERTISING MESSAGE**

Advertising campaigns vary in their creativity. William Bernbach observed: "The facts are not enough... Don't forget that Shakespeare used some pretty hackneyed plots, yet his message came through with great execution." Consider the following example: Clearly, the creativity factor can be more important than the number of dollars spent. Only after gaining attention can a commercial help to increase brand sales. However, a warning is in order. Creative advertising may not be enough. This was the case for Miles and Alka-Seltzer tablets:

**Alka-Seltzer** Alka-Seltzer antacid tablets have been the beneficiary of some of the most creative advertising in history: In 1969, the company began airing the classic "prison spot" in which 260 jailbirds, led by actor George Raft, rebelled against prison food by banging tin cups on tables while chanting "Alka-Seltzer." Later the company aired two more classic Alka-Seltzer TV spots: "Honeymoon," in which the tablets saved a bridegroom after his bride cooked up such meals as poached oysters and marshmallow meatballs, and ads that are remembered for the line "That's a spicy meatball." The company continued to push out more classic TV commercials for Alka-Seltzer, utilizing such slogans as "Try it. You'll like it," "I can't believe I ate the whole thing," and "Paint." Yet over the past few years, the introduction of products such as Pepsid and Zantac doubled the antacid category's size, leaving Alka-Seltzer's market share at only 4.2 percent in 1998, down from 25 percent in 1968. Advertisers go through four steps to develop a creative strategy: message generation, message evaluation and selection, message execution, and social responsibility review.

#### **Message Generation**

The product's "benefit" message should be decided, as part of developing the product concept yet there is usually latitude for a number of possible messages. Over time, the marketer might want to change the message, especially if consumers seek new or different benefits from the product.

Creative people use several methods to generate possible advertising appeals. Many creative people precede irreluctively by talking to consumers, dealers, experts, and competitors. Leo Burnett advocates "in-depth interviewing where I come realistically face to

face with the people I am trying to sell. I try to get a picture in my mind of the kind of people they are-how they use this product and what it is."

Some creative people use a deductive framework for generating advertising messages. Maloney proposed one framework. He saw buyers as expecting one of four types of reward from a product: rational, sensory, social, or ego satisfaction. Buyers might visualize these rewards from results-of-use experience, product-in-use experience, or incidental-to-use experience. Crossing the four types of rewards with the three types of experience generates twelve types of advertising messages. For example, the appeal "gets clothes cleaner" is a rational-reward promise following results-of-use experience. The phrase "real gusto in a great light beer" is a sensory-reward promise connected with product-in-use experience.

How many alternative ad themes should the advertiser create before making a choice? More ads that are independently created, the higher the probability of finding an excellent one. Yet the more time spent on creating alternative ads, the higher the costs. Under the present commission system, the agency does not like to go to the expense of creating and pretesting many ads. Fortunately, the expense of creating rough ads is rapidly falling due to computers. An ad agency's creative department can compose many alternative ads in a short time by drawing from computer files containing still and video images, type sets, and so on.

### **Message Evaluation and Selection**

A good ad normally focuses on one core selling proposition. Twedt suggested that messages be rated on desirability, exclusiveness, and believability." For example: The advertiser should conduct market research to determine which appeal works best with its target audience.

### **Message Execution**

The message's impact depends not only upon what is said but also on how it is said. Some ads aim for rational positioning and others for emotional positioning. U.S. ads typically present an explicit feature or benefit designed to appeal to the rational mind: "gets clothes cleaner"; "Brings relief faster." Japanese ads tend to be more indirect and appeal to the emotions: An example was Nissan's Infiniti ad, which showed not the car but beautiful scenes from nature aimed at producing an emotional association and response.

The choice of headlines and copy can make a difference in impact. Lalita Manrai created two ads for the same car. The first ad carried the headline "A New Car"; the second, the headline "Is This Car for You?" The second headline utilized an advertising strategy called labeling, in which the consumer is labeled as the type of person who is interested in that type of product. The two ads also differed in that the first ad described the car's features and the second described the car's benefits. In the test, the second ad far outperformed the first in terms of overall product impression, reader interest in buying the product, and likelihood of recommending it to a friend.

Message execution can be decisive for highly similar products, such as detergents, cigarettes, coffee, and vodka. Consider the success of Absolut Vodka:

In preparing an ad campaign, the advertiser usually prepares a copy strategy statement describing the objective, content, support, and tone of the desired ad. Here is the strategy statement for a Pillsbury product called 1869 Brand Biscuits: Creative people must also find a cohesive style, tone, words, and format for executing 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. The

Marketing Insight, "Celebrity Endorsements as a Strategy," focuses on the use of testimonials, as does the following example:

The communicator must choose an appropriate tone for the ad. Procter & Gamble is consistently positive in its tone-its ads say something superlatively positive about the product, and humor is almost always avoided so as not to take attention away from the message. In contrast, ads for Staples office-supply superstores focus on 11 humorous situations rather than on the products themselves.

Memorable and attention-getting words must be found. The following themes listed on the left would have had much less impact without the creative phrasing on the right:

Theme	Creative Copy
7-Up is not a cola.	"The Un-Cola."
Let us drive you in our bus instead of driving your car.	"Take the bus, and leave the driving to us."
Shop by turning the pages of the telephone directory.	"Let your fingers do the walking."
We don't rent as many cars, so we have to do more for our customers.	"We try harder."
Red Roof Inns offer inexpensive lodging.	"Sleep cheap at Red Roof Inns."

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").

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 outstanding ad will be noted by less than 50 percent of the exposed audience. About 30 percent of the exposed audience might recall the headline's main point; about 25 percent might remember the advertiser's name; and less than 10 percent will read most of the body copy. Ordinary ads do not achieve even these results.

An industry study listed the following characteristics for ads that scored above average in recall and recognition: innovation (new product or new uses), "story appeal" (as an attention-getting device), before-and-after illustration, demonstrations, problem solution, and the inclusion of relevant characters that become emblematic of the brand.

In recent years critics have bemoaned the spate of bland ads and slogans and, in particular, the frequent use of the nonreferential "it," as in "Coke is it"; Nike's pop- M ular

"Just do it"; and the most egregious offender, Miller Lite's short-lived ad proclaiming, "It's it and that's that. Why do so many ads look or sound alike? Why aren't advertising agencies more creative? Norman W. Brown, former head of the advertising agency of Foote, Cone & Belding, says: "Many ads aren't creative because - many companies want comfort, not creativity."

### **Social Responsibility Review**

Advertisers and their agencies must be sure their "creative" advertising doesn't overstep social and legal norms. Most marketers work hard to communicate openly and honestly with consumers. Still, abuses occur, and public policy makers have developed a substantial body of laws and regulations to govern advertising.

Under U.S. law, companies must avoid false or deceptive advertising. Advertisers must not make false claims, such as stating that a product cures something when it does not. They must avoid false demonstrations, such as using sand-covered plexiglass instead of sandpaper to demonstrate that a razor blade can shave sandpaper. It is illegal in the United States to create ads that have the capacity to deceive, even though no one may actually be deceived. For example, a floor wax cannot be advertised as giving six months' protection unless it does so under typical conditions, and a diet bread cannot be advertised as having fewer calories simply because its slices are thinner. The problem is how to tell the difference between deception and "puffery" simple exaggerations not intended to be believed.

Sellers in the United States are legally obligated to avoid bait-and-switch advertising that attracts buyers under false pretenses. Suppose a seller advertises a sewing machine at \$149. When consumers try to buy the advertised machine, the seller cannot then refuse to sell it, downplay its features, show a faulty one, or promise unreasonable delivery dates in order to switch the buyer to a more expensive machine.

To be socially responsible, advertisers must be careful not to offend ethnic groups, racial minorities, or special-interest groups. Consider the following examples: A Nynex spot was criticized by animal-rights activists because it showed a rabbit colored with a blue dye, commercial for Black Flag insecticide was altered after a veterans group protested the playing of Taps over dead bugs.

Ads for Calvin Klein apparel, featuring the waifish model Kate Moss, have come under attack from Boycott Anorexic Marketing. Some companies have begun to build ad campaigns on a platform of social responsibility: meet its ethical standards while ensuring financially sound investments. Ethical Funds has grown from \$100 million in assets to more than \$2 billion over the last decade.

After choosing the message, the advertiser's 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. Then the results of these decisions need to be evaluated.

### **DECIDING ON REACH, FREQUENCY, AND IMPACT**

Media selection involves finding the most cost-effective media to deliver the desired number of exposures to the target audience. What do we mean by the desired number of exposures? Presumably, the advertiser is seeking a certain response from the target audience—for example, a certain level of product trial. The rate of product trial will depend, among other things, on the level of audience brand awareness. Suppose the rate of product trial

increases at a diminishing rate with the level of audience awareness. If the advertiser seeks a product trial rate of (say), it will be necessary to achieve a brand awareness level of A.

The next task is to find out how many exposures  $E^*$  will produce a level of audience awareness of  $A^*$ . The effect of exposures on audience awareness depends on the exposures' reach, frequency, and impact:

Reach (R): The number of different persons or households exposed to a particular media schedule at least once during a specified time period.

Frequency (F): The number of times within the specified time period that an average age person or household is exposed to the message.

Impact (I): The qualitative value of an exposure through a given medium (thus a food ad in Good Housekeeping would have a higher impact than in the Police Gazette).

The relationship between audience awareness and reach. Audience awareness will be greater, the higher the exposures' reach, frequency, and impact. The media planner recognizes important trade-offs among reach, frequency, and impact. Suppose the planner has an advertising budget of \$1,000,000 and the cost per thousand exposures of average quality is \$5. This means the advertiser can buy 200,000,000 exposures ( $\$1,000,000 = [\$5/1,000]$ ). If the advertiser seeks an average exposure frequency of 10, then the advertiser can reach 20,000,000 people ( $200,000,000 = 10$ ) with the given budget. But if the advertiser wants higher-quality media costing \$10 per thousand exposures, it will be able to reach only 10,000,000 people unless it is willing to lower the desired exposure frequency.

The relationship between reach, frequency, and impact is captured in the following concepts: Total number of exposures (E): This is the reach times the average frequency; that is,  $E = R \times F$ . This measure is referred to as the gross rating points (GRP). If a given Miller media schedule reaches 80 percent of the homes with an average exposure frequency of 3, the media schedule is said to have a GRP of 240 ( $80 \times 3$ ). If another media schedule has a GRP of 300, it is said to have more weight, but we cannot tell how this weight breaks down into reach and frequency. Weighted number of exposures (WE): This is the reach times average frequency times average impact, that is  $WE = R \times F \times I$ .

The media planner has to figure out, with a given budget, the most cost-effective combination of reach, frequency, and impact. Reach is most important when launching new products, flanker brands, extensions of well-known brands, or infrequently purchased brands, or going after an undefined target market. Frequency is most important where there are strong competitors, a complex story to tell, high consumer resistance, or a frequent-purchase cycle.

Many advertisers believe a target audience needs a large number of exposures for the advertising to work. Too few repetitions can be a waste, because they will hardly be noticed. Others doubt the value of high ad frequency. They believe that after people see the same ad a few times, they act on it, get irritated by it, or stop noticing it. Krugman asserted that three exposures to an advertisement might be enough:

The first exposure is by definition unique. As with the initial exposure to anything, a "What is it?" type of cognitive response dominates the reaction. The second exposure to a stimulus ... produces several effects. One may be the cognitive reaction that characterized the first exposure, if the audience missed much of the message the first time around. More often, an evaluative "What of it?" response replaces the "What is it?" response.... The third exposure constitutes a reminder, if a decision to buy based on the evaluations has not been acted on. The third exposure is also the beginning of disengagement and withdrawal of attention from a completed episode."

Krugman's thesis favoring three exposures has to be qualified. He means three actual impressions or advertising exposures-the person sees the ad three times. These exposures should not be confused with vehicle exposures. If only half the magazine readers look at magazine ads, or if the readers look at ads only every other issue, then the advertising exposure is only half of the vehicle exposures. Most research services estimate vehicle exposures, not ad exposures. A media strategist would have to buy more vehicle exposures than three to achieve Krugman's three "hits." Another factor arguing for repetition is that of forgetting. The job of repetition is partly to put the message back into memory. The higher the forgetting rate associated with a brand, product category, or message, the higher the warranted level of repetition. But repetition is not enough. Ads wear out and viewers tune out. Advertisers should not coast on a tired ad but insist on fresh executions by their advertising agency. For example, Duracell can choose from more than 40 different versions of its basic ad.

### **CHOOSING AMONG MAJOR MEDIA TYPES**

The media planner has to know the capacity of the major media types to deliver reach, frequency, and impact. The major advertising media along with their costs, advantages, and limitations are profiled.

#### **Medium Newspapers**

Media planners make their choice among media categories by considering the following variables:

**Target-audience media habits:** For example, radio and television are the most effective media for reaching teenagers.

**Product:** Women's dresses are best shown in color magazines, and Polaroid cameras are best demonstrated on television. Media types have different potentials for demonstration, visualization, explanation, believability, and color.

**Message:** A message announcing a major sale tomorrow will require radio, TV, or newspaper. A message containing a great deal of technical data might require specialized magazines or mailings.

**Cost:** Television is very expensive, whereas newspaper advertising is relatively inexpensive. What counts is the cost-per-thousand exposures.

Ideas about media impact and cost must be reexamined periodically. For a long time, television was dominant in the media mix. Then researchers began to notice television's reduced effectiveness, which was due to increased commercial clutter (advertisers beamed shorter and more numerous commercials at the audience), increased "zipping and zapping" of commercials, and lower viewing owing to the growth in cable TV and VCRs. Furthermore, television advertising costs rose faster than other media costs. Several companies found that a combination of print ads and television commercials often did a better job than television commercials alone.

