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## Praise for *Entrepreneurial Marketing*

If you're unconvinced that marketing makes or breaks entrepreneurial ventures, you'll change your mind after reading this book. The Internet, global distribution, and consolidation all create new challenges and opportunities for today's entrepreneurs. The authors offer sound advice and the same kind of solid direction you would pay hundreds of thousands of dollars to buy from a consulting firm. I've used many of these techniques, with Len Lodish's help, to grow our business from 5 percent of the market to over 50 percent.

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This book is filled with valuable and productive concepts, methods, ideas, and paradigms. These concepts have been an important contribution to Synergy's performance—four consecutive appearances on the Inc. 500 List and a compound growth rate of 80 percent to current profitable revenue in excess of \$20,000,000—all from initial capital of less than \$100,000. A must have for entrepreneurs.

—Mark Stiffler  
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This book's cost/benefit approach to entrepreneurial marketing has helped me to acquire profitable customers at less than 1/30th of the cost of my competitors who have recently gone out of business. If you want to succeed and have limited resources, this book is required reading.

—Ken Hakuta  
Founder and CEO, Allherb.com, Dr. Fad, and Marketer of the Wacky Wall Walkers



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# ENTREPRENEURIAL MARKETING

Lessons from Wharton's  
Pioneering MBA Course

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LEONARD M. LODISH  
HOWARD LEE MORGAN  
AMY KALLIANPUR



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To our best venture partners, our spouses who have supported us in so many ways for most of our lives—Susan Lodish for 35 years and Eleanor Morgan for 33 years. We love you.

—Leonard M. Lodish and Howard Lee Morgan

To the two people I love most in my life—my adopted Mom and Dad.

—Amy Kallianpur



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# Preface

**M**arketing, more than technology, is most often the reason for the success or failure of a new venture. Yet there are few detailed guides, and fewer serious studies, on what does and does not work when dealing with entrepreneurial situations. This book is designed to help today's many entrepreneurs make the best use of their time, money, and effort in growing their businesses. The book is itself the product of entrepreneurial marketing thinking. There is a target market that has a need for help that we hope to provide. We have seen no books that combine conceptually sound marketing concepts and paradigms with practical guidance on how to apply them in entrepreneurial situations.

This book has a very pragmatic objective. We are not trying to deliver a complete compendium on marketing or on entrepreneurship. We cover only marketing concepts, methods, tactics, and strategies that can add value to real entrepreneurial ventures as we move into the next millennium. We have been guided in our thinking, not only by our practical experience with dozens of companies, but also by a newly completed survey of the Inc. 500 companies done jointly by the authors and *Inc. Magazine*. These results, detailed here for the first time, provide new insights into what types of marketing programs and channels are used in diverse business settings. The survey contrasted a representative sample of the Inc. 500 winners in 1999 with a sample of entrepreneurs in the Pennsylvania area who represent more "normal" entrepreneurs. We will outline the differences between the Inc. 500, and non-Inc. 500 groups as we discuss the concepts in each chapter. The survey results are described in Appendix B.

We take very seriously the constraints that entrepreneurial firms typically have. They are limited in (1) financial resources,

(2) people to help with any nonproduction-related research or analysis, and (3) time. While bigger, older companies may have the luxury of waiting longer for their marketing and sales strategies to produce results, the entrepreneurial company has to worry about the short term. For most entrepreneurs, without a short-term cash flow, the longer term is impossible.

## Origins

This book should be the best of both the academic and practical approaches to marketing issues. It comes from the intersection of both approaches. The book got started as a by-product of the Entrepreneurial Marketing course which Len Lodish developed at the Wharton School of the University of Pennsylvania where Amy Kallianpur was a doctoral student and a teaching/research assistant. Len Lodish has over 30 years of applying marketing and strategic thinking to entrepreneurial ventures and of consulting with major packaged goods manufacturers such as Procter & Gamble and Pepsico on improving their marketing productivity. In the class, MBA students worked in groups to develop marketing plans for entrepreneurial ventures they were possibly starting. Along with the instructors' comments on how marketing could be used to help entrepreneurial ventures, the students were exposed to successful entrepreneurs who spoke and answered questions. In the five years since the course began, 25 entrepreneurs have come to share their experiences. A favored presenter in each semester was Howard Morgan who has more than 25 years experience with over 30 high-tech entrepreneurial ventures, as a consultant, director, executive, and financial resource.

## The Importance of Marketing for Entrepreneurs

Marketing is of critical importance to the success of most entrepreneurial ventures. Compared to other business functions, marketing has been rated as much more important to the new venture's prosperity. Fourteen venture capitalists who backed more than 200 ventures rated the importance of business functions to the success of the enterprise. The marketing function was rated 6.7 on a scale of 7.0, higher than any other business functions. In-depth interviews

with the same venture capitalists concluded that venture failure rates can be reduced as much as 60 percent using pre-venture marketing analysis.

As part of the preparation of the 1997 Inc. 500 list of the fastest growing private companies in the United States, the CEOs of those companies were asked to outline their greatest weaknesses and strengths. Note that sales and marketing strategies are perceived as their biggest strengths compared to other strategic assets:

	<b>Strength</b>	<b>Weakness</b>
Sales and marketing strategies	145	19
Managing people	112	89
Financial strategies	53	75
Information technology	28	19
Product innovation	12	2
Other	59	35

Marketing is the tool that the entrepreneur needs to help a product or service be perceived as more valuable than the competition by target segments. Marketing strategies and tactics help guide the development of products and services that the market wants, help target the firm's offering to the right customers, get the product or service to the customer, and help insure that the customers perceive the incremental value of the offering better than the competition and will pay for the added value.

Marketing is important, not just in its traditional role of aiding in developing, producing, and selling products or services that customers want. Marketing can also help the firm recruit the best people, and at least as important, help to raise money to finance the venture. Just as marketing can help in exchanges with customers, it can also help in guiding recruiting efforts to make sure that targeted prospective employees perceive added value compared to competition and are motivated to become new employees. As we will see later, the capital raising problem is also assisted by marketing paradigms, strategies, and tactics. The trick is to realize that capital raising really involves marketing a different product—equity or debt in the entrepreneurial venture—to different sets of target markets (e.g., venture capitalists, “angels”).

## **Marketing in the Next Millennium—The Pervasive Web**

The Internet has been one of the most explosive growth phenomena of our times. In just four years, stock trading on the Internet has grown from zero to more than four million accounts. The success of specialized retailers such as Amazon.com in bookselling, N2K in recorded music, and software.net in software has shown that direct one-to-one marketing to consumers, on a 24 hours/7 days per week basis, can lead to success.

Getting visibility and name recognition as one of more than two million domain names now requires a major marketing effort or creative, leveraged approaches. The Web is important for its ability to connect an organization not only to its customers, but also to its suppliers, investors, and any other stakeholders who have an interest in its operations. Each such connection is an opportunity for marketing and promotion, and for the building of a brand. An entrepreneur ignores the Web at his or her peril. This book describes how to leverage the Internet across the various constituencies.

## **Challenges of the Next Decade**

There are a number of key challenges to any organization that will operate over the next decade. Globalization, corporate consolidation, ecological issues, increasing sensitivity to privacy and data ownership issues, and new governmental regulation must all be considered when designing marketing efforts.

Marketing across national boundaries creates challenges that once could only be profitably managed by large companies. Since the Internet immediately puts your product and service information at the fingertips of the world, it is important to be ready for the global customer from day one. In addition, you must be prepared for competition from very far away, for on the Internet, no one cares if you're next door or halfway across the world, as long as the goods or services can be delivered in a timely, reliable manner. An executive in Australia said he routinely orders his books from Amazon.com, since they arrive in Australia within 48 hours, often months before the Australian bookstores get the same books.

Continuing merger and acquisition growth, and the increased number of strategic alliances are altering the competitive structure of many industries. This creates opportunities for some entrepreneurial ventures, and problems for others. Many new Internet ventures have been bought, often for large amounts of money, just to acquire their customer bases. Hotmail, started as a free e-mail service, was purchased by Microsoft for more than \$200 million so that they could have access to the eight million members. Similarly, Excite bought MatchLogic for their ability to target advertising to users. Once these purchases were made, smaller competitors often found that their value shrunk rapidly, since there were no other obvious acquirers.

