

# Chapter 9

## Strategic Brand Management

### BESPLATNI SEMINARSKI RADOVI

Products play an important role in generating sales and profits and creating growth opportunities for all companies. Moreover, management initiatives for new and existing products are closely interrelated. Many companies have several products and/or brands in their portfolios. The objective is to achieve the highest overall performance from the portfolio of products offered by the firm. Strategic brand management requires several interrelated initiatives designed to build strong brands and a powerful portfolio.

It is important to distinguish between the terms *product* and *brand*. In practice they are often used interchangeably, although there are differences in meaning. A *product* is intended to meet the needs of buyers in the product-market. It may consist of objects, services, organizations, places, people, and ideas.

A *brand* is the product offered by a specific company. The American Marketing Association defines a brand as follows ([www.marketingpower.com](http://www.marketingpower.com)): A name, term, design, symbol, or any other feature that identifies one seller's good or service as distinct from those of other sellers. The legal term for brand is *trademark*. A brand may identify one item, a family of items, or all items of that seller. If used for the firm as a whole, the preferred term is *trade name*.

### The Strategic Role of Brands

Strategic brand management is a key issue in many organizations and is not the domain only of consumer packaged goods companies. A strategic brand perspective requires executives to decide what role brands play for the company in creating customer value and shareholder value. This role should be the basis for directing and sustaining brand investments into the most productive areas. It is important to distinguish between the functions of brands for buyers and sellers." For buyers, brands reduce:

- Customer search costs, by identifying products quickly and accurately.
- The buyer's perceived risk, by providing an assurance of quality and consistency (which may then be transferred to new products).
- The social and psychological risks associated with owning and using the "wrong" product, by providing psychological rewards for purchasing brands that symbolize status and prestige.

For sellers, brands play a function of facilitation, by making easier some of the tasks the seller has to perform. Brands facilitate:

- Repeat purchases that enhance the company's financial performance, because the brand enables the customer to identify and re-identify the product compared to alternatives.
- The introduction of new products, because the customer is familiar with the brand from previous buying experience.
- Promotional effectiveness, by providing a point of focus.
- Premium pricing by creating a basic level of differentiation compared to competitors.
- Market segmentation, by communicating a coherent message to the target audience, telling them for whom the brand is intended and for whom it is not.

- Brand loyalty, of particular importance in product categories where loyal buying is an important feature of buying behavior.

## **Brand Management Challenges**

Several internal and external forces create hurdles for product and brand managers in their efforts to build strong brands:

- **Intense Price and Other Competitive Pressures.** Deciding how to respond to these pressures shifts managers' attention away from brand management responsibilities.

- **Fragmentation of Markets and Media.** Many markets have become highly differentiated in terms of customer needs. Similarly, the media (advertising and sales promotion) available to access market segments have become very fragmented and specialized. The Internet has compounded market targeting and access complexity.

- **Complex Brand Strategies and Relationships.** Multiple additions to core brands such as BMW's initiatives have created complex brand management situations. These complexities may encourage managers to alter strategies rather than building on the existing strategies.

- **Bias Against Innovation.** Brand complacency may result in a failure to innovate. Innovation may be avoided to prevent cannibalism of existing products.

- **Pressure to Invest Elsewhere.** A strong brand may generate complacency and cause management to shift resources to new initiatives.

- **Short-Term Pressures.** Managers encounter many short-term pressures that shift their attention and resources away from important brand-building programs. Top management's need to achieve quarterly financial targets is illustrative.

## **Brand Management Responsibility**

Responsibility for strategic brand management extends to several organizational levels. Three management levels often are found in companies that have strategic business units, different product lines, and specific brands within lines.

### *Product/Brand Management*

Responsibilities for these positions consist of planning, managing, and coordinating the strategy for a specific product or brand. These managers are sponsors or advocates of specific products, negotiating and collaborating on behalf of their product/brand strategies with the salesforce, research and development, operations, marketing research, and advertising and sales promotion managers.

### *Product Group/Marketing Management*

The executive's responsibilities are to manage the brand portfolio. Additionally, the product group manager coordinates product management activities and decisions with the business unit management

### *Product Portfolio Management*

This responsibility is normally assigned to the chief executive of the strategic business unit (SBU), the corporate level of an organization, or a team of top executives.

## Strategic Brand Management

Strategic brand management decisions are relevant to all businesses, including suppliers, producers, wholesalers, distributors, and retailers.



### *Brand Equity Measurement and Management*

Each of the strategic brand management initiatives shown in Exhibit 9.2 may have a positive or negative impact on the value of the brands in the portfolio.

### *Brand Identity Strategy*

The identity may be associated with the product, the organization, a person, or a symbol. Identity implementation determines what part of the identity is to be communicated to the target audience and how this will be achieved.

### *Managing Brand Strategy*

A brand must be managed from its initial launch throughout the brand's life cycle.

### *Managing the Brand Portfolio*

This initiative consists of coordinating the organization's portfolio or system of brands with the objective of achieving optimal system performance. The focus is on the performance of the portfolio and its brand interrelations rather than an individual brand.

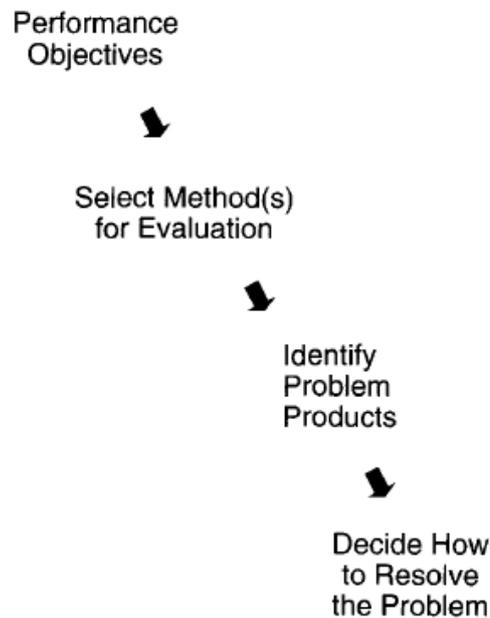
### *Leveraging the Brand*

Leveraging involves extending the core brand identity to a new addition to the product line, or to a new product category.

## Strategic Brand Analysis

A company may have a single product, a product line, or a portfolio of product lines. In our discussion of managing existing products, we assume that product/brand strategy decisions are being made for a strategic business unit (SBU). The product composition of the SBU

consists of one or more product lines and the specific product(s) that make up each line. Strategic brand analysis includes market and customer, competitor, and brand analysis.



### **Product life Cycle Analysis**

As discussed in Chapter 6 the major stages of the product life cycle (PLC) are: introduction, growth, maturity, and decline. Relevant issues in PLC analysis include:

- Determining the length and rate of change of the product life cycle.
- Identifying the current PLC stage and selecting the product strategy that is appropriate for this stage.
- Anticipating threats and finding opportunities for altering and extending the PLC.

#### *Rate of Change*

Product life cycles are becoming shorter for many products due to new technology, rapidly changing preferences of buyers, and intense competition. Determining the rate of change of the PLC is important because of the need to adjust the marketing strategy to correspond to the changing conditions.

#### *Product Life Cycle Strategies*

Different strategy phases are encountered in moving through the PLC. In the first stage the objective is to establish the brand in the market through brand development activities such as advertising, coupons, and sampling. In the growth stage the brand is reinforced through marketing efforts. During the maturity/decline stage, product repositioning efforts may occur by adjusting size, color, and packaging to appeal to different market segments.

### **Product Performance Analysis**

Performance analysis considers whether each product is measuring up to management's minimum performance criteria, and assesses the strengths and weaknesses of the product relative to other products in the portfolio.

## Measuring Brand Equity

Aaker proposes several measures to capture all relevant aspects of brand equity:

- Loyalty (price premium, satisfaction/loyalty).
- Perceived quality and leadership/popularity measures.
- Associations/differentiation (perceived value, brand personality, organizational associations).
- Awareness (brand awareness).
- Market behavior (market share, price and distribution indices).

## Brand Focus

One of several options as to where to focus the brand identity may be appropriate for a company. We look at the features of each. The major alternatives include product line, corporate, and combination branding.

### *Product Line Branding*

This strategy places a brand name on one or more lines of related products representing different product categories (e.g., Crest toothpaste, brushes, and floss). This option provides focus and offers cost advantages by promoting the entire line rather than each product.

### *Corporate Branding*

This strategy builds brand identity using the corporate name to identify the entire product offering. Examples include IBM in computers, BMW in automobiles, and Victoria's Secret in intimate apparel. Corporate branding has the advantage of using one advertising and sales promotion program to support all of the firm's products.

### *Combination Branding*

A company may use a combination of product line and corporate branding. Sears, for example, employs both product-line and corporate branding (e.g., the Kenmore appliance and Craftsman tool lines). Combination branding benefits from the buyer's association of the corporate name with the product or line brand name.

### *Private Branding*

Retailers with established brand names, such as Costco, Krogers, Target, and Wal-Mart Stores, Inc., contract with producers to manufacture and place the retailer's brand name on products sold by the retailer. Called private branding, the major advantage to the producer is eliminating the costs of marketing to end-users, although a private-label arrangement may make the manufacturer dependent on the firm using the private brand.

## Identity Implementation

1. Select a brand position that will be favorably recognized by customers and will differentiate the brand from its competitors.

2. Determine the primary and secondary target audiences.
3. Select the primary communication objectives.
4. Determine the points of advantage.