Another reason for review is the continuous emergence of new media, such as advertorials and infomercials. Advertorials are print ads that offer editorial content and are difficult to distinguish from newspaper or magazine contents; infomercials are TV commercials that appear to be 30-minute TV shows but are advertisements for products. Advertisers have substantially increased their spending on outdoor media over the last decade. Outdoor advertising provides an excellent way to reach important local consumer

segments. Cable television now reaches a majority of U.S. households and produces billions of dollars in advertising revenue a year. Cable systems make it easier to reach select groups.

Another promising new media site is the store itself. In addition to using older promotional vehicles, such as displays and special price tags, some supermarkets are selling space on their floors for company logos, experimenting with talking shelves, and introducing "videocarts," which contain a computerized screen that carries consumer-benefit information ("cauliflower is rich in vitamin C") and advertiser promotions ("20¢ off on White Star Tuna this week").

Ads also appear in best-selling paperback books, sports arenas, movie theaters, and movie videotapes. Written material such as annual reports, data sheets, catalogs, and newsletters increasingly carry ads. Many companies that send out monthly bills are including advertising inserts. Some companies mail audiotapes or videotapes that advertise their products to prospects. Here are some other emerging media:

**Digital magazines (or digazines):** With names like *Trouble & Attitude*, *Mord*, and *Launib*, the latest magazines are not on the newsstand but are available on the Internet. Digazines are much cheaper to start up and operate than are print magazines. Starting a glossy publication for men aged 18 to 34 today would require, at least 510 million, whereas digazine start-up costs are between \$200,000 and \$500,000. Still to be worked out, however, is how to price them or earn money through selling advertising.

**Interactive TV:** Combined computer, telephone, and TV hookups have now made it possible for people to participate in two-way communication with programs or information services via their television sets. Whereas home shopping networks allow customers to call in their orders, interactive TV allows consumers to use a computer keyboard to communicate directly with sellers on their TV screen. So far interactive TV technology is only in the testing phase.

**Fax on demand:** Used most by business marketers, fax-on-demand technology allows businesses to store information in a fax technology program. Customers who need information call a toll-free number, and the fax program automatically faxes the information to them within 5 minutes. Customers can access the information 24 hours a day, 7 days a week. The service can be set up for as little as \$1,000, and business marketers feel that the cost savings in postage alone are worth the investment.

Rust and Oliver see proliferation of new media as hastening the death of traditional mass-media advertising as we know it. They see a greater amount of direct producer-consumer interaction, with benefits to both parties. Producers gain more information about their customers and can customize products and messages better; customers gain greater control because they can choose whether to receive an advertising message or not. See the Marketing for the Millennium "Advertising on IM, Web: Companies Grab the Brass Ring."

Given the abundant media, the media planner must first decide on how to allocate the budget to the major media types. In launching a new biscuit, Pillsbury might decide to allocate \$3 million to daytime network television, \$2 million to women's magazines, \$1 million to daily newspapers in 20 major markets, and \$50,000 to maintaining its home page on the Internet.

### **SELECTING SPECIFIC VEHICLES**

The media planner must search for the most cost-effective media vehicles within each chosen media type. The advertiser who decides to buy 30 seconds of advertising on network television can pay \$154,000 for a popular prime-time show such as *Law and Order*, \$650,000

for especially popular programs like *Frasier* and *FR*, or \$1.3 million for an event like the Super Bowl." The planner has to rely on media measurement services that provide estimates of audience size, composition, and media cost.

Audience size has several possible measures:

**Circulation** : The number of physical units carrying the advertising.

**Audience**: The number of people exposed to the vehicle. (If the vehicle has passon readership, then the audience is larger than circulation.)

**Effective aiidience**: The number of people with target audience characteristics exposed to the vehicle.

**Effective ad-exposed ciuidietice**: The number of people with target audience characteristics who actually saw the ad.

Media planners calculate the cost per thniisand persons rrrached by a vehicle. If a full page, four-color ad in IVewsweek costs \$84000 and Newsweek's estimated readership is 3 million people, the cost of exposing the ad to 1,000 persons is approximately \$28.

The same ad in *Business Week* may cost \$30,000 but reach only 775,000 persons-at-a cost per thousand of \$39. The media planner ranks each magazine by cost per thousand and favors magazines with the lowest cost per thousand for reaching target consumers. The magazines themselves often put together a "reader profile" for their advertisers, summarizing the characteristics of the magazine's readers with respect to age, income, residence, marital status, and leisure activities.

Several adjustments have to be applied to the cost-per-thousand measure. First, the measure should be adjusted for audience quality. For a baby lotion ad, a magazine read by 1 million young mothers would have an exposure value of 1 million; if read by 1 million old men, it would have almost a zero exposure value. Second, the exposure value should be adjusted for the audience-nttention probability. Readers of *Vogue* pay more attention to ads than do readers of *Newsweek*. Third, the exposure value should be adjusted for the magazine's editorial quality (prestige and believability). Fourth, the exposure value should be adjusted for the magazine's ad placement policies and extra services (such as regional or occupational editions and lead-time requirements).

Media planners are increasingly using more sophisticated measures of effectiveness and employing them in mathematical models to arrive at the best media mix. Many advertising agencies use a computer program to select the initial media and

## DECIDING ON MEDIA TIMING

In choosing media, the advertiser faces a macroscheduling problem and a microscheduling problem. The macroscheduling problem involves scheduling the advertising in relation to seasons and the business cycle. Suppose 70 percent of a product's sales occur between June and September. The firm can vary its advertising expenditures to follow the seasonal pattern, to oppose the seasonal pattern, or to be constant throughout the year. Most firms pursue a seasonal policy. Yet consider this example: Some years ago, a soft-drink manufacturer put more money into off-season advertising. This resulted in increased nonseasonal consumption of its brand, while not hurting seasonal consumption. Other soft-drink manufacturers started to do the same, with the net result that a more balanced consumption pattern occurred. The previous concentration of advertising had created a self-fulfilling prophecy.

Forester has proposed using his "industrial dynamics" methodology to test cyclical advertising policies. He believes that advertising has a delayed impact on consumer awareness; awareness has a delayed impact on factory sales; and factory sales have a delayed impact on advertising expenditures. These time-lag relationships can be studied and formulated mathematically into a computer-simulation model. The model can simulate alternative timing strategies to assess varying impacts on company sales, costs, and profits. Rao and Miller also developed a lag (delay) model to relate a brand's share to advertising and promotional expenditures on a market-by-market basis. They tested their model successfully with 5 Lever brands in 15 districts, relating market share to dollars spent on TV; print, price-off, and trade promotions.

Kuehn developed a model to explore how advertising should be timed for frequently purchased, highly seasonal, low-cost grocery products. He showed that the appropriate timing pattern depends on the degree of advertising carryover and the amount of habitual behavior in customer brand choice. Carryover refers to the rate at which the effect of an advertising expenditure wears out with the passage of time. A carryover of 0.75 per month means that the current effect of a past advertising expenditure is 75 percent of its level in the previous month. Habitual behavior indicates how much brand holdover occurs independent of the level of advertising. High habitual purchasing, say 0.90, means that 90 percent of the buyers repeat their brand choice in the next period.

Kuehn found that when there is no advertising carryover or habitual purchasing, the decision maker is justified in using a percentage-of-sales rule to budget advertising. The optimal timing pattern for advertising expenditures coincides with the expected seasonal pattern of industry sales. But if there is advertising carryover or habitual purchasing, it would be better to time advertising to lead sales. Advertising expenditures should peak before sales peak. Lead-time should be greater, the higher the carryover. Furthermore, the advertising expenditures should be steadier, the greater the habitual purchasing.

The microscheduling problem calls for allocating advertising expenditures within a short period to obtain maximum impact. Suppose the firm decides to buy 30 radio spots in the month of September. Several possible patterns. The left side shows that advertising messages for the month can be concentrated ("burst" advertising), dispersed continuously throughout the month, or dispersed intermittently. The topside shows that the advertising messages can be beamed with a level, rising, falling, or alternate frequency,

The most effective pattern depends upon the communication objectives in relation to the nature of the product, target customers, distribution channels, and other marketing factors. Consider the following cases:

A retailer wants to announce a preseason sale of ski equipment. She thinks the target buyers need to hear the message only once or twice. Her objective is to maximize reach, not frequency. She decides to concentrate the messages on sale days at a level rate but to vary the time of day to avoid the same audiences. She uses pattern 1.

A muffler manufacturer-distributor wants to keep his name before the public. Yet he does not want his advertising to be too continuous because only 3 to 5 percent of the cars on the road need a new muffler at any given time. He chooses intermittent advertising. Furthermore, he recognizes that Fridays are paydays, so he sponsors more messages on Friday. He uses pattern 12.

The timing pattern should consider three factors. Buyer turnover expresses the rate at which new buyers enter the market; the higher this rate, the more continuous the advertising

should be. Purchase frequency is the number of times during the period that the average buyer buys the product; the higher the purchase frequency, the more continuous the advertising should be. The forgetting rate is the rate at which the buyer forgets the brand; the higher the forgetting rate, the more continuous the advertising should be.

In launching a new product, the advertiser has to choose among ad continuity, concentration, flighting, and pulsing. Continuity is achieved by scheduling exposures evenly throughout a given period. Generally, advertisers use continuous advertising expanding market situations, with frequently purchased items, and in tightly defined buyer categories. Concentration calls for spending all the advertising dollars in a single period. This makes sense for products with one selling season or holiday. Flighting calls for advertising for some period, followed by a hiatus with no advertising, followed by a second period of advertising activity. It is used when funding is limited, the purchase cycle is relatively infrequent, and with seasonal items. Pulsing is continuous advertising at low-weight levels reinforced periodically by waves of heavier activity. Pulsing draws upon the strength of continuous advertising and flights to create a compromise scheduling strategy." Those who favor pulsing feel that the audience will learn the message more thoroughly, and money can be saved.

### **DECIDING ON GEOGRAPHICAL ALLOCATION**

A company has to decide how to allocate its advertising budget over space as well as over time. The company makes "national buys" when it places ads on national TV networks or in nationally circulated magazines. It makes "spot buys" when it buys TV time in just a few markets or in regional editions of magazines. These markets are called areas of dominant influence (ADIs) or designated marketing areas (DMAs), and ads reach a market 40 to 60 miles from a city center. The company makes "local buys" when it advertises in local newspapers, radio, or outdoor sites. Consider the following example:

### **EVALUATING ADVERTISING EFFECTIVENESS**

Good planning and control of advertising depend on measures of advertising effectiveness. Yet the amount of fundamental research on advertising effectiveness is appallingly small. According to Forrester, "probably no more than 1/5 of 1% of total advertising expenditure is used to achieve an enduring understanding of how to spend the other 99.8%.

Most measurement of advertising effectiveness deals with specific ads and campaigns. Most of the money is spent by agencies on pretesting ads, and much less is spent on evaluating their effectiveness. A proposed campaign should be tested in one or a few cities first and its impact evaluated before rolling it out nationally. One company tested its new campaign first in Phoenix. The campaign bombed, and the company saved all the money that it would have spent by going national.

Most advertisers try to measure the communication effect of an ad—that is, its potential effect on awareness, knowledge, or preference. They would also like to measure the ad's sales effect.

### **Communication-Effect Research**

Communication-effect research seeks to determine whether an ad is communicating effectively. Called copy testing, it can be done before an ad is put into media and after it is printed or broadcast.

There are three major methods of advertising pretesting. The direct rating method asks consumers to rate alternative ads. These ratings are used to evaluate an ad's attention, read-through, cognitive, affective, and behavior strengths (Figure 19.4). Although an imperfect measure of actual impact, a high rating indicates a potentially more effective ad. Portfolio tests ask consumers to view or listen to a portfolio of advertisements, taking as much time as they need. Consumers are then asked to recall all the ads and their content, aided or unaided by the interviewer. Recall level indicates an ad's ability to stand out and to have its message understood and remembered. Laboratory tests use equipment to measure physiological reactions—heartbeats, blood pressure, pupil dilation, perspiration—to an ad. These tests measure attention-getting power but reveal nothing about impact on beliefs, attitudes, or intentions. Table 19.2 describes some specific advertising research techniques.

Haley, Stafforoni, and Fox argue that current copy-testing methods have become so familiar and well-established that it is easy to overlook their sizable limitations. These methods tend to be 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.

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.

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 products and a 1.5-2.0 to 1.0 ratio for new products." Using this information, suppose we observed the following data for three well-established firms selling an almost identical product at an identical price:

	(1) Advertising Expenditure	(2) Share of Voice	(3) Share of Market	(4) Advertising Effectiveness (column 3 % column 2)*
A	\$2,000,000	57.1	40.0	70
B	1,000,000	28.6	28.6	100
C	500,000	14.3	31.4	220

Firm A spends \$2 million of the industry's total expenditures of \$3.5 million, so its share of voice is 57.1 percent. Yet its share of market is only 40 percent. By dividing its share of market by its share of voice, we get an advertising-effectiveness ratio of 70, suggesting that firm A is either overspending or misspending. Firm B is spending 28.6 percent of total advertising expenditures and has a 28.6 market share; the conclusion is that it is spending its money efficiently. Firm C is spending only 14.3 percent of the total and yet achieving a market share of 31.4 percent; the conclusion is that it is spending its money superefficiently and should probably increase its expenditures.

Researchers try to measure the sales impact through analyzing either historical or experimental data. The historical approach involves correlating past sales to past advertising expenditures using advanced statistical techniques. Palda studied the effect of advertising expenditures on the sales of I. v. dia Pinkham's Vegetable Compound between 1908 and 1960. He calculated the short-term and long-term marginal sales effects of advertising. The marginal advertising dollars increased sales by only \$.50 in the short term, suggesting that Pinkham spent too much on advertising. But the longterm marginal sales effect was three times as large. Palda calculated a posttax marginal rate of return on company advertising of 37 percent over the whole period.