Other key issues for entrepreneurial marketers in the next millennium include the changing demographics, values, and expectations of the population. In the developing world, the boomer generation will begin retiring in the early 2000s. At the same time, the lesser developed populations are beginning to acquire technology and consumerism. China, India, and other parts of the world offer growth opportunities, but require closer cooperation with government, and better understanding of different cultures than most U.S. ventures have shown. Entrepreneurial ventures can take the lead in taking advantage of these new opportunities.

The key to any marketing is an understanding of “*What am I selling to whom?*” Chapter 1 addresses this question. After covering positioning and targeting, we cover developing, selecting, and evaluating new products and services. We then cover the important pricing decisions that entrepreneurs must make and need major help with. We then help the entrepreneur to make decisions on the main elements of the venture’s marketing mix—channels, rollout, sales management, promotion and viral marketing, and advertising. We next show how entrepreneurial marketing can help hire the best people and raise capital productively. Finally, we conclude with guidance on building strong brands and strong companies that will endure.

LEONARD M. LODISH  
HOWARD LEE MORGAN  
AMY KALLIANPUR



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# CHAPTER 1

## Positioning, Targeting, and Segmentation

**P**ositioning and segmentation are the real core of what makes the entrepreneurial venture work or not work. All of the venture's important decisions and tactics are critically dependent on these basic decisions. A key question is:

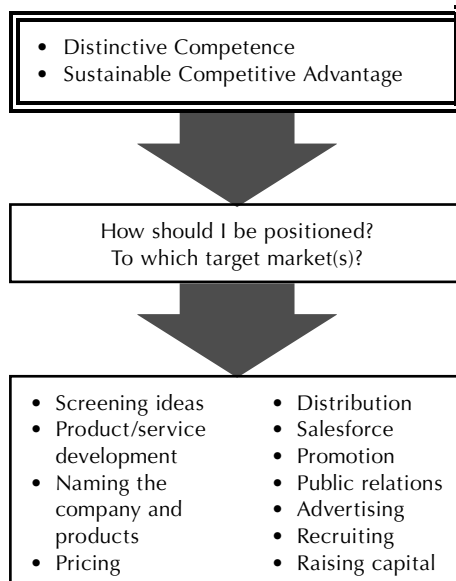
What am I selling to whom?

*Positioning* is how the product or service is to be perceived by a target market compared to the competition. It answers the question: "Why will someone in the target market(s) buy my product or service instead of the competition's?" An equivalent question is: "What should be the perceived value of my offering compared to the competition's?"

*Segmentation* answers the question: "Which is (are) my target market(s)?" Entrepreneurial ventures typically begin life with one product or a small line of related products. The answers to these positioning and segmentation questions are not easy, but are crucial to

the venture's success. Two related concepts of management strategy must be considered to most productively answer the positioning question. These include the venture's *distinctive competence*, and its *sustainable competitive advantage*. Once the positioning decision is made, the entrepreneur can tackle all the other marketing-related decisions. If the other marketing decisions are made before the positioning and targeting is defined, there is a danger that the venture will not be perceived in the market as well as it could be. The sequence of decisions for an entrepreneurial venture is summarized in Figure 1.1.

This book is organized like Figure 1.1. We first discuss the positioning, targeting, and segmentation decisions and their relationship to competitive strategy. We then cover how all of the marketing-related decisions should be made in light of the positioning and segmentation decisions. Please keep in mind that the real decisions are not made in as logical a manner as might be implied by Figure 1.1. There should be constant feedback and adjustment of the positioning and segmentation decisions as other elements of the marketing mix are evaluated, tested, and implemented and as the competition and environment change and evolve.



**Figure 1.1** Market oriented strategy and tactics.

## Distinctive Competence and Sustainable Competitive Advantage

*Sustainable competitive advantage* is the Holy Grail that most entrepreneurs continually pursue. If a way can be found to continually be ahead of competition, then the venture will probably return higher than normal returns to its owners. Being ahead of competition means that the venture can more easily sell more, and/or charge higher prices, and/or have lower costs than “normal” firms. Let’s look at competitive advantage from an entrepreneurial marketer’s point of view. As you will see, the entrepreneurial marketer’s point of view is the customer’s point of view. Your competitive advantage is why the customer or potential customer will more likely buy from you than from your competition. If you have succeeded in developing a competitive advantage that is sustainable from competitive encroachment, you are creating sustainable value.

*Distinctive competence* is how some people refer to the advantage that is the source of the sustainable competitive advantage. If the advantage is sustainable, then your venture has something that is difficult for your competition to emulate and must be somewhat distinctive to your venture. What are sources of distinctive competence for entrepreneurs that might be sources of sustainable competitive advantage? Creative entrepreneurs seem to be finding new distinctive ways to get customers to prefer them to the competition. Here are some of them:

- Many companies use technology to obtain competitive advantage. Patents and trade secrets are weapons to keep the competition from imitation. For software companies, source code for their products is a key competitive advantage. Priceline.com has a patent on their method for having consumers try to name their own price for goods and services. This is a great source of sustainable competitive advantage.
- Other companies may rely on excellent design, perceived high quality, or continual innovation, as distinctive competencies.
- Others will use excellent customer service by loyal employees who have adopted corporate service values. Southwest

Airlines is an excellent example of a venture that differentiates itself from competitors with both excellent customer service and technology for scheduling and turning flights around. Many consumers fly Southwest, not only because it is economical, but because it is fun. Many other airlines have tried to imitate Southwest and have been unsuccessful.

- Reputations and other differences in customer perception of products, services, and companies can be extremely valuable sources of sustainable advantage. If consumers perceive you as being a preferable source, they will be more likely to choose your products or services. Dell's service reputation as well as its business-to-business salesforce have succeeded in getting many customers to perceive them as a trustworthy, reliable resource for computers and related equipment and services. As a result, Dell has also been difficult to compete with.

All of these are ways that entrepreneurs search for sustainable competitive advantage. They relate to how customers choose one product or service versus another. Key positioning and segmentation decisions are intertwined with why customers will choose you versus your competition. Thus, the positioning decision is best made to leverage the distinctive competence of the venture. We first discuss a related key strategic decision: Which customers are you targeting with your positioning?

### **Segmentation and Targeting**

The positioning and segmentation decisions are typically developed together. Although we will take them one at a time, we consider the interrelationships as we go. Conceptually, segmentation is a process in which a firm's market is partitioned into submarkets with the objective of having the response to the firm's marketing activities and product/service offerings vary greatly across segments, but have little variability within each segment. For the entrepreneur, the segments may in many cases only number two: (1) the group we are targeting with our offering and marketing

activity and (2) everyone else. The targeted segment(s) will be related to the product/service offering and the competitive strategy of the entrepreneur.

There are some very important questions that need answers as part of the selection of target market segment(s).

The most important question is: *Does the target segment want the perceived value that my positioning is trying to deliver more than other segments?* Sometimes targeting may involve segments who differ on response to other elements of the marketing mix, however most smaller, entrepreneurial ventures differentiate target segments on the value they place on the differential benefits they perceive the firm to deliver. If a firm can target those people who value their offering the highest compared to the competition, it has many benefits including better pricing and higher margins, more satisfied customers, and usually a better barrier to potential and actual competition.

Almost as important to profitable segmentation is the question: *How can the segment be reached? And how quickly?* Are there available distribution or media options or can a self-selection strategy be used? Are the options for reaching the segment cost effective? Can enough of the segment be reached quickly enough so that you can be a leader before competitors (particularly on the Internet) can target the same segment?

Another question is: *How big is the segment?* If the segment is not big enough in terms of potential revenue and gross margin to justify the cost of setting up a program to satisfy it, it will not be profitable.

Other questions to keep in mind include: *What are likely impacts of changes in relevant environmental conditions (e.g., economic conditions, lifestyle, legal regulations) on the potential response of the target segment? What are current and likely competitive activities directed at the target segment?*<sup>1</sup>

## **Virtual Communities—The Ultimate Segment?**

The Internet has fostered thousands of virtual communities. These are made up of groups of people who are drawn together online by common interests. Just as enthusiasts for certain activities (such as

hobbies, sports, recreation) have gotten together in metropolitan areas for years, the Internet lets enthusiasts from all over the world “get together” virtually. The same phenomenon holds for business users of certain software or specialized equipment. Users or potential users like to get together to help each other with mutual solutions to common problems, helpful hints, new ideas, or evaluations of new products that might help the community members. It is much easier to post notices on an online virtual bulletin board than to physically go to a meeting. A virtual community member can interact with his counterparts any time of the day or night and reach people with very similar needs and experiences.

