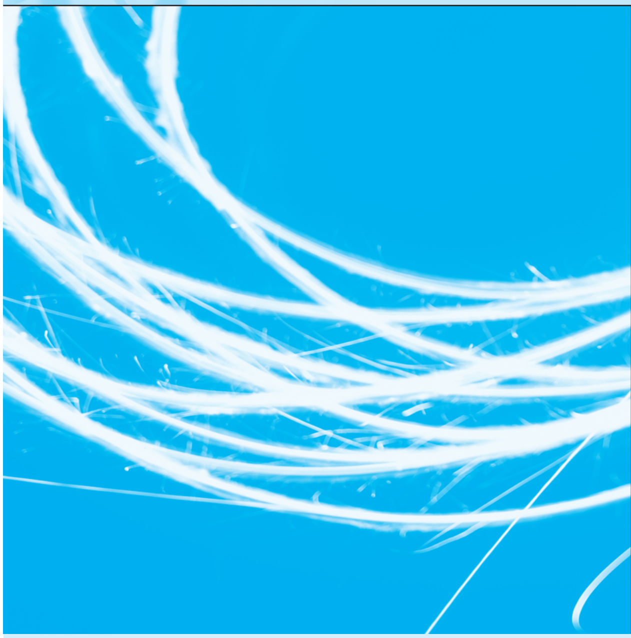
chapter twelve

12 Competing through the new marketing mix



[An executive is] a mixer of ingredients, who sometimes follows a recipe as he goes along, sometimes adapts a recipe to the ingredients immediately available, and sometimes experiments with or invents ingredients no one else has tried.

(Culliton, J., 1948)

When building a marketing program to fit the needs of his firm, the marketing manager has to weigh the behavioural forces and then juggle marketing elements in his mix with a keen eye on the resources with which he has to work.

(Borden, 1964)

Introduction

In the early 1960s one of the leading US marketing writers, Neil Borden (1964), coined the term 'marketing mix' to cover the main activities of firms that were then thought to contribute to the marketability of their products and services. These were classified under the famous '4Ps' of marketing: product, price, promotion and place.

Recent thinking, spurred on through the development of relationship marketing (see Chapter 14), has extended the four Ps to include people, processes and physical evidence. In addition, as the service sector has grown in many developed economies, a new 'dominant logic' is emerging in marketing (see Vargo and Lusch, 2004; Lusch, Vargo and Malter, 2006), in which service provision rather than the exchange of goods has centre stage. This has further encouraged a re-think of the traditional elements of the marketing mix and their relevance to twenty-first century marketing.

Particularly significant has been the increasing use of the Internet for marketing purposes. The advent of the Internet as a major marketing medium has had impacts right across the spectrum of activities of the marketing mix. Initially seen primarily as a communications tool for reaching prospective customers, it is clear that the impact of the Internet has been far more pervasive, affecting the ways in which customers shop, how they gather and use information, and also their expectations of the type and level of service they should receive. Not least, the Internet has resulted in new forms of product. The music retailer i-Tunes, for example, now sells more tracks for download electronically than its largest high-street competitor sells tracks on conventional CDs. New 'bit-based' products, immediately and cheaply downloadable, are affecting many markets.

In this chapter we summarise the main ingredients of the new marketing mix and examine the changes brought about by Internet technology.

12.1 The market offer

Most market offers are combinations of physical, tangible product and intangible service (see Chapter 14). For ease of presentation here we refer to 'product' as the mix of physical, emotional, tangible and intangible elements that go to make up the overall market offer. It is important to always bear in mind that the product is what it does for the customer. Customers do not buy products; they buy what the product can do for them.

12.1.1 Key product/service concepts

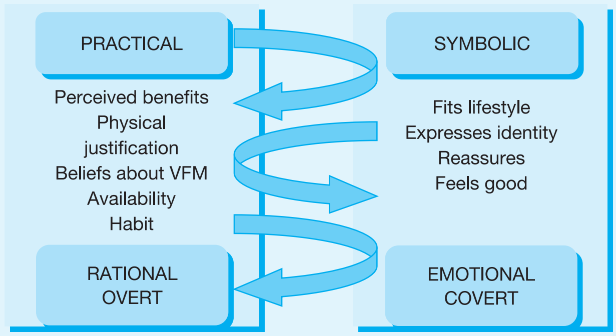
Products are best viewed as solutions to customers' problems or ways of satisfying customer needs. American Marketing guru Philip Kotler (1997) put this neatly when he said that customers do not buy a quarter-inch drill bit – they buy the hole that the drill bit can create. In other words customers buy the benefits a product can bring to them, rather than the product itself.

That has two particularly important implications for marketing. First, it follows that customer perceptions of the product – what they believe about it – can be as, or even more, important to them than objective reality. If customers believe that a product gives them a particular benefit (for example enhanced attractiveness from using a particular cosmetic), that is what is likely to motivate them to purchase. Second, most if not all products are likely to have limited lives; they will only exist as solutions to customer problems until a better solution comes along. There is some evidence that product life cycles are shortening, with new offers coming to market more rapidly than in the past, and existing products becoming obsolete more quickly. That has implications for new product development (Chapter 13).

12.1.2 Product/service choice criteria

The reasons why customers choose one product over another can be simple ('it's cheaper') or far more complex ('it feels right for me'). In seeking to understand

Figure 12.1 Product choice criteria



choice criteria it is useful to distinguish two main sets, the rational and overt; and the emotional and covert (Figure 12.1).

When questioned about their purchase decisions in market research surveys most customers will rationalise their choices. They will articulate objective reasons for their actions that they feel can be logically justified. These might include the practical benefits of the product, belief about value for money, the availability of the product and perhaps habit. These are reasons customers can give without loss of self-esteem, demonstrating that they are in control of the buying situation.

For many products, however, emotional reasons may play as big a, or even a bigger role. The purchase of branded goods, for example, may be prompted by the reassurance that a well-known and respected brand can bring. The physical product may be no better, a 'rational' comparison may show no differences, but customers will pay more to have the reassurance of the brand. Similarly, products may be chosen because they are believed to fit the lifestyle of the customer more closely, or make a statement about the purchaser (why else would someone pay thousands of pounds for a watch, such as a Rolex, when a cheap alternative can be as accurate in delivering the overt, rational benefit of telling the time?).

While conventional quantitative market research may uncover the rational and overt motivations of customers, more in-depth, qualitative and often projective research is needed to uncover emotional and covert motivations. Famously, researchers in the USA trying to understand why more people did not fly between major cities rather than driving found through direct questions that reasons given were rational (cost of flying, greater convenience of driving) but when projective techniques were used (asking respondents why others did not fly more) fears of flying and concerns for safety began to emerge.

Most purchases are a combination of the rational and the emotional. The balance between the two, however, will vary significantly across brands and it is an important task for marketers to understand the balance for their particular market offering.

12.1.3 Product/service differentiation

Central to successful marketing is product differentiation – ensuring that the total market offer is different and distinct from competitor offerings in ways that are of value to the target customer. This was discussed in more detail in Chapter 11.

With the convergence of manufacturing technology, and the widespread application of total quality management (TQM) methods, it is increasingly difficult for firms to differentiate on their core products. Differentiation in most markets now focuses on the augmented product (see Chapter 11), and in particular on ways of tailoring to individual customer requirements. In automobiles, for example, using basic building blocks of sub-frames, engines, body panels and interior options, there is now the opportunity for new car buyers to create near unique cars, matching their requirements or tastes very closely. Indeed, the industry's quest in the 3DayCar Programme is to find ways to customise the vehicle to the buyer's exact preferences and to deliver it three or four days after it is specified and ordered.

12.1.4 Diffusion of innovation

New products (those new to the market) require careful management as they enter the product life cycle. A theory of the diffusion of innovations (of which new products are one type) was proposed by Rogers (1962) (see Chapter 3). He suggested that the rate of diffusion of any innovation depends on a number of factors including:

- the relative advantage of the innovation over previous solutions;
- the compatibility of the innovation with existing values and norms;
- a lack of complexity in using the innovation;
- the divisibility of the innovation facilitating low-risk trial; and
- the communicability of the advantages of the innovation (see Chapter 13 and Figure 13.3).

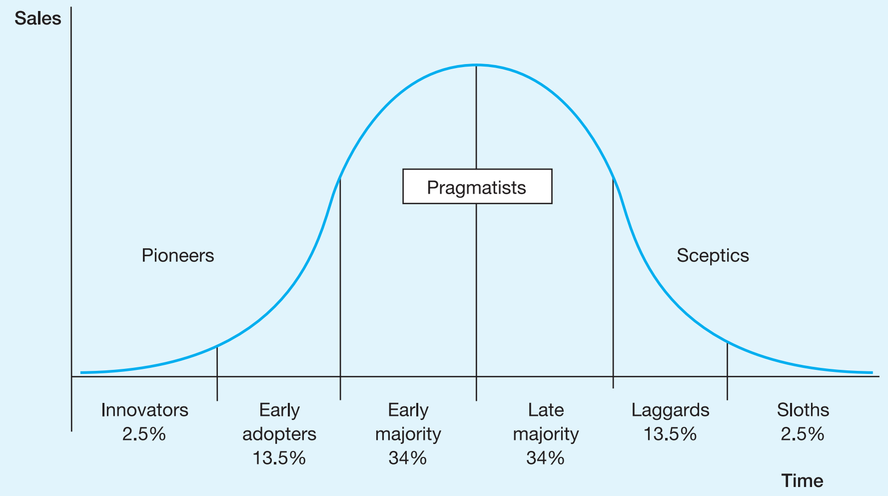
In considering these factors with regard to the adoption of the Internet and e-business techniques, for example, it can be seen that some of those techniques are likely to diffuse more rapidly than others.

Recently, Parasuraman and Colby (2001) have introduced the concept of 'technology readiness' as a measure of customers' predispositions to adopt new technologies – based on their fears, hopes, desires and frustrations about technology. They identify five types of technology customers:

1. **Explorers** – highly optimistic and innovative.
2. **Pioneers** – the innovative but cautious.
3. **Sceptics** – who need to have the benefits of the technology proven to them.
4. **Paranoids** – those who are insecure about the technology.
5. **Laggards** – those who resist the technology.