Montgomery and Silk estimated the sales effectiveness of three communication tools used in the pharmaceutical industry." A drug company spent 38 percent of its

communication budget on direct mail, 32 percent on samples and literature, and 29 percent on journal advertising. Yet the sales-effects research indicated that journal advertising, the least-used communication tool, had the highest long-run effectiveness, followed by samples and literature, and then by direct mail.

Other researchers use an experimental design to measure advertising's sales impact. Here is an example:

In allocating an advertising budget geographically, the company should consider area differences in market size, advertising response, media efficiency, competition, and profit margins. Urban developed a media allocation model that uses these geographic variables to allocate the advertising budget. A growing number of companies are striving to measure the sales effect of advertising expenditures instead of settling only for communication-effect measures. Millward Brown International has conducted tracking studies in the United Kingdom for many years to provide information to help advertisers decide whether their advertising is benefiting their brand."

### **A Summary of Current Research**

Professional researchers have drawn some general conclusions that are useful to marketers. The impact of advertising on brand switching: Tellis analyzed household purchases of 12 key brands of a frequently purchased consumer product and concluded that advertising appears effective in increasing the volume purchased by loyal buyers but less effective in winning new buyers. Advertising appears unlikely to have some cumulative effect that leads to loyalty; rather, features, displays, and especially price have a stronger impact on response than does advertising." These findings did not sit well with the advertising community, and several people attacked Tellis's data and methodology. A set of controlled experiments by the research firm IRI found advertising's impact is grossly underestimated when only a one-year perspective is employed because of lagged effects.

The effect of surroundings: Ads may be more effective when their message is congruent with their surroundings. A "happy" commercial placed within an upbeat television show is more likely to be effective than a downbeat commercial in the same place." In addition, people are more likely to believe a TV or radio ad and to become more positively disposed toward the brand when the ad is placed within a program they like.

The effect of positive versus negative messages: Consumers may sometimes respond more to negative messages than to positive messages. For example, a credit-card company contacted customers who did not use the card for three months. To one group of nonusers it sent a message explaining the benefits of using the card. To another group it sent a message explaining the losses they could suffer by not using the card. The impact of the loss-oriented message was much stronger: The percentage of customers who started to use the card in the loss condition was more than double and the charges of the former customers were more than twice that of the positive message receivers.

### **SALES PROMOTION**

Sales promotion is a key ingredient in marketing campaigns. We define it as follows: Sales promotion consists of a diverse collection of incentive tools, mostly short term, designed to stimulate quicker or greater purchase of particular products or services by consumers or the trade.

Whereas advertising offers a reason to buy, sales promotion offers an incentive to buy. Sales promotion includes tools for consumer promotion (samples, coupons, cash refund

offers, prices off, premiums, prizes, patronage rewards, free trials, warranties, tie-in promotions, cross-promotions, point-of-purchase displays, and demonstrations); trade promotion (prices off, advertising and display allowances, and free goods); and business- and sales force promotion (trade shows and conventions, contests for sales reps, and specialty advertising).

Sales-promotion tools are used by most organizations, including manufacturers, distributors, retailers, trade associations, and nonprofit organizations. Churches, for example, often sponsor bingo games, theater parties, testimonial dinners, and raffles.

A decade ago, the advertising-to-sales-promotion ratio was about 60:40. Today, in many consumer-packaged-goods companies, sales promotion accounts for 65 to 75 percent of the combined budget. Sales-promotion expenditures have been increasing as a percentage of budget expenditure annually for the last two decades.

Several factors contribute to the rapid growth of sales promotion, particularly in consumer markets." Internal factors include the following: Promotion is now more accepted by top management as an effective sales tool; more product managers are qualified to use sales-promotion tools; and product managers are under greater pressure to increase current sales. External factors include the following: The number of brands has increased; competitors use promotions frequently; many brands are seen as similar; consumers are more price-oriented; the trade has demanded more deals from manufacturers; and advertising efficiency has declined because of rising costs, media clutter, and legal restraints.

The rapid growth of sales-promotion media has created a situation of promotion clutter similar to advertising clutter. Consumers might start tuning out, in which case coupons and other promotion media will weaken in their ability to trigger purchase. Manufacturers will have to find ways to rise above the clutter—for instance, by offering larger coupon-redemption values or using more dramatic point-of-purchase displays or demonstrations.

#### **PURPOSE OF SALES PROMOTION**

Sales-promotion tools vary in their specific objectives. A free sample stimulates consumer trial, whereas a free management-advisory service aims at cementing a longterm relationship with a retailer.

Sellers use incentive-type promotions to attract new triers, to reward loyal customers, and to increase the repurchase rates of occasional users. New triers are of three types—users of another brand in the same category, users in other categories, and frequent brand switchers. Sales promotions often attract the brand switchers, because users of other brands and categories do not always notice or act on a promotion. Brand switchers are primarily looking for low price, good value, or premiums. Sales promotions are unlikely to turn them into loyal users. Sales promotions used in markets of high brand similarity produce a high sales response in the short run but little permanent gain in market share. In markets of high brand dissimilarity, sales promotions can alter market shares permanently.

Today, many marketing managers first estimate what they need to spend in trade 1 promotion, then what they need to spend in consumer promotion. Whatever is left they will budget for advertising. There is a danger, however, in letting advertising take J a back seat to sales promotion because advertising typically acts to build brand loyalty. alty. But the question of whether or not sales promotion weakens brand loyalty is subject to different interpretations. Sales promotion, with its incessant prices off, coupons, deals, premiums, and blaring quality, may devalue the product offering in the buyers' minds. Buyers

learn that the list price is largely a fiction. But before jumping to any conclusion, we need to distinguish between price promotions and added-value promotions. These examples show how certain types of sales promotion can actually enhance brand image:

The makers of Pine-Sol, a general liquid cleaning agent, ran a "Pine-Sol in Pine Valley" sweepstakes in which Pine Valley was the habitat of the TV soap opera *All My Children*. Sweepstake winners would travel to Los Angeles to meet the stars and watch four days of filming. This association of an ordinary cleaning agent with glamorous stars enhanced the brand image of Pine-Sol.

Toro, a major manufacturer of lawn mowers and snowblowers, wanted to sell its snowblowers in early September. Knowing that most people would wait to buy until the first snow, Toro offered to include Toro Snow Insurance: The company promised to send a rebate of \$50 to each September buyer if it didn't snow before January. This sales promotion did not hurt, and may have helped, Toro's brand image.

Haagen-Dazs ran a cents-off sales promotion called Sweet Charity where the price savings would be contributed to support public television. This offer enhanced the Haagen-Dazs image by making Haagen-Dazs "a patron of the arts."

Akai, a Japanese manufacturer of stereo equipment and TV sets, managed to become a TV set market leader in India by running value-added sales promotions. It offered good trade-in value on black-and-white TV sets at the purchase of a new color TV set. At other times, it would offer a free watch, or calculator or radio, along with the purchase of a new TV set. This steady promotion made Akai a very popular brand in India, and competitors such as Sony were not free to compete in the same way.

But usually, when a brand is price promoted too often, the consumer begins to devalue it and buy it mainly when it goes on sale. So there is risk in putting a well-known brand leader on promotion over 30 percent of the time." Dominant brands offer deals less frequently, because most deals only subsidize current users. Brown's study of 2,500 instant coffee buyers concluded that:

Sales promotions yield faster and more measurable responses in sales than advertising does. Sales promotions do not tend to yield new, long-term buyers in mature markets because they attract mainly deal-prone consumers who switch among brands as deals become available.

Loyal brand buyers tend not to change their buying patterns as a result of competitive promotion. Advertising appears to be capable of deepening brand loyalty. There is also evidence that price promotions do not build permanent total category volume. Small-share competitors find it advantageous to use sales promotion, because they cannot afford to match the market leaders' large advertising budgets. Nor can they obtain shelf space without offering trade allowances or stimulate consumer trial without offering incentives. Price competition is often used by a small brand seeking to enlarge its share, but it is less effective for a category leader whose growth lies in expanding the entire category.

The upshot is that many consumer-packaged-goods companies feel they are forced to use more sales promotion than they wish. Kellogg, Kraft, and other market leaders are trying to return to "pull" marketing by increasing their advertising budgets. They blame the heavy use of sales promotion for decreasing brand loyalty, increasing consumer price sensitivity, brand-quality-image dilution, and a focus on short-run marketing planning.

Farris and Quelch, however, dispute this conclusion." They counter that sales promotion provides a number of benefits that are important to manufacturers as well as

consumers. Sales promotions enable manufacturers to adjust to short-term variations in supply and demand. They enable manufacturers to test how high a list price they can charge, because they can always discount it. They induce consumers to try new products instead of never straying from current ones. They lead to more varied retail formats, such as the everyday-low-price store and the promotional-pricing store. They promote greater consumer awareness of prices. They permit manufacturers to sell more than they would normally sell at the list price. They help the manufacturer adapt programs to different consumer segments. Consumers themselves enjoy some satisfaction from being smart shoppers when they take advantage of price specials.

### **MAJOR DECISIONS IN SALES PROMOTION**

In using sales promotion, a company must establish its objectives, select the tools, develop the program, pretest the program, implement and control it, and evaluate the results.

#### **Establishing Objectives**

Sales-promotion objectives are derived from broader promotion objectives, which are derived from more basic marketing objectives developed for the product. The specific objectives for sales promotion vary with the target market. For consumers, objectives include encouraging purchase of larger-size units, building trial among nonusers, and attracting switchers away from competitors' brands. For retailers, objectives include persuading retailers to carry new items and higher levels of inventory, encouraging off-season buying, encouraging stocking of related items, offsetting competitive promotions, building brand loyalty, and gaining entry into new retail outlets. For the sales force, objectives include encouraging support of a new product or model, encouraging more prospecting, and stimulating off-season sales. See the Marketing Memo "Sales Promotions as Brand Builders.

#### **Selecting Consumer-Promotion Tools**

The promotion planner should take into account the type of market, sales-promotion objectives, competitive conditions, and each tool's cost effectiveness. The main consumer-promotion tools are summarized in Table 19.3. We can distinguish between manufacturer promotions and retailer promotions. The former are illustrated by the auto industry's frequent use of rebates, gifts to motivate test-drives and purchases, and high-value trade-in credit. The latter include price cuts, feature advertising, retailer coupons, and retailer contests or premiums. We can also distinguish between sales-promotion tools that are "consumer-franchise building," which reinforce the consumer's brand understanding, and those that are not. The former impart a selling message along with the deal, as in the case of free samples, coupons when they include a selling message, and premiums when they are related to the product. Sales-promotion tools that are not consumer-franchise building include priceoff packs, consumer premiums not related to a product, contests and sweepstakes, consumer refund offers, and trade allowances.

Sales promotion seems most effective when used together with advertising. In one study, a price promotion alone produced only a 15 percent increase in sales volume. When combined with feature advertising, sales volume increased 19 percent; when combined with feature advertising and a point-of-purchase display, sales volume increased 24 percent. Many large companies have a sales-promotion manager whose job is to help brand managers choose the right promotional tool. The following example shows how one firm determined the appropriate tool:

A firm launched a new product and achieved a 20 percent market share within six months. Its penetration rate (the percentage of the target market that purchased the brand at least once) is 40 percent. Its repurchase rate (the percentage of first-time triers who repurchased the brand one or more times) is 10 percent. This firm needs to create more loyal users. An in-pack coupon would be appropriate to build repeat purchase. But if the repurchase rate has been high, say 50 percent, then the company should try to attract more new triers. Here a mailed coupon might be appropriate.

### **Selecting Trade-Promotion Tools**

Manufacturers use a number of trade-promotion tools. Surprisingly, a higher proportion of the promotion pie is devoted to trade-promotion tools (46.9 percent) than to consumer promotion (27.9 percent), with media advertising capturing the remaining 25.2 percent. Manufacturers award money to the trade for four reasons:

**1. To persuade the retailer or wholesaler to carry the brand:** Shelf space is so scarce that manufacturers often have to offer prices off, allowances, buyback guarantees, free goods, or outright payments (called slotting allowances) to get on the shelf, and once there, to stay on the shelf.

**2. To persuade the retailer or wholesaler to carry more units than the normal amount:** Manufacturers will offer volume allowances to get the trade to carry more in warehouses and stores. Manufacturers believe the trade will work harder when they are "loaded" with the manufacturer's product.

**3. To induce retailers to promote the brand by featuring, display, and price reductions:** Manufacturers might seek an end-of-aisle display, increased shelf facings, or price reduction stickers and obtain them by offering the retailers allowances paid on "proof of performance."

**Samples:** Offer of a free amount of a product or service delivered door to door, sent in the mail, picked up in a store, attached to another product, or featured in an advertising offer. Example: Lever Brothers had so much confidence in its new Surf detergent that it distributed free samples to four out of five U.S. households at a cost of \$43 million.

**Coupons:** Certificates entitling the bearer to a stated saving on the purchase of a specific product mailed, enclosed in other products or attached to them, or inserted in magazine and newspaper ads. Redemption rate varies with mode of distribution. Coupons can be effective in stimulating sales of a mature brand and inducing early trial of a new brand. Example: P&G broke into the Pittsburgh market with its Folger's brand of coffee by offering a 35 cent discount coupon on a one-pound can mailed to area homes and a coupon in the coffee can for 10 cents off.

**Cash Refund Offers (rebates):** Provide a price reduction after purchase rather than at the retail shop: consumer sends a specified "proof of purchase" to the manufacturer who "refunds" part of the purchase price by mail. Example: Toro ran a clever preseason promotion on specific snowblower models, offering a rebate if the snowfall in the buyer's market area was below average.