These virtual communities can be an entrepreneur’s penultimate segment. In terms of the previous segmentation selection questions, the answers to the first two questions are almost part of the definition of an online virtual community. If your product or service offering is tailored (or as importantly, is *perceived* to be tailored) to the members of a virtual community, then it will be positioned as very valuable to that segment compared to any other group. The size of the segment is easily determined as the size of the virtual community.

The incentives for entrepreneurial companies to get involved with virtual communities are great, but it is not a one-way street. All elements of the marketing program need to be cleverly adapted to the new segmentation environment. The challenges of marketing in virtual communities are summarized nicely by McKinsey consultants John Hagel III and Arthur G. Armstrong:

Virtual communities are likely to look very threatening to your average company. How many firms want to make it easier for their customers to talk to one another about their products and services? But vendors will soon have little choice but to participate. As more and more of their customers join virtual communities, they will find themselves in “reverse markets”—markets in which customers seek out vendors and play them off against one another, rather than the other way around. Far-sighted companies will recognize that virtual communities actually represent a tremendous opportunity to expand their geographical reach at minimal cost.

## An Entrepreneurial Segmentation Example—Tandem's East

A clever entrepreneur can use target segmentation as a prime reason for beginning a venture. An example is Mel Kornbluh who began a company called *Tandem's East* in his garage in the late 1980s. Mel is a specialist in selling and servicing tandem bicycles—bicycles built for two (or three or four). Mel realized that there was a segment composed of bicycling couples who would appreciate the unique benefits of tandem riding. It is the only exercise that two people can do communicating while they exercise, appreciating nature together, even though they may have very different physical abilities.

When he began his venture, intuitively Mel had very good answers to the set of questions. There were actually two target segments that Mel could target. The first was existing tandem enthusiasts—those who already had a tandem and would need an upgrade or replacement. The other target segment was relatively affluent bicycling couples who had trouble riding together because of differences in physical abilities. The couples needed to be affluent because tandems are relatively expensive when compared with two regular bicycles. They are not mass-produced and do not take advantage of mass scale economies.

At the time he started, there was no one on the East Coast who had staked out a position as a specialist in tandems. Because tandem inventory is expensive and selection is very important to potential buyers, Mel could establish barriers to potential competitors by being first to accumulate a substantial inventory. He was also able to establish some exclusive arrangements with suppliers by being first in the area and offering them a new outlet. Thus, his distinctive competencies, tandem knowledge, a substantial inventory, and some exclusive lines were the source of sustainable competitive advantage.

It was relatively easy for Mel to reach both of his segments. Existing tandem enthusiasts were members of the Tandem Club of America that has a newsletter they publish bimonthly. It was relatively inexpensive to advertise in the newsletter that reached his first segment precisely. Not only did it reach the segment, but also



because the readers were already enthusiasts, they paid attention to every page of the newsletter. Over time, Internet user groups dedicated to tandeming also formed. They were also natural vehicles for effectively reaching the segment.

His second segment was also relatively easy to reach cost effectively. Affluent bicycling couples read cycling magazines—the major one being *Bicycling Magazine*. Again, because they were enthusiasts, the target segment paid a lot of attention to even small ads. This segment also attended bicycling rallies and organized rides.

Both segments were way larger than he needed to make the business viable. With very small response rates in either segment, he could afford to pay his overhead and begin to accumulate a suitable inventory. In fact, his advertising costs were significantly under 10 percent of revenues, an extremely cost effective way to reach his segment.

Thus, Tandems East began and flourished by creatively seeing target segments that valued what Mel was selling. The segments were substantial, very easily reached cost effectively, and competitive barriers could be erected.

## An Entrepreneurial Segmentation Audit

Appendix A is a segmentation audit that the entrepreneur can use as a checklist to make sure that he or she has considered all elements of segmentation. For an entrepreneur, many of the issues in the audit can cost effectively be answered only qualitatively. However, not considering these issues can cause big problems.

For perspective, our survey shows that 12 percent of the Inc. 500 CEOs did significant segmentation studies, but only 2.3 percent of the non-Inc. entrepreneurs did such studies. So both groups could profit from becoming more sophisticated in their segmentation.

One of the audit's most important issues is: *How well is the segmentation reflected in all the other marketing decisions that the venture makes?* The goal of the rest of this book is to flush out the issues. How does segmentation and targeting relate to all the other elements of the marketing mix for an entrepreneurial venture?

The interrelated positioning decisions to which we turn next are fundamental to segmentation and targeting.

## Positioning

Positioning answers the question: *Why should a member of the target segment buy my product or service rather than my competitor's?* A related positioning question is: *What are the unique **differentiating** characteristics of my product or service as **perceived** by members of the target segment(s)?* The bold words in these positioning questions are crucial for effective implementation. First the word **perceived** must be analyzed. It is obvious that people make decisions based only on what they perceive. Many entrepreneurial firms are happy when they have developed products or services that are *actually* better than competition on characteristics that they know should be important to people in their target market(s). What they forget is that the job is not done until the targeted people actually **perceive** the differences between their product and competition. In fact, on the Internet, many companies try to gain the perception that they're better long before they can deliver on that in reality.

One of the hindrances to effective positioning is that most humans cannot perceive more than two or three differentiating attributes at a time. It is important that the targeted positioning be easy to remember. If there are too many differentiating attributes, the potential consumer can get confused. The entrepreneur's job is to isolate the most important differentiating attributes of his or her offering and use those in all the elements of the marketing mix. In many cases, it is very cost effective to do concept testing or other research with potential consumers to isolate the best combination of attributes (see the concept testing section that follows). In other cases, the entrepreneur can instinctively isolate a good combination of attributes.

Entrepreneurs, who have been successful, may overstate how easy it was to get a good combination of attributes for their positioning. Companies such as Starbucks (just great tasting, excellent quality coffee) or Apple Computer (fun and easy to use) were

successful at least partly because of very effective positioning. What has not been documented has been how many entrepreneurial ventures failed (or were not as successful as they could have been) because their positioning and associated target segments weren't very effective. Venture capitalists' estimate that as many as 60 percent of failures can be prevented by better prelaunch marketing analysis. This underscores how important it is to get your positioning right and testing with real consumers that it is right.

A big mistake many entrepreneurs make is to position based on *features* of their product offering compared to their competitors. It's amazing how many entrepreneurs we have encountered who have great ideas that are based on technical features that are somehow better than their competitors. The fundamental paradigm that *customers don't buy features, they buy benefits* has been lost on many entrepreneurs. Even more precisely, customers buy based on *perceived benefits*. Not only does the entrepreneur need to develop the best set of benefits versus the competition; she must also somehow get the customers to perceive these benefits.

In his book, *What Were They Thinking? Lessons I've Learned From Over 80,000 New Product Innovations and Idiocies*, Robert McMath also says that communicating features instead of perceived benefits is "one of the most common mistakes marketers make."<sup>2</sup> He describes a training film in which British comedian John Cleese illustrates how a surgeon might explain a new surgical procedure to a patient lying in a hospital bed:

Have I got an operation for you. Only three incisions and an Anderson Slash, a Ridgeway stubble-side fillip and a standard dormer slip! Only five minutes with a scalpel; only 30 stitches! We can take out up to five pounds of your insides, have you back in your hospital bed in 75 minutes flat, and we can do 10 of them in a day.<sup>3</sup>

The surgeon is concerned only with technical features that he as producer (entrepreneur) is excited over. The customer has very different concerns. All that the customer probably wants to know is whether he'll get better, what his risks of complication are, and whether he'll experience pain.

## An Entrepreneurial Positioning Example—the Wharton School

The following example is an excellent example of very effective positioning and entrepreneurial marketing. *Business Week* recently ranked the Wharton MBA program first in the United States for the third time. This rating can be traced to the entrepreneurial marketing thinking and positioning insight of Professor Jerry Wind, a colleague in the Marketing Department of the Wharton School. Jerry headed the faculty-student-alumni-administration committee that developed the new Wharton curriculum in the early 1990s. When the faculty adopted the innovative new curriculum, Jerry was the person who did most of the public relations interviews following the approval.

