

Summary of Material Covered in Class for Midterm

Firm, Brand, and Product Line Objectives

Firm level objectives: It is not enough to simply state a firm's goal as maximizing the present value of total profit since this does not differentiate it from other firms and says nothing about *how* this objective is to be achieved. Instead, a business and marketing plan should suggest how the firm can best put its unique resources to use to maximize stockholder value. A number of resources come into play—e.g.,

- *Distinctive competencies*—knowledge of how to manufacture, design, or market certain products or services effectively;
- *Financial*—possession of cash or the ability to raise it;
- *Ability and willingness to take risk*;
- The *image of the firm's brand*;
- *People* who can develop new products, services, or other offerings and run the needed supports;
- *Running facilities* (no amount of money is going to get a new microchip manufacturing plant started tomorrow);
- *Contacts* with suppliers and distributors and others who influence the success of the firm.

Market balance: It is essential that different firms in the same business not attempt to compete on exactly the same variables. If they do, competition will invariably degenerate into price—there is nothing else that would differentiate the firms. Thus, for example, in the retail food market, there are low price supermarkets such as Food 4 Less that provide few if any services, intermediate level markets like Ralph's, and high-end markets such as Vons' Pavillion that charge high prices and claim to carry superior merchandise and offer exceptional services.

Risk: In general, firms that attempt riskier ventures—and their stockholders—expect a higher rate of return. Risks can come in many forms, including immediate loss of profit due to lower sales and long term damage to the brand because of a poor product being released or because of distribution through a channel perceived to carry low quality merchandise.

Brand level objectives: Ultimately, brand level profit centers are expected to contribute to the overall maximization of the firm's profits. However, when a firm holds several different brands, different marketing and distribution plans may be required for each. Several variables come into play in maximizing value. Profits can be maximized in the short run, or an investment can be made into future earnings. Product profit can be measured in several ways. If you sell a computer that cost \$950 to make for \$1,000, you are making only a 5% gross profit. However,

selling a product that cost \$5 to make for \$10 will result in a much higher percentage profit, but a much lower absolute margin. A decision that is essential at the brand level is *positioning*. Options here may range from a high quality, premium product to a lower priced value product. Note here that the same answer will not be appropriate for all firms in the same market since this will result in market imbalance—there should be some firms perceiving each strategy, with others being intermediate.

Distribution issues come into play heavily in deciding *brand level strategy*. In order to secure a more exclusive brand label, for example, it is usually necessary to sacrifice volume—it would do no good, for Mercedes-Benz to create a large number of low priced automobiles. Some firms can be very profitable going for quantity where economies of scale come into play and smaller margins on a large number of units add up—e.g., McDonald’s survives on much smaller margins than upscale restaurants, but may make larger profits because of volume. Some firms choose to engage in a *niching* strategy where they forsake most customers to focus on a small segment where less competition exists (e.g., clothing for very tall people).

In order to maintain one’s brand image, it may be essential that retailers and other channel members provide certain services, such as warranty repairs, providing information to customers, and carrying a large assortment of accessories. Since not all retailers are willing to provide these services, insisting on them will likely reduce the intensity of distribution given to the product.

Product line objectives: Firms make money on the totality of products and services that they sell, and sometimes, profit can be maximized by settling for small margins on some, making up on others. For example, both manufacturers and retailers currently tend to sell inkjet printers at low prices, hoping to make up by selling high margin replacement cartridges. Here again, it may be important for the manufacturer that the retailer carry as much of the product line as possible.

Distribution Objectives

Interrelated objectives: A firm’s distribution objectives will ultimately be highly related—some will enhance each other while others will compete. For example, as we have discussed, more exclusive and higher service distribution will generally entail less intensity and lesser reach. Cost has to be traded off against speed of delivery and intensity (it is much more expensive to have a product available in convenience stores than in supermarkets, for example).

Narrow vs. wide reach: The extent to which a firm should seek narrow (exclusive) vs. wide (intense) distribution depends on a number of factors. One issue is the consumer’s likelihood of switching and willingness to search. For example, most consumers will switch soft drink brands rather than walking from a vending machine to a convenience store several blocks away, so intensity of distribution is essential here. However, for sewing machines, consumers will expect to travel at least to a department or discount store, and premium brands may have more credibility if they are carried only in full service specialty stores.