Rogers identified five adopter groups, namely innovators, early adopters, early majority, late majority and laggards which were further developed by Moore (1991,

Figure 12.2 The diffusion of innovation



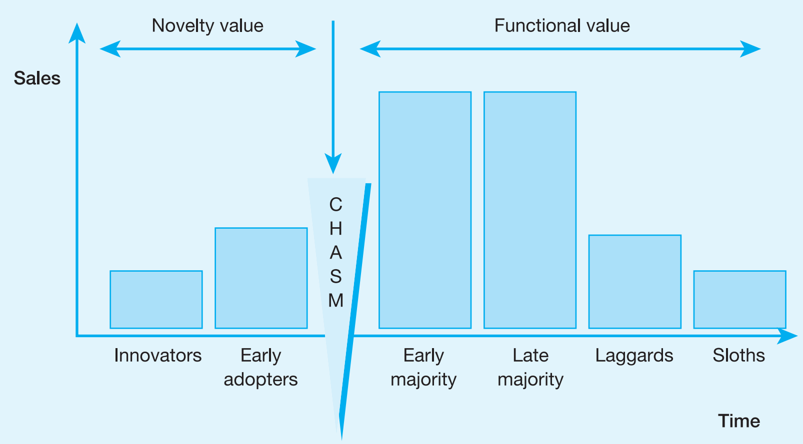
2004, 2006) in his discussion of the adoption of high-technology products and services. We add a sixth and final adopter group, the sloths (see Figure 12.2).

- **Innovators** are the first to adopt a new technology or product. Often they are technology enthusiasts and adopt because the technology is new and they wish to be, and be seen to be, up to date. It is often the novelty value of the technology that drives their adoption. Many innovations fail as they are technology driven rather than meeting the real needs of customers and once the novelty value has worn off, and newer technologies have been substituted by the innovators, the product dies a natural death.
- **Early adopters** are similar to the innovators, but often demonstrate a more visionary reason for adopting the new technology. In business markets, for example, early adopters often see significant advantages from adoption and ways in which the new technology can enable them to change the way a market works, to the benefit both of themselves and of customers. Early adopters of e-business approaches, for example, include Jeff Bezos at Amazon.com who saw in the use of the Internet a whole new way of retailing books and other products that could add value for customers. Vision such as this can lead to spectacular success, as well as spectacular failure.
- **Early majority** adopters are even more pragmatic than the early adopters. Typically they are less likely to see ways of revolutionising their markets, more likely to see incremental possibilities for improvement. They may, for example, take a particular aspect of the supply chain, such as purchasing, and use Internet technologies to improve the efficiency of this activity. Early majority adopters are often efficiency driven while the early adopters had seen opportunities to improve effectiveness.

- **Late majority** adopters have been described as 'conservatives' (Moore 1991) who often enter a market or adopt a technology largely because others in the market have done so and they fear being left behind. More reluctant in their adoption than the early majority, and in greater need of support and direction in use of the new technology, these adopters are often confused about how the technology can be beneficial to them and wait until the technology has been tried and tested before adopting it. But they are sure that they need to embrace it or be overtaken by competitors.
- The **laggards** have been described as 'sceptics' who do not really see the potential for the new technology, will resist its adoption as long as possible, but may eventually be forced into adoption because all around them, including their suppliers, distributors and customers, have adopted.
- Finally, the **sloths** are the very last adopters of new technologies, often going to great lengths to avoid adoption. In some instances they change the way they operate to isolate themselves from the innovations taking place around them, and may even make a virtue of non-adoption. Some accountants still use the quill pen in preference to the spreadsheet! Some firms will never adopt e-business technologies, and may actually carve viable niches for themselves serving similarly minded customers.

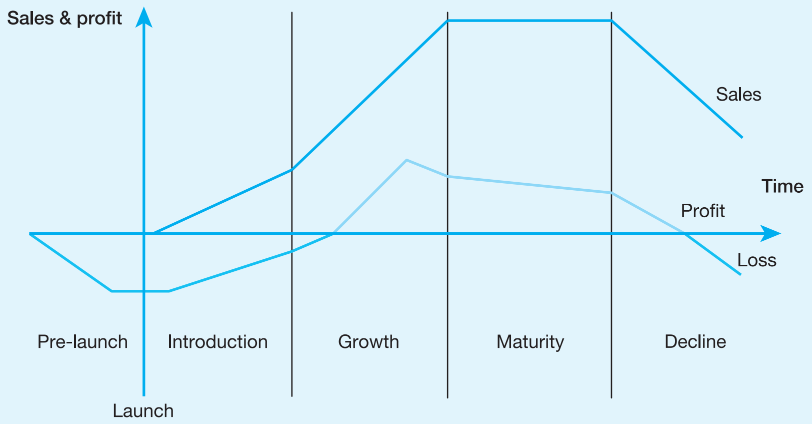
Moore (1991) argued that, in the adoption of new high-technology products, there existed a gulf between the early adopters and the early majority that he referred to as the new product chasm, into which many fall (Figure 12.3). This is essentially the transition from a technology for enthusiasts and visionaries to a technology for the pragmatists. While the enthusiasm of the innovators and early adopters is often sufficient to carry an innovation forward, its ultimate success depends on its ability to convince the pragmatists of the productivity and process enhancements it can deliver.

Figure 12.3 The new product chasm



Source: Based on Moore (1991), p. 17.

Figure 12.4 The product life cycle



12.1.5 Managing the product over its life cycle

The concept of the product life cycle was introduced in Chapter 3 (see Figure 12.4). With changing market conditions over the life cycle it is important that product and service strategies are designed to match. It will also be apparent that different adopter groups (see above) are likely to form key target markets at different stages of the product life cycle.

Pre-launch

In the pre-launch phase, before the product has appeared on the market, the main emphasis of the organisation will be on research and development, as well as gearing up production capacity for launch. High levels of expenditure may be incurred before any returns are seen through sales receipts. Also important at this stage is market research to identify likely early adopters of the product (see Chapter 13) and to develop key sales messages demonstrating the benefits of the new offering relative to the current solutions to customers' problems.

Market research into wholly new products can be notoriously inaccurate. Sony's formal market research into the Walkman concept showed that there was little potential demand for a mobile music player, but the Chairman, Akio Morita, went ahead anyway and created a whole new market now dominated by Apple's iPod. The lesson is that customers may not know what they want, or what they could find useful, before they see it.

Launch

The launch phase of the life cycle is the major opportunity for the organisation to shout loudly about the benefits the new product can offer. This will often take the form of explaining to customers the new benefits over and above those enjoyed from the products they currently use to satisfy their needs.

At this stage, by definition, there is one product in the market and the real task is one of convincing the best prospect customers (the innovators identified through research during pre-launch) of the value of the new offering. The launch period offers significant opportunities for creative communication with prospective customers while the product is novel and newsworthy. Public relations (PR) can be particularly effective at this stage as can the use of exhibitions and conventions.

Expenditures can be very high during launch and returns in the form of sales not yet realised. Significant budgets may need to be assigned to give the launch the best prospects of success. Classic examples include the launch of new movies or new car models where high advertising spend prior to and during launch excites interest and stimulates demand. The launch by Apple of their iPhone in January 2007 was attended by significant media coverage.

Introduction

The introduction phase following launch is crunch time for the new product. Many new products do not get beyond this phase. During the introductory phase sales begin to take off but expenditures on marketing remain high to establish the new product as a superior alternative to previous offerings.

It is at this stage that competitors are likely to take increasing interest in the new product, attempting to gauge whether it will be a success, and hence present opportunities for copy or further improvement, or a costly failure. As the success of the new product becomes more certain, so competitive products will begin to appear as ‘me too’ products or improvements on the market pioneer. In digital portable music the pioneering iPod was soon joined in the market by rival products from iRiver, Sony, Phillips and others.

Growth

The growth phase of the PLC is often considered the most exciting. Most brand and marketing managers prefer to operate in growth markets. At this stage the product is becoming rapidly accepted on the market, sales are growing rapidly and returns begin to outstrip expenditures. Other things also happen during this phase that significantly affect marketing strategies. First, the success and growth are likely to attract more competitors into the market, especially those that have adopted a ‘wait and see’ attitude during launch and introduction. Now that the market is proven, risks are lowered and potential returns beckon.

With further competitor entry comes greater product differentiation among offerings, and typically greater segmentation of the market. The early majority, the new macro-target, are likely to be diverse in their exact wants and needs, offering greater opportunities for micro-targeting. Expenditures continue to be high in researching market opportunities and product improvements, second generation and so on. In the MP3 player market, for example, by Christmas 2006 there were several different versions of the iPod available (from Shuffle to Nano to Video). For Apple a problem began to emerge as the innovators, primarily younger and more fashion-conscious purchasers, saw their parents’ generation buying the bigger, 60GB iPod Videos. In response Apple launched coloured versions of the iPod Nano, with additional add-on features and skins, to retain the younger market.

iPod range in January 2007

Corbis/Ruaridh Stewart/ZUMA

It is at this stage that returns peak and surplus cash can be diverted into developing and launching the new generation of new products (see portfolio theory section).

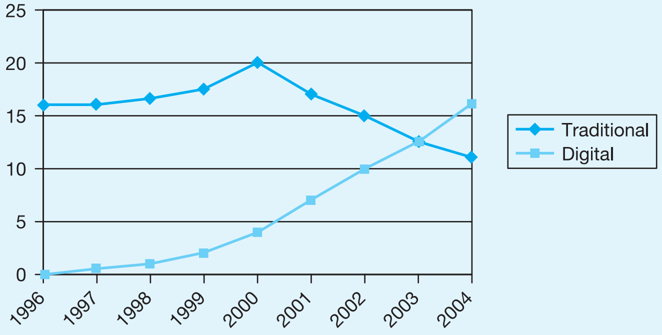
Maturity

The mature phase is reached when growth slows and the bulk of the market (late majority) have entered. This phase can be characterised by particularly fierce competition as those who entered the market during the growth phase fight for market share rather than market expansion to improve performance. Price wars are common, profit margins are squeezed, and expenditures on marketing and research and development scrutinised more critically. Mobile phones are a case in point, where prices have tumbled as excess supply has left manufacturers with unsaleable stocks.

Decline

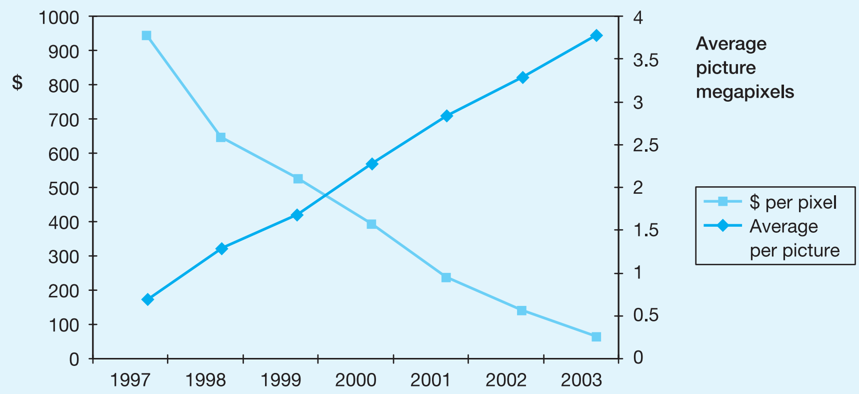
The decline, and eventual death, phase sees profits squeezed even more as the next generation of products takes over the market. Figure 12.5 shows the sales of cameras

Figure 12.5 US amateur camera sales



Source: *New Scientist*, 16 October 2004.