In every interview Jerry repeated four key phrases over and over. Wharton will train managers who are *global, cross-functional, good leaders, and leveraged by technology*. These benefits were designed into the new curriculum because the school's research showed them to be very valuable to Wharton's various constituencies and not perceived as delivered by the other premier business schools. All of the other Wharton administrators who spoke to the press took their cue from Jerry and also emphasized those four attributes over and over. Because these all were fairly new concepts for business schools to adopt and because Wharton was the first major business school to overhaul its curriculum, all the major business media picked up the story and gave it emphasis. Most of the target segments that Wharton wanted to influence changed their perception of Wharton's position because of this media blitz.

There was a perceptual vacuum on most of those attributes that Wharton was able to fill. Once a perception has been lodged in someone's mind, it is not easily changed. Thus, in the competition among business schools, it has been very difficult for a major business school to capture from Wharton the public's perception of distinctiveness on any of those four dimensions.

There was a lot more to the new curriculum than the four phrases that were emphasized. However, because Jerry is a positioning expert, he knew that the target markets would be able to perceive only a limited number of differentiating attributes. The

market research done by Jerry's committee helped them to decide the four most important new differentiating attributes to stress. If the school had tried to publicize all of the new attributes of the new curriculum, the message would have been diluted and the school would not have been able to reach its preeminent perceptual position with its target markets.

Again for perspective, 53 percent of the Inc. 500 CEOs did many positioning studies, but only 26 percent of the non-Inc. 500 did them. One of the reasons behind the Inc. 500 success could be their positioning.

### **Distinctive Competence, Sustainable Competitive Advantage, and Positioning**

Now that we have explored segmentation and positioning, their relationship to the strategic concepts of distinctive competence and sustainable competitive advantage should be easy to understand. The fundamental positioning and segmentation decisions of *What am I selling to whom?* cannot be changed easily. It takes typically more effort to try to change a positioning than to attempt to establish a new one in a vacuum. To change a positioning means undoing one perception and replacing it with another. In the Wharton School example, the school had to develop or have internally strength in areas that would lead to perceptions of "global, cross-functional, good leaders and leveraged by technology." These should be distinctive competencies that differentiate Wharton from its competitors and should be such that they would be sustainable from competitive inroads.

For entrepreneurial companies, the intertwined positioning, distinctive competence, and sustained competitive advantage decisions are the most important strategic decisions made before beginning a new business or revitalizing an older business. The positioning and segmentation decisions are just the public face put on the distinctive competence and sustainable competitive advantage decisions. If the market doesn't value "what they perceive to be the distinctive competence of your firm versus the competition" (another way of defining positioning), then the positioning will not be successful. Furthermore, since it is difficult

to change perceptions, the perceived distinctive competence should be sustainable over time. Thus it is crucial to get the positioning reasonably close to right *before going public the first time*. In Chapter 2 we will explore cost-effective ways of getting market reaction to positioning options before going public.

### **Orvis Company—Excellent Entrepreneurial Positioning**

The Orvis Company has done an excellent job of capitalizing on a unique positioning in a very competitive industry. They sell “country” clothing, gifts, and sporting gear in competition with much bigger brands like L.L.Bean and Eddie Bauer. Like their competitors, Orvis sells both retail and mail order. How is Orvis different? They want to be perceived as the place to go for all areas of fly-fishing expertise. Their particular expertise is making a very difficult sport “very accessible to a new generation of anglers.”<sup>4</sup> Since 1968, when their sales were less than \$1million, Orvis has been running fly-fishing schools located near their retail outlets. Their annual sales are now over \$350 million. The fly-fishing products contribute only a small fraction of the company’s sales, but the fly-fishing heritage adds a cachet to all of Orvis’s products. According to Tom Rosenbauer, beginner fly fishermen who attend their schools become very loyal customers and are crucial to continuing expansion of the more profitable clothing and gift lines. He says, “Without our fly-fishing heritage, we’d be just another rag vendor.”<sup>5</sup>

The Orvis positioning pervades their entire operation. Their catalog and their retail shops all reinforce their fly-fishing heritage. They also can use very targeted segmentation to find new recruits for their fly-fishing courses. There are a number of targeted media and public relations vehicles that reach consumers interested in fishing. Their margins are higher than the typical “rag vendor” because of their unique positioning. The positioning is also defensible because of the consistent perception that all of their operations have reinforced since 1968. A competitor would have a very difficult time and large expense to reproduce the Orvis schools and retail outlets. It also would be difficult for a competitor to be a “me too” in an industry where heritage is so important. The positioning and segmentation decisions Orvis made in 1968

probably added close to a billion dollars of incremental value to their venture since that time. That value is our estimate of the difference of Orvis's actual profit since 1968 compared to what the venture's profitability might have been had they just been "another rag vendor."

### **Positioning, Names, and Slogans**

Many entrepreneurs miss positioning opportunities when they name their products, services, and companies. As we will discuss in depth later, entrepreneurs have very limited marketing funds to educate their target markets about the positioning of their products and services. If the names chosen do not themselves connote the appropriate positioning, then the entrepreneur has to spend more funds to educate the market in two ways instead of one. They have not only to get potential customers to recognize and remember their product name, but they also have to educate them about the attributes and benefits of the product that goes with the name. Many new technology and Internet based ventures have been very intelligent and creative in their names that do connote the appropriate positioning. Companies such as CDNow (CDs on the Internet), ONSale (online Internet auctions), Netscape Communications (Internet browsers), @Home (using existing TV cable for home Internet connections), and Reel.com (movie sales on the Internet) make it easy for potential customers to remember what they do and at least part of their positioning. On the other hand, all you know from the name Amazon.com is that it is an Internet company. The fact that it sells books is not evident from its name. Educating consumers needs to be done with other marketing activities.

Some fortunate companies have gone even further by making their names not only support their positioning, but also simultaneously let their potential customers know how to get in touch with them (for example, 1-800-FLOWERS, 1-800-MATTRESS, Reel.com). Some entrepreneurs have registered Internet locations that will be valuable to others who have not yet realized their value. These entrepreneurs intend to sell those locations to the companies who will find them valuable. These fast-moving

entrepreneurs have already taken Internet sites for all of the potential political candidates for the U.S. presidential election in 2004.

If the name of the company or product is not enough to position it in the customer's mind, then the next need is for a slogan or byline that succinctly and hopefully memorably hammers home the positioning. If the positioning has been done well, then a slogan or byline can in many cases fairly completely communicate the appropriate attributes. One good example is Alan Marcus & Co. They advertise with very small space ads in the *Wall Street Journal* with their slogan and byline always the same. The ads always begin with "America's Largest Fine Watch, Diamond, and Jewelry Discounters" and have "Elegant Price Cutters since 1973" below the company name. Nothing else really needs to be said to communicate what the company does, who the company is, and why people should buy from it. The positioning inherent in these two bylines is a good example of concentrating on only the few, most important, attributes to stress in order to position the company. BMW has been using "the Ultimate Driving Machine" for many years to differentiate itself as a performance automobile. Michelin uses "Because so Much is Riding on Your Tires" to try to differentiate itself as better on the safety attribute for tire buyers.

Just as brevity and simplicity are valuable in positioning, they are also as valuable in slogans and bylines. The slogan that goes with a company or product name should be one that can be retained for quite a long time, as long as the positioning will be in force. Robert Keidel proposed other ground rules for effective slogans: Avoid cliches (e.g., "genuine" Chevrolet, Miller); be consistent; use numbers, but have them backed up; be brief; take a stand; and make it distinctively your own.<sup>6</sup> All of these rules are consistent with our effective positioning paradigm and make good sense.

## Summary

Each venture must answer the *What am I selling to whom?* question before it can create successful marketing strategy and tactics. Segmentation selects the subgroup(s) of all consumers to whom



we think we should sell our products. Positioning tells members of the segment why they should buy our product or service, vis-à-vis any competitors. The positioning and segmentation decisions are intertwined with strategy decisions about distinctive competence and sustainable competitive advantage. The Internet creates the opportunity for the address (URL) to be of great service in positioning, since the name (e.g., reel.com, or etoys.com) can be both descriptive and informative.