## **Strategies for Improving Product Performance**

### *Additions to the Product Line*

Management may decide to add a new product to the line to improve performance. As discussed in Chapter 8 the new product concept should be carefully evaluated before it is developed and introduced in the market.

### *Cost Reduction*

We know that lower costs give a company a major advantage over the competition. A product's cost may be reduced by changes in its design, manufacturing improvements, reduction of the cost of supplies, and improvements in marketing productivity.

### *Product Improvement*

Products are often improved by changing their features, quality, and styling. Automobile features and styles are modified on an annual basis. Many companies allocate substantial resources to the regular improvement of their products.

### *Marketing Strategy Alteration*

Changes in market targeting and positioning may be necessary as a product moves through its life cycle. However, the changes should be consistent with the core strategies.

### *Product Elimination*

Dropping a problem product may be necessary when cost reduction, product improvement, or marketing strategy initiatives are not feasible for improving poor performance of the product.

### *Environmental Effects of Products*

Environmental issues concerning product labeling, packaging, use, and disposal need to be considered. Protection of the environment involves a complex set of trade-offs among social, economic, political, and technology factors.

## **Managing the Brand Portfolio**

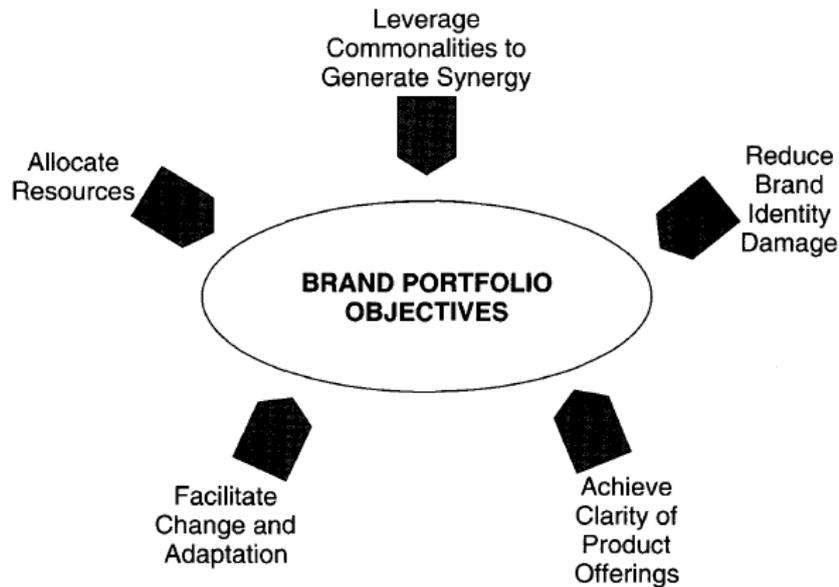
Portfolio management is concerned with enhancing the performance of all the brands and product lines offered by a company. Initiatives include changing brand and product line priorities, adding new product lines or brands, and deleting product lines or brands.

## **BESPLATNI SEMINARSKI RADOVI**

### **Strategies for Brand Strength**

Strategies for building brand strength and sustaining that strength for the brand portfolio require attention to the implementation of brand identification, revitalizing brands in

the later stages of their life cycles, and recognizing the strategic vulnerabilities of core brands to competitive attack or changing market conditions.



#### *Adding a New Line*

The motivation for adding a new product line may be to:

- Increase the growth rate of the business.
- Offer a more complete range of products to wholesalers and retailers.
- Gain marketing strength and economies in distribution, advertising, and personal selling.
- Leverage an existing brand position.
- Avoid dependence on one product line or category.

#### *Brand Building Strategies*

The essence of strategies for brand strength is that management should actively "build, maintain, and manage the four assets that underlie brand equity—awareness, perceived quality, brand loyalty, and brand association.

#### *Brand Revitalization*

Mature brands that are important in the company's overall strategy may require rejuvenation. For example, Procter & Gamble's Oil of Olay has a fifty-three-year-old brand history and retains a strong position in the skin care market by adding products that link to the brand heritage.

### **Brand Leveraging Strategy**

Established brand names may be useful to introduce other products by linking the new product to an existing brand name. The primary advantage is immediate name recognition for the new product. Methods of capitalizing on an existing brand name include line extension, stretching the brand vertically, brand extension, co-branding, and licensing.

### **Line Extension**

This leveraging strategy consists of offering additional items in the same product class or category as the core brand. Extensions may include new flavors, forms, colors, and package sizes.

### **Stretching the Brand Vertically<sup>42</sup>**

This form of line extension may include moving up or down in price/quality from the core brand. It may involve sub-brands that vary in price and features. The same name may be used (e.g., BMW 300, 500, 700), or the brand name linked less directly (Courtyard by Marriott). The advantages of this strategy include expanded market opportunities, shared costs, and leveraging distinctive capabilities.

### **Brand Extension**

This form of leveraging benefits from buyers' familiarity with an existing brand name in a product class to launch a new product line in another product class. There are several potential risks associated with brand extensions: (1) diluting existing brand associations; (2) creating undesirable attribute associations; (3) failure of the new brand to deliver on its promise; (4) an unexpected incident (e.g., product recall); and (5) cannibalization of the brand franchise.

### **Co-Branding**

This strategy consists of two well-known brands working together in promoting their products. The brand names are used in various promotional efforts. Airline co-branding alliances with credit card companies are illustrative.

### **Licensing**

Another popular method of using the core brand name is licensing. The sale of a firm's brand name to another company for use on a non-competing product is a major business activity.

### **Global Branding**

Companies operating in international markets face various strategic branding challenges. For example, European multinational Unilever reduced its brand portfolio from 1,600 to 400, to focus on its strong global brands like Lipton, while acquiring more global brands for its portfolio: SlimFast, Ben & Jerry's Homemade, and Bestfoods (Knorr, Hellmans).

## **Chapter 10**

# **Value Chain Strategy**

The group of vertically aligned organizations that add value to a good or service in moving from basic supplies to finished products for consumer and organizational end users is the value chain. The value chain (or network) is the configuration of distribution channels linking value chain members with end-users. We examine the decisions faced by a company in developing a channel of distribution strategy. Channels of distribution are a central issue in managing the value chain.

### **Distribution Functions**

The *channel of distribution* is a network of value chain organizations performing functions that connect goods and services with end-users. The distribution channel consists of *interdependent* and *interrelated* institutions and agencies, functioning as a system or network,

cooperating in their efforts to produce and distribute a product to end-users. Several value-added activities are necessary in moving products from producers to end-users.

*Buying and selling* activities by marketing intermediaries reduce the number of transactions for producers and end-users. *Assembly* of products into inventory helps to meet buyers' time-of-purchase and variety preferences. *Transportation* eliminates the locational gap between buyers and sellers, thus accomplishing the physical distribution function. *Financing* facilitates the exchange function. *Processing and storage* of goods involves breaking large quantities into individual orders, maintaining inventory, and assembling orders for shipment. *Advertising and sales promotion* communicate product availability, location, and features. *Pricing* sets the basis of exchange between buyer and seller. *Reduction of risk* is accomplished through mechanisms such as insurance, return policies, and futures trading. *Personal selling* provides sales, information, and supporting services. *Communications* between buyers and sellers include personal selling contacts, written orders and confirmations, and other information flows. Finally, *servicing and repairs* are essential for many types of products. Increasingly, the Internet provides an enabling and information-sharing technology, changing the way in which these value-adding functions are carried out.

### **Direct Distribution by Manufacturers**

We consider channel of distribution strategy from a manufacturer's point of view, although many of the strategic issues apply to firms at any level in the value chain—supplier, wholesale, or retail. Manufacturers are unique because they may have the option of going directly to end-users through a company sales force or serving end-users through marketing intermediaries. Manufacturers have three distribution alternatives: (1) direct distribution; (2) use of intermediaries; or (3) situations in which both (1) and (2) are feasible.

#### *Buyer Considerations*

Manufacturers look at the amount and frequency of purchases by buyers, as well as the margins over manufacturing costs that are available to pay for direct selling costs. Customers' needs for product information and applications assistance may determine whether a company sales force or independent marketing intermediaries can best satisfy buyers' needs.

#### *Competitive Considerations*

Distribution channels may be an important aspect of how a company differentiates itself and its products from others, and this may impel decision makers towards increased emphasis on direct channels.

#### *Product Characteristics*

Companies often consider product characteristics in deciding whether to use a direct or distribution-channel strategy. Complex goods and services often require close contact between customers and the producer, who may have to provide application assistance, service, and other supporting activities.