Figure 12.6 US amateur camera market



Source: *New Scientist*, 16 October 2004.

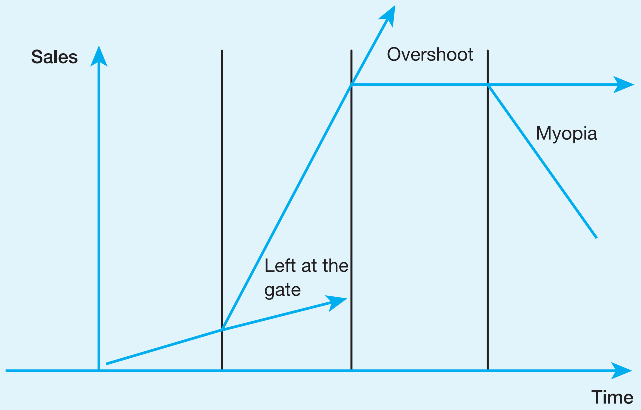
in the USA. The sales of traditional, film-based cameras peaked around 2000 but since then have been in steep decline due to the growth of digital versions. Surprisingly, the market downturn for film-based cameras has been even more dramatic in countries like China. This switch in market has been fuelled by technological advances (Figure 12.6) where the cost of sharper definition in digital pictures (as measured by the number of megapixels) has plummeted, allowing the quality of digital pictures to rapidly challenge that of film.

Turning points

The phases of the product life cycle are notoriously difficult to predict, and especially difficult to identify are transitions between stages (Figure 12.7). First, the transition from introductory phase to growth. Here the danger is being left behind as the market takes off. Second, the transition from growth to maturity. The clear danger here is being left with over-capacity, or high stock levels, of difficult to move products (as happened with the over-supply of mobile phones when the market became mature in the early 2000s). This is another reason why the mature phase is so competitive – firms often have excess capacity and stock available that they need to move. Finally, transition from steady state maturity to decline can leave some firms wedded to old technology and unable to embrace the new.

The product life cycle concept has also been criticised for encouraging tunnel vision in marketers (Moon, 2005). Moon suggests that managers slavishly following the PLC see only an inexorable advance along the curve, and because they all see the cycle in the same way they all adopt similar positions for products and services during each of the life cycle stages. To counter this convergence of strategies Moon suggests three alternative positioning strategies for breaking free of the life cycle: reverse positioning; breakaway positioning; and stealth positioning.

Figure 12.7 The product life cycle



- **Reverse positioning** involves stripping down the augmented product to its core, and then seeking new ways to differentiate. This strategy recognises that in the quest to augment core products firms may have added so many additional features that they become the expected, rather than the exception that differentiates. The example of toothpaste is cited where the core product has been augmented with whitener, fluoride, plaque preventative, breath freshener etc. to the extent that all these now feature in leading brands and no longer serve to differentiate. Ikea have adopted this approach in their successful self-assembly furniture stores. Rather than adopt the strategy of other furniture retailers of carrying enormous product lines, varied inventories, high-pressure sales operations and seemingly permanent 'sales' and 'special offers', Ikea offers stores with play areas for children, Scandinavian restaurants, no high-pressure sales staff, very little in-store support or service, self-collection (rather than delivery weeks or months after order) and self-assembly.
- **Breakaway positioning** is where a product is deliberately moved from one product category to another. The category a product occupies is determined by the way customers perceive that product – the competing products they associate it with, the messages that are employed to promote it, the price charged, the channels through which it is distributed – in short, the entire marketing mix employed. By switching categories products can gain a new lease of life beyond the existing PLC. Swatch, for example, is an example of breakaway positioning. Before its launch in 1983 Swiss watches were sold as jewellery and most customers rarely bought more than one model. Swatch changed that by defining its watches as playful fashion accessories, fun, ephemeral, inexpensive and showy. Impulse buying was encouraged and customers typically bought several watches for different outfits.

- **Stealth positioning** involves shifting to a different product category in a covert way, rather than overtly as practised through breakaway positioning. This may be appropriate where there is prejudice about a product or the company which needs to be overcome. Moon stresses this is not the same as deceit and can backfire if customers believe they are being cheated or exploited. Sony have been highly successful in the games console market with their PlayStation product but its market penetration has been limited to a narrow customer base – primarily males in their late teens and early twenties. The company wished to broaden its platform for home entertainment and communications but found that the PlayStation format did not appeal beyond the narrow customer focus. In response, in July 2003 it launched a PlayStation product in Europe called EyeToy: Play. This included a video camera (EyeToy) and game software (Play) that plugged into the PlayStation 2 console but allowed the user to become part of the game, appearing inside the television where they interact with objects on the screen by moving their bodies, rather than using hand-held controllers. The product sold 2.5 million units in the first seven months, crucially engaging a much wider target market including parents and even grandparents (Moon, 2005).

12.1.6 The impact of the Internet on market offerings

With the advent of marketing over the Internet, two types of market offering became apparent: the so-called 'atom-based' and 'bit-based' products.

Atom-based products are physical offerings that have a separate presence and form for the customer. While they may be promoted over the Internet they need to be physically shipped to the customer, are subject to returns where they are not satisfactory and can be resold by customers. Typical examples include books and videos (Amazon.com), clothes and appliances. For the customer the product at the end of the day is the same as that purchased through a bricks-and-mortar retailer, but the experience may be enhanced through the additional services, convenience and low price available through Internet purchase. For the retailer the logistics of delivery represent significant challenges.

Bit-based products, on the other hand, do not have a physical presence. They can be represented as digital data in electronic form. They are typically non-returnable but do not require separate shipping and can be transferred online. Bit-based products include music, news, information services, movies and TV programmes. These products are ideally suited to marketing over the Internet as the complete supply chain, from procurement, through sales and marketing, to delivery can be conducted online. This synergy provided the logic for the global merger in 2000 of AOL (a leading Internet Service Provider) with Time Warner (an entertainment and news conglomerate) as a foundation for online provision of enhanced information and entertainment products (though integration of the two business cultures proved more problematic).

For both atom- and bit-based products sold over the Internet, the power of the customer is significantly greater than in purchases from bricks-and-mortar suppliers. Put simply, the information available to the customer is far greater, enabling wider search of competitor offerings, online recommendations, and greater price comparisons. The online customer can decide at the click of a mouse to buy or bypass a firm's offerings, whereas in a face-to-face situation a vendor may rely more on personal selling and persuasion. For offerings to be consistently chosen over competing offerings they need to offer greater value to customers, through lower prices, greater convenience, additional valued features, speed, or whatever. Hence the driver of web-based marketing is increasingly to look to the augmented product for differentiation (see Chapter 14).

The Internet has also facilitated integrated marketing of bit-based and atom-based products. In December 2001 New Line Cinema launched their epic movie *The Lord of the Rings: The Fellowship of the Ring* (LOTR) based on the bestseller books by J.R.R. Tolkien. More than 100 million copies of the books have been sold in 45 languages prior to the movie launch. To heighten interest in the movie New Line created a website in May 1999 (www.lordoftherings.com). A trailer for the movie became available on the website in April 2000 and was downloaded more than 1.7 million times. The site was updated three to four times per week as part of a four-year editorial schedule spanning the life of the three films in the trilogy (the second was released in December 2002, the third in December 2003). The aim was to create an online community as a hub for the 400 fan sites devoted to LOTR.

Merchandising associated with the movie is extensive with toys and 'collectibles' based on the film sculpted by WETA, the New Zealand-based firm that created the creatures and special effects of the film. There have also been marketing partnerships with restaurants (Burger King), consumer products manufacturers (JVC, General Mills), book sellers (Barnes and Noble, Amazon – sales of the books are up 500 per cent since the launch of the film) and even the New Zealand Post Office (in December 2001 a set of New Zealand stamps was issued with images from LOTR on them – see http://www.newzeal.com/Stamps/NZ/LOTR/Rings.htm). In addition, AOL Time Warner launched a new version of AOL (version 7) with an LOTR sweepstake which generated 800,000 entries in its first two weeks.

Customer service and support

Potentially the Internet offers many opportunities for customising and tailoring the service offered to the needs and requirements of individual customers. Jeff Bezos, CEO and founder of Amazon.com, is reported as saying that if Amazon has 4.5 million customers it should have 4.5 million stores, each one customised for the person who visits (Janal, 2000). When customers make initial purchases from Amazon they are invited to give information, such as billing details and address shipping address, which will be stored and used for future transactions. On logging into Amazon the customer is greeted by a 'personalised' greeting, recommendations for books based on previous purchases, and one-click ordering for new books. The system is automated for efficiency, but, from the perspective of the customer, tailored to their individual needs and requirements.

The interactivity of the Internet makes it possible to establish two-way relationships with customers so that feedback on product performance or operational problems can be received, as well as advice for solving problems provided. Firms offering bit-based products, such as software, often use the Internet as a way of providing product upgrades and patches. Norton Antivirus, for example, post on their web pages new files to update their virus-checking software each month. These are downloadable files that subscribers can access to update their Norton software.

Some firms offer added value services by encouraging chat rooms and online communities through their sites. Reebok, for example, established an online community where potential customers could 'chat' with famous sports personalities. They regularly post articles and news items of interest to their target customers. All these activities are designed to help build the brand and establish its credentials with the target market (Janal, 2000).

Deise *et al.* (2000) identify five types of website that allow or encourage customers to interact with the company. Content sites provide customers with basic information about the company, its products and its services. FAQ sites answer frequently asked questions and can help customers with common queries. Knowledge-based sites have knowledge bases, or databases, that can be searched by customers. These require a greater degree of involvement from the customer but may be more convenient than making a service call. Trouble ticket sites allow customers to post queries or problems and then receive personalised feedback or problem solving. Interactive sites facilitate interaction between the firm and its customers. Often these are part of an extranet where customers are given access to proprietary information.