# CHAPTER 2

## Selecting, Developing, and Evaluating New Products and Services

**M**ost entrepreneurs have at least one product or service concept in mind when they begin planning their venture. In this chapter, we describe some helpful methodologies and concepts and codified entrepreneurial experience that can help screen new product and service concepts. We also describe cost efficient methods for getting marketplace and channel participants to help both improve the design and gauge the potential sales outlook for the idea. The idea is to try to conserve scarce resources by developing and implementing only ideas that are likely to make significant entrepreneurial returns. After discussing screening and concept testing for existing new product ideas, we then review some very interesting research that helps the entrepreneur choose

a better battlefield to enter, if she has the option of choosing different kinds of products or services to consider for her venture.

## Evaluating Specific Venture Ideas—Concept Testing

Every product or service idea has to be wanted by some market segment more than competitive products or services in order to obtain sales. Very simply, if customers won't choose your new product or service over the existing product or service, then you won't succeed. It is amazing that so many entrepreneurs do all kinds of analyses of costs, patent protection, possible competition, and market potential (if every one who could use one of my widgets bought one, we would have sales of \$5 billion!) What they don't do is get actual reaction from real customers to the product or service concept. The entrepreneur just doesn't know all of the factors that the end customer will consider when he evaluates the new product or service. As we discuss in Chapter 5 on distribution channels, it is also very important to get channel intermediary reactions to the concept as well. Before we describe methods for getting customer and intermediary's reactions and suggestions for product improvements, we provide an example of how valuable these methods can be.

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### **Trakus: the Value of Concept Testing**

An MIT MBA, Eric Spitz and two high-tech MIT undergraduates founded Trakus, Inc. in 1997. The company was originally named Retailing Insights to reflect their initial product concept. They were going to do Videocart right using the latest technology. Videocart was a computerized shopping cart that was developed and introduced in the early 1990s. The cart would know where it was in a store and let the shopper know about specials and other useful information that depended on the cart's location in the store. So if a shopper were in the cereal aisle, the screen on the cart would show the cereal specials for the day. The cart could also show advertisements for cereals when the cart was in the cereal aisle. To keep shoppers' attention, the cart had a number of useful consumer functions. These functions included locating items in the

store, getting a number for the meat or deli line remotely and being paged when your number is ready, providing recipes and store location for all of the recipe's items, local news, and so on.

The original Videocart venture failed because of poor execution. The carts were not recharged or repaired on a timely basis. Thus, when a consumer went to take one, the odds were that the cart would not function well. Word of mouth among consumers and the early store sites became negative so no new stores wanted to put the carts in. From a public market value at one time over \$300 million, Videocart Inc. failed and declared bankruptcy in the mid 1990s.

Eric's team was going to do Videocart right using all the new technology. Instead of FM transmitters for location in the store, they had developed an indoor version of the GPS global positioning system to use. They would be able to identify the shopper's frequent shopper card or name and pull information from the Internet. Thus, the shopper could put their shopping list in at home and it would be available electronically at the store. The carts would be of value to store operators because they would get more customers to patronize their stores. The retailers would also be able to sell promotion opportunities on the cart to the manufacturers just as they did in their weekly circulars. This was a significant profit opportunity for the retailers. To advertisers, the computerized shopping cart was the perfect opportunity to reach the consumer at the most important point—just as they were making their actual purchasing decision. The new Videocart was going to be much cheaper than the original because of the lower costs of new technology. On paper, the venture looked terrific. Eric obtained \$50,000 seed money from an angel investor. The angel investor requested that before the team spend any money on product development, that they concept test the idea to both of the customer groups that would need to buy the idea. These were the retailers who needed to subsidize putting the carts in the stores in return for promotional funds they would get, and the advertisers who were to pay for advertising on the carts.

The team developed a very compelling description of the new generation videocart, which included all of the benefits that either the retailer or manufacturer would obtain. They even had a neat

simulation of how the system would work and what the cart's screen would look like that they put on their laptop personal computers. They showed this to retailers and manufacturers and at a given price asked how likely they would be to buy into the carts. After asking the purchase intent question, they also asked a number of questions about what manufacturers and retailers liked and what they disliked about the cart concept. The answers the team received were not very encouraging. For retailers, the cart's previous bad reputation was a big barrier. Retailers were very apprehensive to try another version of a product that had a terrible reputation. This implied that the team would have to establish extensive beta sites (at the venture's expense) to prove over a long term that the carts would work and would provide the benefits the team anticipated. Not only that, but retailers were also very frugal and were very reticent to commit their own funds to investing even partially in the carts. The retailers were used to having manufacturers pay for most new innovations as a way of getting or improving their shelf space and in-store position.

For the manufacturers, they were only willing to pay for advertising on the carts if the carts would demonstrate that they actually had an incremental effect on the manufacturer's sales in the stores. Not only that, but manufacturers also required significant scale to justify their infrastructure to support the new advertising medium. That meant that Eric's team would have to be in a significant fraction of all of the U.S. supermarkets before the manufacturers would begin to commit significant advertising and promotion funds to the medium. It did not take much rough calculating to determine that the cash investment required to reach a break even (if a break even were at all possible) would be huge. The probability of convincing venture capital or angel sources to invest that kind of money was very low. Eric's team was discouraged for a couple days by the results. However, they had most of their angel's seed money left and lots of technical skills in the areas of GPS location, communications, and digital signal processing. After the bad concept testing results sunk in, the team had a brainstorming session where they generated and evaluated a number of product ideas that would leverage their distinctive competence as they viewed it.

The outcome of that brainstorming session took the team in a very different, but much more profitable direction. Eric, a sports nut, conceptualized a product concept that the rest of the team said could be accomplished technically. They were going to put little rugged transmitters on athletes (in their helmets or on their clothes) and put receiving antennas in a few places in the stadium. They could then determine in real time, digitally, where every athlete on a team is, record it, and process that data to generate new valuable statistics, and display the information virtually immediately. The information would include speed and acceleration of each player and real time location of each player. If you know the weight of two players and their acceleration the instant they collide, you can easily calculate a “hit” gauge. This hit gauge would be a valuable addition to the broadcasting of football or hockey. The broadcaster could also analyze any plays by showing the digital picture of the replay and associated speed and acceleration statistics and processing the digital data to illustrate good or poor performance of some players. The digital, real time data and information would also be perfect for “broadcasting “ the games over the Internet.

The team concept tested this idea similarly to the way they had potential customers evaluate the videocart. They developed a simulation of what the system might look like and presented it to members of potential market segments that might be interested in the system. They also changed their name to Trakus, Inc. to reflect their new orientation. The segmentation and decision process that would be used by each segment was much more complicated for the new Trakus sports product. There were teams, leagues, players associations, coaches (who could use the system for training), advertisers, agents, Internet sports companies, and so on who all could contribute to or influence Trakus’ market reception and potential revenue. Before they exposed the concept to all of these market participants, they applied for patents on their ideas to give them some protection after they exposed them to the market.

In contrast to the lukewarm reception they received for Videocart, the Trakus concept “rolled the socks up and down” of almost all of the people they interviewed. The biggest concern anyone expressed was whether the team could actually develop

the product and have it work reliably. At the time this is being written, Trakus has raised over \$4 million from angels and a venture capital firm. They are on schedule to introduce the Trakus system at the Fleet Center for the Boston Bruins 2000–2001 hockey season. They have already demonstrated that the system can track 12 players in real time and just need to ruggedize the system for a production version. Recently, Trakus was identified by *Inc.* magazine as one of the 10 “hottest” new companies of 1999 and by *Fortune* magazine as one of 10 high potential, new high-technology companies.

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If the Trakus team had not concept tested their original Videocart idea and had gone ahead to develop and implement that concept, it is not certain that they would have failed. However, given their concept testing results, the odds of having a huge success were low. On the other hand, the concept testing results were used the way they should have been used—to screen an idea before a lot of resources were spent on it. The concept testing caused the team to “go back to the drawing board” and generate other product ideas that could best leverage their unique skills and abilities.

The team deserves credit for interpreting the concept testing results in a rational manner. Human nature goes against rational interpretation of valuable, but negative information. When the team had organized itself and made its mission to “do Videocart right,” it was very difficult emotionally to receive and rationally process information that said that the market did not want a new Videocart nearly as much as the team thought they did. The U.S. culture seems to reinforce these emotional reactions to negative, but valuable information. It is not seen as “macho” to decide to give up on an idea, admit you were wrong, and go on to make the best of what you have left. Especially in an entrepreneurial venture that is typically started with the product/service idea as the main motivation for the team to get together, it is very difficult to admit that the initial idea may not be as profitable as the team first thought. As we describe how to do concept testing for entrepreneurial ventures, keep in mind that it is a challenge to use the concept testing results rationally.