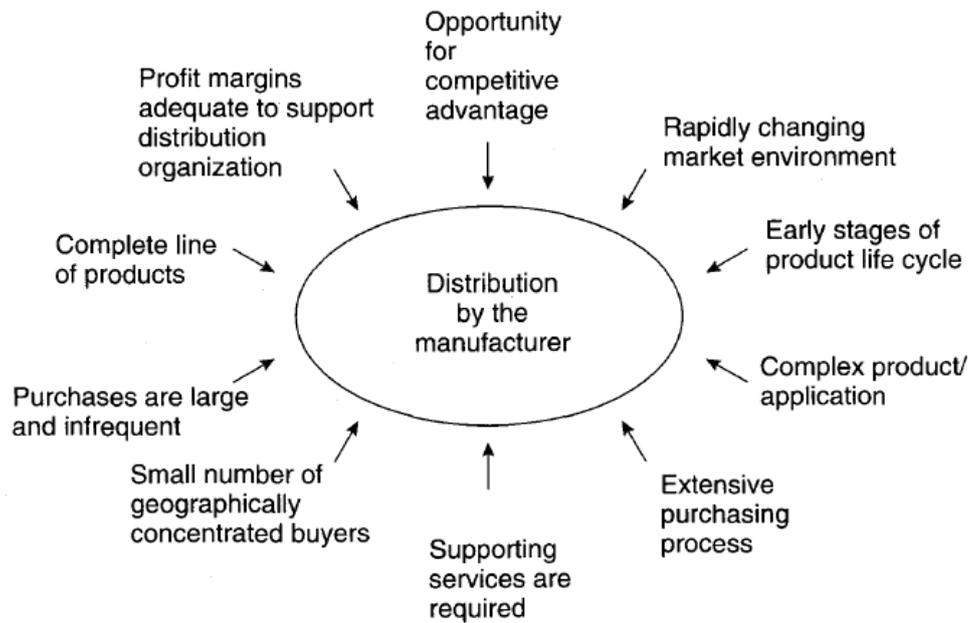
#### *Financial and Control Considerations*

It is necessary to decide if resources are available for direct distribution, and, if they are, whether selling direct to end-users is the best use of the resources. Both the costs and benefits need to be evaluated. Direct distribution gives the manufacturer control over distribution, since independent organizations cannot be managed in the same manner as company employees. This may be an important factor to the manufacturer.

**BESPLATNI SEMINARSKI RADOVI**

## Channel Strategy

We now consider the decisions that are necessary in developing a channel of distribution strategy. They include (1) determining the type of channel arrangement; (2) deciding the intensity of distribution; (3) selecting the channel configuration (Exhibit 10.3).



Management may seek to achieve one or more objectives using the channel of distribution strategy. While the primary objective is gaining access to end-user buyers, other related objectives may also be important.

## Types of Channels

The major types of channels are conventional channels and vertical marketing systems (VMS), although horizontal marketing systems are important in some situations, along with emerging digital channels.

### *Conventional Channel*

The conventional channel of distribution is a group of vertically linked independent organizations, each trying to look out for itself, with limited concern for the total performance of the channel. The relationships between the conventional channel participants are rather informal and the members are not closely coordinated.

### *Vertical Marketing Systems*

The second type of distribution channel is the vertical marketing system (VMS). Marketing executives in an increasing number of firms realize the advantages to be gained by managing the channel as a coordinated or programmed system of participating organizations. A primary feature of a VMS is the management (or coordination) of the distribution channel by one organization. Three types of vertical marketing systems may be used: *ownership*, *contractual*, and *administered*.

### *Ownership VMS*

Ownership of distribution channels from source of supply to end-user involves a substantial capital investment by the channel coordinator. This kind of VMS is also less adaptable to change compared to the other VMS forms.

#### *Contractual VMS*

The contractual form of the VMS may include various formal arrangements between channel participants including franchising and voluntary chains of independent retailers.

#### *Administered VMS*

The administered VMS exists because one of the channel members has the capacity to influence other channel members. This influence may be the result of financial strengths, brand image, specialized skills (e.g., marketing, product innovation), and assistance and support to channel members.

#### *Relationship VMS*

This type of channel shares certain characteristics of the administered VMS, but differs in that a single firm does not exert substantial control over other channel members. Instead, the relationship involves close collaboration and sharing of information. The relationship VMS may be more logical in channels with only two or three levels.

#### *Horizontal Marketing Systems*

The horizontal marketing system exists when two or more unrelated companies put together resources or programs to exploit a marketing opportunity.'

#### *Digital Channels*

A further relevant development is the digital-or Internet-based-distribution channel. While online selling has become commonplace, there are several emerging issues meriting attention. *First*, product digitization is important in many markets. Where a traditional product can be converted to digital format, then it can be constructed and delivered to the user directly through the Internet, and conventional distribution may be avoided.

### **Distribution Intensity**

The second step in channel strategy is selecting distribution intensity (Exhibit 10.3). Distribution intensity is best examined in reference to how many retail stores (or industrial product dealers) carry a particular brand in a geographical area. If a company decides to distribute its products in many of the retail outlets in a trading area that might normally carry such a product, it is using an *intensive* distribution approach. If one retailer or dealer in the trading area distributes the product, then management is following an *exclusive* distribution strategy. Examples include Lexus automobiles and Caterpillar industrial equipment. *Selective* distribution falls between the two extremes. Rolex watches and Louis Vuitton fashion goods are distributed on a selective basis.

The major issues in deciding distribution intensity are:

- Identifying which distribution intensities are feasible, taking into account the size and characteristics of the market target, the product, and the requirements likely to be imposed by prospective intermediaries (e.g., they may want exclusive sales territories).
- Selecting the alternatives that are compatible with the proposed market target and marketing program positioning strategy.

- Choosing the alternative that (1) offers the best strategic fit; (2) meets management's financial performance expectations; and (3) is attractive enough to intermediaries so that they will be motivated to perform their assigned functions.

The distribution intensity should correspond to the marketing strategy selected.

### **Channel Configuration**

The third step in selecting the distribution strategy is deciding: (1) how many levels of organizations to include in the vertical channel; and (2) the specific kinds of intermediaries to be selected at each level (Exhibit 10.3). The type (conventional or VMS) of channel and the distribution intensity selected help in deciding how many channel levels to use and what types of intermediaries to select.

#### *End-User Considerations*

It is important to know *where* the targeted end-users might expect to purchase the products of interest. The intermediaries that are selected should provide an avenue to the market segments(s) targeted by the producer. Analysis of buyer characteristics and preferences provides important information for selecting firms patronized by end-users.

#### *Product Characteristics*

The complexity of the product, special application requirements, and servicing needs are useful in guiding the choice of intermediaries. Looking at how competing products are distributed may suggest possible types of intermediaries, although adopting competitors' strategies may not be the most promising channel configuration.

#### *Manufacturer s Capabilities and Resources*

Large producers with extensive capabilities and resources have a lot of flexibility in choosing intermediaries. These producers also have a great deal of bargaining power with the intermediary, and, the producer may be able (and willing) to perform certain of the distribution functions. Such options are more limited for small producers with limited capabilities and resource constraints.

#### *Required Functions*

The functions that need to be performed in moving products from producer to end-user include various channel activities such as storage, servicing, and transportation. Studying these functions is useful in choosing the types of intermediary that are appropriate for a particular product or service.

#### *Availability and Skills of Intermediaries*

Evaluation of the experience, capabilities, and motivation of the intermediaries which are under consideration for channel membership is also important. Firms within the same industry often vary in skills and experience.

### **Selecting the Channel Strategy**

The major channel-strategy decisions we have examined are summarized in Exhibit 10.3. Management: (1) chooses the type(s) of channel to be used; (2) determines the desired intensity of distribution; and (3) selects the channel configuration. One of the first issues to be resolved is deciding whether to manage the channel, partner with other members, or instead to be a participant.

### *Market Access*

As emphasized throughout the chapter the market target decision needs to be closely coordinated with channel strategy, since the channel connects products and end-users. The market target decision is not finalized until the channel strategy is selected. Information about the customers in the market target can help eliminate unsuitable channel-strategy alternatives.

### *Value-Added Competencies*

The channel selected should offer the most favorable combination of value-added competencies. Making this assessment requires looking at the competencies of each participant and the trade-offs concerning financial and flexibility and control considerations.

### *Flexibility and Control Considerations*

Management should decide how much flexibility it wants in the channel network and how much control it would like to have over other channel participants. An example of flexibility is how easily channel members can be added (or eliminated).

### *Channel Strategy Evaluation*

*Bira između dvije opcije kanala...*

## **Changing Channel Strategy**

The issue of flexibility in channel strategy has been a considerably higher priority for many companies in recent years.

### *Channel Strategy Modification*

Channel strategy should be reviewed regularly, since modifications may be required when: marketing strategy has changed market targets and priorities; distribution is not working as planned; new channel possibilities have developed; customer buying patterns have changed; market structure or segmentation changes; new competitors have entered; or the product moves into a later product life cycle stage. The optimal channel strategy will almost certainly change over time.

### *Channel Migration*

Channel migration refers to the strategic shift from one channel to another (for example, the move in low-cost airlines like Ryanair away from selling tickets through travel agents to selling only on the Internet-98 percent of Ryanair tickets are now sold online). Companies face a challenge in responding to opportunities for channel migration when a new channel possibility opens up.

### *Channel Audit*

Channel modification and migration decisions require careful analysis. The channels map discussed earlier (Exhibit 10.4) is a starting point. The map provides a tool for monitoring the amount of business going through different channels to different customer types, and to include new channel possibilities in the model.

## **Managing the Channel**

Channel management activities include choosing how to assist and support intermediaries, developing operating policies, providing incentives, selecting promotional programs, and evaluating channel results.

## **Channel leadership**

Some form of interorganization management is needed to ensure that the channel has satisfactory performance as a competitive entity.<sup>15</sup> One firm may gain power over other channel organizations because of its specific characteristics (e.g., size), experience, and environmental factors, and its ability to capitalize on such factors.

## **Management Structure and Systems**

Channel coordination and management are often the responsibility of the sales organization (Chapter 13). For example, a manufacturer's salespeople develop buyer-seller relationships with wholesalers and/or retailers. The management structure and systems may vary from informal arrangements to highly structured operating systems.

## **Physical Distribution Management**

Physical distribution (logistics) management has received considerable attention from distribution, marketing, manufacturing, and transportation professionals. The objective is improving the distribution of supplies, goods in process, and finished products. Physical distribution is a key channel function and thus an important part of channel strategy and management.