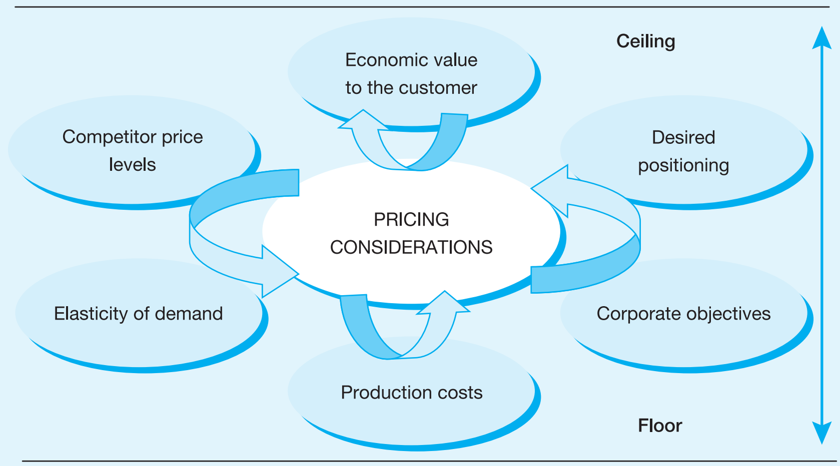
Again, however, it should be noted that the power lies with the customer. Online, as in the physical world, customers are only likely to be attracted by services that provide value for them. The key to successful service online will remain identifying what gives customers value, and what can be uniquely offered through the Internet. Because of the ease of competitor copying, however, service benefits need to be constantly upgraded.

A related issue which may complicate matters is broader concerns for issues like customer privacy, which may hold some back from Internet relationships with companies, as well as the enormous potential for dissatisfied customers to quickly spread news of their dissatisfaction through the Internet, e.g. the companyXsucks.com website may be just a start.

12.2 Pricing strategies

Setting prices can be one of the most difficult decisions in marketing. Price too high and customers may not buy, price too low and the organisation may not achieve the profit levels necessary to continue trading. In the 1960s British Leyland had major product success with the Mini, a small car aimed at a growing market of increasingly affluent consumers. Part of the market success was down to relatively low prices being charged. Unfortunately, however, the margins achieved were very thin and the company did not generate enough profits from the Mini to put back into R&D to develop the next generation of cars, and cars for other market segments. The company was financially crippled in 1975 by falling sales (brought about by strong competition from Japan and elsewhere), the first OPEC oil crisis, and high levels of UK inflation.

Figure 12.8 Pricing considerations



12.2.1 Pricing considerations

A number of factors need to be taken into account when setting price levels (Figure 12.8).

- **Production costs**. The simplest, and most often used, pricing method is to set price at cost plus a percentage mark-up (e.g. cost plus 20 per cent). Provided the product sells in sufficient quantities at this price, this strategy ensures a given level of profitability. It also ensures that products are not sold at below cost – a strategy that is not sustainable in the long term without subsidy. In practice costs should be seen as a floor below which prices should not be allowed to fall.
- **Economic value to the customer**. The value of the product to the customer over its lifetime gives a ceiling above which prices would be unacceptable to customers. Doyle and Stern (2006) explain how EVC can be calculated with an example from B2B marketing (see below).
- **Competitor price levels**. Also important to consider are the prices set by competitors. Where two or more product offerings are similar on other characteristics, price can become the final determinant of choice. Firms may decide to price higher than competitors (as a signal of superior quality), at similar prices (and compete on other features), or lower prices (and compete primarily on price). In the UK market for petrol (gas) there is very little price differentiation between competitors. This is in part due to the high level of taxation (VAT and duty) on petrol, at 72 per cent in 2000, leaving little margin for price differences.
- **Desired competitive positioning**. The price charged can be a powerful signal to the market of the quality and reliability of the product. Too low a price may

suggest poor quality rather than good value for money. In the hi-fi market Bose have deliberately priced their offerings significantly higher than competitors as a signal of superior product quality. Other brands, such as LG, price below competition to attract the more price-sensitive consumer. In between these extremes brands such as Sony, JVC and Samsung compete at similar prices but offering different features, styles and other customer benefits.

- **Corporate objectives.** Are the objectives to grow the market rapidly (which might argue for a relatively low price), to harvest (which might argue for prices at the high end), or to maximise profit (which would indicate marginal cost pricing)?
- **Price elasticity of demand.** A further consideration in setting prices is the extent to which demand will vary at different price levels. Some products, such as luxury goods, are highly price elastic – changes in price affect quantity demanded to a great extent. Others, such as essentials, are relatively price inelastic, with price having little effect on demand.

12.2.2 Price elasticity of demand

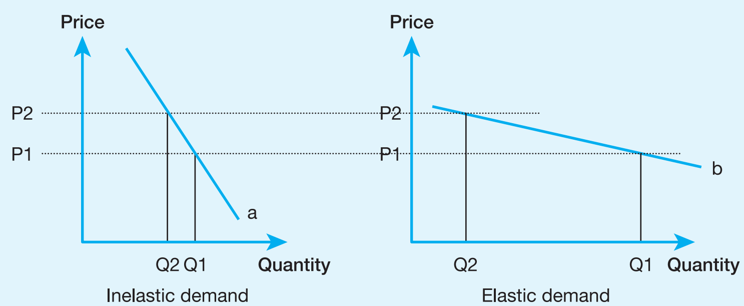
The price elasticity of demand is the effect of changes in price on demand for the product. Most demand curves slope downwards from top left to bottom right (see Figure 12.9). In other words, the lower the price, the more of a product is purchased, and conversely, as prices rise, less is demanded. Price elasticity is defined as:

Price elasticity = (% change in demand) ÷ (% change in price)

Where price elasticity >1 we term this 'elastic demand' (a change in price generates a greater change in quantity demanded); where price elasticity <1 we term this 'inelastic demand' (a change in price generates a smaller change in quantity demanded).

The extent to which quantity demanded is affected by differences in price varies from market to market. Where there is a steep slope to the demand curve (a in Figure 12.9) a change in price has relatively little effect on quantity demanded; demand

Figure 12.9 Price elasticity of demand



$$\text{Price elasticity} = \frac{\%\text{ change in demand}}{\%\text{ change in price}}$$

is 'inelastic'. A price rise from P1 to P2 results in a reduction in quantity demanded from Q1 to Q2. By multiplying price by quantity we can see that revenue changes from P1 × Q1 to P2 × Q2. The loss of quantity demanded is offset by the higher prices and revenues will increase. Markets which enjoy inelastic demand are often monopoly or near monopoly supply where customers have little or no choice about how much of a product they use and where switching costs are high.

A shallow demand curve (b in Figure 12.9) occurs where a relatively small change in price stimulates a more significant change in demand; demand is 'elastic'. An increase of price from P1 to P2 results in a much more significant reduction of demand from Q1 to Q2. Similarly, price reductions are likely to have a more significant effect on stimulating demand. Markets where demand is more price elastic are generally characterised by greater levels of competition, more customer choice and the easy ability of customers to switch from one supplier to another.

12.2.3 Assessing value to the customer

Economic value to the customer (Forbis and Mehta, 1981) and customer value propositions (Anderson *et al.,* 2006) are central concepts in pricing of industrial products such as plant and equipment. This approach entails attempting to identify the lifetime value to the customer of the purchase, taking into account all costs (e.g. purchase price, running costs, maintenance etc.) and all benefits.

Doyle and Stern (2006) show the example of a market-leading machine tool selling at €30,000. In addition to the purchase price the customer will incur €20,000 start-up costs (including installation, training of operatives etc.), and post-purchase running costs over the life of the machine of €50,000. In total, the lifetime cost is €100,000. Of this the initial purchase price is less than one-third. A new competitor coming into the market might be tempted to charge less for the product, but the effect of that lower price over the life will be considerably less. A 20 per cent reduction in initial price, for example, of €6,000 is in effect only a 6 per cent reduction in lifetime costs.

A more productive approach might be to estimate the total output value to the customer over the life of the machine. This could be done by estimating the number of outputs from the machine tool over its life together with an assessment of likely defects. If the new machine is an improvement on the existing one, with say 20 per cent greater efficiency, it can be expected to save 20 per cent of total costs or produce 20 per cent more output (both equivalent to €20,000 added value for the customer). Hence there is scope to actually increase the initial purchase price to, say, €40,000 while still offering an overall saving of €10,000 to the customer. In this case a higher price might also be needed to signal a higher quality product that can deliver the 20 per cent savings claimed. A lower price might raise doubts on ability to deliver the savings.

In markets where lifetime value may be less easy to demonstrate (e.g. consumer markets for appliances) the perceived value of the product can be used as an alternative to EVC. Using techniques such as Vickrey auctions value to the customer can be estimated. In normal auctions the item will go to the highest bidder. There can be times, however, where bidders will bid below the perceived value of the item in an attempt to get a bargain (this happens regularly on eBay!). Vickrey auctions are a technique to get to the true value the bidder places on the item. They are sealed bids to purchase where bidders submit written bids without knowledge of who else is bidding for the same item. While the highest bidder wins, they pay the price bid by the second highest, not the price they bid. This creates a powerful incentive for bidders to bid the real value they place on an item rather than gamble on getting it for a bargain, lower price (see www.wikipedia.org).

Trade-off analysis (also called conjoint analysis) can also be used to estimate the 'utility' of different price levels, and how customers will trade-off between alternative configurations of benefits (features) at different prices (see Green, Carroll and Goldberg, 1981).

12.2.4 Pricing methods

A number of alternative pricing methods are used by organisations, sometimes in combination.

- **Cost plus pricing.** This the simplest approach to setting prices and employs little understanding of customers and their needs. Prices are set at cost plus a percentage mark-up. Prices therefore reflect directly the costs of creating and delivering the product. The disadvantage of this method, of course, is that it takes no account of the value of the product to the customer. If the value to the customer is greater than cost plus mark-up, the product will be attractive, but if the value to the customer is lower, sales are likely to suffer.
- **Going rate pricing.** In some markets, such as petrol and diesel, prices are typically set on a 'going rate' basis – at what others set – and there is little price competition between suppliers. Competition takes place on other factors such as availability, location, convenience.
- **Perceived value pricing.** Pricing products at their perceived value to customers requires sophisticated research methods to identify value. When customers are asked direct questions about value (e.g. 'how much would you pay for . . .') few would vote for high prices! Projective techniques and other approaches such as trade-off, or conjoint, analysis (see above) can be more useful. Under these approaches customers are put into simulated purchasing situations and their behaviour is observed to gauge the value they perceive in the market offer.
- **Sealed bids.** In many industrial purchasing situations, especially in capital projects, a number of potential suppliers may be invited to bid to supply. Normally at least two stages will be employed. First, a specification stage where suppliers need to demonstrate their ability to supply to specification and on time. This stage will reduce the number of potential suppliers to a manageable number. Second, a sealed bid which indicates the price each selected supplier would charge. Deciding how to bid under competitive situations can be highly sophisticated. Typically firms will take into account not only their own costs but also their predictions of the prices competitors will bid at (based on their costs and expectations of competitors). Game theory may be useful in this context. Game theory refers to a set of techniques and approaches that studies situations where players choose different actions in an attempt to maximise their returns. It provides a formal modelling approach to situations in which decisions are not made in isolation, and where

the decisions of one party can be influenced by the decisions of others. Hence the need to model and predict the intentions of others (see www.Wikipedia.org). The growing use of Internet auctions that ask suppliers to bid prices online to a purchaser's product specification is the newest approach to this situation.