## Concept Testing

Concept testing is a research technique that checks whether the prospective purchaser and/or user of a new product-offering bundle understands the product/service idea, feels that it answers a need, and would be willing to purchase and/or use it. Concept testing is basically a set of procedures in which potential customers are exposed to a product or service concept and are asked for their reactions to it. Next we discuss in detail how to perform these procedures most advantageously for entrepreneurs.

The technique can also help to improve the product-offering bundle by understanding problems and/or improvement opportunities that are perceived by the potential consumers. Its primary purpose is to estimate customer and/or intermediary reactions to a product-offering bundle before committing substantial resources to it. Concept testing forces the entrepreneur to expose the idea to the people who will have to receive perceived benefits from it, and to make sure that these people do perceive the benefits. If done well, concept testing and associated procedures can provide a number of important benefits to the entrepreneur, including:

- Identifying likely product failures and limiting the amount of resources spent on ideas that the market does not perceive as helpful.
- Separating good ideas from poor ones and supporting resource allocation to those ideas that the market does want.
- Supplies suggestions for improving the product-offering bundle to make it perceived as more useful to the market participants.
- Generates rough price-sales volume demand curves for new product-offering bundles (see Chapter 3). Well-designed and well-executed concept testing can provide estimates of how the demand for a product will change at alternative price levels.

Because concept testing is best at estimating consumer reaction to the product-offering bundle *before* they actually use it, it works for estimating a new product or service trial, but is not very



effective at estimating repeat purchases for goods. The experience with the physical product or service bundle and whether it delivers on its implied promise will be the most important determinant of whether the customer purchases the product again. Thus, concept testing is more useful for estimating trial rates for frequently purchased products and potential sales for consumer-durable products as well as business-to-business durable products. However, even for durable products and business-to-business products, if the initial customers are not satisfied, they will tell other potential customers that the product is bad. Word of mouth can be the biggest help and also the biggest problem for entrepreneurs, depending on whether the initial users are satisfied that the product meets their expectations. The entrepreneur should keep in mind that concept testing can only help estimate revenue *assuming that the product meets the customer expectations* when the customers actually use the product or service.

Concept testing can be a very productive tool for the entrepreneur. It can be done relatively quickly at a relatively low cost. It is also a very flexible technique. A number of ideas can be handled in a single study, as well as the evaluation of different versions of the same basic product-offering bundle. From a cost/benefit viewpoint, concept testing is usually a great value for the entrepreneur. We next discuss some “nuts and bolts” of concept testing and then discuss what concept testing doesn’t do, that is, some of its limitations.

### **Doing Concept Testing—the “Nuts and Bolts”**

To use concept testing productively, the following questions must be addressed:

- What kind of information specifically should be collected from respondents?
- What should be in the concept statement?
- What are the best modes of data collection?
- Who should be exposed to the concept?
- How should the questions be asked?

We’ll take each of the previous questions in order.

*What Kind of Information Specifically Should Be Collected from Respondents?*

The most valid information you could gather from a respondent is to *actually ask for and receive an order* for purchase of the product based on the concept statement. We discuss these *dry tests* when we discuss modes of data collection. If you can not realistically perform dry tests, then the next most valid information is *purchase intention*. Purchase intention is an indication of how likely the respondent would be to buy the product, after they were exposed to the concept. The usual scale that is used to scale purchase intention is: Definitely would buy, Probably would buy, Might or might not buy, Probably would not buy, and Definitely would not buy.

It is risky to interpret purchase intentions absolutely; especially any answer except Definitely would buy. The exposure of the concept will typically sensitize the respondent to the product concept and may bias them to tell the perceived source of the concept test what they feel the concept tester wants to hear. People want to “be nice.” The purchase intent question also implicitly assumes that the respondent has been exposed to the product, has understood the attributes of the product, and is able to find the product available in the channel that the respondent would use to buy the product.

To counteract the “be nice” bias, include somewhere in the concept test a comparison of the new product with some existing product it might replace. Equivalently, some respondents can respond to a concept that describes the existing product in the same form as the new product. The purchase intent scores on the existing product can then be a base from which to compare the intent scores on the new product. For example, if product A is an existing product and product B is the new product, both products would be described by a concept statement as shown below, and purchase intent would be collected for both products. The fraction who “Definitely would buy” can be compared for A and B. If B has 20 percent more intent to “Definitely buy,” then it is reasonable to assume that if consumers are aware of product B, understand its attributes, and can find it distributed, then B could reasonably sell 20 percent more than A. Some researchers will take a small fraction, around 30 percent of the “Probably would buy” into their calculations by

adding 30 percent of the responses to the “Probably would buy” box, to the responses for the “Definitely would buy.”

To counteract the other awareness and distribution limitations, the researcher should multiply the fraction of the market that the concept test says would buy by at least three estimated reduction factors, all fractions less than one. The first factor,  $f_1$ , is the fraction of the target population(s) that will be aware of the new product. This will depend on how successful the marketing plan is for the product. The second factor,  $f_2$ , is whether those who are aware will understand and perceive the attributes and benefits of the product as well as those who were exposed to the concept in the concept test. This reduction factor,  $f_2$ , also depends on the success of the marketing plan. Finally the third factor,  $f_3$ , reflects the odds that members of the target market(s) will be able to easily purchase the product where they would expect to find it. Multiplying the concept test purchase intent fraction by  $f_1$  times  $f_2$  times  $f_3$  will reduce the purchase intent number to one that is much more reasonable and more predictable of in-market performance.

For example, let's assume a concept test was executed to a representative sample of potential customers in our target market and that 30 percent of those responding indicated they would “Definitely buy it.” To be conservative, we'll assume that none of the people who said “Probably would buy it” will eventually buy the product. We must multiply the 30 percent by  $f_1$ ,  $f_2$ , and  $f_3$  to reflect awareness and distribution limitations. Based on our introductory marketing plan, we'll assume that 40 percent of the target market will become aware of the product ( $f_1 = 40$  percent) and that only 30 percent of those aware will perceive the benefits and attributes as well as those exposed in the concept test ( $f_2 = 30$  percent). Further, based on how much of our category volume is sold in stores which plan to carry our product, we assume that 60 percent of our target market will easily be able to find the product where they will expect to purchase it ( $f_3 = 60$  percent). Thus, if we multiply the 30 percent by 0.4 times 0.3 times 0.6, we obtain 2.16 percent, an estimate of the percent of the target market that might make an initial purchase of the product. Different assumptions for these reduction fractions can be used to test for sensitivity of sales forecasts to these assumptions.

Other questions can aid in both improving the actual product and the way it is described to potential consumers. These questions should be asked *after* the purchase intent question. The purchase intent question is meant to measure the attraction of a concept after the potential customer has been exposed to the concept, not after the potential customer has been asked many questions about the concept that normally heighten his interest in the concept.

Questions about how well potential consumers understood the concept and what they liked and didn't like about the product are usually very helpful. The likes and dislikes can be very useful in improving either the product or the way the product is described. The respondent should be able to "play back" the products attributes and benefits, as they perceived them after having been exposed to the concept statement. The respondents could also answer questions about how interested they are in the product—extremely interested, somewhat interested, and so on. If many respondents are extremely interested, but relatively few express high purchase intent, then perhaps the price used in the concept test was too high.

Depending on the product and its target market, other questions can be asked about situations for which the respondent sees the product as useful, or problems the product might solve. If the respondent can tell which products the new product might replace, this is also helpful. Answers to these questions can be valuable for improving the marketing materials for the product's introduction.

Some people put price response questions into the concept test by asking *the same person* purchase intent questions *at different price levels in the same concept test*; for example, "How likely would you be to purchase the product if it were \$140, \$130, \$120, or \$100?" The respondent would give a separate response for each alternative price level. *This procedure is extremely biasing and should be avoided.* The respondent assumes that she is "negotiating" with the concept tester and gives very biased results that are not usually indicative of how the respondent would actually react if she were exposed to the product at different price levels.

The right way to include price response in a concept test is to include *one price* as part of the product's description. *Each*

*respondent* is exposed to only one price as a descriptor of the product. However, *each respondent* can be exposed to *different prices* than other respondents. As we'll see later with some examples, price is a very psychological attribute and can have a big impact on how potential consumers perceive a product or service. This procedure insures that the potential consumer sees only one price, the same way the person will see the product in the real market.