### *Supply Chain Strategy*

The impact of supply chain strategies has extended beyond issues of transportation, storage, and stock-holding issues to influence relationships between channel members and customer value. For example, the Efficient Consumer Response (ECR) program is a cooperative partnership between retailers and manufacturers to reduce supply chain costs—lower stock levels; fewer damaged goods; simpler transaction management.

### *The Impact of Supply Chain Management on Marketing*

Supply chain strategies impact on several critical issues for marketing strategy and the value chain: product availability in the market, speed to market with innovations, the range of product choices offered to customers, product deletion decisions, prices, and competitive positioning.

### *E-Procurement*

The development of Internet-based supply chain management highlights the growing role of e-procurement—where customers search and buy online, accessing a far greater choice of suppliers. The major impact is with business-to-business customers, including retailers and purchasers of industrial products.

## **Channel Relationships**

Chapter 7 considers various forms of strategic relationships between organizations, examining the degree of collaboration between companies, the extent of commitment of the participating organizations, and the power and dependence ties between the organizations.

### *Degree of Collaboration*

Channel relationships are often transactional in conventional channels but may become more collaborative in VMS's. The extent of collaboration is influenced by the complexity of the product, the potential benefits of collaboration, and the willingness of channel members to work together as partners.

### *Commitment and Trust Among Channel Members*

The commitment and trust of channel organizations is likely to be higher in VMS's compared to conventional channels. For example, a contractual arrangement (e.g., franchise agreement) is a commitment to work together. Yet the strength of the commitment may vary depending on the contract terms.

### *Power and Dependence*

In VMS's, power is concentrated with one organization and the other channel members are dependent on the channel manager. This concentration of power does not exist with the Relationship VMS. Power in conventional channels is less concentrated than in VMS's, and channel members are less dependent on each other.

### **Channel Globalization**

Significantly for consumer goods suppliers, many major retail chains have expanded internationally. The globalization of distribution channels is underlined by the launch of Internet-based online exchanges. With the ability to source and merchandize globally, efficient supply chains, and powerful information technology, major retailers have more bargaining power than many of their suppliers. Domestic suppliers face global competition.

### **Multichanneling**

An important trend in distribution is the use of multiple channels to gain greater access to end-user customers. Increasingly, suppliers face the challenge of managing relationships between the multiple channels used in the same market. The problem is to define innovative channel combinations that best meet customer needs. However, in many situations the way channels are used is defined by customer choice.

## **Chapter 11 Pricing Strategy**

Pricing decisions have substantial consequences for many companies as illustrated by the effects of price competition from China. Once implemented, it may be difficult to alter price strategy-particularly if the change calls for a significant increase in prices. Pricing actions that violate laws can land managers in jail. Price has many possible uses as a strategic instrument in business strategy.

### **Strategic Role of Price**

Pricing plays an important strategic role in marketing strategy. Strategic choices about market targets, positioning strategies, and products and distribution strategies set guidelines for both price and promotion strategies. Product quality and features, type of distribution channel, end-users served, and the functions performed by value chain members all help establish a feasible price range.

### **Price in the Positioning Strategy**

Price is an important part of positioning strategy, and pricing decisions need to be coordinated with decisions for all of the positioning components. Importantly, this pricing perspective mandates understanding how pricing is viewed and understood by customers.

#### *Product Strategy*

Pricing decisions require analysis of the product mix, branding strategy, and product quality and features to determine the effects of these factors on price strategy. When a single product is involved, the pricing decision is simplified. Yet, in many instances, a line or mix of products must be priced. The prices for products in a line do not necessarily correspond to the cost of each item. Understanding the composition of the mix and the interrelationships among products is important in determining pricing strategy, particularly when the brand identity is built around a line or mix of products rather than on a brand-by-brand basis. Consider a situation involving a product and consumable supplies for the product. One popular strategy is to price the product at competitive levels and set higher margins for supplies. Examples include parts for automobiles and cartridge refills for laser printers. Product quality and features affect price strategy. A high-quality product may benefit from a high price to help establish a prestige position in the marketplace and satisfy management's profit performance requirements. Alternatively, a manufacturer supplying private-branded products to a retailer like Wal-Mart or Target must price competitively in order to obtain sales.

#### *Distribution Strategy*

Type of channel, distribution intensity, and channel configuration also influence pricing decisions. The functions performed and the motivation of intermediaries need to be considered in setting prices. Value-added resellers require price margins to pay for their activities and provide incentives to obtain their cooperation. Pricing is equally important when distribution is performed by the producer. Pricing in coordinated and managed channels reflects total channel considerations more so than in conventional channels. Intensive distribution is likely to call for more competitive pricing than selective or exclusive distribution. **In** multi-channel situations, pricing may pose a particular challenge. For example, if the website offers a lower price than conventional channels, how will members of those channels react? Pricing decisions must take into account these issues.

#### *Responsibility for Pricing Decisions?*

Responsibility for pricing decisions varies across organizations. Marketing executives determine pricing strategy in many companies. Pricing decisions may be made by the chief executive officer in some firms such as aircraft producers and construction firms. Manufacturing and engineering executives may be assigned pricing responsibility in companies that produce custom-designed industrial equipment. The vital importance of pricing decisions argues strongly for cross-functional participation. Pricing impacts all business functions. Coordination of strategic and tactical pricing decisions with other aspects of marketing strategy is also critical because of the marketing program inter-relationships involved.

### **Pricing Situations**

Pricing strategy requires continuous monitoring because of changing external conditions, the actions of competitors, and the opportunities to gain a competitive edge through pricing actions. Various situations require pricing actions such as:

- Deciding how to price a new product, or line of products.
- Evaluating the need to adjust price as the product moves through the product life cycle.
- Changing a positioning strategy that calls for modifying the current pricing strategy.
- Deciding how to respond to the pressures of competitive threats.

Decisions about pricing for existing products may include increasing, decreasing, or holding prices at current levels. Understanding the competitive situation and possible actions by competitors is important in deciding if and when to alter prices. Demand and cost information are strong influences on new-product pricing. Deciding how to price a new product also should include considering competing substitutes, since few new products occupy a unique position in the market.

### **Roles of Pricing**

Prices perform various roles in the marketing program—as a signal to the buyer, an instrument of competition, a means to improve financial performance, and a substitute for other marketing program functions (e.g., promotional pricing).

#### *Signal to the Buyer*

Price offers a fast and direct way of communicating with the buyer. The price is visible to the buyer and provides a basis of comparison between brands. Price may be used to position the brand as a high-quality product or instead to pursue head-on competition with another brand.

#### *Instrument of Competition*

Price offers a way to quickly attack competitors or, alternatively, to position a firm away from direct competition. Price strategy is always related to competition whether firms use a higher, lower, or equal price.

### *Improving Financial Performance*

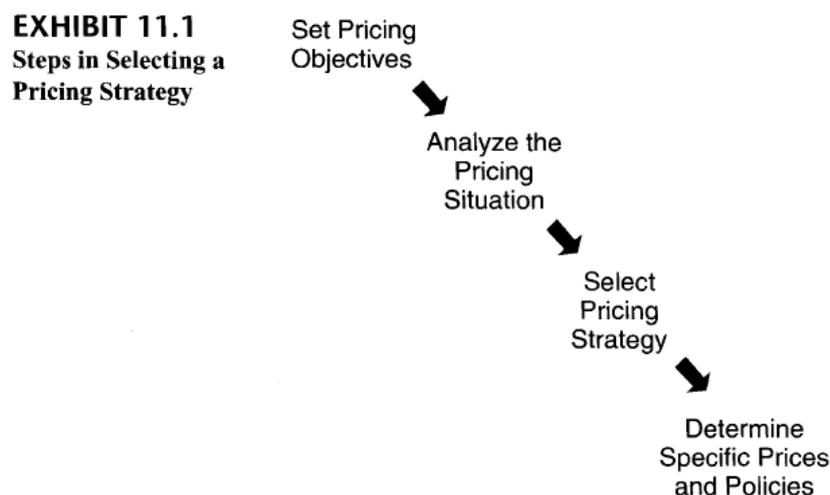
Since prices and costs determine financial performance, pricing strategies need to be assessed as to their estimated impact on the firm's financial performance, both in the short and long run. Global competition has forced many firms to adopt pricing approaches that will generate revenues in line with forecasts. Importantly, both revenues and costs need to be taken into account in selecting pricing strategies.

### *Marketing Program Considerations*

Prices may substitute for selling effort, advertising, and sales promotion. Alternatively, price may be used to reinforce these promotion activities in the marketing program. The role of pricing often depends on how other components in the marketing program are used. In deciding the role of pricing in marketing strategy, management evaluates the importance of prices to competitive positioning, probable buyers' reactions, financial requirements, and interrelationships with other components in the marketing program.

## **Pricing Strategy**

The major steps in selecting a pricing strategy for a new product or altering an existing strategy are shown in Exhibit 11.1. Strategy formulation begins by determining pricing objectives, which guide strategy development. Next, it is necessary to analyze the pricing situation, taking into account demand, cost, competition, and pricing objectives.



These analyses indicate how much flexibility there is in pricing a new product or changing the pricing strategy for an existing product. Based on the situation analysis and the pricing objectives, the pricing strategy is selected. Finally, specific prices and operating policies are determined to implement the strategy.