Retailers involved in a more exclusive distribution arrangement are likely to be more “loyal”—i.e., they will tend to:

- Recommend the product to the customer and thus sell large quantities;
- Carry larger inventories and selections;
- Provide more services

Thus, for example, Compaq in its early history instituted a policy that all computers must be purchased through a dealer. On the surface, Compaq passed up the opportunity to sell large numbers of computers directly to large firms without sharing the profits with dealers. On the other hand, dealers were more likely to recommend Compaq since they knew that consumers would be buying these from dealers. When customers came in asking for IBMs, the dealers were more likely to indicate that if they really wanted those, they could have them—"But first, let's show you how you will get much better value with a Compaq."

Distribution opportunities: Distribution provides a number of opportunities for the marketer that may normally be associated with other elements of the marketing mix. For example, for a cost, the firm can promote its objective by such activities as in-store demonstrations/samples and special placement (for which the retailer is often paid). Placement is also an opportunity for promotion—e.g., airlines know that they, as "prestige accounts," can get *very* good deals from soft drink makers who are eager to have their products offered on the airlines. Similarly, it may be useful to give away, or sell at low prices, certain premiums (e.g., T-shirts or cups with the corporate logo.) It may even be possible to have advertisements printed on the retailer's bags (e.g., "Got milk?")

Other opportunities involve "parallel" distribution (e.g., having products sold both through conventional channels and through the Internet or factory outlet stores). Partnerships and joint promotions may involve distribution (e.g., Burger King sells clearly branded Hershey pies).

Deciding on a strategy. In view of the need for markets to be balanced, the same distribution strategy is unlikely to be successful for each firm. The question, then, is exactly which strategy should one use? It may not be obvious whether higher margins in a selective distribution setting will compensate for smaller unit sales. Here, various research tools are useful. In focus groups, it is possible to assess what consumers are looking for and which attributes are more important. Scanner data, indicating how frequently various products are purchased and items whose sales correlate with each other may suggest the best placement strategies. It may also, to the extent ethically possible, be useful to observe consumers in the field using products and making purchase decisions. Here, one can observe factors such as (1) how much time is devoted to selecting a product in a given category, (2) how many products are compared, (3) what different kinds of products are compared or are substitutes (e.g., frozen yogurt vs. cookies in a mall), (4) what are "complementing" products that may cue the purchase of others if placed nearby. Channel members—both wholesalers and retailers—may have valuable information, but their comments should be viewed with suspicion as they have their own agendas and may distort information.

Direct Marketing

We consider direct marketing early in the term as a "contrast" situation against which later

channels can be compared. In general, you cannot save money by “eliminating the middleman” because intermediaries specialize in performing certain tasks that they can perform more cheaply than the manufacturer. Most grocery products are most efficiently sold to the consumer through retail stores that take a modest mark-up—it would not make sense for manufacturers to ship their grocery products in small quantities directly to consumers.

Intermediaries perform tasks such as

- moving the goods efficiently (e.g., large quantities are moved from factories or warehouses to retail stores);
- breaking bulk (manufacturers sell to a modest number of wholesalers in large quantities—quantities are then gradually broken down as they make their way toward the consumer);
- consolidating goods (retail stores carry a wide assortment of goods from different manufacturers—e.g., supermarkets span from toilet paper to catsup); and
- adding services (e.g., demonstrations and repairs).

Direct marketers come in a variety of forms, but their categorization is somewhat arbitrary. The main thing to consider here is each firm’s functions and intentions. Some firms sell directly to consumers with the express purpose of eliminating retailers that supposedly add cost (e.g., Dell Computer). Others are in the business not so much to save on costs, but rather to reach groups of consumers that are not easily reached through the stores. Others—e.g., online travel agents or check printers—provide heavily customized services where the user can perform much of the services. Telemarketers operate by making the promotion an integral part of the process—you are explained the benefits of the program in an advertisement or infomercial and you then order directly in response to the promotion. Finally, some firms combine these roles—e.g., Geico is a customizer, but also claims, in principle, to cut out intermediaries.

There are certain circumstances when direct marketing may be more useful—e.g., when absolute margins are very large (e.g., computers) or when a large inventory may be needed (e.g., computer CDs) or when the customer base is widely dispersed (e.g., bee keepers).

Direct marketing offers exceptional opportunities for segmentation because marketers can buy lists of consumer names, addresses, and phone-numbers that indicate their specific interests. For example, if we want to target auto enthusiasts, we can buy lists of subscribers to auto magazines and people who have bought auto supplies through the mail. We can also buy lists of people who have particular auto makes registered.