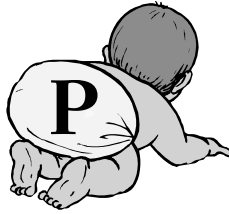
#### *What Should Be in the Concept Statement?*

The concept statement should as closely and realistically as possible mimic how the respondent would be exposed to the product and its attributes when the product is actually introduced. Most concept statements look like product brochures or print ads. The concept statement typically also includes where the respondent could expect to buy the product or service, and all the benefits that are part of the positioning plan. As discussed, the price of the product is one of the attributes that should be an integral part of the concept statement. Figure 2.1 shows a concept statement for one product from a new novelty diaper line that has university and sports team logos on them. To be realistic, the concept test should be done in each of the possible target market segments with the specific logo for that segment as part of the concept description. One of the possible market segments was alumni of the University of Pennsylvania. The concept is slightly disguised to protect confidentiality.

#### *What Are the Best Modes of Data Collection?*

The entrepreneur wants to have the respondent exposed to the concept in a manner as close as possible to how they would be exposed in reality. There are limits and trade-offs of costs versus validity of the concept test results. If you would use a print ad or direct mail piece to introduce your product, it is not very expensive to "dummy up" some sample ads as part of the concept statement and then to expose people to those ads. These kinds of concepts are most validly exposed through personal interviews with the respondent either at her home or at her place of work. Depending on the segmentation targets, it sometimes is cheaper and not less valid to use centralized locations like malls. Telephone interviews can be very cost effective for concepts that are

*Product Concept:* Futurewear is a line of designer diapers, which feature university and professional sports team logos. One of the diapers has the University of Pennsylvania “Penn Quaker” logo, both on the tape and bottom (“tush”) of the diaper. This diaper is made of premium materials and is functionally equivalent to a good disposable diaper. It is a fun, novelty item, which will typically be purchased as a gift (i.e., baby shower, Christmas) rather than as an everyday item by parents. The diapers will be white, packaged in a very nice gift box of 19 that also has the Penn Quaker logo, and be priced at \$11.95. The diaper will be available at most stores that have other University of Pennsylvania logo merchandise, as well as Web stores that sell baby merchandise. What a nice, fun way to help a loyal Penn alumnus start his or her child show their support of Penn! The perfect gift for anyone who is a Penn supporter!



**Figure 2.1** Logo diaper concept statement.

easily understood over the phone and may be advertised on radio when they are introduced. Sometimes a combination of mailing, e-mailing, or faxing the concept statement can be combined with telephone interviews. These combinations can be very cost effective and for many products and services do not lose much validity compared to in-person interviews.

It is usually cost effective to contract with a local market research firm to actually field the concept test. They have experience in getting with the right people and can help with the actual test design. However, if they tell you to do something that contradicts the major points in this chapter, then you should change suppliers. Depending on your time versus resource constraints, it may be possible to use students at nearby universities who are studying market research. However, if they use your product as a class project, it may take two or three months to get results. Commercial firms can turn around some concept tests in a few weeks.

For products that will be sold or promoted with the Web as a primary marketing tool, concept testing can very easily be done directly on the Internet. In fact, depending on one's ethics, it is very feasible to "dummy up" online ads and/or product descriptions, and *actually ask for the order online*. When respondents actually start the order process, you then can explain to them that the product is in development and that you were testing market place reaction. You could then send them some kind of a gift as a token of thanks and apology, and put their name on a list of those who will get the first chance to buy the product when it's ready. This *dry test* as direct marketers call it, is the most valid way of getting real consumer demand for a new product or service. Such dry tests are often used in countries where questionable marketing practices are more widely accepted; in the United States, this mode of assessing reactions may raise ethical concerns. The Web is not the only place dry tests can and have been used. Direct response marketers have been using dry tests for years. Depending on which media vehicles they use for advertising, they have to consider that they are prematurely letting their competitors know their new product plans. Dry tests with direct mail are much easier to hide than dry tests in radio, television, or print.

#### *Who Should Be Exposed to the Concept?*

If your positioning and segmentation planning are complete, then it is obvious that decision makers and decision influencers of the target segments should be exposed to the concept. In concept testing, it usually pays to be inclusive with possible target segments. If you are doubtful about a target segment, it makes sense to concept test some members to help decide whether to include the segment in your plans. The cost of concept testing is typically small compared to the foregone profits of missing a possible segment.

For business-to-business products and some complex and/or expensive consumer products, you must be careful to interview all of the possible influencers of the purchase decision. For example, you are considering introducing a new angiography product to hospitals, you should interview not only the physicians who would use the product, but hospital administrators who would need to approve the purchase as well as nurses who might influence how

the product were to be used. For high-involvement consumer purchases like appliances, computers, and telecommunications equipment, there may be many possible decision influencers that need to be tested. For example, for computers and telecommunications equipment, many consumers turn to “experts” whose opinions they request before they make purchase decisions. It is very important for the entrepreneur to seek out and interview these experts.

If the entrepreneur does not know the decision process in her target markets well enough, before performing the concept testing, it makes sense to do some qualitative questioning of market participants to find out how these type of decisions are typically made. Questions such as “Would you consult anyone else before making a purchase decision?” or “Who else would have to approve this decision?” can be very enlightening.

### Concept Testing Channel Members

In Chapter 6, we discuss concept testing for channel members as being as important as for the end purchasers. However, concept testing with channel members *is no substitute* for getting systematic end user reaction to a product. In the book *The Silicon Valley Way*, Elton Sherwin Jr. describes a disguised, but real company, The Palo Alto PC Company, that neglected to concept test the end purchaser and solely relied on the results from the distribution channels.<sup>1</sup> This company had been successful designing and building small, good looking, premium-priced notebook PCs and selling them through a strong network of distributors.

As Palo Alto PC began designing their fourth generation notebook, they did a cursory survey of their largest distributors. They assumed, and their distributors confirmed, that “Customers want it even smaller.”

The new Palo Alto PC was a hit with the media. Its innovative keyboard made it both small and cute. Unfortunately, few customers bought it. Sales plummeted. It turns out that executives wanted longer battery life, brighter screens, and thinner PCs—but not smaller keyboards.<sup>2</sup>

Distributors are very good at reacting to the aspects of the product that affect how well they will “push” them—the mark-up, the terms, the logistics, the end-user marketing program, and so on.



They also can sometimes tell you what *they think* their customers will want. However, as this example points out, there is typically no substitute for getting end-user reaction to concepts.

#### *How Should the Questions Be Asked?*

Concept testing for entrepreneurs typically involves either *monadic* testing (a person gets exposed to only one concept) or *paired comparison* testing (a person is exposed to a pair of concepts).

Monadic testing should be used when you seek a detailed uncontaminated reaction to a concept. It is typically better to monadic test when direct competitors are hard to identify. Monadic tests also work better when there is little external search for alternatives prior to purchasing.

On the other hand, when there are direct competitors already in the market, it can be useful to also do a *paired comparison* evaluation of the new product versus others. If there's enough time, the paired comparison can be done after the monadic evaluation. The paired comparison purchase intent can be asked as "Which would you prefer to purchase, Product A or Product B?" Here also a scale can be used, just as it was in the monadic purchase intent: Definitely prefer A, Moderately prefer A, Toss-up, Moderately prefer B, Definitely prefer B.

As we discussed, this comparison evaluation helps to ground revenue predictions in what you know about existing products. For example, if your new entrepreneurial product is preferred by 20 percent more people than existing product A, you know that its potential is to sell even better than Product A. This is only a *potential*, however. The above caveats on any purchase intent measure are also salient here (e.g., awareness, understanding the product benefits, and finding the product in distribution).

#### **Concept Screening**

Getting reactions of potential purchase influencers can be very helpful, not only after one product concept has been determined, but also to help *screen* candidate product ideas before much work or resources have been spent on them. For this screening application, *card sorting and evaluation* is sometimes cost effective. Simply give the respondent several product descriptions, each on a

card or a separate sheet. The respondent can sort them into a rank order and can rate each idea on either a semantic (excellent, good, fair, poor, etc.) or numeric scale. For consumers over about 35 years old, the movie *Ten* has made it very easy to use 1 to 10 scales for marketing research.