## **Pricing Objectives**

Pricing strategies are expected to achieve specific objectives. Sometimes the objectives may conflict with each other. If so, adjustments may be needed on one of the conflicting objectives. Objectives set essential guidelines for pricing strategy. Pricing objectives vary according to the situational factors (e.g., intensity of competition, economic

conditions, etc.) present and management's preferences. A high price may be set to recover investment in a new product. This practice is typical in the pricing of new prescription drugs. A low price may be used to gain market position, discourage new competition, or attract new buyers. Several examples of pricing objectives follow:

#### *Gain Market Position*

Low prices may be used to gain sales and market share. Limitations include encouraging price wars and reduction (or elimination) of profit contributions.

#### *Achieve Financial Performance*

Prices are selected to contribute to financial objectives such as profit contribution and cash flow. Prices that are too high may not be acceptable to buyers.

#### *Product Positioning*

Prices may be used to enhance product image, promote the use of the product, create awareness, and other positioning objectives. The visibility of price (high or low) may contribute to the effectiveness of other positioning components such as advertising.

#### *Stimulate Demand*

Price is used to encourage buyers to try a new product or to purchase existing brands during periods when sales slow down (e.g., recession). A potential problem is that buyers may balk at purchasing when prices return to normal levels. Discount coupons for new products like Colgate's Total toothpaste help stimulate demand without actually lowering listed prices.

#### *Influence Competition*

The objective of pricing actions may be to influence existing or potential competitors. Management may want to discourage market entry or price cutting by current competitors. Alternatively, a price leader may want to encourage industry members to raise prices. One problem is that competitors may not respond as predicted.

## **Analyzing the Pricing Situation**

Pricing analysis is essential in evaluating new product concepts, developing test marketing strategy, and designing a new product introduction strategy. Pricing analysis is also important for existing products because of changes in the market and competitive environment, unsatisfactory market performance, and modifications in marketing strategy over the product's life cycle. The factors influencing the pricing situation include:

- (1) customer price sensitivity;
- (2) product costs;
- (3) current and potential competitive actions; and
- (4) pricing objectives

### **Customer Price Sensitivity**

Analysis of buyers' price sensitivity should answer the following questions:

1. Size of the product-market in terms of buying potential.
2. The market segments and market targeting strategy to be used.
3. Sensitivity of demand in each segment to changes in price.
4. Importance of non-price factors, such as features and performance.
5. The estimated sales at different price levels.

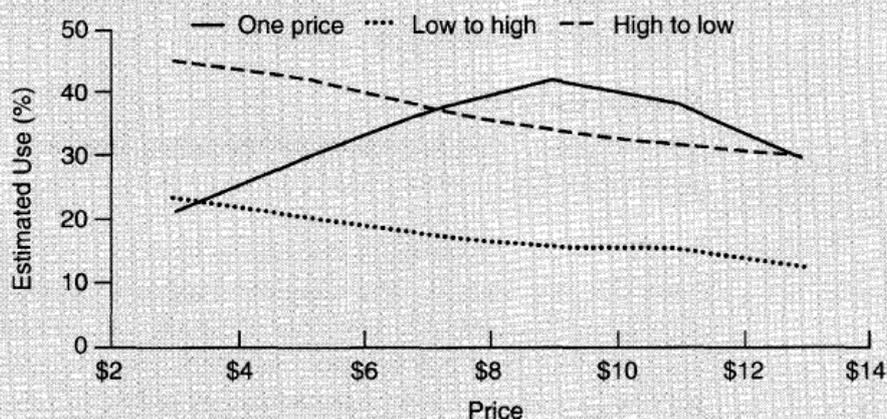
The core issue in pricing is finding out what value requirements (benefits-costs) the buyer places on the product or brand. Pricing decision makers need this information in order to determine the pricing strategy. Basing price only on cost may lead to pricing too high or too low compared to the value perceived by the buyer. Buyers see different values depending on their use situation so market segment analysis is essential.

### Price Elasticity

Price elasticity is the percentage change in the quantity sold of a brand when the price changes, divided by the percentage change in price. Elasticity is measured for changes in price from some specific price level so elasticity is not necessarily constant over the range of prices under consideration. Surprisingly, research indicates that in some situations people will buy more of certain products at *higher* prices, thus displaying a price-quantity relationship that slopes upward to the right, rather than the typical downward sloping volume and price relationship. In these instances, buyers seem to be using price as a measure of quality because they are unable to evaluate the product. There are ways to estimate the sensitivity of customers to alternative prices. Test marketing can be used for this purpose. Study of historical price and quantity data may be helpful. End-user research studies, such as consumer evaluations of price, are also used. These approaches, coupled with management judgment, help indicate the responsiveness of sales to different prices in the range of prices that is under consideration.

One problem in conducting price research is how to get information from respondents about their willingness to purchase a product at different prices. Ideally, we would like to know how the individual would respond to different prices. However, once they realize that we are trying to estimate their demand curve individuals may provide answers that reflect their understanding of the traditional demand curve—that they buy more at lower prices and less or none at higher prices. The problem is that price is presented as a cost or sacrifice to potential buyers, not as an attribute. To present price as an attribute means that other product or service information must be presented to the respondents.

One research study looked at a range of prices, but the researchers varied whether only one price was presented to respondents or whether multiple prices were presented. In the multiple price situation, prices were presented sequentially, either high to low or low to high. As the graph indicates, substantial differences occurred in the estimates. Presenting multiple prices produced downward sloping demand curves, but a single price presentation revealed increasing estimated usage between \$3 and \$9, declining thereafter.



### *Nonprice Factors*

Factors other than price may be important in analyzing buying situations. For example, buyers may be willing to pay a premium price to gain other advantages or, instead, be willing to forgo certain advantages for lower prices. Factors other than price which may be important are quality, uniqueness, availability, convenience, service, and warranty. In some instances the buying situation may reduce the importance of price in the buyer's choice process. The price of the product may be a minor factor when the cost is small compared to the importance of the use situation. Examples include infrequently purchased electric parts for home entertainment equipment, batteries for appliances, and health and beauty aids during a vacation. The need for important but relatively inexpensive parts for industrial equipment is another situation that reduces the role of price in the buyer's purchase decision. Other examples of non-price factors that affect the buying situation include:

- (1) purchases of products that are essential to physical health, such as pain relief;
- (2) choices among brands of complex products that are difficult to evaluate, such as DVD equipment (a high price may be used as a gauge of quality); and
- (3) image-enhancement situations such as serving prestige brands of drinks to socially important guests.

### *Forecasts*

Forecasts of sales are needed for the price alternatives that management is considering. These forecasts, when combined with cost estimates, indicate the financial impact of different price strategies. The objective is to estimate sales in units for each product (or brand) at the prices under consideration. Controlled tests can be used to forecast the effects of price changes.

## **Cost Analysis**

### *Composition of Product Cost*

First, it is necessary to determine the fixed and variable costs involved in producing and distributing the product. Also, it is important to estimate the amount of the product cost accounted for by purchases from suppliers. For example, a large portion of the cost of a personal computer are the components purchased from suppliers. It is useful to separate the costs into labor, materials, and capital categories when studying cost structure.

Activity based costing (ABC) is a technique which provides information for pricing strategy. The key component of ABC is to assign costs based upon the activities that are performed to create the good or provide the service being examined. Since ABC estimates the cost of the product in terms of a collection of activities, it is much easier to evaluate pricing for particular attributes or service levels. Similarly, it is possible to make comparisons to competitors by evaluating the costs of activities necessary to offer product enhancements.

Firms that successfully implement ABC do so initially as an accounting technique, yet the ultimate objective is to facilitate activity based management (ABM). In this manner, the cost data become an integral part of the product strategy in terms of considering the entire value chain, encompassing suppliers, customers, and competitors.

### *Volume Effect on Cost*

Volume effect analysis determines the extent to which the volume produced or distributed should be taken into account in estimating costs.

### *Competitive Advantage*

Comparing key competitors' costs is often valuable. Are their costs higher, lower, or about the same? Although such information may be difficult to obtain, experienced managers can often make accurate estimates. It is useful to place key competitors into relative product cost categories (e.g., higher, lower, same).

### *Experience Effect*

Experience or learning-curve analysis (using historical data) indicates whether costs and prices for various products decline by a given amount each time the number of units produced doubles. However, price declines may be uneven because of competitive influences. When unit costs (vertical axis) are plotted against total accumulated volume (horizontal axis), costs decline with volume if an experience effect is present. This occurs when experience over time increases the efficiency of production operations.

### *Control over Costs*

These considerations are interrelated with experience-curve analysis, yet may operate over a shorter time range. The bargaining power of an organization in its channels of distribution, for example, can have a major effect on costs, and the effects can be immediate.

## **Competitor Analysis**

Each competitor's pricing strategy needs to be evaluated to determine:

- (1) which firms represent the most direct competition (actual and potential) for buyers in the market targets that are under consideration;
- (2) how competing firms are positioned on a relative price basis and the extent to which price is used as an active part of their marketing strategies;
- (3) how successful each firm's price strategy has been; and
- (4) the key competitors' probable responses to alternative price strategies.

The most difficult of the four questions about competition is predicting what rivals will do in response to alternative price actions. No changes are likely unless one firm's price is viewed as threatening (low) or greedy (high). Competitive pressures, actual and potential, often narrow the range of feasible prices and rule out the use of extremely high or low prices relative to competition. In new-product markets, competitive factors may be insignificant, although very high prices may attract potential competitors.

Game theory is a promising method for analyzing competitors' pricing strategy options. The technique became very popular in the 1990s. An interesting application of game theory is discussed in the STRATEGY FEATURE.