**Price Packs (cents-off deals):** Offers to consumers of savings off the regular price of a product, flagged on the label or package. A reduced-price pack is a single package sold at a reduced price such as two for the price of one). A banded pack is two related products banded together such as a toothbrush and toothpaste). Example: Air freshener companies sometimes package several types of air fresheners together for example, a spray mist, carpet deodorizer, and solid air freshener.

**Premiums (gifts):** Merchandise offered at a relatively low cost or free as an incentive to purchase a particular product. A with-pack premium accompanies the product inside or on the package. The package itself can serve as a premium. A free in-the-mail premium is mailed to consumers who send in a proof of purchase, such as a box top or UPC code. A self-liquidating premium is sold below its normal retail price to consumers who request it. Example: Quaker Oats inserted 55 million in gold and silver coins in bags of Ken-L Ration dog food.

**Prizes (contests, sweepstakes, games):** Prizes are offers of the chance to win cash, trips, or merchandise as a result of purchasing something. A contest calls for consumers to submit an entry to be examined by a panel of judges who will select the best entries. A sweepstake asks consumers to submit their names in a drawing. A game presents consumers with something every time they buy—bingo numbers, missing letters—which might help them win a prize. Example: A British cigarette company included a lottery ticket in each pack providing the chance to win up to 510,000.

**Patronage Awards:** Values in cash or in other forms that are proportional to patronage of a certain vendor or group of vendors. Example: Most airlines offer frequent flier plans. Marriott hotels has adopted an honored guest plan that awards points for users of its hotels.

**Free Trials:** Inviting prospective purchasers to try the product without cost in the hope that they will buy the product. Example: Auto dealers encourage free test-drives to stimulate purchase interest; America Online offers free trials of its software.

**Product Warranties:** Explicit or implicit promises by sellers that the product will perform as specified or that the seller will fix it or refund the customer's money during a specified period. Example: When Chrysler offered a five-year car warranty, substantially longer than GM's or Ford's, customers took notice. Sears's offer of a lifetime warranty on its auto batteries certainly screams quality to the buyers.

**Tie-in Promotions:** Two or more brands or companies team up on coupons, refunds, and contests to increase pulling power. Multiple sales forces push these promotions to retailers, giving them a better shot at extra display and ad space. Example: MCI has offered 10 minutes of free long-distance service on cans of Crystal Light powdered soft drinks and Taster's Choice coffee, and boxes of Keebler cookies and crackers.

**Cross-Promotions:** Using one brand to advertise another noncompeting brand. Example: Nabisco cookies might advertise that they contain Hershey chocolate chips, and the box may even contain a coupon to buy a Hershey product.

**Point-of-Purchase (POP) Displays and Demonstrations:** POP displays and demonstrations take place at the point of purchase or sale. Many retailers do not like to handle the hundreds of displays, signs, and posters they receive from manufacturers. Manufacturers are creating better POP materials, tying them in with television or print messages, and offering to set them up. Example: The L'Eggs pantyhose display is one of the most creative in the history of POP materials and has been a major factor in the success of this brand.

**4. To stimulate retailers and their sales clerks to push the product:** Manufacturers compete for retailer sales effort by offering push money, sales aids, recognition programs, premiums, and sales contests.

Manufacturers spend more on trade promotion than they want to spend. The growing power of large retailers has increased their ability to demand trade promotion at the expense

of consumer promotion and advertising. These retailers depend on promotion money from the manufacturers. No manufacturer could unilaterally stop offering trade allowances without losing retailer support.

The company's sales force and its brand managers are often at odds over trade promotion. The sales force says that the local retailers will not keep the company's products on the shelf unless they receive more trade-promotion money, whereas the brand managers want to spend the limited funds on consumer promotion and advertising. Because the sales force knows the local market better than do the brand managers sitting at headquarters, companies have given substantial funds to the sales force to handle.

Manufacturers face several challenges in managing trade promotions. First, they often find it difficult to police retailers to make sure they are doing what they agreed to do. Manufacturers are increasingly insisting on proof of performance before paying any allowances. Second, more retailers are doing forward buying—that is, buying a greater quantity during the deal period than they can sell during the deal period. Retailers might respond to a 10 percent off-case allowance by buying a 12-week or longer supply. The manufacturer has to schedule more production than planned and bear the costs of extra work shifts and overtime. Third, retailers are doing more diverting, buying more cases than needed in a region in which the manufacturer offered a deal and shipping the surplus to their stores to nondeal regions. Manufacturers are trying to handle forward buying and diverting by limiting the amount they will sell at a discount, or producing and delivering less than the full order in an effort to smooth production.

All said, manufacturers feel that trade promotion has become a nightmare. It contains layers of deals, is complex to administer, and often leads to lost revenues. Kevin Price describes trade promotion in the following way:

A decade ago, the retailer was a chihuahua nipping at the manufacturer's heels—a nuisance, yes, but only a minor irritant; you fed it and it went away. Today it's a pit bull and it wants to rip your arms and legs off. You'd like to see it roll over, but you're too busy defending yourself to even try... Today management of trade promotions is a president-level issue."

**Price-Off (off-invoice or off-list):** A straight discount off the list price on each case purchased during a stated time period. The offer encourages dealers to buy a quantity or carry a new item that they might not ordinarily buy. The dealers can use the buying allowance for immediate profit, advertising, or price reductions.

**Allowance:** An amount offered in return for the retailer's agreeing to feature the manufacturer's products in some way. An advertising allowance compensates retailers for advertising the manufacturer's product. A display allowance compensates them for carrying a special product display.

**Free Goods:** Offers of extra cases of merchandise to intermediaries who buy a certain quantity or who feature a certain flavor or size. Manufacturers might offer push money or free specialty advertising items to retailers that carry the company's name.

### **Selecting Business- and Sales Force Promotion Tools**

Companies spend billions of dollars on business- and sales force promotion tools. These tools are used to gather business leads, impress and reward customers, and motivate the sales force to greater effort. Companies typically develop budgets for each business-promotion tool that remain fairly constant from year to year.

## **Developing the Program**

In planning sales-promotion programs, marketers are increasingly blending several media into a total campaign concept. Kerry E. Smith describes a complete salespromotion program:

A sports trivia game to create pull-through at taverns for a premium beer brand would use TV to reach consumers, direct mail to incentivize distributors, point-of-purchase for retail support, telephones for consumer call-ins, a service bureau for call processing, live operators for data entry, and computer software and hardware trade Shows and Conventions: Industry associations organize annual trade shows and conventions. Firms selling products and services to the particular industry buy space and set up booths and displays to demonstrate their products. Over 5,600 trade shows take place every year, drawing approximately 80 million attendees. Trade show attendance can range from a few thousand people to over 70,000 for large shows held by the restaurant or hotel-motel industries Participating vendors expect several benefits, including generating new sales leads, maintaining customer contacts, introducing new products, meeting new customers, selling more to present customers, and educating customers with publications, videos, and other audiovisual materials.

Business marketers may spend as much as 35 percent of their annual promotion budget on trade shows. They face a number of decisions, including which trade shows to participate in, how much to spend on each trade show, how to build dramatic exhibits that attract attention, and how to follow up effectively on sales leads.

**Sales Contests:** A sales contest aims at inducing the sales force or dealers to increase their sales results over a stated period, with prizes going to those who succeed. A majority of companies sponsor annual or more frequent sales contests for their sales force; top performers may receive trips, cash prizes, gifts, or points, which the receiver can turn into a variety of prizes. Incentives work best when they are tied to measurable and achievable sales objectives (such as finding new accounts or reviving old accounts) where employees feel they have an equal chance.

**Specialty Advertising:** Specialty advertising consists of useful, low-cost items bearing the company's name and address, and sometimes an advertising message that salespeople give to prospects and customers. Common items are ballpoint pens, calendars, and memo pads. One survey indicated that over 86 percent of manufacturers supply their salespeople

With speciality items. In deciding to use a particular incentive, marketers have several factors to consider. First, they must determine the size of the incentive. A certain minimum is necessary if the promotion is to succeed. A higher incentive level will produce more sales response but at a diminishing rate.

Second, the marketing manager must establish conditions for participation. Incentives might be offered to everyone or to select groups. A premium might be offered only to those who turn in proof-of-purchase seals or UPC codes. Sweepstakes might not be offered in certain states or to families of company personnel or to persons under a certain age.

Third, the marketer has to decide on the duration of promotion. If the period is too short, many prospects will not be able to take advantage of it. If the promotion runs too long, the deal will lose some of its "act now" force. According to one researcher, the optimal frequency is about three weeks per quarter, and optimal duration is the length of the average purchase cycle." Of course, the optimal promotion cycle varies by product category and even by specific product.

Fourth, the marketer must choose a distribution which. A fifteen-cents-off coupon can be distributed in the package, in stores, by mail, or in advertising. Which distribution method involves a different level of reach, cost, and impact?

Fifth, the marketing manager must establish the timing of promotion. For example, brand managers develop calendar dates for annual promotions. These dates are used by the production, sales, and distribution departments.

Finally, the marketer must determine the total sales promotion budget. The budget can be built from the ground up, with the marketer choosing the individual promotions and estimating their total cost. The cost of a particular promotion consists of the administrative cost (printing, mailing, and promoting the deal) and the incentive cost (cost of premium or cents-off, including redemption costs), multiplied by the expected number of units that will be sold on the deal. In the case of a coupon deal, the cost would take into account the fact that only a fraction of the consumers will redeem the coupons. For an in-pack premium, the deal cost must include the procurement cost and packaging of the premium, offset by any price increase on the package.

The more common way to develop the budget is to use a conventional percentage of the total promotion budget. For example, toothpaste might get a sales-promotion budget of 30 percent of the total promotion budget, whereas shampoo might get 50 percent. These percentages vary for different brands in different markets and are influenced by stage of the product life cycle and competitive expenditures on promotion.

### **Pretesting the Program**

Although most sales-promotion programs are designed on the basis of experience, pretests should be conducted to determine if the tools are appropriate, the incentive size optimal, and the presentation method efficient. Strang maintains that promotions usually can be tested quickly and inexpensively and that large companies should test alternative strategies in selected market areas with each national promotion." Consumers can be asked to rate or rank different possible deals, or trial tests can be run in limited geographic areas.

### **Implementing and Controlling the Program**

Marketing managers must prepare implementation and control plans for each individual promotion. Implementation planning must cover lead-time and sell-in time. Lead time is the time necessary to prepare the program prior to launching it: initial planning, design, and approval of package modifications or material to be mailed or distributed; preparation of advertising and point-of-sale materials; notification of field sales personnel; establishment of allocations for individual distributors; purchasing and printing of special premiums or packaging materials; production of advance inventories in preparation for release at a specific date; and, finally, the distribution to the retailer.

Sell-in time begins with the promotional launch and ends when approximately 95 percent of the deal merchandise is in the hands of consumers.

### **Evaluating Results**

Manufacturers can use three methods to measure sales-promotion effectiveness: sales data, consumer surveys, and experiments.

The first method involves using scanner sales data, which are available from companies such as Information Resources Inc. and Nielsen Media Research. Marketers can analyze the types of people who took advantage of the promotion, what they bought before the promotion, and how consumers behaved later toward the brand and other brands. Suppose

a company has a 6 percent market share in the prepromotion period. The share jumps to 10 percent during the promotion, falls to 5 percent immediately after the Promotion, and rises to 7 percent in the postpromotion period. The promotion evidently attracted new triers and also stimulated more purchasing by existing customers. After the promotion, sales fell as consumers worked down their inventories. The long-run rise to 7 percent indicates that the company gained some new users.

In general, sales promotions work best when they attract competitors' customers to try a superior product and these customers switch as a result. If the company's product is not superior, the brand's share is likely to return to its prepromotion level. The promotion may have covered its costs, but more likely did not. One study of more than 1,000 promotions concluded that only 16 percent paid off.

If more information is needed, consumer surveys can be conducted to learn how many recall the promotion, what they thought of it, how many took advantage of it, and how the promotion affected subsequent brand-choice behavior. Sales promotions can also be evaluated through experiments that vary such attributes as incentive value, duration, and distribution media. For example, coupons can be sent to half of the households in a consumer panel. Scanner data can be used to track whether the coupons led more people to buy the product immediately and in the future. This information can then be used to calculate the increase in revenues that stemmed from the promotion.

Beyond the cost of specific promotions, management must recognize additional costs. First, promotions might decrease long-run brand loyalty by making more consumers deal prone rather than advertising prone. Second, promotions can be more expensive than they appear. Some are inevitably distributed to the wrong consumers. Third there are the costs of special production runs, extra sales force effort, and handling requirements. Finally, certain promotions irritate retailers, who may demand extra trade allowances or refuse to Cooperate.

Not only must the company relate constructively to customers, suppliers, and dealers, but it must also relate to a large number of interested publics. We define a public as follows:

A public is any group that has an actual or potential interest in or impact on a company's ability to achieve its objectives. Public relations (PR) involve a variety of programs designed to promote or protect a company's image or its individual products.

A public can facilitate or impede a company's ability to achieve its objectives. PR has often been treated as a marketing stepchild, an afterthought to more serious promotion planning. But the wise company takes concrete steps to manage successful relations with its key publics. Most companies operate a public-relations department. The PR department monitors the attitudes of the organization's publics and distributes 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, idea, place, 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.<sup>67</sup> 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.

Clearly, creative public relations can affect public awareness at a fraction of the cost of advertising. The company does not pay for the space or time obtained in the media. It pays only for a staff to develop and circulate the stories and manage certain events. If the company develops an interesting story, it could be picked up by the news media and be worth millions

of dollars in equivalent advertising. The Body Shop, for example, has spent very little money on advertising; its success has been almost entirely due to publicity. MPR carries more credibility than advertising. Some experts save that consumers are five times more likely to be influenced by editorial copy than by advertising.