12.2.5 Promotional pricing

- **Loss leaders.** Used extensively by retailers and other suppliers as a means of attracting customers into their stores, or on to their websites, loss leaders are products sold below cost for promotional purposes. Once customers have been attracted in by the loss leader the retailer will attempt to sell other market offerings at a profit. Manufacturers also use this tactic where the lifetime cost of a product is considerably greater than the initial purchase price. Home photograph printers, for example, are sold at very low prices with little margin because the manufactures and retailers can make their profits through selling ink cartridges, photo quality paper and other consumables.
- **Special events.** Seasonal sales, special price promotions and 'once-in-a-lifetime' deals are ways in which price is used to gain customers. Sales originated as a means of moving old stock to make way for new season offerings. Some organisations now appear to have near permanent sales, suggesting that really they are offering products at prices lower than the 'ticket price' but, because they do not want the product to appear low quality, justify this through discount.
- **Cash rebates.** Money back offers and coupons are popular among marketers of fast moving consumer goods. Coupons can be most cost effective as not all are cashed in, and only when another purchase is made. Money back can be more expensive as claims are more likely to be made.
- **Low interest finance.** For the purchase of significant goods such as furniture and automobiles, some suppliers will offer low, or 'zero' interest on hire purchase deals. In effect this gives a discount on price when net present values are calculated and can be powerful inducements to customers to move to higher price points.
- **Psychological pricing.** Pricing just beneath psychological barriers (e.g. €2.99 rather than €3 or at €9,995 rather than €10,000) is common practice. The assumption (rarely tested) is that customers have a psychological price threshold and will group prices in broad bands for comparison purposes. A car priced at €19,995 is seen in a lower price band than one priced at €20,000.

12.2.6 The effects of the Internet on pricing decisions

The Internet makes it far easier for customers to compare prices than in the past. Not only can prices be compared between manufacturers (for example, the price of a BMW compared with the price of an equivalent model Mercedes) but also the prices of alternative suppliers of the same product or model. And the latter is no longer confined to the immediate geographic vicinity – comparisons can be made nationwide and even globally. The advent of a single currency in some parts of the EU has made price comparisons across the Euro Zone even easier.

Kerrigan *et al*. (2001) report that in B2B markets customers experience price savings of around 10 per cent for commodity products and up to 25 per cent for custom purchases. These result from the increased choice customers enjoy, coupled with increased price competition between suppliers. P&G, for example, is reducing its supply costs by conducting 'reverse auctions' with suppliers and estimates annual savings in the order of 20 per cent on supplies of around $700 million.

In addition, the advent of C2C communications or chat lines between customers help to spread information about competitive prices, as well as product and service recommendations or warnings. Through C2B communications reverse auctions are now taking place where buyers post what they are looking for and invite suppliers to bid to supply them.

Overall, it is likely that the Internet will make customers more, rather than less, price sensitive in future as they will have access to greater amounts of information, easily searched, and not controlled by the sellers.

12.3 Communications strategies

For many people advertising is synonymous with marketing. In practice, advertising is one (albeit an important one) of the ways in which firms communicate with their customers and prospective customers. The range of communications tools available is increasing as new technologies present new opportunities. At the time of writing podcasting is becoming a new and popular communications tool. Very soon that will become a standard tool in the communications tool box, and other approaches will be developed.

12.3.1 The communications process

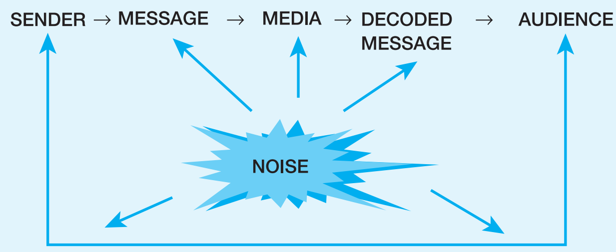
Communications are about two-way exchanges between sender and recipient (see Figure 12.10).

All marketing communications take place under 'noisy' conditions. Other communicators, both direct competitors and others with different market offerings to communicate, are also bombarding the same audience with messages. It has been estimated, for example, that US consumers are subjected to some 3,000 advertising messages each day (*The Economist*, 26 June 2004). It is therefore important to ensure that the message is clear as well as effectively communicated. A starting point is to be clear about what the communications objectives are. These are best viewed using a simple model of marketing communications.

12.3.2 A basic communications model

A number of models of how communications work have been developed. Most, however, come back to a basic model termed AIDA – Awareness→Interest→Desire→Action.

Figure 12.10 The communications process



Source: Developed from Doyle and Stern, 2006.

- **Awareness.** At a very basic level marketing communications set out to create or raise awareness of the market offering among the selected target market. If customers are not aware of the existence of the offer they are very unlikely to purchase! Awareness raising is particularly important at the launch and introductory stages of the product life cycle. In the early stages of the MP3 player market, for example, the communications task was to explain to the market what an MP3 player was and what it did.
- **Interest.** Once awareness has been created the communication goal changes to creating interest in the market offer. Customers are bombarded by many messages every hour of every day and may have an awareness of many products and services. Relatively few will interest them, however. Key to creating interest is demonstrating how the offer is relevant to the wants and needs of the customer. In the case of the MP3 player, the advantages of music on the move beyond the personal cassette player (Walkman) and personal CD player were stressed (e.g. does not skip tracks or mangle the tape, is smaller and more convenient, batteries last longer, there is no need to carry libraries of cassettes or discs as they are already loaded etc.).
- **Desire.** Once interest has been stimulated, communications seek to create desire for the offer ahead of other offers in the market. Rather than demonstrating the benefits of the generic product group the emphasis is now on creating a desire for this particular brand or offering. Much of Apple's promotion of the iPod MP3 player centres on creating a cool image for iPod as the only MP3 player to own. So successful has this been that iPod has now moved from its original target market of 15 to 30-year-olds to a more mature market. This is in danger of weakening its position among the original market (see above).
- **Action.** Awareness, interest and desire are of little value to a supplier unless they result in purchases or other forms of support. Communications aimed at taking the customer to the next stage, creating action, include offers, promotions and deals to stimulate purchase, as well as the use of personal selling.

12.3.3 Communications decisions

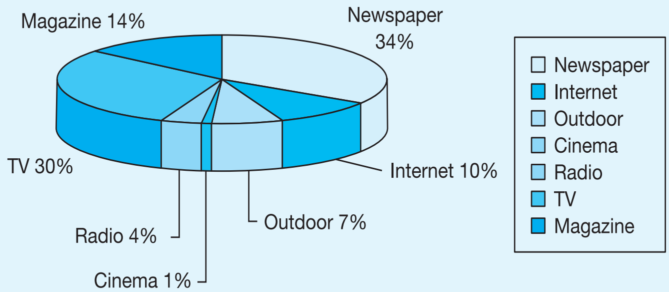
A number of decisions need to be made regarding communications.

- **What message to convey.** First and foremost the message to be conveyed needs to be clearly understood and accepted by those responsible for sending it. Confused messages create confusing signals in the minds of customers. The most effective communications have a single but clear message they are trying to get across. This has been referred to as the USP (unique selling proposition) of the market offer. Communications centring on conveying the key benefits of the product in a novel and attractive way (see copy below) help not only to raise awareness but also to create a powerful position for the product in the mind of the customer.
- **What communications tools to use.** There are many different communications tools available. These include advertising, public relations, sales promotions, personal selling (see Chapter 15), direct marketing and sponsorship. Each has advantages and disadvantages (discussed below). Some are better at creating awareness (e.g. advertising) while others focus more on creating desired actions (personal selling). The various tools are used in combination at different stages in the communications process.
- **How to translate the message in copy.** Not only is it important for the communicator to known what message they are trying to convey, they must also translate it into effective words and symbols that the recipient of the message can understand and decode. Too subtle, or complicated, translations can result in a confused message being received, or even the wrong message being received. Early anti-drug use advertisements in the UK were criticised for actually making drug taking look glamorous, rather than getting across the message that drugs can seriously damage your health.
- **Which media to use.** The media available for marketing communications vary across different countries, as do their effectiveness. Relevant media include press, television, cinema, posters, Internet, radio, post box (e-mail inbox as well as the physical letterbox still used for direct mail), point of sale, fax machines, WAP phones.
- **How much to spend on communications.** Setting communications budgets is notoriously difficult. Years ago a marketing executive said, 'half my advertising budget is wasted – the trouble is, I don't know which half!' Advertising effectiveness modelling by leading firms such as Millward Brown can assess the levels of awareness created through promotional campaigns (see Maunder, Harris, Bamford, Cook and Cox (2005)) by surveying the target audience regularly and modelling the relationship with advertising activity.

12.3.4 Communications tools

- **Advertising.** Advertising is particularly effective at creating awareness. It can have high visual impact, wide reach and is easily repeated to reinforce messages. Its disadvantages are that it is impersonal, lacks flexibility, is generally not interactive

Figure 12.11 UK advertising expenditure by media

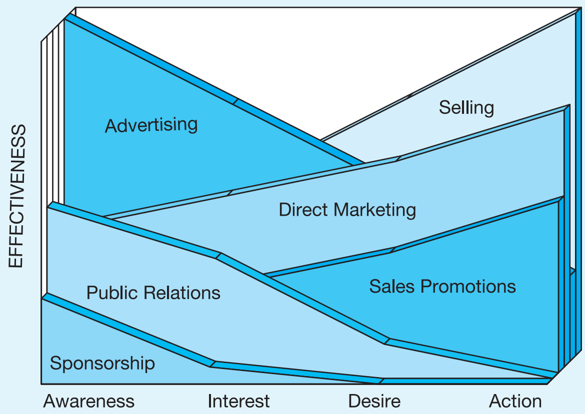


Source: OFCOM, World Advertising Trends 2006.

with the customer (questions cannot be answered, objections cannot be overcome) and has a limited ability to close the sale on its own. Figure 12.11 shows the proportion of advertising expenditure in each of the main media in the UK in 2006.