## **Pricing Objectives**

Management's objectives may affect the extent of pricing flexibility and should be included as the last part of analyzing the pricing situation. Similar assessments are needed depending on the pricing objectives set by management. Importantly, if one or more of the pricing objectives cannot be achieved based on the assessments of customer price sensitivity, costs, and competitors' likely responses the feasibility of the objective(s) may need to be evaluated.

## **Selecting the Pricing Strategy**

Analysis of the pricing situation provides essential information for selecting the pricing strategy. Using this information management needs to:

- (1) determine extent of pricing flexibility; and

(2) decide how to position price relative to costs and how visible to make the price of the product.

The pricing strategy needs to be coordinated with the development of the entire marketing program since in most, if not all, instances there are other important marketing program component influences on buyers' purchasing behavior.

### **How Much Flexibility Exists?**

Demand and cost factors determine the extent of pricing flexibility. Within these upper and lower boundaries, competition and pricing objectives also influence the choice of a specific pricing strategy. The price gap between demand and cost may be narrow or wide. A narrow gap simplifies the decision; a wide gap provides a greater range of feasible pricing options. Choice of the pricing strategy is influenced by competitors' strategies, present and future, and by management's pricing objectives. **In** competitive markets the feasibility range may be very narrow. New markets or emerging market segments in established markets may allow management more flexibility in strategy selection.

### **Price Positioning and Visibility**

A key decision is how far above cost to price a new product within the flexibility band. A relatively low market entry price may be used with the objective of building volume and market position, or instead, a high price may be selected to generate large margins. The former is a "penetration" strategy whereas the latter is a "skimming" strategy. Analysis of the results of low price strategies in highly competitive markets indicates that while the strategies are sometimes necessary, they should be used with considerable caution.

Lack of knowledge about the probable market response of buyers to the new product complicates the pricing decision. Several factors may affect the choice of a pricing approach for a new product, including the cost and life span of the product, the estimated responsiveness of buyers to alternative prices, and assessment of competitive reaction. A decision should also be made about how visible price will be in the promotion of the new product. The use of a low entry price requires active promotion of the price to gain market position. When firms use a high price relative to cost, price often assumes a passive role in the marketing mix, and performance in combination with other attributes of the product are stressed in the marketing program.

### **Illustrative Pricing Strategies**

The pricing strategy selected depends on how management decides to position the product relative to competition, and whether price will perform an active or passive role in the marketing program. The use of price as an active (or passive) factor refers to whether price is highlighted in advertising, personal selling, and other promotional efforts. Many firms choose neutral pricing strategies (at or near the prices of key competitors), emphasizing non-pricing factors in their marketing strategies." The neutral pricing strategy seeks to remove price as the basis of choosing among competing brands.

*High-Active Strategy*

**BESPLATNI SEMINARSKI RADOVI**

Emphasizing a high price in promotional activities is intended to convey to the buyer that the expensive brand offers superior value. While used on a very limited basis, this pricing strategy has been employed to symbolically position products such as high-end alcoholic beverages. Making price visible and active can appeal to the buyer's perceptions of quality, image, and dependability of products and services. A firm using a high-price strategy is also less subject to retaliation by competitors, particularly if its brand is differentiated from other brands.

**EXHIBIT 11.7**  
**Role of Price**

		Role of Price	
		Active	Passive
Price Level	High	High-Active e.g. value superiority	High-Passive e.g. emphasize non-price competitive factors
	Low	Low-Active e.g. discounters	Low-Passive e.g. avoid price comparisons

*High-*

*Passive Strategy*

High prices may be essential to gain the margins necessary to serve small target markets, produce high-quality products, or pay for the development of new products. Relatively high-priced brands are often marketed by featuring non-price factors rather than using high-active strategies. Product features and performance can be stressed when the people in the target market are concerned with product quality and performance. Expensive Swiss watches are marketed using the high-passive pricing strategy.

#### *Low-Active Strategy*

When price is an important factor for a large segment of buyers, a low-active price strategy is very effective, as indicated by the rapid growth of retailers like Wal-Mart. It is a more attractive option when competition for the market target is not heavy or when a company has cost advantages and a strong position in the product-market.

#### *Low-Passive Strategy*

This strategy may be used by small producers whose brands are not familiar to buyers and have lower-cost features than other suppliers. By not emphasizing a low price, the firm runs less danger that potential buyers will assume the brand is inferior to other brands. Some firms participating in conventional distribution channels may not spend much on marketing their products and, thus, can offer low prices because of lower costs.

### **Legal and Ethical Considerations**

A wide variety of laws and regulations affect pricing actions. Legal constraints are important influences on the pricing of goods and services in many different national and cooperative regional trade environments. Pricing practices in the United States that have received the most attention from government include:

#### *Price Fixing*

A conspiracy among firms to set prices for a product is termed price fixing. Pricing fixing is illegal. When two or more competitors collude to explicitly or implicitly set prices, this practice is called *horizontal price fixing*. *Vertical price fixing* involves controlling

agreements between independent buyers and sellers (a manufacturer and a retailer) whereby sellers are required to not sell products below a minimum retail price.

### *Price Discrimination*

Law prohibits price discrimination the practice of charging different prices to different buyers for goods of like grade and quality. However, not all price differences are illegal; only those that substantially lessen competition or create a monopoly are deemed unlawful.

### *Deceptive Pricing*

Price deals that mislead consumers fall into the category of deceptive pricing. Deceptive pricing is outlawed by the Federal Trade Commission. *Bait and switch* is an example of deceptive pricing. This occurs when a firm offers a very low price on a product (the bait) to attract customers to a store. Once in the store, the customer is persuaded to purchase a higher-priced item (the switch) using a variety of tricks, including (1) degrading the promoted item and (2) not having the promised item in stock or refusing to take orders for it.

### *Predatory Pricing*

Predatory pricing is charging a very low price for a product with the intent of driving competitors out of business. Once competitors have been driven out, the firm raises its prices. Proving the presence of this practice has been difficult and expensive because it must be shown that the predator explicitly attempted to destroy a competitor and the predatory price was below the defendant's average cost.

Ethical issues in pricing are more subjective and difficult to evaluate than legal factors. Companies may include ethical guidelines in their pricing policies. Deciding what is or is not ethical is often difficult. Possible ethical issues should be evaluated when developing a pricing strategy.

## **Determining Specific Prices and Policies**

### **Determining Specific Prices**

It is necessary to either assign a specific price to each product item or to provide a method for computing price for a particular buyer-seller transaction. Many methods and techniques are available for calculating price. Price determination is normally based on *cost, demand, competition*, or a combination of these factors.

### *Cost-Oriented Approaches*

Break-even pricing is a cost-oriented approach that may be used to determine prices. The initial computation is as follows:

$$\text{Break-even (units)} = \text{Total fixed costs} \div \text{Unit price} - \text{Unit variable cost}$$

When using this method, we select a price and calculate the number of units that must be sold at that price to cover all fixed and variable costs. Management must assess the feasibility of exceeding the break-even level of sales to generate a profit. Break-even analysis is not a complete basis for determining price, since both demand and competition are important considerations in the pricing decision.

Another popular cost-oriented pricing method is cost-plus pricing. This technique uses cost as the basis of calculating the selling price. A percentage amount of the cost is added to cost to determine price. A similar method, popular in retailing, markup pricing, calculates

markups as a percentage of the selling price. When using markup pricing, this formula determines the selling price.

$$\text{Price} = \text{average unit cost divided by } 1 - \text{markup percent}^*$$

\* Percent expressed in decimal form

### *Competition-Oriented Approaches*

Pricing methods that use competitors' prices in calculating actual prices include setting prices equal to or at some specified increment above or below the competition's prices. In industries such as air travel, one of the firms may be viewed by others as the price leader. When the leader changes its prices, other firms follow with similar prices. Another form of competition-oriented pricing is competitive bidding where firms submit sealed bids to the purchaser. This method is used in the purchase of various industrial products and supplies.

Reverse auction pricing is an interesting competitive form of Internet pricing. Buyers benefit through savings and suppliers expand their market coverage. This method of determining price involves sellers bidding for organizational buyers' purchases.

### *Demand-Oriented Approaches*

The buyer is the frame of reference for these methods. One popular method is estimating the value of the product to the buyer. The objective is to determine how much the buyer is willing to pay for the product based on its contribution to the buyer's needs or wants. This approach is used for both consumer and business products. Information on demand and price relationships is needed in guiding demand-oriented pricing decisions. Internet auction pricing is a demand-oriented method of pricing.

Many pricing methods are in use, so it is important to select specific prices within the guidelines provided by price strategy and to incorporate demand, cost, and competition considerations. Other sources provide extensive coverage of pricing decisions.

## **Establishing Pricing Policy and Structure**

Determining price flexibility, positioning price against competition, and deciding how active price will be in the marketing program do not provide the operating guidelines necessary for implementing the pricing strategy. Policy guidelines must be determined for use in guiding pricing decisions and pricing structure.

### *Pricing Policy*

A pricing policy may include consideration of discounts, allowances, returns, and other operating guidelines. The policy serves as the basis for implementing and managing the pricing strategy.

### *Pricing Structure*

When more than one product item is involved, management must determine product mix and line-pricing interrelationships in order to establish price structure. Pricing structure concerns how individual items in the line are priced in relation to one another: The items may be aimed at the same market target or different end-user groups. In the case of a single product category, price differences among the product items typically reflect more than variations in costs.