Here are two examples of the creative use of MPR: Intel and the Pentium Chip When users of Intel's Pentium computer chip began to notice a problem with it in 1994, the company refused to replace the chip unless the computer users could prove they needed their computers for complex mathematical operations (the only operations affected by the flaw). Following an uproar of consumer dissatisfaction, Intel's MPR people came to the rescue by using a "one-two punch," following up intense one-on-one marketing to corporate and retail Pentium users with the introduction of a worldwide network of Pentium-replacement service centers (offering free replacements on request). Intel tried to reach customers one-on-one, whether they were large customers or individual users. The company did this by mobilizing huge numbers of people inside the company, putting them on phone lines to talk to anybody concerned, and by flying marketing teams all over the country to visit corporate accounts and replace Pentium chips. To reach individual consumers, Intel even placed its own employees inside retail stores in the weeks before Christmas of 1994. As a result of the intense MPR campaign, Intel was able to rescue its reputation, which had been seriously jeopardized just a few weeks earlier."

Microsoft and Windows 95 Microsoft's campaign launching Windows 95 was an MPR success story. No paid ads for Windows 95 had appeared by August 24, 1995, the launch day. Yet everyone knew about it! The Wall Street Journal estimated that 3,0 (>n headlines, 6,852 stories, and over 3 million words were dedicated to Windows 95 from July 1 to August 24. Microsoft teams around the world executed attention-grabbing publicity. Microsoft hung a 600-foot Windows 95 banner from Toronto's CN Tower. The Empire State Building in New York was bathed in the red, yellow, and green colors of the Windows 95 logo. Microsoft paid The London Times to distribute free its entire daily run of 1.5 million copies to the public. By the end of the first week, U.S. sales alone were \$108 million, not bad for a \$90 product. The lesson is clear: Good advance PR can be much more effective than millions of dollars spent on advertising.

## **MAJOR DECISIONS IN MARKETING PR**

In considering when and how to use MPR, management must establish the marketing objectives, choose the PR messages and vehicles, implement the plan carefully, and evaluate the results.

### **Establishing the Marketing Objectives**

MPR can contribute to the following objectives:

**Build awareness:** MPR can place stories in the media to bring attention to a product, service, person, organization, or idea.

**Build credibility:** MPR can add credibility by communicating the message in an editorial context.

**Stimulate the sales force and dealers:** MPR can help boost sales force and dealer enthusiasm. Stories about a new product before it is launched will help the sales force sell it to retailers.

**Publications:** Companies rely extensively on published materials to reach and influence their target markets. These include annual reports, brochures, articles, company newsletters and magazines, and audiovisual materials.

**Events:** Companies can draw attention to new products or other company activities by arranging special events like news conferences, seminars, outings, exhibits, contests and competitions, anniversaries, and sport and cultural sponsorships that will reach the target publics.

**News:** One of the major tasks of PR professionals is to find or create favorable news about the company, its products, and its people. News generation requires skill in developing a story concept, researching it, and writing a press release. But the PR person's skill must go beyond preparing news stories getting the media to accept press releases and attend press conferences calls for marketing and interpersonal skills.

**Speeches:** Speeches are another tool for creating product and company publicity. Lee Iacocca's charismatic talks before large audiences helped Chrysler sell its cars. Increasingly, company executives must field questions from the media or give talks at trade associations or sales meetings, and these appearances can build the company's image.

**Public-Service Activities:** Companies can build goodwill by contributing money and time to good causes. Large companies typically ask executives to support community affairs. In other instances, companies will donate an amount of money to a specified cause. Such cause-related marketing is used by a growing number of companies to build public goodwill.

**Identity Media:** In a society marked by sensory overload, companies compete for attention. They need a visual identity that the public immediately recognizes. The visual identity is carried by company logos, stationery, brochures, signs, business forms, business cards, buildings, uniforms, and dress codes.

**Hold down promotion cost.:** MPR costs less than direct mail and media advertising. The smaller the company's promotion budget, the stronger the case for using PR to gain share of mind.

**Specific objectives should be set for every MPR campaign:** Whereas PR practitioners will continue to reach their target publics through the mass media, MPR is increasingly borrowing the techniques and technology of directresponse marketing to reach target audience members one to one. PR expert Thomas L. Harris offers suggestions for how PR and direct-response marketing can work together to achieve specific marketing objectives:

**Build marketplace excitement before media advertising breaks:** For example, the announcement of a new product offers a unique opportunity for obtaining publicity and for dramatizing the product.

**Build a core consumer base:** Marketers are increasingly recognizing the value of maintaining consumer loyalty, because it costs far less to keep a consumer than to get a new one.

**Build a one-to-one relationship with consumers:** Marketers can use telephone hot lines and 800 numbers, plus the Internet, to build and maintain relationships with individual consumers. The influencer may be an authority figure like a teacher, doctor, or pharmacist, but it also can be someone who has a different kind of one-to-one relationship with the consumer, such as a hair stylist or personal trainer.

### **Choosing Messages and Vehicles**

The manager must identify or develop interesting stories to tell about the product. Suppose a relatively unknown college wants more visibility. The MPR practitioners will warch for possible stories. Do any faculty members have unusual backgrounds, or are any working on unusual projects? Are any new and unusual courses being taught? Are any interesting events taking place on campus?

If the number of interesting stories is insufficient, the MPR practitioner should propose newsworthy events the college could sponsor. Here the challenge is to create news. PR ideas include hosting major academic conventions, inviting expert or speakers, and developing news conferences. Each event is an opportunity to 'cvelop a multitude of stories directed'at different audiences.

Creation is a particularly important skill in publicizing fund-raising drives for nonprofit organizations. Fund-raisers have developed a large repertoire of special events, including anniversary celebrations, art exhibits, auctions, benefit evenings, hingo games, book sales, cake sales, contests, dances, dinners, fairs, fashion shows, parties in unusual places, phonathons, rummage sales, tours, and walkathons. No sooner is one type of event created, such as a walkathon, than competitors spawn new versions, such as readathons, bikeathons, and jogathons.

For-profit organizations also use events to call attention to their products and services. Fuji Photo Film Company flew its blimp over the renovated Statue of Liberty during its massive celebration, outdoing its rival Kodak, which had mounted a permanent photo exhibit at the site. Anheuser-Busch sponsored a Black World Championslnp Rodeo in Brooklyn, attracting more than 5,000 spectators. P&G chose sponsor a Barry Manilow concert tour under the names of some of its detergent products, because it wanted to attract the middle-aged women who were Barry Manilow tans and who were the target market for the detergents.

The best MPR practitioners are able to find or create stories on behalf of even mundane products such as pork ("the other white meat"), garlic, and potatoes. Here is an example for cat food:

### **Implementing the Plan**

Implementing public relations requires care. Consider placing stories in the media: A great story is easy to place, but most stories are less than great and might not get past busy editors. One of the chief assets of publicists is their personal relationship with media editors. PR people look at media editors as a market to satisfy so that these editors will continue to use their stories.

### **Evaluating Results**

MPR's contribution to the bottom line is difficult to measure, because it is used along with other promotional tools. If it is used before the other tools come into action, its contribution is easier to evaluate. The three most commonly used measures of MPR effectiveness are number of exposures; awareness, comprehension, or attitude change; and contribution to sales and profits.

The easiest measure of MPR effectiveness is the number of exposures carried by the media. Publicists supply the client with a clippings book showing all the media that carried news about the product and a summary statement such as the following:

Media coverage included 3,500 column inches of news and photographs in 350 publications with a combined circulation of 79.4 million; 2,500 minutes of airtime of 290 radio stations and an estimated audience of 65 million; and 660 minutes of airtime on 160 television stations with an estimated audience of 91 million. If this time and space had been purchased at advertising rates, it would have amounted to \$1,047,000.

The exposure measure is not very satisfying because it contains no indication of how many people actually read, heard, or recalled the message and what they thought afterward. Nor does it contain information on the net audience reached, because publications locations overlap in readership. Because publicity's goal is reach, not frequency, it would be more useful to know the number of unduplicated exposures.

A better measure is the change in product awareness, comprehension, or attitude resulting from the MPR campaign (after allowing for the effect of other promotional tools). For example, how many people recall hearing the news item? How many told others about it (a measure of word of mouth)? How many changed their minds after hearing it? In a Potato Board campaign, the board found that the number of people who agreed with the statement "Potatoes are rich in vitamins and minerals" went from 36 percent before the campaign to 67 percent after the campaign, a significant improvement in product comprehension.

Sales-and-profit impact is the most satisfactory measure, if obtainable. For example, 9-Lives sales had increased 43 percent by the end of the Morris the Cat PR campaign. However, advertising and sales promotion had also been stepped up, and their contribution has to be allowed for. Suppose total sales have increased \$1,500,000, and management estimates that MPR contributed 15 percent of the total sales increase. Then the return on MPR investment is calculated as follows:

Total sales increase	\$1,500,000
Estimated sales increase due to PR (15 percent)	225,000
Contribution margin on product sales (10 percent)	22,500
Total direct cost of MPR program	-10,000
	-----
Contribution margin added by PR investment	\$ 12,500
Return on MPR investment (\$12,500/\$10,000)	125%

In the years ahead, we can expect marketing public relations to play a larger role in the company's communication efforts.

## DESIGNING THE SALES FORCE

Sales personnel serve as the company's personal link to the customers. The sales representative is the company to many of its customers. It is the sales rep who brings back much-needed information about the customer. Therefore, the company carefully needs to consider issues in sales force design—namely, the development of sales force objectives, strategy, structure, size, and compensation.

## SALES FORCE OBJECTIVES AND STRATEGY

Companies must define the specific objectives they expect their sales force to achieve. The old idea was that the sales force should "sell, sell, and sell." At IBM, salespeople would "push metal" and at Xerox they would "sell boxes." Salespeople had quotas, and the better salespeople met or exceeded their quotas. Later, the idea arose that sales representatives should know how to diagnose a customer's problem and propose a solution. Salespeople do not try to sell a specific product initially. Rather, they show a customer-prospect how their

company can help the customer improve its profitability. They seek to join their company with the customer's company as "partners for profit."

Regardless of the selling context, salespeople will have one or more of the following specific tasks to perform: Prospecting: Searching for prospects, or leads

Targeting: Deciding how to allocate their time among prospects and customers

Curmuttering: Communicating information about the company's products and services

Selling: Approaching, presenting, answering objections, and closing sales

Servicing: Providing various services to the customers--consulting on problems, rendering technical assistance, arranging financing, expediting delivery

Information gathering: Conducting market research and doing intelligence work

Allocating: Deciding which customers will get scarce products during product shortages

Companies need to define the specific objectives they want their sales force to achieve. For example, a company might want its sales representatives to spend 80 percent of their time with current customers and 20 percent with prospects, and 85 percent of their time on established products and 15 percent on new products. If norms are not established, sales representatives might spend most of their time selling established products to current accounts and neglect new products and new prospects.

The sales representative's tasks vary with the state of the economy. During product shortages, sales representatives have no problem selling. Some companies jump to the conclusion that fewer sales representatives are needed during such periods. But this thinking overlooks the salesperson's other roles--allocating the product, counseling unhappy customers, communicating company plans on remedying shortages, and selling company products that are not in short supply.

During periods of product abundance, sales representatives compete vigorously to win customer preference. Companies are increasingly judging their sales reps not only on their sales volume but also on their ability to create customer satisfaction and profit. Here are two examples:

In building long-term customer relationships. The managers of these key accounts have several ways of satisfying their customers beyond offering reduced rates. As Marriott's representative, the key account manager is responsible for solving problems and securing any special services the customer requires. By learning the customer's business, the account manager can assist the customer in planning travel. By working with support from personnel throughout the Marriott organization, the account manager can offer the services of all the Marriott properties.

Companies must deploy sales forces strategically so that they call on the right customers at the right time and in the right way. Sales representatives work with customers in several ways: Sales representative to buyer: A sales representative discusses issues with a prospect or customer in person or over the phone.

Sales representative to buyer group: A sales representative gets to know as many members of the buyer group as possible. Sales team to buyer group: A company sales team works closely with the members of the customer's buying group.

Conference selling: The sales representative brings company resource people to discuss a major problem or opportunity.

Seminar selling: A company team conducts an educational seminar for the customer company about state-of-the-art developments.

Today's sales representatives act as "account managers" who arrange fruitful contact between various people in the buying and selling organizations. Selling increasingly calls for teamwork requiring the support of other personnel, such as top-management, especially when national accounts or major sales are at stake; technical people, who supply technical information and service to the customer before, during, or after product purchase; customer service representatives, who provide installation, maintenance, and other services; and an office staff, consisting of sales analysts, order expeditors, and secretaries. An example of a successful sales team orientation is provided by DuPont. When it heard that corn growers needed a herbicide that could be applied less often, DuPont appointed a team of chemists, sales and marketing executives, and regulatory specialists to solve the problem. They created a product that topped \$57 million in sales its first year.'

To maintain a market focus, salespeople should know how to analyze sales data, measure market potential, gather market intelligence, and develop marketing strategies and plans. Sales representatives need analytical marketing skills, and these skills become especially important at the higher levels of sales management. Marketers believe that sales forces will be more effective in the long run if they understand marketing as well as selling.

Once the company decides on an approach, it can use either a direct or a contractual sales force. A direct (company) sales force consists of full- or part-time paid employees who work exclusively for the company. This sales force includes inside sales personnel, who conduct business from the office using the telephone and receive visits from prospective buyers, and field sales personnel, who travel and visit customers. A contractual sales force consists of manufacturers' reps, sales agents, and brokers, who are paid a commission based on sales.

## **SALES FORCE STRUCTURE**

The sales force strategy has implications for the sales force structure. If the company sells one product line to one end-using industry with customers in many locations, it would use a territorial sales force structure. If the company sells many products to many types of customers, it might need a product or market sales force structure. Table 20.1 summarizes the most common sales force structures, and the Marketing Insight, "Major Account Management-What It Is and How It Works," discusses major account management, a specialized form of sales force structure.