No one list will contain *all* the consumers we want, and in recent years technology has made it possible, through the “*merge-purge*” process, to combine lists. For example, to reach the above-mentioned auto-enthusiasts, we buy lists of subscribers to several different car magazines, lists of buyers from the Hot Wheels and Wiring catalog, and registrations of Porsche automobiles in several states. We then combine these lists (the *merge* part). However, there will obviously be some overlap between the different lists—some people subscribe to more than one magazine, for example. The *purge* process, in turn, identifies and takes out as many duplicates as possible. This is not as simple a task as it may sound up front. For example, the address “123 Main Street, Apartment 45” can be written several ways—e.g., 123 Main St., #123, or 123-45 Main Str.

Similarly, John J. Jones could also be written as J. J. Jones, or it could be misspelled Jon J. Jonnes. Software thus “standardizes” addresses (e.g., all street addresses would be converted into the format “123 Main St #45” and even uses phonetic analysis to identify a likely alternative spelling of the same name.

Response rates for “good” lists—lists that represent a logical reason why consumer would be interested in a product—are typically quite low, hovering around 2-3%. Simply picking a consumer out of the phone-book would yield even lower responses—much less than one percent. Keep in mind that a relevant comparison here is to conventional advertising. The response rate to an ad placed in the newspaper or on television is usually well below one percent (frequently more like one-tenth of one percent). (More than one percent of people who see an ad for Coca Cola on TV will buy the product, but most of these people would have bought Coke anyway, so the *marginal* response is low).

Electronic Commerce

Online marketing can serve several purposes:

- *Actual sales of products*—e.g., Amazon.com.
- *Promotion/advertising*: Customers can be quite effectively target in many situations because of the context that they, themselves, have sought out. For example, when a consumer searches for a specific term in a search engine, a “banner” or link to a firm selling products in that area can be displayed. Print and television advertisements can also feature the firm’s web address, thus inexpensively drawing in those who would like additional information.
- *Customer service*: The site may contain information for those who no longer have their manuals handy and, for electronic products, provide updated drivers and software patches.
- *Market research*: Data can be collected relatively inexpensively on the Net. However, the response rates are likely to be very unrepresentative and recent research shows that it is very difficult to get consumers to read instructions. This is one of the reasons why the quality of data collected online is often suspect.

There are many obstacles to the growth of e-commerce:

- *Reach*: Although the majority of U.S. households now have computers connected to the Internet, a very large minority does not, and penetration rates are considerably lower in some countries. In foreign countries, even those households that have computers may be reluctant to spend time online due to the per minute charges, which discourage the more leisurely “browsing” American style.
- *Concerns about privacy*: A number of consumers are concerned about giving up information to marketers that can easily be collected electronically. Naturally, few consumers would like information about their medical status widely collected by firms, but many consumers are even reluctant to have marketers know the ages of their children and past book purchase records.
- *Reputational issues*: Although not as much as a problem before, firms operating online or through direct mail have often been viewed with suspicion since consumers may

- question whether they will be around if they do not deliver satisfactorily.
- *Transshipments*: Although the Internet should facilitate commerce across borders, customers paperwork and ambiguities in duty liability make shipments across countries burdensome.
 - *Costs*. During the "boom," Internet firms were not expected to be efficient and thus developed bad habits. Although shipping and handling charges can help cover costs of shipping and administration, these often take away the attractiveness of Internet shopping. The most successful e-commerce firms turn out to be the ones that have been successful doing other kinds of direct marketing (e.g., catalog sales) before and have developed the discipline and efficiency required there. For products that have relatively high absolute margins—e.g., computers—there is more money to cover administrative costs.
 - *Language*. Since the Internet reaches around the world, it is often difficult to match viewers with their preferred languages. Because U.S. firms and individuals tended to predominate among those first to occupy the Web, most sites are in U.S. English. British speakers of English generally do not perceive American English as American—they tend to perceive spelling such as "color" rather than their "colour" as misspellings. French consumers do not like to have to click to get from an English language to a French language site. It is estimated that by the year 2007, the majority of web surfers will not be comfortable in English and will want sites in their own languages.
 - *Government regulations*: In the U.S., the government has tried to keep its hands off the Net as much as possible to foster its growth as a trade area, and a recently expired moratorium on new sales taxes was even instituted. However, governments in many other countries are more forceful in their regulations. In countries such as China, where sites can be used to spread "subversive" ideas, there is a great deal of government scrutiny and suspicion.
 - *Cultural obstacles* are often severe. The whole purpose of the web is to make information readily available. In countries where information is closely guarded, that is a frightening idea. There is often also a desire for personal interaction, which may be required to establish the trust needed to secure a deal.
 - *Payment issues*. U.S. consumers exposed to credit card fraud have very limited liabilities, but these protections do not exist to the same extent in Europe or Asia. In China, much of the purpose of the Internet is defeated with some 80% of transactions being completed off-line, usually with funding instruments other than credit cards.