Once product relationships are established, some basis for determining the price structure must be selected. Many firms base price structure on market and competitive factors as well as differences in the costs of producing each item. Most product line pricing

approaches include both cost considerations and demand and competitive concerns. For example, industrial-equipment manufacturers sometimes price new products at or close to cost and depend on sales of high-margin items such as supplies, parts, and replacement items to generate profits. The important consideration is to price the entire mix and line of products to achieve pricing objectives.

### **Pricing Management**

Pricing strategy is an ongoing process rather than a once-a-year budgeting activity. Importantly, pricing strategy is an interrelated process requiring central management direction and control. Special pricing situations may occur in particular industries, markets, and competitive environments.

#### *Price Segmentation*

Price may be used to appeal to different market segments. For example, airline prices vary depending on the conditions of purchase. Different versions of the same basic product may be offered at different prices to reflect differences in materials and product features. Industrial-products firms may use quantity discounts to respond to differences in the quantities purchased by customers. Price elasticity differences make it feasible to appeal to different segments.

#### *Value Chain Pricing*

The pricing strategies of sellers in the value chain should include consideration of the pricing needs (e.g., flexibility and incentives) of producers and facilitating firms (e.g., wholesalers). These decisions require analysis of cost and pricing at all value chain levels. If producer prices to intermediaries are too high, inadequate margins may discourage intermediaries from actively promoting the producer's brand. Margins vary based on the nature and importance of the added value that intermediaries in the channel are expected to provide. For example, margins between costs and selling prices must be large enough to compensate a wholesaler for carrying a complete stock of replacement parts. When a firm uses more than one distribution channel, the question of price differences between channels also has to be considered.

#### *Price Flexibility*

Will prices be firm, or will they be negotiated between buyer and seller? Perhaps most important, firms should make price flexibility a policy decision rather than a tactical response. Some companies' price lists are very rigid while others have list prices that give no indication of actual selling prices. It is also important to recognize the legal and ethical issues in pricing products when using flexible pricing policies. When considering reducing prices it is important to estimate how operating profits will be impacted.

#### *Product Life Cycle Pricing*

Some companies have policies to guide pricing decisions over the life cycle of the product. Depending on its stage in the product life cycle, the price of a particular product or an entire line may be based on market share, profitability, cash flow, or other objectives. In

many product-markets, price declines (in constant dollars) as the product moves through its life cycle. Because of life-cycle considerations, different objectives and policies may apply to particular products within a mix or line. Price becomes a more active element of strategy as products move through the life cycle and competitive pressures build, costs decline, and volume increases. Life-cycle pricing strategy should be consistent with the overall marketing program positioning strategy used.

## **BESPLATNI SEMINARSKI RADovi**

### **Chapter 12**

## **Promotion, Advertising, and Sales Promotion Strategies**

### **Promotion Strategy**

Promotion strategy consists of planning, implementing, and controlling an organization's communications to its customers and other target audiences. The purpose of promotion in the marketing program is to achieve management's desired communications objectives with each audience.

#### **The Composition of Promotion Strategy**

##### *Advertising*

Advertising consists of any form of non-personal communication concerning an organization, product, or idea that is paid for by a specific sponsor. The sponsor makes payment for the communication via one or more forms of media (e.g., television, radio, magazine, newspaper, online).

Among the advantages of using advertising to communicate with buyers are the low cost per exposure, the variety of media (newspapers, magazines, television, radio, Internet, direct mail, and outdoor advertising), control of exposure, consistent message content, and the opportunity for creative message design. In addition, the appeal and message can be adjusted when communications objectives change. Advertising also has some disadvantages. It cannot interact with the buyer and may not be able to hold viewers' attention.

##### *Personal Selling*

Personal selling consists of verbal communication between a salesperson (or selling team) and one or more prospective purchasers with the objective of making or influencing a sale. Personal selling has several unique strengths: salespeople can interact with buyers to answer questions and overcome objections, they can target buyers, and they have access to market and competitor knowledge and provide feedback.

##### *Sales Promotion*

Sales promotion consists of various promotional activities including trade shows, contests, samples, point-of-purchase displays, product placement in films and other media, trade incentives, and coupons. Sales promotion expenditures are much greater than spending on advertising, and as large as sales force expenditures. This array of special communications techniques and incentives offers several advantages: sales promotion can be used to target buyers, respond to special occasions, and create an incentive for purchase. Sales promotion activities may be targeted to consumers, value chain members, or employees (e.g., salespeople).

### *Direct Marketing*

Direct marketing includes the various communications channels that enable companies to make direct contact with individual buyers. Examples are catalogs, direct mail, telemarketing, television selling, radio/magazine/newspaper selling, and electronic shopping. The distinguishing feature of direct marketing is the opportunity for the marketer to gain direct access to the buyer. Direct marketing expenditures account for an increasingly large portion of promotion expenditures.

### *Interactive/Internet Marketing*

Included in this promotion component are the Internet, CD-ROM, kiosks, and interactive television. Interactive media enable buyers and sellers to communicate with each other.

### *Public Relations*

Public relations for a company and its products consist of communications placed in the commercial media at no charge to the company receiving the publicity. The objective of the public relations department is to encourage relevant media to include company-released information in media communications. Publicity in the media can be negative as well as positive and cannot be controlled by the organization to the same extent as other promotion components. Since a company does not purchase the media coverage, public relations is a cost-effective method of communication.

## **Designing Promotion Strategy**

Market target and positioning strategies guide promotion decisions as shown in Exhibit 12.1. Several activities are involved in designing an organization's promotion strategy including:

- (1) setting communication objectives;
- (2) deciding the role of each of the components make in the promotion program;
- (3) estimating the promotion budget;
- (4) selecting the strategy for each promotion component;
- (5) integrating and implementing the promotion component strategies; and
- (6) evaluating the effectiveness of the integrated promotion strategies.

Specific strategies must be determined for advertising, personal selling, sales promotion, direct marketing, Internet, and public relations, and these promotion components need to be carefully integrated and coordinated to achieve communication objectives.

**EXHIBIT 12.1**  
**Designing Promotion**  
**Strategy**



Market targets and product, distribution, and price decisions provide a frame of reference for: (1) deciding the role of promotion strategy in the total marketing program; and (2) identifying the specific communications tasks of the promotion activities. One important question is deciding the role that the promotion strategy will play in marketing strategy.

**Communication Objectives**

Communication objectives help determine how the promotion strategy components are used in the marketing program.

*Need Recognition*

A communication objective, which is important for new-product introductions, is to trigger a need. Need recognition may also be important for existing products and services, particularly when the buyer can postpone purchasing or choose not to purchase (such as life insurance).

*Finding Buyers*

Promotion activities can be used to identify buyers. The message seeks to get the prospective buyer to respond.

*Brand Building*

Promotion can aid a buyer's search for information. One of the objectives of new product promotional activities is to help buyers learn about the product. Advertising is often a more cost-effective way to disseminate information than personal selling, particularly when the information can be exposed to targeted buyers by electronic or printed media.

*Evaluation of Alternatives*

Promotion helps buyers evaluate alternative brands, and such evaluations may be a primary objective of promotion activities. Both comparative advertising and personal selling are effective in demonstrating a brand's strengths over competing brands.

#### *Decision to Purchase*

Influencing the buyer's decision to purchase a brand is an important promotion objective. Several of the promotion components may be used to encourage the buyer to purchase a brand. Personal selling is often effective in obtaining a purchase commitment from the buyers of consumer durable goods and industrial products. Point-of-purchase sales promotions, such as displays in retail stores, are intended to influence the purchase decision, as are discount coupons.

#### *Customer Retention*

Communicating with buyers after they purchase a product is an important objective of promotion for many brands. Follow-up by salespeople, advertisements stressing a firm's service capabilities, and toll-free numbers placed on packages to encourage users to seek information or report problems are illustrations of post-purchase communications.

### **Deciding the Role of the Promotion Components**

Early in the process of developing the promotion strategy, it is useful to set guidelines as to the expected contribution for each of the promotion components. These guidelines help determine the strategy for each promotion component. It is necessary to decide which communication objective(s) will be the responsibility of each component.

### **Determining the Promotion Budget**

Budgeting in practice is likely to emphasize improving promotion effectiveness rather than seeking the optimal size of the budget. Because of this, more practical budgeting techniques are normally used, such as:

(1) objective and task; (2) percent of sales; (3) competitive parity; or (4) all you can afford.

#### *Objective and Task*

This logical and cost-effective method is probably the most widely used budgeting approach. Management sets the communication objectives, determines the tasks (activities) necessary to achieve the objectives, and adds up costs. This method also guides determining the role of the promotion components by selecting which component(s) is appropriate for attaining each objective. The effectiveness of the objective and task method depends on the judgment and experience of the marketing team.

#### *Percent of Sales*

Using this method, the budget is calculated as a percent of sales and is, therefore, quite arbitrary. The percentage figure is often based on past expenditure patterns. The method fails to recognize that promotion efforts and results are related. Budgeting by percent of sales can result in too much spending on promotion when sales are high and not enough when sales are low.

#### *Competitive Parity*

Promotion expenditures for this budgeting method are guided by how much competitors spend. Yet competitors may be spending too much (or not enough) on promotion.