- **Public relations.** PR can be more credible than advertising at is uses a third party, the reporter and the medium used, to convey the message – the final message to the customer does not come directly from the marketer. As such it can have a higher impact than advertising for a fraction of the cost, and may also reach audiences that would be difficult or impossible to reach otherwise. The major disadvantage, however, is the loss of control. Once a press release has been issued there is no guarantee that it will be taken up and acted on by the media, and it is quite possible that the message will be distorted so that it does not get across as intended. It may also reach the wrong audience.
- **Sales promotions.** Sales promotions include money off, bonus packs, three for the price of two, free samples, coupons, loyalty cards, prizes, bulk discounts, competitions, allowances and any other creative 'deal' that firms can dream up. Their advantages are that they can have a very direct effect on behaviour and those effects can generally be directly monitored and evaluated. The disadvantages are that their effects may be short-lived and hence they could be a costly way of achieving sales. Excessive use of promotions may also weaken the image of a brand ('it can't be very good if they are always giving it away!').
- **Personal selling.** One of the most effective tools for closing a sale is personal selling (see Chapter 14). It is flexible, can be adjusted to individual situations, can be used to build relationships with customers, and can be used to understand, address and overcome barriers and objections to purchase. It can, however, be costly, is highly dependent on the skills of individual salespeople, and in some markets may incur customer resistance.
- **Direct marketing.** At its best direct marketing can offer a highly personalised service, tightly targeted to those customers who are prime targets for the offers made. Thus there is less wastage of the promotional budget. At its worst, however, direct mail can be indiscriminate, can generate high levels of scepticism among customers and result in message and material overload. As with all communications

Figure 12.12 Communications effectiveness



tools, effective targeting is the key to ensure the messages are effectively directed to the target market.

- **Sponsorship.** Sponsorship of sporting, social, cultural and other events, or of teams, causes or facilities, can be an effective way of targeting potential customer groups through their wider interests and concerns. This can help with credibility building and reputation enhancement. It is perhaps the most difficult communications tool to measure the impact of, however. It can be expensive, and may not be particularly effective in achieving awareness goals. Sponsorship of the Sydney Olympics achieved very low levels of recall among target audiences. It can also be subject to 'ambush' – competitor products achieving placement in sponsored events.

Communications tools effectiveness

Figure 12.12 shows the effectiveness of each of the above across the four stages of the communications model. In general, advertising, PR and sponsorship are better at raising levels of awareness and interest than creating desire or action. Personal selling, direct marketing and sales promotions are more effective at inducing action. An effective communications campaign will determine first what the objectives are, then select an appropriate mix of tools to achieve that objective.

12.3.5 The use of the Internet for marketing communications

In 2001 it was estimated that advertising over the Internet totalled \$9.6 billion. By 2006 that had risen to \$27 billion. In 2006 that represented approximately 5 per cent of worldwide advertising expenditure, but is expected to rise to around 20 per cent over the next few years (*The Economist*, 25 November 2006). By 2010 it is expected to rise to over \$60 billion.

In the UK over £2 billion was spent on Internet advertising in 2006 (up 41 per cent on 2005), accounting for 11.4 per cent of all advertising spend. For the first time Internet advertising overtook newspaper advertising (10.9 per cent of all spend). Of that the biggest sectors were recruitment ads (25 per cent), finance and banking (14 per cent), technology (13 per cent) and motors (13 per cent) (*The Observer*, 1 April 2007, quoting PriceWaterhouseCoopers).

As noted above, a significant feature of the Internet is the shift in power away from manufacturers and retailers towards customers. While the period to the middle of the twentieth century saw power concentrated in the hands of manufacturers and suppliers (due to demand typically outstripping supply in many industries), a major feature of the last quarter of that century was the shift in power to retailers. It was the retailers who controlled the connection between manufacturers and customers, and crucially managed the information flows to customers. Customers who wanted to gather information about competing products could do so, but the process was often time consuming and cumbersome, resulting in choices being made with limited, imperfect information. A major characteristic of the Internet-based marketplace of the twenty-first century is the 'information superhighway' that makes comparative information far more easily available to customers. Indeed, the customer now typically initiates information search, whereas in the past the manufacturer or the retailer initiated and controlled this.

For example, powerful retailers like Tesco and Wal-Mart participate in global online exchanges based on the web. They can source products from the cheapest suppliers anywhere in the world. They can also pressure their suppliers to switch sources for raw materials and components to cheaper alternatives located on the exchange (though not obliged to adopt such suggestions, suppliers find that their prices are adjusted down as though they had). This represents a significant change in the marketing communications process, and shift in power from seller to buyer. Information search is more likely to be triggered by customers than by marketers, despite the large sums being spent on online advertising.

Customers are becoming information seekers rather than passive recipients as evidenced by the extensive use of search engines such as Google and Yahoo. Coupled with this are changes in media viewing habits brought about by the explosion in channel availability through cable and satellite and media merging as the boundaries between phones, television and Internet technologies become blurred.

One of the potential benefits of communicating over the Internet is the possibility to more accurately relate sales to promotions. These are reflected in a number of new marketing communication methods emerging to take advantage of the particular characteristics of the Internet. Among these are banner advertising and viral marketing.

Banner advertising and pay-per-click

Banner advertising is the use of advertisements on web pages that have click-through options to take browsers through to company websites. They are currently the main form of advertising on the Internet. Advertisers bid on key words they believe potential customers will use in their searches (using Google, Yahoo or other Internet search engines). The search engines then display advertisements next to the results of the Internet search. While irritating to some customers they have proven very successful when linked to the page content being viewed. For example, search engines such as Yahoo and Lycos will flash links to commercial sites offering goods and services related to the items that are the subject of searches. Much of the early success of Amazon was attributed to the banner advertising it enjoyed on the AOL website which directed purchasers to books on the topics of interest. The effectiveness of banner advertisements in general, however, is questionable, with Timmers (1999) reporting that click-throughs (visitors clicking on banner ads to link through to the corresponding website) can be as low as 0.5 per cent (one in two hundred). As users of the Internet become more sophisticated and experienced it is likely that the click-through rate will fall rather than increase. To be effective a banner advertisement must make an immediate impact on an often crowded computer screen, as well as conveying in a few words reasons to click through.

Most rapidly growing, and predicted to account for more than half of Internet-based advertising by 2010, is pay-per-click advertising. The advertiser only pays when a customer clicks on their advertisement and is taken to their website. As only interested customers are likely to click through, the quality of the leads generated is very high and can therefore cost between \$0.10 and \$30 (average in 2006 was \$0.50) depending on the keyword (*The Economist*, 25 November 2006).

Viral marketing

Viral marketing involves creating a marketing message with the intention that people will forward it to friends. This has a significant advantage over 'spam' messaging in that the friend will have some level of credibility which may cause the messageto be viewed more sympathetically. While not unique to the web, Internet-based technologies have greatly facilitated easy use of this type of marketing.

The paint marketer Dulux, for example, wanted to sell more paint to British women. Rather than indiscriminately bombarding women with e-mail messages to 'buy more paint' the company created a website featuring a 'belly fluff' game and e-mailed 10,000 women invitations to play. In the event, 13,000 did play. The company estimates that one-third of the people entering the competition received the e-mail forwarded from a friend (*The Guardian*, February 2002).

Forrester Research (www.forrester.com) estimates that a high-quality e-mail distribution list should generate a response rate (purchase) of around 6 per cent. A list created through panning will generate 1 per cent. Viral marketing, on the other hand, has achieved response rates of between 25 and 50 per cent (Forrester Research, quoted in the *The Guardian*, February 2002).

Nestlé uses viral marketing for its Nescafé products including Blend 37. In one campaign 20,000 Nescafé drinkers were e-mailed invitations to click onto www.b37.challenge.com to enter a prize draw for tickets to the Silver Historic Festival in August 2001. The top 36 scores won VIP passes to an event at the Silverstone racing circuit (*Precision Marketing*, 29 June 2001).

Pre-launch promotion

The Internet can be an ideal vehicle for 'teaser' ads prior to new product launches (see for example *The Lord of the Rings* movie above). Before launching its new Crest

Whitener into the US market P&G set up a pre-retail launch website which attracted 1.2 million visitors and actually sold 140,000 units (worth over $6 million retail). The company estimated that the initiative created around 500,000 buyers before the launch advertising and retail distribution began (*Marketing Business*, July/August 2001).

Advertising audience measurement

In order to standardise the ways in which measurements of advertising reach and effectiveness are made the UK advertising industry has established a Joint Industry Committee for Web Standards (JICWEB). The committee has now agreed definitions of 'users', 'page impressions', 'visits' and 'sessions'. JICWEB is addressing circulation issues, but there has been little attention to date to audience profiling through panels and surveys, as exists for other media such as television (BARB) and the press (JICNAR). A newly formed industry committee for Internet Advertising Research (JICNET) is putting forward proposals for one survey-based audience measure for the UK advertising industry to use with confidence (*Marketing Business*, July/August 2001).

12.4 Distribution strategies

Distribution strategy focuses on how products and services will be physically delivered to the customer. The distribution network used or created will depend on a number of factors including whether the final customers are consumers or other businesses.

12.4.1 Channels of distribution

The main choice facing most marketers is whether to sell through intermediaries or direct to customers. Intermediaries, such as wholesalers and retailers, can have a number of advantages. The most significant advantage is that they have direct relationships with customers that may be helpful.

In UK consumer grocery markets, for example, retailers such as Tesco, Sainsbury, Asda, Morrisons and Waitrose have loyal customers who regularly shop in their stores. Products sold through the stores gain credibility in the eyes of the customer because of where they are sold. The disadvantage, however, is that the retailer has many competing products on their shelves, and has little incentive to promote one brand over another. Suppliers attempt to counter this through either a 'push' or a 'pull' strategy. A push strategy is one where the retailer is given incentives to stock the product (for example, bulk discounts or additional promotional offers that might encourage additional shoppers into the store). A pull strategy, on the other hand, is where the supplier encourages customers to go into the store demanding the product. In this way the product is 'pulled' through the distribution channel rather than being 'pushed'.

In business markets intermediaries may also be used (usually trade wholesalers) but it is more common to find direct sales through the firm's salesforce. The advantages of direct selling through a salesforce are discussed above. The obvious disadvantage is the cost incurred, though this is generally offset by the higher prices that can be charged. In addition many firms may hire a contract salesforce to help with special activities, such as the launch of a new product, or peak demand periods.

12.4.2 Effects of the Internet on distribution strategies

The Internet has greatly facilitated the distribution of bit-based products such as information, music and video. Indeed, in the recorded music industry, many now suggest that physical products like the CD are on the point of obsolescence because of the attractiveness of downloading music from the web. In 2005 there were more sales of albums as music downloads in the UK from iTunes than through the leading high-street CD retailer. The challenge for the music companies is to find ways of generating income from music downloads in the face of competition from pirate sites providing the music free.

With atom-based products the key to success has often rested with efficient and effective distribution systems and logistics. Every book sold by Amazon online must be delivered to the customer, and customers increasingly accustomed to rapid access via the Internet also expect rapid physical delivery once they have made purchases. The traditional '28-day delivery' period is no longer acceptable to many customers. Failures in distribution destroyed many of the dot.coms – eToys found, for example, that the 'virtual business' is an illusion, when you have to operate warehouses full of toys. The fulfilment strength of Amazon.com is proving a core competence, driving many of its alliances, for example with Toys 'R' Us.