There are a number of problems in running and developing web sites. First of all, the desired domain name may not be available—e.g., American Airlines could not get "American.com" and had to settle for "AmericanAir.com." There is also a question having your site identified to potential users. Research has found that most search engines have a great deal of "false hits" (sites irrelevant that are identified in a search—e.g., information about computer languages when the user searches for foreign language instruction) and "misses" (sites that would have been relevant but are not identified). It is crucial for a firm to have its site indexed favorably in major search engines such as Yahoo, AOLFind, and Google. However, there is often a constant struggle between web site operators and the search engines to outguess each other, with the web promoters trying to "spam" the search engines with repeated usage of terms and "meta tags."

The fact that many computer users employ different web browsers raises questions about compatibility. A major problem is that many of the more recent, fancier web sites rely on “java script” to provide animation and various other impressive features. These animations have proven very unreliable. Sites may “crash” on the user or prove unreliable, and many consumers have found themselves unable to complete their transactions.

Legal issues. There are a number of legal issues associated with the Internet:

- *Reach across borders.* Web sites transcend country lines and thus, a firm may be subjected to legal standards of different countries. It may be difficult to create advertising that simultaneously complies with rules for each country.
- *Taxation:* There is a great deal of ambiguity as to which state and local governments may collect taxes on merchandise sold on the Internet. There is also a question as to who has the responsibility for making the payment—the seller or the buyer?
- *Privacy issues.* Many foreign governments prohibit the collection of personal information of consumers (as Amazon.com does), which greatly reduces the customization opportunities online.

Web site design: The web designer must make various issues into consideration:

- *Speed vs. aesthetics:* As we saw, some of the fancier sites have serious problems functioning practically. Consumers may be impressed by a fancy site, or may lack confidence in a firm that offers a simple one. Yet, fancier sites with extensive graphics take time to download—particularly for users dialing in with a modem as opposed to being “hard” wired—and may result in site crashes.
- *Keeping users on the site:* A large number of “baskets” are abandoned online as consumers fail to complete the “check-out” process for the products they have selected. One problem here is that many consumers are drawn away from a site and then are unlikely to come back. A large number of links may be desirable to consumers, but they tend to draw people away. Taking banner advertisers on your site from other sites may be profitable, but it may result in customers lost.
- *Information collection:* An increasing number of consumers resist collection of information about them, and a number of consumers have set up their browsers to disallow “cookies,” files that contain information about their computers and shopping habits.

Cyber-consumer behavior: In principle, it is fairly easy to search and compare online, and it was feared that this might wipe out all margins online. More recent research suggests that consumers in fact do not tend to search very intently and that large price differences between sites persist. We saw above the problem of keeping consumers from prematurely departing from one’s site.

Search engine optimization: Since this field is changing so rapidly, please refer to your notes from the class discussion.

Legal Issues

Distribution issues raise significant legal questions, many of which relate to antitrust law. The main purpose of antitrust law is to enforce fair competition among firms. There are two different

kinds of competition that are relevant here. *Interbrand* competition refers to different brands that compete against each other—e.g., Nike competes against Reebok. On the other hand, *intra*brand competition refers to competition between different channels that sell the same branded goods—e.g., Footlocker competes against other retailers that sell Nike products. Often, it may be necessary to sacrifice the one kind of competition to bolster the other. For example, by introducing exclusive territories given to some retailers who alone are given the right to sell in one geographic area, these retailers may have extra incentive to “push” the product. The theory here, then, is that by reducing the *intra*brand competition among retailers all carrying, say, Guess jeans, the retailer will be motivated to put up a strong competition against other retailers who carry Levi’s, thus enhancing *interbrand* competition.

There are a number of ways in which competition can be threatened:

- *Collusion*: Retailers and/or manufacturers get together and agree to limit competition—e.g., the three laundromats in a small town all get together and agree that no one will charge less than one dollar per wash. Although blatantly illegal in the United States, this kind of behavior is accepted in certain parts of the world, although European countries are now beginning to be less tolerant.
- *Discriminatory pricing*: Some full service manufacturers may decide to give better deal to more powerful buyers—e.g., Wal-Mart may negotiate better prices than Joe’s Grocery Store can. Such differences in prices paid by competing firms are generally legal only if they are justified by actual cost savings in selling to the two different firms—obviously, the average overhead per case of Bandaid will be much lower when selling to Wal-Mart, which buys in huge quantities.
- *Predatory pricing*: Firms may attempt to temporarily sell products below their costs so that competitors are driven out of business, after which the predators will raise their own prices. This is generally illegal in the U.S.
- *Territorial restrictions* (as discussed above) and *customer coverage restrictions* (e.g., one firm is designated as the only firm that is allowed to sell to hospitals, while another one may be designed the sole authorized seller to gyms). These may or may not be legal, depending on the courts’ interpretation of their impact on overall market competition.
- *Price maintenance*. Manufacturers may put pressure on retailers not to sell their products below or above a certain price. While certain manufacturers are concerned that some distributors may take advantage of exclusive distribution deals and set maximum prices, the greatest concern is about minimum prices. Here, manufacturers may be concerned that if price competition is too intense, services will suffer. By trying to ensure that no one sells below a designated floor price, full service retailers are guaranteed certain levels of profitability. Generally, it is explicitly illegal for retailers and manufacturers to agree not to sell below a certain price (in legal terms, that would be a “conspiracy in restraint of trade”). However, it frequently is legal for the manufacturer to tell the retailer that if he or she sells below the price, the manufacturer will stop him or her. It would be illegal, however, for the manufacturer to promise another competitor to “cut off” the offending retailer.
- *Tying*: Here, a customer may be required to buy two products even if he or she only wants one. Firms may want to engage in this activity if they have a monopoly-like situation for one product but face competition for another (e.g., Intel dominates the

market for the newest chips but has much more competition for the motherboards and modems that the firm also produces. Thus, the firm might like to buyers of their newest CPUs to also buy motherboards also. Tying is legal under some circumstances when it is deemed to be reasonable (the customer cannot expect to be able to buy a car without tires even if he or she can find cheaper alternatives elsewhere) but can be illegal if it is abusive and serves no legitimate purpose (as in the Intel case).

Antitrust law is often rather murky, and it may be hard to find a straight answer as to whether something is legal or not. In general, courts have classified various kinds of activities in categories of varying certainty of legality or illegality. *Per se illegality* includes practices that are definitely illegal if it can be proven that they have taken place (e.g., two retailers agreeing not to sell below certain prices). Under the *modified rule of reason*, certain practices are presumed to be illegal, but the courts will hear exculpatory evidence which may clear a firm (e.g., courts are likely to be suspicious if a supplier drops a discount retailer after receiving complaints from a full service retailer, but if the manufacturer can prove that it did not agree with the full service retailer to stop the supply and that the termination benefits *interbrand* competition, the practice may be accepted). Under the *rule of reason*, the totality of circumstances are examined to assess impact on competition, and a decision is made—thus, the law is not as clear (e.g., whether tying—requiring a consumer to buy two products even if he or she wishes to buy only one—is subject to significant review). Finally, certain practices are *per se legal*—i.e., they are accepted as legal and no legal action can be taken (e.g., since consumers do not compete against each other, it is legal to charge different airline passengers different fares based on advance purchase and Saturday night stayovers).

Service Outputs

As we have discussed earlier, firms have to make tradeoffs between different considerations such as cost of distribution, intensity vs. exclusivity, and service provided. Some of the services ultimately desired by consumers include *bulk-breaking* (as previously discussed), *spatial convenience* (being able to buy milk in the supermarket rather than having to drive out to a farmer to get it), *timing of availability* (having someone—the retailer and other channel members—plan to have toothpaste available in the store when the consumer needs it), and providing a *breadth of assortment* (the same store will carry different kinds of food and other merchandise from different suppliers).

The text discusses a number of U.S. consumer trends, including increased time pressure, growing disparities in consumer income, and increased consumer knowledge in some areas. Please see the text for more detail.

Segmentation involves identifying groups of consumers who respond relatively similarly to different treatments. In general, we want to find segments that contain people who are as similar as possible to each other while, simultaneously, being as different as possible from members of other segments. Thus, for example, members of what we might term a *price sensitive food segment* are likely to seek out the lowest priced retailers even if they are not located conveniently, buy larger packages, switch brands depending on what is on sale, and cut

coupons. The “fussy” segment, in contrast, may shop either where the best quality is found or at the most convenient location, and may be brand loyal and not cut coupons. Note that not all members of each segment will be completely alike, and there is some tension between precision of description and cutting the segments into too small pieces. The idea, here, then, is for different channels to serve different consumers (e.g., price sensitive individuals are targeted by Food 4 Less while more upscale stores target the price insensitives).

Channel Flows and Efficiency

The text discusses eight “generic” channel flows, and we did not elaborate much in class. The “big” picture here is that different functions can be performed by different members of the channel—e.g., promotion can be done either by the manufacturer through coupons or advertising, or by the retailer who may allocate extra space. In general, each channel member will expect to be rewarded in proportion to the amount of services provided. Please see the text for further details.