#### *All You Can Afford*

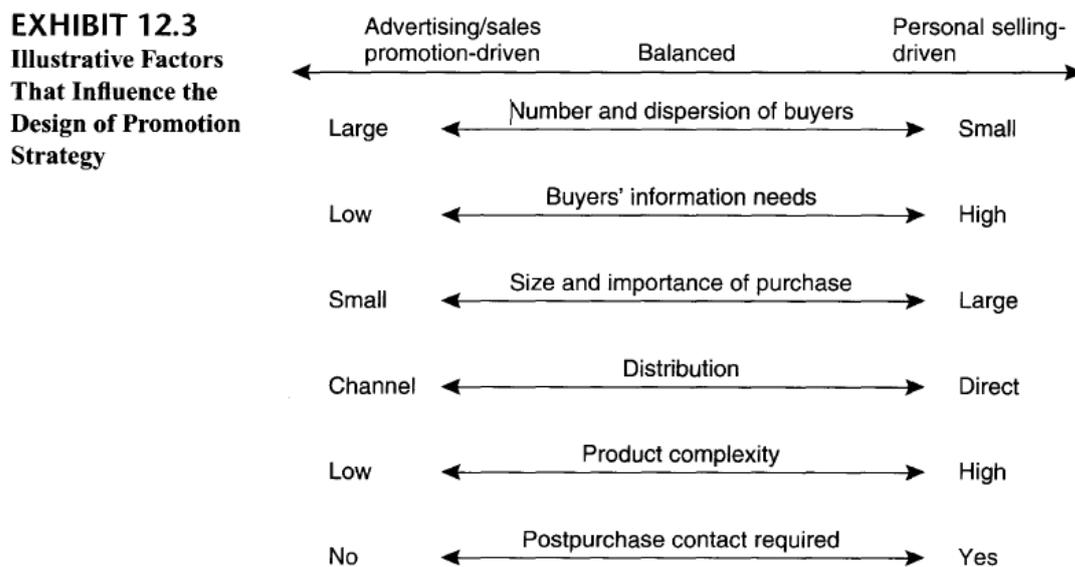
Since budget limits are a reality in most companies, this method is likely to influence all budget decisions. Top management may specify how much can be spent on promotion. The objective and task method can be combined with the "all-you-can-afford" method by setting task priorities and allocating the budget to the higher priority tasks.

### Promotion Component Strategies

The strategies for the promotion components need to be consistent with market targeting strategy and contribute to the desired positioning of the brand. Determining the strategy for each promotion component includes setting objectives and budget, selecting the strategy, and determining the promotion activities (and timing) to be pursued.

### Integrating and Implementing the Promotion Strategy

Several factors may affect the composition of the promotion program as shown by Exhibit 12.3.



Advertising, public relations, personal selling, direct marketing, Internet, and sales promotion strategies have the potential to be fragmented when responsibility is assigned across several departments. Coordinating the activities of the two functions is an important responsibility of higher-level management. The separation of selling and advertising strategies also prevails in a variety of consumer and industrial products firms. An important marketing management issue is how to integrate the promotion strategy components.

### Effectiveness of Promotion Strategy

Tracking the performance of promotion strategy involves:

- (1) evaluating the effectiveness of each promotion component, and
- (2) assessing the overall effectiveness of the integrated promotion strategy.

### Advertising Strategy

Management's perception of how advertising can contribute to the communication objectives has an important influence in deciding advertising's role. Estimating the impact on buyers helps to decide advertising's role and scope in the marketing program and to choose specific objectives for advertising.

### Setting Advertising Objectives and Budgeting

*Advertising Objectives*

Our earlier discussion of promotion strategy objectives identified various objectives that may be relevant for advertising. These include need recognition, identifying buyers, brand building, evaluation of alternatives, decision to purchase, and customer retention. More than one objective may be applicable for a particular advertising strategy.

### *Budget Determination*

The budgeting methods for promotion discussed earlier in the chapter are also used in advertising budgeting. The objective and task method has a stronger supporting logic than the other methods. Budget determination, creative strategy, and media/programming strategy are closely interrelated, so these decisions need to be closely coordinated.

### **Creative Strategy**

The creative strategy is guided by the market target and the desired positioning for the product or brand. The creative theme seeks to effectively communicate the intended positioning to buyers and others influencing the purchase of the brand. Creative advertising designs enhance the effectiveness of advertising by providing a unifying concept that binds together the various parts of an advertising campaign. Advertising agencies are experts in designing creative strategies. Choosing the right creative theme for the marketing situation can make a major contribution to the success of an advertising program.

### **Media/Scheduling Decisions**

A company's advertising agency or media placement organization normally guides media selection and scheduling decisions. The media, timing, and programming decisions are influenced largely by two factors:

- (1) access to the target audience(s); and
- (2) the costs of reaching the target group(s).

### **Role of the Advertising Agency**

Advertising agencies perform various functions for clients including developing creative designs and selecting media. In addition to creative skills and media selection, full service agencies offer a range of services including marketing research, sales promotion, marketing planning. The better the agency understands the company's targeting and positioning strategies, the more effective the agency can be in providing advertising services.

### *Agency Compensation*

Most agencies operate on some type of commission arrangement, though the arrangement may involve a commission for media placement and a separate arrangement for other services.

### **Implementing the Advertising Strategy and Measuring Its Effectiveness**

Measuring effectiveness provides necessary feedback for future advertising decisions. Importantly, the quality of advertising can be as critical to getting results as the amount of advertising.

### *Tracking Advertising Performance*

As previously discussed advertising's impact on sales may be difficult to measure because other factors also influence sales and profits. Most efforts to measure effectiveness

consider objectives such as attitude change, awareness, or exposure. Comparing objectives and results helps managers decide when to alter or stop advertising campaigns.

#### *Methods of Measuring Effectiveness*

Several methods are used to evaluate advertising results. Analysis of historical data identifies relationships between advertising expenditures and sales using statistical techniques such as regression analysis. Longitudinal studies track advertising expenditures and sales results before, during, and after an advertising campaign. Test marketing can be used to evaluate advertising effectiveness. Effort/results models use empirical data to build a mathematical relationship between sales and advertising effort.

### **Sales Promotion Strategy**

Sales promotion activities provide extra value or incentives to consumers and value chain participants. The intent is to encourage sales. Sales promotion is some form of inducement (e.g., coupon, contest, rebate, etc.). Importantly, sales promotion activities can be targeted to various points of influence in the value chain.

#### **Nature and Scope of Sales Promotion**

Purchase rebates are one of the most active forms of sales promotion. Rebates are popular with companies, although consumers dislike the hassles of submitting rebate forms, providing proof of purchase, and delays in obtaining the rebates. The responsibility for sales promotion activities often spans several marketing functions, such as advertising, merchandising, product planning, and sales.

#### **Sales Promotion Activities**

Many activities may be part of the total promotion program, including trade shows, specialty advertising (e.g., imprinted calendars), contests, point-of-purchase displays, coupons, recognition programs (e.g., awards to top suppliers), and free samples. Sales promotion programs fall into three major categories: incentives, promotional pricing, and informational activities.

#### *Promotion to Consumer Targets*

Sales promotion is used in the marketing of many consumer goods and services, and includes a wide variety of activities such as coupons, rebates, contests, and other awards; The sponsoring of sports events; Product-placement activities and etc.

Sales Promotion Activity	Targeted to:			
	Consumer Buyers	Industrial Buyers	Channel Members	Salespeople
<i>Incentives</i>				
Contests	X	X	X	X
Trips	X	X	X	X
Bonuses			X	X
Prizes	X	X	X	X
Advertising support			X	
Free items	X	X		
Recognition			X	X
<i>Promotional Pricing</i>				
Coupons	X			
Allowances		X	X	
Rebates	X	X	X	
Cash	X			
<i>Informational Activities</i>				
Displays	X			
Demonstrations	X	X	X	
Selling aids			X	X
Specialty advertising (e.g., pens)	X	X	X	
Trade shows	X	X	X	

#### *Promotion to Industrial Targets*

Many of the sales promotion methods that are used for consumer products also apply to industrial products, although the role and scope of the methods may vary. The cost per contact is much less than a salesperson calling on prospects at their offices. Sales promotion programs that target industrial buyers may consume a greater portion of the marketing budget than advertising. Many of these activities support personal selling strategies. They include catalogs, brochures, product information reports, samples, trade shows, application guides, and promotional items such as calendars, pens, and calculators.

#### *Promotion to value Chain Members*

Sales promotion is an important part of manufacturers' marketing efforts to wholesalers and retailers for such products as foods, beverages, and appliances. Promotional pricing is often used to push new products through channels of distribution. Specialty advertising items such as calendars and memo pads are used in maintaining buyer awareness of brands and company names.

#### *Promotion to the Sales Force*

Incentives and informational activities are the primary forms of promotion used to assist and motivate company salespeople. Sales contests and prizes are popular. Companies also make wide use of recognition programs like the "salesperson of the year."

### **Advantages and limitations of Sales Promotion**

Because of its wide array of incentive, pricing, and communication capabilities, sales promotion has the flexibility to contribute to various marketing objectives. A marketing

manager can target buyers, value chain members, and salespeople, and the sales response of the sales promotion activities can be measured to determine their effectiveness.

Sales promotion is not without its disadvantages. In most instances, rather than substituting for advertising and personal selling, sales promotion supports other promotional efforts. Control is essential to prevent some people from taking advantage of free offers, coupons and other incentives.

### **Sales Promotion Strategy**

The steps in developing the sales promotion strategy are similar to the design of advertising strategy. First, it is necessary to define the communications task(s) that the sales promotion program is expected to accomplish. Next, specific promotion objectives are set for awareness levels and purchase intentions. Both the content of the sales promotion and its timing should be coordinated with other promotion activities. Finally, the program is implemented and is evaluated on a continuing basis. Evaluation examines the extent to which objectives are achieved.

## **BESPLATNI SEMINARSKI RADOVI**