**Territorial:** Each sales representative is assigned an exclusive territory. This sales structure has a number of advantages. First, it results in a clear definition of the salesperson's responsibilities. Second, territorial responsibility increases the rep's incentive to cultivate local business and personal ties. Third, travel expenses are relatively small, because each rep travels within a small area.

**Territorysize:** Territories can be designed to provide either equal sales potential or equal workload. Territories of equal potential provide each sales representative with the same income opportunities and provide the company with a means to evaluate performance. However, because customer density varies by territory, territories with equal potential can vary widely in size. Territories can also be designed to equalize the sales workload so that each sales rep can cover his or her territory adequately.

**Territory shape:** Territories are formed by combining smaller units, such as counties or states, until they add up to a territory of a given sales potential or workload. Design must take into account the location of natural barriers, the compatibility of adjacent areas, the

adequacy of transportation, and so forth Territory shape can influence the cost and ease of coverage and the sales reps' job satisfaction. Today, companies can use computer programs to design sales territories that optimize such criteria as compactness, equalization of workload or sales potential, and minimal travel time.

**Product:** The importance of sales reps' knowing their products, together with the development of product divisions and product management, has led many companies to structure their sales forces along product lines. Product specialization is particularly warranted where the products are technically complex, highly unrelated, or very numerous. Kodak uses one sales force for its film products that are intensively distributed, and another sales force to sell complex products that require technical support.

**Market:** Companies often specialize their sales forces along industry or customer lines. Separate sales forces can be set up for different industries and even different customers. IBM set up a sales office for finance and brokerage customers in New York, another for GM in Detroit, and still another for Ford in nearby Dearborn. The advantage of market specialization is that each sales force can become knowledgeable about specific customer needs. The major disadvantage is that customers are scattered throughout the country, requiring extensive travel.

**Complex:** When a company sells a wide variety of products to many types of customers over a broad geographical area, it often combines several sales force structures. Sales representatives can be specialized by territory-product, territory-market, product-market, and so on. A sales representative might then report to one or more line and staff managers. Motorola, for example, manages four types of sales forces: (1) a strategic market sales force composed of technical, applications, and quality engineers and service personnel who are assigned to major accounts; (2) a geographic sales force calling on thousands of customers in different territories; (3) a distributor sales force calling on and coaching Motorola distributors; and (4) an inside sales force doing telemarketing and taking orders via phone and fax.

Established companies need to revise their sales force structure as market and economic conditions change. IBM is an excellent example.

### **SALES FORCE SIZE AND COMPENSATION**

Once the company clarifies its strategy and structure, it is ready to consider sales force size. Sales representatives are one of the company's most productive and expensive assets. Increasing their number will increase both sales and costs.

Once the company establishes the number of customers it wants to reach, it can use a workload approach to establish sales force size. This method consists of the following five steps:

1. Customers are grouped into size classes according to annual sales volume.
2. Desirable call frequencies (number of calls on an account per year) are established for each class.
3. The number of accounts in each size class is multiplied by the corresponding call frequency to arrive at the total workload for the country, in sales calls per year.
4. The average number of calls a sales representative can make per year is determined.
5. The number of sales representatives needed is determined by dividing the total annual calls required by the average annual calls made by a sales representative.

Suppose the company estimates that there are 1,000 A accounts and 2,000 B accounts in the nation. An account requires 36 calls a year, and B accounts require 12 calls a year. The company needs a sales force that can make 60,000 sales calls a year. Suppose the average rep can make 1,000 calls a year. The company would need 60 full-time sales representatives.

Many companies are shrinking their sales forces because the sales department is one of the costliest to maintain. Consider the case of Coca-Cola Amatil, the Australian Coke franchisee:

To attract top-quality sales reps, the company has to develop an attractive compensation package. Sales reps would like income regularity, extra reward for aboveaverage performance, and fair payment for experience and longevity. Management would like to achieve control, economy, and simplicity. Some management objectives will conflict with sales rep objectives. No wonder compensation plans exhibit a tremendous variety from industry to industry and even within the same industry.

Management must determine the level and components of an effective compensation plan. The level must bear some relation to the "going market price" for the type of sales job and required abilities. For example, the average earnings of a typical U.S. sales and marketing manager in 1998 was \$110,000." If the market price for salespeople is well defined, the individual firm has little choice but to pay the going rate. However, the market price for salespeople is seldom well defined. Published data on industry sales force compensation levels are infrequent and generally lack sufficient detail.

The company must next determine the four components of sales force compensation—a fixed amount, a variable amount, expense allowances, and benefits. The fixed amount, a salary, is intended to satisfy the sales reps' need for income stability. The variable amount, which might be commissions, bonus, or profit sharing, is intended to stimulate and reward greater effort. Expense allowances enable sales reps to meet the expenses involved in travel, lodging, dining, and entertaining. Benefits, such as paid vacations, sickness or accident benefits, pensions, and life insurance, are intended to provide security and job satisfaction. A popular rule favors making about 70 percent of the salesperson's total income fixed and allocating the remaining 30 percent among the other elements. Fixed compensation receives more emphasis in jobs with a high ratio of nonselling to selling duties and in jobs where the selling task is technically complex and involves teamwork. Variable compensation receives more emphasis in jobs where sales are cyclical or depend on individual initiative.

Fixed and variable compensation give rise to three basic types of compensation plans—straight salary, straight commission, and combination salary and commission. Only one-fourth of all firms use either a straight-salary or straight-commission method. Three-quarters use a combination of the two, though the relative proportion of salary versus incentives varies widely.

Straight-salary plans provide sales reps with a secure income, make them more shrink-willing to perform nonselling activities, and give them less incentive to overstock a tomer. From the company's perspective, they provide administrative simplicity and lower turnover. Straight-commission plans attract higher sales performers, provide more motivation, require less supervision, and control selling costs. Combination plans feature the benefits of both plans while reducing their disadvantages.

With compensation plans that combine fixed and variable pay, companies may link the variable portion of a salesperson's pay to a wide variety of strategic goals. Some see a new trend toward deemphasizing volume measures in favor of factors such as gross

profitability, customer satisfaction, and customer retention. For example, IBM now partly rewards salespeople on the basis of customer satisfaction as measured by customer surveys."

## **MANAGING THE SALES FORCE**

Once the company has established objectives, strategy, structure, size, and compensation, it has to move to recruiting, selecting, training, supervising, motivating, and evaluating sales representatives. Various policies and procedures guide these decisions

## **RECRUITING AND SELECTING SALES REPRESENTATIVES**

At the heart of a successful sales force is the selection of effective representatives. One survey revealed that the top 27 percent of the sales force brought in over 52 percent of the sales. Beyond differences in productivity is the great waste in hiring the wrong people. The average annual turnover rate for all industries is almost 20 percent. When a salesperson quits, the costs of finding and training a new person-plus the cost of lost sales-can run as high as \$50,000 to \$75,000. A sales force with many new people is less productive.

The financial loss due to turnover is only part of the total cost. If a new representative receives \$50,000 a year, another \$50,000 goes into fringe benefits, expenses, supervision, office space, supplies, and secretarial assistance. Consequently, the new representative needs to produce sales on which the gross margin at least covers the selling expenses of \$100,000. If the gross margin is 10 percent, the new salesperson will have to sell at least \$1,000,000 for the company to break even.

Selecting sales reps would be simple if one knew what traits to look for. One good starting point is to ask customers what traits they prefer in salespeople. Most customers say they want the rep to be honest, reliable, knowledgeable, and helpful. The company should look for these traits when selecting candidates.

Another approach is to look for traits common to the most successful salespeople in the company. Charles Garfield, in his study of superachievers, concluded that supersales performers exhibit the following traits: risk taking, powerful sense of mission, problem-solving bent, care for the customer, and careful call planners.<sup>12</sup> Robert McMurry wrote: It is my conviction that the possessor of an effective sales personality is a habitual 'wooer,' an individual who has a compulsive need to win and hold the affection of others." He listed five additional traits: "A high level of energy, abounding self-confidence, a chronic hunger for money, a well-established habit of industry, and a state of mind that regards each objection, resistance, or obstacle as a challenge." Mayer and Greenberg offered one of the shortest lists of traits. They concluded that the effective salesperson has two basic qualities: empathy, the ability to feel as the customer does; and ego drive, a strong personal need to make the sale.

After management develops its selection criteria, it must recruit. The human resources department seeks applicants by various means, including soliciting names from current sales representatives, using employment agencies, placing job ads, and contacting college students. Unfortunately, few students decide to go into selling as a career. Reasons include "Selling is a job and not a profession," and "There is insecurity and too much travel." To counter these objections, company recruiters emphasize starting salaries, income opportunities, and the fact that one-fourth of the presidents of large U.S. corporations started out in marketing and sales. Selection procedures can vary from a single informal interview to prolonged testing and interviewing, not only of the applicant but of the applicant's spouse." If the spouse is not ready to support the "away from home" lifestyle of the salesperson, the hire will not be a good one.

Many companies give formal tests to sales applicants. Although test scores are only one information element in a set that includes personal characteristics, references, past employment history, and interviewer reactions, they are weighted quite heavily by such companies as IBM, Prudential, Procter & Gamble, and Gillette. Gillette claims that tests have reduced turnover by 42 percent and have correlated well with the subsequent progress of new reps in the sales organization.

### **TRAINING SALES REPRESENTATIVES**

Many companies send their new reps into the field almost immediately, supplied with samples, order books, and a description of the territory. Much of their selling is ineffective. A vice president of a major food company once spent a week watching 50 sales presentations to a busy buyer for a major supermarket chain. Here is what he observed:

The majority of salesmen were ill prepared, unable to answer basic questions, uncertain (is to what they wanted to accomplish during the call. They did not think of the call as a studied professional presentation. They didn't have a real idea of the busy retailers needs and wants.'

Today's customers expect salespeople to have deep product knowledge, to add ideas to improve the customer's operations, and to be efficient and reliable. These demands have required companies to make a much higher investment in sales training.

Today, new sales reps may spend a few weeks to several months in training. The median training period is 28 weeks in industrial-products companies, 12 in service companies, and 4 in consumer-products companies. Training time varies with the complexity of the selling task and the type of person recruited into the sales organization. At IBM, new reps receive extensive initial training and may spend 15 percent of their time each year in additional training. Sales training programs have several goals:

- Sales representatives need to know and identify with the company.
- Sales representatives need to know the company's products.
- Sales representatives need to know customers' and competitors' characteristics.
- Sales representatives need to know how to make effective sales presentations.
- Sales representatives need to understand field procedures and responsibilities.

New methods of training are continually emerging, such as role playing, sensitivity training, cassette tapes, videotapes, CD-ROMs, programmed learning, and films on selling. IBM uses a self-study system called Info-Window that combines a personal computer and a laser videodisc. A trainee can practice sales calls with an on-screen actor who portrays a buying executive in a particular industry. The actor-buyer responds differently depending on what the trainee says.

As sales-automation technology has freed reps from the office and put them on the road, it has become more costly to train them by traditional methods. Reps simply are not in the office enough, and they are often overwhelmed with paperwork and information whether in-house or on the road. But technology promises to help reps increase efficiency and productivity. Many companies are now embracing CIROM- interactive training. For instance, reps at Iandem Computers used to complain that they could not keep up with the printed unturniation and training materials the company sent them. Now field repsposible with their own miniature training rooms with them. They simply slip a CID-ROM disk into their laptop coniputecs.

## **SUPERVISING SALES REPRESENTATIVES**

New sales representatives are given more than a territory, compensation package, and training—they are also given supervision. Companies vary how closely they supervise sales reps. Reps paid mostly on commission generally receive less supervision. Those who are salaried and must cover definite accounts are likely to receive substantial supervision.

### **Norms for Customer Calls**

In the early 1980s, the average salesperson made 5 calls a day; by 1989, 4.2 sales calls a day; and the latest McGraw-Hill survey still shows just over 4. The downward trend is due to the increased use of the phone, fax machines, and e-mail; the increased reliance on automatic ordering systems; and the drop in cold calls owing to better market research information.

How many calls should a company make on a particular account each year? Magee described an experiment where similar accounts were randomly split into three sets. Sales representatives were asked to spend less than five hours a month with accounts in the first set, five to nine hours a month with those in the second set, and more than nine hours a month with those in the third set. The results demonstrated that additional calls produced more sales, leaving only the question of whether the magnitude of the sales increase justified the additional cost. Some later research has suggested that today's sales reps are spending too much time selling to smaller, less profitable accounts when they should be focusing more of their efforts on selling to larger, more profitable accounts.

### **Norms for Prospect Calls**

Companies often specify how much time reps should spend prospecting for new accounts. Spector Freight wants its sales representatives to spend 25 percent of their time prospecting and to stop calling on a prospect after three unsuccessful calls.

Companies set up prospecting standards for a number of reasons. Left to their own devices, many reps will spend most of their time with current customers, who are E known quantities. Reps can depend upon them for some business, whereas a prospect - might never deliver any business. Some companies rely on a missionary sales force to open new accounts.

### **Using Sales Time Efficiently**

Studies have shown that the best sales reps are those who manage their time effectively. One effective planning tool is configurator software, a program that automates the order preparation process. Concentra Corporation of Burlington, Massachusetts is a producer of this timesaving product:

Another tool is time-and-duty analysis, which helps reps understand how they spend their time and how they might increase their productivity. Sales reps spend time in the following ways:

- Preparation: Getting information and planning call strategy.
- Travel: In some jobs, travel time amounts to over 50 percent of total time. Travel time can be cut down by using faster means of transportation—but this will increase costs.
- Food and breaks: Some portion of the workday is spent in eating and taking breaks.
- Waiting: Time spent in the buyer's outer office, which is dead time unless the representative uses it to plan or to fill out reports.
- Selling: Time spent with the buyer in person or on the phone.