Increasingly, the distribution issue becomes one of multi-channels – numerous ways in which the same products and services reach the customer. For example, one major strength of the Tesco.com Internet grocery offering was that it recognised that Internet grocery purchasing is not a substitute for store visits; it is a supplement. Managing complex multi-channel systems will be a substantial challenge for many companies. The critical tension will be between what companies want from multi-channel strategies and how customers react to them.

For example, PC market leader Dell Computers aims to get the majority of sales onto the web because of the huge economies this achieves. However, the company also has internal and external salesforces to promote new products with corporate customers and to win business from the competition. Their view is that, if you want to buy a few PCs, then you buy on the web or go elsewhere. If you want to buy for a whole company, then you buy through the direct salesforce. If you are another Boeing with a potential installed base of 100,000 PCs, then the founder Michael Dell will come and see you. To make this multi-channel work, Dell has grasped the nettle of paying salespeople commission for sales through the web, and even offering salespeople additional bonuses for moving smaller buyers on to the web.

However logical multi-channel models may be, they can be re-interpreted by customers in other ways. One leading financial services company in the UK designed its channel system with three main options: the Internet, the branch network, and postal/telephone banking. They saw customers as either Internet customers or branch customers. Customers, on the other hand, tended to redefine the model in their own terms: why not go to the branch to open a deposit account and get a passbook, then do all the transactions through the post or on the telephone, and then operate the current account on the Internet? The company's multi-channel strategy was wrong-footed (along with all the cross-selling and promotional plans in each channel), but they are learning to cope with the fact that this is how their customers want to use different channels.

12.5 The extended marketing mix – people, processes and physical evidence

12.5.1 People

While important in any business, the quality, training and enthusiasm of the people employed in the organisation are absolutely critical to service businesses. Happy, skilled and motivated staff are much more likely to serve customers well and effectively, and establish an ongoing relationship that can be mutually beneficial. A number of factors are important in designing the staffing strategy:

- **Job design and description.** The starting point is to have a clear idea of the job roles and tasks that staff will be required to carry out. This will include identifying the level of technical competence required, as well as the softer skills of dealing with people in a manner that will leave them satisfied (or better still, delighted). In service firms, however, jobs rarely conform to exact specifications. There is a need for flexibility to adapt the job as conditions change and as customer requirements also change.
- **Selection.** Choice of which staff to employ is largely driven by the job specification. If a 'bouncer' is being hired for a nightclub, the job specification will include an ability to physically defend himself and others. In hiring an accountant, however, other technical qualifications will be more important.
- **Training.** While staff may be highly skilled on appointment, ongoing training is essential to ensure that skills are maintained and enhanced in the light of changing circumstances. Much training may occur 'on the job' but it can also be important to allow time out for reflection and to sharpen specific skills.
- **Appraisal.** Also important is regular appraisal and feedback to staff on their performance. Provided this is done in a constructive manner most staff welcome feedback on their performance and suggestions as to how it can be improved. Also part of the appraisal process is revisiting the job description and updating it in the light of experience.

Because the people employed have the direct contact with customers it can be problematic when staff leave. In some instances they make take the customers with them if they move to a rival organisation (e.g. account executives being poached from one advertising agency to another). The human resource management strategy needs to ensure the firm is not over-vulnerable to changes in personnel. This may be through rotation of customer contact staff, or through team approaches to serving particularly valuable customers or clients. In some instances 'golden handcuffs' might be appropriate to stop particular staff leaving and taking key clients with them.

12.5.2 Processes

The systems and processes involved in delivering the product or service to customers will not only impact on the ability of staff to effectively serve customers, they will also affect how customers judge the level of service they have received. Staff need to be given the tools to do the job. This may include ICT tools such as customer relationship management (CRM) packages (see http://en.wikipedia.org/wiki/Customer_relationship_management), as well as more basic order processing and delivery techniques.

CRM covers all the methods and technologies used by companies to manage their relationships with customers and clients. Information held on existing customers (and potential customers) is analysed and used to create a stronger and hopefully mutually beneficial relationship. Amazon.com use automated CRM processes to generate automatic personalised marketing (such as book and CD suggestions or recommendations) based on the customer information, including recent purchases, stored in the system. Using this technology advantage, Amazon is becoming a general trading platform for diverse products and services beyond books and CDs.

An effective CRM system helps organisations to acquire customers, build closer relationships with them, provide better customer services and hence retain valued customers. By tracking customer contacts through the CRM the organisation is able to ensure appropriate levels of contact are maintained, and to monitor the effectiveness of specific interactions.

In the public sector, universities are increasingly using CRM packages to track contacts with students through initial enquiry, decision to study, course performance and progress, on to graduation, career progress and alumni status. In this way additional opportunities can be pursued for improving the overall student experience through a complete life cycle, and hopefully maximise the return to the university by way of repeat business, donations and endowments from the student as well!

CRM applications often track customer interests and requirements, as well as their buying habits. This information can be used to target customers more selectively. In addition, the products a customer has purchased can be tracked throughout the product's life cycle, allowing customers to receive information concerning a product or to target customers with information on alternative products once a product begins to be phased out. Baby products companies now have sophisticated CRM packages that alert them to stages in the baby's development when, for example, there is a need to change from one type of nappy to another, or from baby food to toddler food. In some cases they even trigger automatic birthday cards.

12.5.3 Physical evidence

As discussed in Chapter 14, a key aspect of service delivery evaluation is tangibles, or the physical evidence that accompanies the offer. In the marketing of physical, atom-based, products the appearance of the product itself and its packaging, together with the surroundings in which it is marketed, can have an impact on the overall attractiveness to customers. For example, sophisticated retail facility design pays detailed attention to the smells and sounds that comprise part of the retail experience, as well as the sound and feel of the floor underfoot, and the space allowed to avoid the 'butt brush' (when one shopper brushes against another and disturbs their purchase consideration), and the effect of lighting on mood and ambience. In service encounters the appearance and demeanour of staff can be equally important.

Customers take many cues to the quality of the product or service they are purchasing from the physical evidence that surrounds it. When lecturing to MBA students or executives on management development programmes, most faculty members will dress in a more 'businesslike' fashion than when teaching undergraduates. The formalities of dress code are used to establish rapport with the audience and are varied depending on the particular audience. Packaging for products may also vary to give cues as to quality. For example, the Sunday Times Wine Club distributes to members some of its fine wines in wooden crates while more everyday wines are despatched in cardboard boxes.

12.6 New businesses and business models

In the wake of the uncertainty and undoubted opportunities generated by the Internet, two distinct types of firms are emerging: Internet pioneers and Internet pragmatists.

12.6.1 Internet pioneers

The Internet pioneers have set up radically new types of business to exploit the benefits of the new technology to do business in very different ways. Straub and Klein (2001) refer to these as 'Omega' level firms and note that the successful ones have harnessed the power of the new technology to gather information about customer preferences and to tailor products and services specifically to the needs of individual customers. These firms, however, are relatively rare but do include the likes of Amazon.com in consumer goods retailing, e-Bay in online auctions and Monster.com in the jobs market.

eBay is a prime example of an Internet pioneer. In the late 1990s it became the preferred place on the web to trade collectibles, building its position largely through word of mouth rather than media advertising, and creating a virtuous circle whereby more buyers attracted more sellers, who in turn attracted more buyers. In 2001 eBay had 38 million users worldwide. In the third quarter of 2001 they listed 109 million items and spent US$2.4 billion between them. eBay received $194 million in revenue from the sales, 71 per cent up on the same period in 2000 (*Fortune*, 21 January 2002).

A further example of an Internet pioneer is Egg, the UK's first Internet bank. The bank was launched with a positioning as both innovative and tailored to customer needs (the brand statement was 'Egg is your ground breaking partner, who is always there for you offering simple, smart financial solutions'). Within a week of its launch it had received 1.75 million visits to its website. By the end of 2001 it had gained 9 per cent of the UK credit card market and brand awareness has risen to a staggering 88 per cent. By then it had 1.58 million customers, on a par with many of the high-street banks. This was all achieved through the use of innovative technologies, which effectively lowered the entry barriers to a once well entrenched market (*Marketing Business*, September 2001).

12.6.2 Internet pragmatists

The second type of firm to emerge has been termed 'Internet pragmatists' (Fahy and Hooley, 2002). These firms have embraced the opportunities of the Internet to enhance their existing business models. Dell, for example, uses online ordering to enhance its direct marketing operations, FedEx uses the technology to enable personalised tracking of customer packages during transit (3.1 million packages per day with 99 per cent on-time, accurate delivery), and Cisco saves US$700 million annually through offering customer support over the web. These pragmatists have used the Internet to enhance the services they already offered to their customers, and also to reduce costs, but have not completely thrown out their existing business models. Rather, these have been adapted to the new environment.

The national roll-out of Tesco's Internet grocery service in 2000 followed almost five years of preparation and piloting, and that preparation means Tesco.com leads the Internet quality measurements published by the Chicago-based Gomez company, and is regarded by many US companies in this field as a world leader. Certainly, Tesco.com is now the world's largest e-grocery business, and plans expansion into the USA. The formulation of Tesco Direct's value proposition and business model was based on close study of what customers wanted from Internet grocery shopping. Contrary to expectations that online shoppers would want to abandon traditional stores, they found customers liked to visit stores to examine fresh produce personally and to see what new products were available, and trusted their local stores to provide quality goods at fair prices. Most customers did not see online shopping as a substitute for traditional shopping, but as a complement. For this reason the online shopper uses the same store that they visit in person, choosing from the same regional product selection and buying at the same prices. The proposition was to 'shop online from my store'. The Tesco model integrates online and offline business – online sales are part of branch sales and feed into store-based replenishment. The value proposition is convenience and time-saving, but also greater personalisation – the software remembers previous purchasing and gives 'reminders', and can also warn those vulnerable about things like nut allergies and food choices. The relatively low start-up costs (£35 million) and fast national coverage reflect use of the conventional stores as 'mini-depots' where pickers can make up six online orders a time using a special trolley. Company estimates are that the average online shopping order is 2 or 3 per cent more profitable than the average in-store order, because Internet shoppers tend to select the higher margin products on offer.

The difference between the pioneers and the pragmatists can clearly be seen by the stage of diffusion at which they adopted the newer technologies. It seems that we are now firmly in the majority phase of diffusion of the Internet as an enabling technology (possibly even late majority stage) where the majority of adopters are pragmatists, using the new technology to enhance and improve existing business models, rather than to revolutionise them.