- **Administration:** Time spent in report writing and billing, attending sales meetings, and talking to others in the company about production, delivery, billing, sales performance, and other matters.

With so many duties, it is no wonder that actual face-to-face selling time can amount to as little as 25 percent of total working time!<sup>24</sup> Companies are constantly seeking ways to improve sales force productivity. Their methods take the form of training sales representatives in the use of "phone power," simplifying record-keeping forms, and using the computer to develop call and routing plans and to supply customer and competitive information.

To reduce time demands on their outside sales force, many companies have increased the size and responsibilities of their inside sales force. In a survey of 135 electronics distributors, Narus and Anderson found that an average of 57 percent of the sales force's members were inside salespeople." As reasons for the growth of the internal sales force, managers cited the escalating cost of outside sales calls and the growing use of computers and innovative telecommunications equipment.

Inside salespeople are of three types. There are technical support people, who provide technical information and answers to customers' questions. One encounters them in phoning computer companies and on-line services. There are sales assistants, who provide clerical backup for the outside salespersons. They call ahead and confirm appointments, carry out credit checks, follow up on deliveries, and answer customers' questions. There are telemarketers, who use the phone to find new leads, qualify them, and sell to them. Telemarketers can call up to 50 customers a day compared to the 4 that an outside salesperson can contact. They can cross-sell the company's other products; upgrade orders; introduce new products; open new accounts and reactivate former accounts; give more attention to neglected accounts; and follow up and qualify direct-mail leads.

The inside sales force frees the outside reps to spend more time selling to major accounts, identifying and converting new major prospects, placing electronic ordering systems in customers' facilities, and obtaining more blanket orders and systems contracts. The inside salespeople spend more time checking inventory, following up orders, and phoning smaller accounts. The outside sales reps are paid largely on an incentive-compensation basis, and the inside reps on a salary or salary plus bonus pay.

Another dramatic breakthrough is the new high-tech equipment—desktop and laptop PCs, videocassette recorders, videodiscs, automatic dialers, e-mail, fax machines, and teleconferencing and videophones. The salesperson has truly gone "electronic." Not only is a sale and inventory information transferred much faster, but specific computer-based decision support systems on CDs have been created for sales managers and sales representatives. For more information on how sales automation is increasing sales productivity, see the Marketing for the Millennium "Automation for the Personal Touch."

## **MOTIVATING SALES REPRESENTATIVES**

Some sales representatives will put forth their best effort without any special coaching from management. To them, selling is the most fascinating job in the world. They are ambitious and self-starters. But the majority of reps require encouragement and special incentives. This is especially true of field selling:

The field job is one of frequent frustration. Reps usually work alone, their hours are irregular, and they are often away from home. They confront aggressive, competing sales reps; they

have an inferior status relative to the buyer; they often do not have the authority to do what is necessary to win an account; and they sometimes lose large orders they have worked hard to obtain.

- Most people operate below capacity in the absence of special incentives, such as financial gain or social recognition.
- Reps are occasionally preoccupied with personal problems, such as sickness in the family, marital discord, or debt. The problem of motivating sales representatives has been studied by Churchill, Ford, and Walker. Their basic model says that the higher the salesperson's motivation, the greater his or her effort. Greater effort will lead to greater performance; greater performance will lead to greater rewards; greater rewards will lead to greater satisfaction; and greater satisfaction will reinforce motivation.

The model thus implies the following:

- Sales managers must be able to convince salespeople that they can sell more by working harder or by being trained to work smarter: But if sales are determined largely by economic conditions or competitive actions, this linkage is undermined.
- Sales managers must be able to convince salespeople that the rewards for better performance are worth the extra effort: But if the rewards seem to be set arbitrarily or are too small or of the wrong kind, this linkage is undermined.

The researchers went on to measure the importance of different possible rewards. The reward with the highest value was pay, followed by promotion, personal growth, and sense of accomplishment. The least-valued rewards were liking and respect, security, and recognition. In other words, salespeople are highly motivated by pay and the chance to get ahead and satisfy their intrinsic needs, and less motivated by compliments and security. But the researchers also found that the importance of motivators varied with demographic characteristics:

- Financial rewards were mostly valued by older, longer-tenured people and those who had large families.
- Higher-order rewards (recognition, liking and respect, sense of accomplishment) were more valued by young salespeople who were unmarried or had small families and usually more formal education.

Motivators also vary across countries. Whereas money is the number-one motivator of 37 percent of U.S. salespeople, only 20 percent of salespeople in Canada feel the same way. Salespeople in Australia and New Zealand were the least motivated by a fat paycheck.

### **Sales Quotas**

Many companies set sales quotas prescribing what reps should sell during the year. Quotas can be set on dollar sales, unit volume, margin, selling effort or activity, and product type. Compensation is often tied to degree of quota fulfillment.

Sales quotas are developed from the annual marketing plan. The company first prepares a sales forecast. This forecast becomes the basis for planning production, workforce size, and financial requirements. Management then establishes quotas for regions and territories, which typically add up to more than the sales forecast. Quotas are set higher than the sales forecast to encourage managers and salespeople to perform at their best level. If they fail to make their quotas, the company nevertheless might make its sales forecast.

Each area sales manager divides the area's quota among the area's sales reps. There are three schools of thought on quota setting. The high-quota school sets quotas higher than

what most sales reps will achieve but that are attainable. Its adherents believe that high quotas spur extra effort. The modest-quota school sets quotas that a majority of the sales force can achieve. Its adherents feel that the sales force will accept the quotas as fair, attain them, and gain confidence. The variable-quota school thinks that individual differences among sales reps warrant high quotas for some, modest quotas for others.

One general view is that a salesperson's quota should be at least equal to the person's last year's sales plus some fraction of the difference between territory sales potential and last year's sales. The more the salesperson reacts favorably to pressure, the higher the fraction should be.

### **Supplementary Motivators**

Companies use additional motivators to stimulate sales force effort. Periodic sales meetings provide a social occasion, a break from routine, a chance to meet and talk with "company brass" and each other, and a chance to air feelings and to identify with a larger group. Sales meetings are an important tool for education, communication, and motivation.

Companies also sponsor sales contests to spur the sales force to a special selling effort above what is normally expected. The contest should present a reasonable opportunity for enough salespeople to win. At IBM, about 70 percent of the sales force qualifies for the 100 percent Club. The reward is a three-day trip that includes a recognition dinner and a blue-and-gold pin. The contest period should not be announced in advance. If it is, some salespersons will defer sales and others pad their sales during the period with customer promises to buy that do not materialize after the contest period ends.

Whether a sales contest is focused on selling a specific product or products during a limited time period or is a more general recognition of top revenue earners for the quarter, the reward should be commensurate with the achievement. Reps who are well paid and whose earnings are based in large part on commissions are more likely to be motivated by a trip, a trophy, or merchandise than by a check of equal value. Consider Okidata's program:

### **EVALUATING SALES REPRESENTATIVES**

We have been describing the feed-forward aspects of sales supervision-how management communicates what the sales reps should be doing and motivates them to do it. But good feed-forward requires good feedback, which means getting regular information from reps to evaluate performance.

#### **Sources of Information**

Management obtains information about its reps in several ways. The most important source is sales reports. Additional information comes through personal observation, customer letters and complaints, customer surveys, and conversations with other sales representatives.

Sales reports are divided between activity plans and write-ups of activity results. The best example of the former is the salesperson's work plan, which sales reps submit a week or month in advance. The plan describes intended calls and routing. This report forces sales reps to plan and schedule their activities, informs management of their whereabouts, and provides a basis for comparing their plans and accomplishments. Sales reps can be evaluated on their ability to "plan their work and work their plan."

Many companies require their representatives to develop an annual territory marketing plan in which they outline their program for developing new accounts and increasing business from existing accounts. This type of report casts sales reps into the role of

market managers and profit centers. Sales managers study these plans, make suggestions, and use them to develop sales quotas.

Sales reps write up completed activities on call reports. Sales representatives also submit expense reports, new-business reports, lost-business reports, and reports on local business and economic conditions. These reports provide raw data from which sales managers can extract key indicators of sales performance: (1) average number of sales calls per salesperson per day, (2) average sales call time per contact, (3) average revenue per sales call, (4) average cost per sales call, (5) entertainment cost per sales call, (6) percentage of orders per hundred sales calls, (7) number of new customers per period, (8) number of lost customers per period, and (9) sales force cost as a percentage of total sales.

### **Formal Evaluation**

The sales force's reports along with other observations supply the raw materials for evaluation. There are several approaches to conducting evaluations. One type of evaluation compares current performance to past performance.

The sales manager can learn many things about a rep from this table. Total sales increased every year (line 3). This does not necessarily mean that the person is doing a better job. The product breakdown shows that he has been able to push the sales of product B further than the sales of product A (lines 1 and 2). According to his quotas for the two products (lines 4 and 5), his success in increasing product B sales could be at the expense of product A sales. According to gross profits (lines 6 and 7), the company earns more selling A than B. The rep might be pushing the higher-volume, lower-margin product at the expense of the more profitable product. Although he increased total sales by \$1,100 between 1998 and 1999 (line 3), the gross profits on total sales actually decreased by \$580 (line 8).

Sales expense (line 9) shows a steady increase, although total expense as a percentage of total sales seems to be under control (line 10). The upward trend in total dollar expense does not seem to be explained by any increase in the number of calls (line 11), although it might be related to success in acquiring new customers (line 14). There is a possibility that in prospecting for new customers, this rep is neglecting present customers, as indicated by an upward trend in the annual number of lost customers (line 15).

The last two lines show the level and trend in sales and gross profits per customer. These figures become more meaningful when they are compared with overall company averages. If this rep's average gross profit per customer is lower than the company's average, he could be concentrating on the wrong customers or not spending enough time with each customer. A review of annual number of calls (line 11) shows that he might be making fewer annual calls than the average salesperson. If distances in the territory are similar to other territories, this could mean that he is not putting in a full workday, he is poor at sales planning and routing, or he spends too much time with certain accounts.

The rep might be quite effective in producing sales but not rate high with customers. Perhaps he is slightly better than the competitors' salespeople, or his product is better, or he keeps finding new customers to replace others who don't like to deal with him. An increasing number of companies are measuring customer satisfaction not only with their product and customer support service, but also with their salespeople. The customers' opinion of the salesperson, product, and service can be measured by mail questionnaires or telephone calls.

Evaluations can also assess the salesperson's knowledge of the company, products, customers, competitors, territory, and responsibilities. Personality characteristics can be rated,

such as general manner, appearance, speech, and temperament. The sales manager can also review any problems in motivation or compliance.

The sales manager can also check that the representative knows and observes the law. For example, it is illegal for salespeople to lie to consumers or mislead them about the advantages of buying a product. Under U.S. law, salespeople's statements must match advertising claims. In selling to businesses, salespeople may not offer bribes to purchasing agents or others influencing a sale. They may not obtain or use competitors' technical or trade secrets through bribery or industrial espionage. Finally, sales; people must not disparage competitors or competing products by suggesting things that are not true.

## **PRINCIPLES OF PERSONAL SELLING**

Personal selling is an ancient art. It has spawned a large literature and many principles. Effective salespersons have more than instinct; they are trained in methods of analysis and customer management. We will examine three major aspects of personal selling: sales professionalism, negotiation, and relationship marketing." Figure shows these aspects in schematic form.

### **PROFESSIONALISM**

Today's companies spend hundreds of millions of dollars each year to train salespeople in the art of selling. Over a million copies of books, cassettes, and videotapes on selling are purchased annually, with such tantalizing titles as Questions That Make the Sale; Green Light Selling: Your Secret Edge to Winning Sales and Avoiding Dead Ends; You'll Never Get No for an Answer; Secrets of Power Persuasion; What They Don't Teach You in Sales 101; Close! Close! Close! How to Make the Sale; How to Make Money Tomorrow Morning; Samurai Selling; and World Class Selling. One of the most enduring books is Dale Carnegie's How to Win Friends and Influence People.

All sales-training approaches try to convert a salesperson from a passive order taker into an active order getter. Order takers operate on the assumption that customers know their own needs, resent attempts to influence them, and prefer courteous and self-effacing salespersons. There are two basic approaches in training salespersons to be order getters, a sales-oriented approach and a customer-oriented approach. The sales oriented approach trains the person in the stereotyped high-pressure techniques used P' in encyclopedias or automobiles. This form of selling assumes that customers are not likely to buy except under pressure, that they are influenced by a slick presentation, and that they will not be sorry after signing the order-or, if they are, that it doesn't matter.

The customer-oriented approach trains salespeople in customer problem solving. The person learns how to listen and question in order to identify customer needs and come up with sound product solutions. Presentation skills are secondary to customerneed analysis skills. This approach assumes that customers have latent needs that constitute opportunities, that they appreciate constructive suggestions, and that they will be loyal to sales reps who have their long-term interests at heart. The problem solver is a much more congruent concept for the salesperson under the marketing concept than the hard seller or order taker.

No approach works best in all circumstances. Yet most sales-training programs agree on the major steps involved in any effective sales process. These steps are shown' in Figure and their application to industrial selling is discussed next.

Prospecting and qualifying; the first step in selling is to identify and qualify prospects. Historically, most companies left it to their salespeople to find leads. Now, however, more

companies are taking responsibility for finding and qualifying leads so that the salespeople can use their expensive time doing what they can do best: selling. Companies can generate leads in the following ways:

Examining data sources (newspapers, directories, CD-ROMs) in search of names. Firms can acquire company and industry information from commercial list vendors such as Dun & Bradstreet, R. L. Polk, and TRW.

- Putting up a booth at trade shows to encourage drop-bys.
- Inviting current customers to suggest the names of prospects.
- Cultivating other referral sources, such as suppliers, dealers, noncompeting sales representatives, bankers, and trade association executives.
- Contacting organizations and associations to which prospects belong.
- Engaging in speaking and writing activities that will draw attention.
- Using the telephone, mail, and the Internet to find leads.
- Dropping in unannounced on various offices (cold canvassing).