Many of the pragmatists represent the much-maligned 'old economy'. These are companies that, in some instances, were slow to join the information technology revolution and also includes those firms that are selective in their use of the Internet. For example, firms like IBM and Cisco Systems have moved most of their customer service online and customers now serve themselves from the menus of options available on their websites. These companies claim cost savings of the order of $500–700 million per annum through providing service online. Some of the kinds of online customer service currently available include customised web pages, targeted information, customer-service provider interaction, customer-to-customer interaction, customised products and rewards and incentives (Walsh and Godfrey, 2000).

Similarly, right through the business system, pragmatists are using the Internet to enhance what they are currently doing (Porter, 2001). For example, Compaq Computer Corporation is increasingly distributing software online rather than on CD and floppy disk. They have pioneered a 'try it and buy it' distribution system where customers use the software for a trial period and then the licence is extended should a customer wish to purchase. Sales conversion rates have increased significantly using this system. Many of the basic organisational activities are now being outsourced electronically. Mobile phone companies like Vodafone offer fleet management services for corporate clients while corporate health plans can be managed off-site by companies like BUPA. Corporate training services can be managed remotely by e-learning companies like Smartforce and even basic corporate R&D activity is enhanced by vast stores of information now available electronically. In summary, Internet pragmatists are those that have adopted the Internet to enhance existing products and processes. These are frequently labelled 'bricks and clicks' operations, meaning that the company sees the Internet as an additional channel which complements existing activities. Dell Computer Corporation found that its make-to-order model was very well suited to the Internet and consequently more than 50 per cent of its business is now being conducted through this medium. Allied Irish Banks examined the option of setting up an Internet-only bank to compete with the likes of First-e but dropped the idea in favour of improving its Internet banking facilities for existing customers.

While the Internet pioneers have grabbed the headlines, it is likely to be Internet pragmatists who eventually dominate the use of the Internet as a business channel.

Summary

The 'new' marketing mix is constantly changing. New ingredients are being added all the time by creative marketers. The most significant development over the last decade, however, has been the advent of the Internet. This has significantly impacted on all aspects of the marketing mix, from product and price through to promotions and distribution. A number of conclusions (and possible warnings) emerge:

1 Don't assume that the Internet will cure all your marketing ills. Firms that are poor at marketing in the bricks-and-mortar world are unlikely to suddenly succeed in the virtual world of the Internet. For creative, Internet-savvy firms, however, the new technologies may offer ways of leapfrogging more conventional competitors and adding value for customers in innovative ways.

2 Remember that atom-based products will still need efficient and effective distribution systems to physically get them to customers. Indeed, the logistics and distribution systems of online retailers may need to be even more effective than

those of bricks and mortar firms as expectations of speed are greater for Internet-based firms.

3 Beware of assuming that today's atom-based products will be tomorrow's atom-based products. Increasingly, physical products (such as music CDs, videos, newspapers, magazines) are being turned into bit-based products. Because of the Internet the market for TVs and PC monitors is blurring; PDAs and mobile telephones can now access broadcast material.

4 Continue to base your competitive advantage on the marketing resources you possess that can be protected from competitor imitation. Actively develop the new resources, skills and competencies necessary to take advantage of the new technologies.

Tyrrells

FT

Case study

Courtesy of Tyrells Crisps

William Chase is not 'a corporate person'. The farmer turned creator of Tyrrells Potato Chips – an entrepreneurial Herefordshire business producing 'artisan' crisps – is blunt and outspoken. He eschews 'management jargon' in favour of home-grown opinions. 'It's not turnover, it's left-over [profits] that matters,' Mr Chase declares repeatedly.

So far Tyrrells Potato Chips is living up to his maxim. Sales grew more than 80 per cent in its second year. The fledgling company is already producing tasty 'leftovers', as Mr Chase puts it, with pre-tax profits of £1.2m in the last financial year, yielding a 35 per cent margin.

Recent success at Tyrrells Potato Chips shows how niche marketing can help a small player hold its own against the distribution power of large supermarkets.

Mr Chase bought Tyrrells Court, the farm where he grew up, from his father in 1982, at the age of 20. By the mid-1990s the farm was producing reasonable profits, but the one fly in the ointment was dealing with large supermarkets.

They were 'constantly pressing for discounts' and prone to cutting off suppliers at short notice, he says. 'We could see the cracks appearing on the wall. We had no bargaining power plus we were producing a commodity, which is no fun at all.'

To get off the treadmill of selling a low-margin commodity to price-conscious buyers, Mr Chase began looking for branded products that would make use of the farm's potatoes and move the business up the value chain.

After toying with various possibilities, such as potato wedges, he hit on the idea of making premium-priced 'artisan'-style potato crisps, or 'chips'.

He set up Tyrrells Potato Chips in 2002 with start-up capital of £2.5m, raised from personal finance and bank loans. The company generated sales of nearly £2m in fiscal year 2004, followed by £3.6m the next year. By March 2006 revenues are forecast to reach about £6m.

As he speaks, Mr Chase cranes his neck towards the yard where big agricultural vehicles carry loads of potatoes harvested from his fields. They are on their way to the factory, which sits below his office.

The premises are cramped, which is not surprising given the rate at which Tyrrells – a finalist in the current National Business Awards Entrepreneur of the Year contest – is growing.

Changes in eating habits combined with rising levels of disposable income have helped the brand grow quickly. Consumers, once content with mass-produced crisps, have proved willing to pay extra for traditionally made products containing only natural ingredients.

Tyrrells' packaging, which Mr Chase designed himself, highlights the fact that his potatoes are home-grown and cooked on the Herefordshire farm.

This helps differentiate Tyrrells from competitors such as Walkers Sensations (the premium sub-brand of Walkers Crisps) and niche producers of 'hand-fried' chips, such as Burts and Kettle Chips, which pioneered the market.

Where possible, Mr Chase prefers to sell directly to retailers, maintaining that distributors 'lack the passion and commitment' to get an unknown brand into the best shops.

Working from the premise that it is easier to trade down than trade up, Tyrrells has made a point of targeting the most exclusive shops first, using the cachet of being seen on the shelves of famous stores – such as Harrods, Fortnum & Mason and Harvey Nichols – to spark interest in Tyrrells and persuade other fine-food retailers to stock its products.

Making up the bulk of Tyrrells' customers are several thousand independent retailers – delicatessens, sandwich shops, tea-rooms and gastro-pubs, plus some chains such as Costa Coffee, as well as Pret A Manger, for which Tyrrells manufactures under contract.

The UK's largest supermarkets are notably absent. Mr Chase says he was approached two years ago by J. Sainsbury, which wanted to sell his products nationally. He turned down the opportunity. 'If you go in too early with the largest supermarkets they dictate the terms on which you sell your brand.'

One supermarket that Mr Chase has no reservations about supplying is Waitrose, which he praises for 'respecting its suppliers'.

Tyrrells is also to be found in smaller community-based stores, such as Budgens and some local co-operatives, because, Mr Chase claims, they – like Waitrose – treat their suppliers well and allow them a reasonable margin.

The rationale for selling through such stores is that they serve a cross-section of consumers, including the less price-sensitive ones, who use them for 'top-up' purchases of smaller snack items.

With this strategy, Mr Chase aims to double sales each year. Yet he faces the challenge of expanding rapidly without devaluing his brand. One line of attack is to expand overseas, again targeting the best stores first.

So far the approach has paid off. Around 20 per cent of Tyrrells' sales now come from exports, predominantly to France, where the brand is sold in a number of top food halls, such as La Grande Epicerie de Paris.

Other countries where Tyrrells has made headway include Ireland, Denmark, Italy and Norway, where the brand is stocked by leading delicatessens Smør-Petersen and the upmarket convenience chain, Deli de Luca.

Developing new flavours and higher value products creates further opportunities for growth. Tyrrells' apple and root vegetable chips retail at

99p for 40g, or almost twice the price of its potato crisps. Mr Chase also intends to diversify into related categories, such as cereal bars, biscuits and muesli.

But in some ways Tyrrells' home-grown nature is in danger of being compromised by expansion. Tyrrells has the capacity to supply all of the potatoes that it needs for several more years, but a number of the other vegetable ingredients used in its other products have had to be bought in until the home farm can become 'self-sufficient'.

Exporting has also forced the company to depend more heavily on distributors. In addition, it has modified its packaging and pricing for overseas markets. To meet the expectations of French consumers, Tyrrells has recently added a smaller 35g pack to the range, which is priced below the psychologically significant threshold of €1.

If he is to fulfil his growth plans for Tyrrells, Mr Chase may have to revisit the thorny question of whether to work with the major supermarkets. But he admits not relishing the prospect and hints at seeking a buyer, or taking a back seat in the business to avoid having to deal with the largest supermarkets personally.

'Supplying the big stores involves you in a huge number of meetings; it's not how I want to live my life,' he says simply.

Whether Mr Chase lives up to that maxim remains to be seen.

How to create cachet and reap profits

The public's appetite for premium and 'hand-fried' chips has lightened the gloom of crisp manufacturers in a market that Mintel, the researchers, term 'otherwise disappointing'. A relative latecomer, Tyrrells has worked to capture a share of this growth through:

- Branding. Tyrrells' marketing taps into the public's enthusiasm for 'authenticity' and 'provenance'. Its crisp packets tell the story of Tyrrells. Pictures of employees growing potatoes on the Herefordshire farm and then cooking them illustrate the journey from 'seed to chip'.
- Quality. Tyrrells chips are made from traditional varieties of potato and 'hand-fried' in small batches.
- Distribution. Tyrrells sells directly to 80 per cent of its retail stockists. Students from a local agricultural college are employed to trawl through directories and identify fine-food shops to target with samples. After winning their business, Tyrrells develops the relationship through personal contact.
- Diffusion strategy. Selling to the most exclusive shops creates a showcase for Tyrrells to target consumers who are not sensitive to price, allowing it to grow profitably.
- New product development. Tyrrells is constantly bringing out new flavours and products. Experimental recipes are produced in sample runs and given free to shops to test with customers. Recent introductions include apple chips, honey glazed parsnips and Ludlow sausage with wholegrain mustard.
- Exporting. This has created a further sales channel through fine-food stores. Yet it has also forced greater dependence on distributors, introducing an unwelcome layer between itself and its customers.

Source: Alicia Clegg, 'Crisp profits at the potato farm', *The Financial Times*, 11 October 2005.

Discussion questions

1. Tyrrells have successfully moved away from selling a commodity to producing an added value product. What are the reasons for this success?
2. How can Tyrrells use the PLC and diffusion of innovation theories to further grow sales?
3. Personal selling is a key part of Tyrrells' communications strategy. With what tools and media should this be supplemented, bearing in mind that the communications mix should be fully integrated and in line with the rest of the marketing mix?