Companies can then qualify the leads by contacting them by mail or phone to assess their level of interest and financial capacity. The leads can be categorized as hot prospects, warm prospects, and cool prospects, with the hot prospects turned over to the field sales force and the warm prospects turned over to the telemarketing unit for follow-up. Even then, it usually takes about four calls on a prospect to consummate a business transaction.

Sometimes companies develop original sales prospecting approaches, as John Deere has done:

### **Preapproach**

The salesperson needs to learn as much as possible about the prospect company (what it needs, who is involved in the purchase decision) and its buyers (their personal characteristics and buying styles). The salesperson can consult standard sources (Moody's, Afqhanist Standard & Poor's, Dun & Bradstreet), acquaintances, and others to learn about the company. The salesperson should set call objectives: to qualify the prospect, gather information, make an immediate sale. Another task is to decide on the best approach, which might be a personal visit, a phone call, or a letter. The best timing should also be considered because many prospects are busy at certain times. Finally, the salesperson should plan an overall sales strategy for the account.

### **Approach**

The salesperson should know how to greet the buyer to get the relationship off to a good start. The salesperson might consider wearing clothes similar to what buyers wear (for instance, in California, office clothing is more casual than in Washington, DC); show courtesy and attention to the buyer; and avoid distracting mannerisms, such as staring at the customer. The opening line should be positive; for example, "Mr. Smith, I am Alice Jones from the ABC Company. My company and I appreciate your willingness to see me. I will do my best to make this visit profitable and worthwhile for you and your company." This opening line might be followed by key questions and active listening to understand the buyer's needs.

### **Presentation and Demonstration**

The salesperson now tells the product "story" to the buyer, following the AIDA formula of gaining attention, holding interest, arousing desire, and obtaining action. The

salesperson uses a features, advantages, benefits, and value approach (FABV). Features describe physical characteristics of a market offering, such as chip processing speeds or memory capacity. Advantages describe why the features provide an advantage to the customer. Benefits describe the economic, technical, service, and social benefits delivered by the offering. Value describes the summative worth (often in monetary terms) of the offering. Too often, salespeople spend too much time dwelling on product features (a product orientation) and not stressing enough the offering's benefits and value (a customer orientation).

Companies have developed three different styles of sales presentation. The oldest is the canned approach, which is a memorized sales talk covering the main points. It is based on stimulus-response thinking; that is, the buyer is passive and can be moved to purchase by the use of the right stimulus words, pictures, terms, and actions. The formulated approach is also based on stimulus-response thinking but first identifies the buyer's needs and buying style and then uses a formulated approach to this type of buyer.

The need-satisfaction approach starts with a search for the customer's real needs by encouraging the customer to do most of the talking. The salesperson takes on the role of a knowledgeable business consultant hoping to help the customer save money or make more money.

Sales presentations can be improved with demonstration aids such as booklets, flip charts, slides, movies, audio and videocassettes, product samples, and computerbased simulations. Visual aids can show how a product performs and provide other information about it. Booklets and brochures remain useful as "leave behinds" for customer reference. For group presentations, Powerpoint and similar software have replaced the flip chart. These programs enable reps to project professionally prepared visuals on a screen or download them to the laptops of audience members. Johnson & -Johnson's Advanced Sterilization Products division uses a visual aid that includes a small video player with five headsets, all easily transported in a briefcase-sized package. Computer animation shows the viewer the inner workings of the Sternad Sterilization System, providing more information in a more engaging way than could be done by displaying the actual machinery-even if the system were portable.

### **Overcoming Objections**

Customers almost always pose objections during the presentation or when asked for the order. Psychological resistance includes resistance to interference, preference for established supply sources or brands, apathy, reluctance to giving up something, unpleasant associations created by the sales rep, predetermined ideas, dislike of making decisions, and neurotic attitude toward money. Logical resistance might consist of objections to the price, delivery schedule, or certain product or company characteristics. To handle these objections, the salesperson maintains a positive approach, asks the buyer to clarify the objection, questions the buyer in a way that the buyer has to answer his or her own objection, denies the validity of the objection, or turns the objection into a reason for buying. Handling and overcoming objections is a part of the broader skills of negotiation.

### **Closing**

Now the salesperson attempts to close the sale. Some salespeople do not get to this stage or do not do it well. They lack confidence or feel uncomfortable about asking for the order or do not recognize the right psychological moment to close the sale. Salespersons need

to know how to recognize closing signs from the buyer, including physical actions, statements or comments, and questions. Salespersons can use one of several closing techniques. They can ask for the order, recapitulate the points of agreement, offer to help the secretary write up the order, ask whether the buyer wants A or B, get the buyer to make minor choices such as the color or size, or indicate what the buyer will lose if the order is not placed now. The salesperson might offer the buyer specific inducements to close, such as a special price, an extra quantity, or a token gift.

### **Follow-up and Maintenance**

Follow-up and maintenance are necessary if the salesperson wants to ensure customer satisfaction and repeat business. Immediately after closing, the salesperson should cement any necessary details on delivery time, purchase terms, and other matters that are important to the customer. The salesperson should schedule a follow-up call when the initial order is received to make sure there is proper installation, instruction, and servicing. This visit or call will detect any problems, assure the buyer of the salesperson's interest, and reduce any cognitive dissonance that might have arisen. The salesperson should also develop a maintenance and growth plan for the account.

## **NEGOTIATION**

Much business-to-business selling involves negotiating skills. The two parties need to reach agreement on the price and the other terms of sale. Salespersons need to win the order without making deep concessions that will hurt profitability. Marketing is concerned with exchange activities and the manner in which the terms of exchange are established. In routinized exchange, the terms are established by administered programs of pricing and distribution. In negotiated exchange, price and other terms are set via bargaining behavior, in which two or more parties negotiate long-term binding agreements. Although price is the most frequently negotiated issue, other issues include contract completion time; quality of goods and service offered; purchase volume; responsibility for financing, risk taking, promotion, and title; and product safety. Marketers who find themselves in bargaining situations need certain traits and skills to be effective. The most important are preparation and planning skill, knowledge of subject matter being negotiated, ability to think clearly and rapidly under pressure and uncertainty, ability to express thoughts verbally, listening skill, judgment and general intelligence, integrity, ability to persuade others, and patience.

### **When to Negotiate**

Lee and Dobler have listed the following circumstances where negotiation is an appropriate procedure for concluding a sale:

1. When many factors bear not only on price, but also on quality and service.
2. When business risks cannot be accurately predetermined.
3. When a long period of time is required to produce the items purchased.
4. When production is interrupted frequently because of numerous change orders.

Negotiation is appropriate whenever a zone of agreement exists." A zone of agreement exists when there are simultaneously overlapping acceptable outcomes for the parties. Suppose two parties are negotiating a price. The seller has a reservation price,  $s$ , which is the minimum he will accept. Any final-contract value,  $x$ , that is below  $s$  is worse than not reaching an agreement at all. For any  $x > s$ , the seller receives a surplus. Obviously, the seller desires as large a surplus as possible while maintaining good relations with the

buyer. Likewise, the buyer has a reservation price  $b$  that is the maximum he will pay; any  $x$  above  $b$  is worse than no agreement. For any  $x < b$ , the buyer receives a surplus. If the seller's reservation price is below the buyer's—that is,  $s < b$ —then a zone of agreement exists, and the final price will be determined through bargaining. There is an obvious advantage in knowing the other party's reservation price and in making one's own reservation price seem higher (for a seller) or lower (for a buyer) than it really is. The openness with which buyers and sellers reveal their reservation prices depends upon the bargainers' personalities, the negotiation circumstances, and expectations about future relations.

### **Formulating a Negotiation Strategy**

Negotiation involves preparing a strategic plan before meeting the other party and making good tactical decisions during the negotiation sessions. A negotiation strategy is a commitment to an overall approach that has a good chance of achieving the negotiator's objectives. Some negotiators pursue a "hard" strategy with opponents, whereas others maintain that a "soft" strategy yields more favorable results. Fisher and Ury propose another strategy, that of "principled negotiation," described in the Marketing Memo "The Principled-Negotiation Approach to Bargaining.

Negotiators use a variety of tactics when bargaining. Bargaining tactics are maneuvers made at specific points in the bargaining process. Several classic bargaining tactics are listed in Table 20.3. Fisher and Ury have offered tactical advice that is consistent with their strategy of principled negotiation. If the other party is more powerful, the best tactic is to know one's BATNA—Best Alternative to a Negotiated Agreement. By identifying the alternatives if a settlement is not reached, the company sets a standard against which any offer can be measured. Knowing its BATNA protects the company from being pressured into accepting unfavorable terms from a more powerful opponent.

Another set of bargaining tactics are responses intended to deceive, distort, or otherwise influence the bargaining. What tactic should be used when the other side uses a take-it-or-leave-it tactic or seats the other party on the side of the table with the sun in his eyes? A negotiator should recognize the tactic, raise the issue explicitly, and question the tactic's legitimacy and desirability—in other words, negotiate over it. If negotiating fails, the company should resort to its BATNA and terminate the negotiation until the other side ceases to employ these tactics. Meeting such tactics with defending principles is more productive than counterattacking with tricky tactics.

### **RELATIONSHIP MARKETING**

The principles of personal selling and negotiation thus far described are transaction-oriented because their purpose is to close a specific sale. But in many cases, the company is not seeking an immediate sale but rather to build a long-term supplier-customer relationship. The company wants to demonstrate that it has the capabilities to serve the account's needs in a superior way. Neil Rackham has developed a method that he calls SPIN selling (Situation, Problem, Implication, Need-Payoff). Gone is the script of the slick salesperson, and in its place is the sales. Neil Rackham trains salespeople to raise four types of questions with the prospect:

1. Situation questions: These ask about facts or explore the buyer's present situation. For example, "What system are you using to invoice your customers?"
2. Problem questions: These deal with problems, difficulties, and dissatisfactions the buyer is experiencing. For example, "What parts of the system create errors?"

3. **Implication questions:** These ask about the consequences or effects of a buyer's problems, difficulties, or dissatisfactions. For example, "How does this problem affect your people's productivity?"

4. **Need-payoff questions:** These ask about the value or usefulness of a proposed solution. For example, "How much would you save if our company could help reduce the errors by 80 percent?"

Rackham suggests that companies, especially those selling complex products or services, should have their salesperson move from preliminaries, to investigating the prospect's problems and needs, to demonstrating the supplier's superior capabilities, and then obtaining a long-term commitment. This approach reflects the growing interest of many companies in moving from pursuing an immediate sale to developing a long-term customer relationship.

More companies today are moving their emphasis from transaction marketing to relationship marketing. Today's customers are large and often global. They prefer suppliers who can sell and deliver a coordinated set of products and services to many locations; who can quickly solve problems that arise in different locations; and who can work closely with customer teams to improve products and processes. Unfortunately, most companies are not set up to meet these requirements. Their products are sold by separate sales forces that don't work together easily. The company's technical people may not be willing to spend time to educate a customer.

Companies recognize that sales teamwork will increasingly be the key to winning and maintaining accounts. Yet they recognize that asking people for teamwork doesn't produce it. They need to revise compensation systems to give credit for work on shared accounts. They need to set up better goals and measures for their sales force. They also must emphasize the importance of teamwork in their training programs, while at the same time honoring the importance of individual initiative.

**Acting Crazy:** Put on a good show by visibly demonstrating your emotional commitment to your position. This increases your credibility and may give the opponent a justification to settle on your terms.

**Big Pot:** Leave yourself a lot of room to negotiate. Make high demands at the beginning. After making concessions, you'll still end up with a larger payoff than if you started too low.

**Get a Prestigious Ally:** The ally can be a person or a project that is prestigious. You try to get the opponent to accept less because the person/object he or she will be involved with is prestigious.

**The Well is Dry:** Take a stand and tell the opponent you have no more concessions to make.

**Limited Authority:** You negotiate in good faith with the opponent, and when you're ready to sign the deal, you say, "I have to check with my boss".

**Whipsaw/Action:** You let several competitors know you're negotiating with them at the same time. Schedule competitors' appointments with you for the same time and keep them all waiting to see you.

**Divide and Conquer:** If you're negotiating with the opponent's team, sell one member of the team on your proposals. That person will help you sell the other members of the team.

**Get Lost/Stall for Time:** Leave the negotiation completely for a while. Come back when things are getting better and try to renegotiate then. Time period can be long (say you're going out of town) or short (go to the bathroom to think).

**We Noodle:** Give no emotional or verbal response to the opponent. Don't respond to his or her force or pressure. Sit there like a wet noodle and keep a "pocker face".

**Be patient:** If you can afford to outwait the opponent, you'll probably win big.

**Let's Split the Difference:** The person who first suggests this has the least to lose.

**Trial Balloon:** You release your possible contemplated decision through a so-called reliable source before the decision is actually made. This enables you to test reactions to your decision.

**Surprises:** Keep the opponent off balance by a drastic, dramatic, sudden shift in your tactics. Never be predictable—keep the opponent from anticipating your moves.

Relationship marketing is based on the premise that important accounts need focused and continuous attention. Salespeople working with key customers must do more than call when they think customers might be ready to place orders. They should call or visit at other times, take customers to dinner, and make useful suggestions about their business. They should monitor key accounts, know their problems, and be ready to serve them in a number of ways.

When a relationship management program is properly implemented, the organization will begin to focus as much on managing its customers as on managing its products. At the same time, companies should realize that while there is a strong and warranted move toward relationship marketing, it is not effective in all situations. Ultimately, companies must judge which segments and which specific customers will respond profitably to relationship management. (For some guidelines, see the Marketing Insight "When-and How-to Use Relationship Marketing.")