### **Using the Web for Concept Testing—CarsDirect.com and Goto.com**

Many times, the reactions of consumers to concepts are biased by their inability to really understand what would be offered. The Web allows for certain concepts to be tested in a live manner, with direct validation or refutation of the basic concept. When CarsDirect.com was started, there was a lot of skepticism about whether or not people would actually buy big ticket items sight unseen on the Web. Rather than do a lot of focus groups, screening, and so on, these entrepreneurs elected to do a quick test on the Web.

With less than a week's work, they put up a site that offered "Cars at invoice price." The pricing was already widely available on the Internet, and a small number of pages were put up inviting the user to search for the car they desired, and submit an order on the Web. Once their order was received, a phone call was made to verify that they were serious, and a deposit was taken, and the car delivered.

When the test site was ready, CarsDirect.com bought the top listing for the cars keyword at GoTo.com, to direct some traffic to the site. Over the course of a single weekend, four cars were ordered. The company bought them at retail prices and subsidized the difference between that price and the invoice pricing that had been advertised. For less than \$20,000, they had proven that people would buy very large ticket items on the Web. After that, several million dollars was invested to build the successful Web site that sold more than \$250 million worth of cars by the end of 1999.

Similarly, with GoTo.com, a search site that charges for higher position in search results, there was great skepticism that either consumers or advertisers would use it. The company put up the site, and verified that advertisers would give us credit cards and pay for their ads. None of the cards was actually charged in the first

month, since it was merely a concept testing experiment. The refined version created a public company worth several billion dollars.

### **Caveats for Concept Testing**

Even though concept testing is typically very valuable in terms of cost/benefits for entrepreneurs, it has a number of limitations that constantly need to be kept in mind:

1. As discussed, if the product or service does not deliver the benefits promised in the concept, the revenue predictions will never happen. The more costly, risky, and high involvement the product is, the more important is the experience of the innovator and early adopter users. If this experience is worse than the benefits expectation of the concept test and the expectations of these “lead users” based on the introductory sales and marketing material, then the product will be severely penalized.
2. Changes in the product between the concept test and the product’s introduction will cause possible changes in consumer reactions.
3. Sometimes R&D and production cannot execute the product exactly as promised in the concept test.
4. If the concept test has not been tested in a very realistic way, respondents may overstate their preferences in order to “be nice” to the interviewer. It is human nature to tell someone what you think they would like to hear. Thus, respondents may say they like the product, but not buy it when it actually comes on the market.
5. Concept testing can only predict initial purchase. It cannot predict how many people will use the product regularly, or how many will repeat purchase it. For repetitively purchased products, high trial rate alone does not guarantee success.

### **The Survey Results on Concept Testing and New Product Testing**

Only 33 percent of both Inc. 500 and non-Inc. 500 entrepreneurs concept tested their first products before they introduced them.

However, 38 percent of the Inc. 500 report that they continually do new product testing versus only 21 percent of the non-Inc. group. Thus at least the Inc. 500 group is learning to be more careful versus the non-Inc. group in evaluating new products before they are launched. However, both groups should be doing more concept testing.

## Summary

Concepts testing really amounts to getting systematic direct reactions of market and channel participants to your product/service concept before you spend the time and resources to develop, produce, and introduce it. Historically, traditional concept testing has been able to predict product trial rates within a 20 percent range, about 80 percent of the time for frequently purchased packaged goods. For example, if predicted trial was 50 percent, the product trial rate would be between 40 percent to 60 percent in 8 out of 10 cases. However, today most packaged goods firms do qualitative focused groups rather than systematic concept testing for their new product screening and evaluation. Entrepreneurial firms do not have the luxury of using less than the most cost effective methods.

The details of exactly how and who should be concept tested are not nearly as important *as just doing it!* The most important thing is to get direct reaction, including some measure of purchase intent from members of your target markets. If you don't do that, you *significantly increase your odds of failure* for your new venture. As an added bonus, concept testing can be combined with price testing to help maximize the profit contribution of the new product. We show this in the next chapter. Before we discuss pricing in the next chapter, we will review some very interesting research that helps the entrepreneur choose a better battlefield to enter, if she has the option of choosing different kinds of products or services to consider for her venture.

## Finding More Receptive Battlefields

Are there better markets for entrepreneurial survival? Are there characteristics of product/markets that make them more likely to

be receptive to successful entrepreneurial activity? Three European researchers analyzed 30,000 new U.S. businesses to find characteristics that were more likely to be associated with entrepreneurial ventures that would survive for ten years or more.<sup>3</sup> The researchers developed measures of three groups of characteristics: the first was customer-buying patterns, the second was competitor's marketing and channel strategies, and the third was production requirements.

Customer-buying patterns were described by the following characteristics: The first was *purchase frequency* which was measured by the proportion of product line which was generally purchased less than once per year compared with products which were purchased frequently. The second was *purchase significance* which was measured by the percentage of the product line which represented a major purchase for the ultimate buyer. The third measure of consumer buying patterns was the degree of customer/distributor fragmentation. This was measured by the percentage of product lines for which there were over 1,000 customer accounts at the manufacturer level.

Competitors' marketing and channel strategies were described by three variables: The first variable was *pull marketing* which was measured by the expenditures on media advertising as a percentage of total sales revenue. The second variable was *push marketing* which was defined as the cost of marketing excluding media spending as a percentage of sales revenue for the product lines in each group. Finally, *channel dependence* was described as the percentage of products which pass through an intermediary before reaching the user.

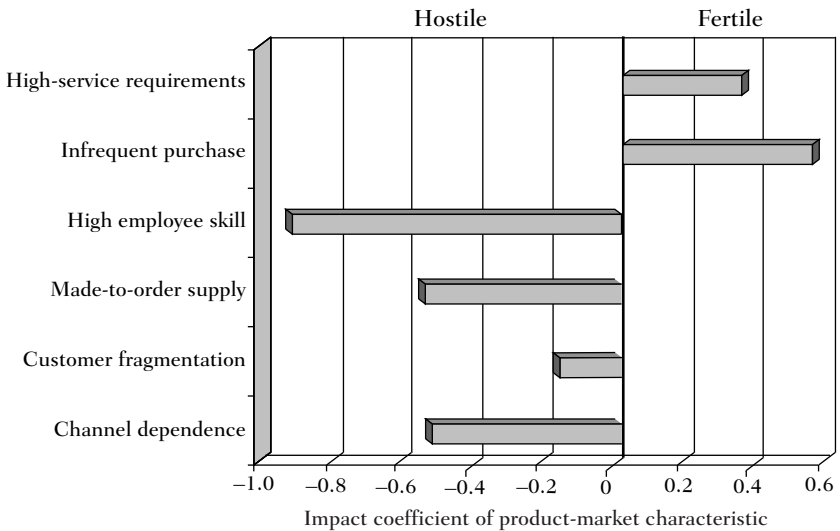
Production requirements were described by four variables: The first was *labor versus capital intensity* which was measured by calculating the ratio of total employees to the total book value of plant and equipment in the industry producing each group of products. The second variable was *employee skill requirements*. It was defined as the number of "high skills" jobs as a percentage of total employees involved in producing the product group. The third variable was *service requirements*. It was calculated as the percentage of products requiring a moderate to high degree of sales or technical service as classified by the suppliers who were surveyed. The last

variable in this group was *made to order supply*. It was defined as the percentage of product lines that were made to order based on customer specifications.

They analyzed almost 30,000 independent start-ups for a five-year period ending in the mid-1980s. They performed a statistical analysis of the relationship of survival rates of independent start-ups and the above product/market characteristics. Their main results are summarized in Figure 2.2,<sup>4</sup> which shows hostile and fertile product/market segments for independent start-ups.

The data showed that entrepreneurial start-ups had significantly better chances of survival in two product/market segment types: those that had high-service requirements and those that had low purchase frequency. The high-service requirements results imply that the greater attention to customer needs and flexibility an entrepreneurial start-up can offer can give it an advantage over less attentive established vendors for that product/market segment.

The result that product/market segments which made infrequent purchase decisions are also more fertile is consistent with



**Figure 2.2** The impact of product and market characteristics on the survival of independent start-ups. *Source:* Hay, Verdin, and Williamson, "Successful New Ventures: Lessons for Entrepreneurs and Investors," *Long Range Planning*, vol. 26, no. 5, (1993), pp. 31-41.

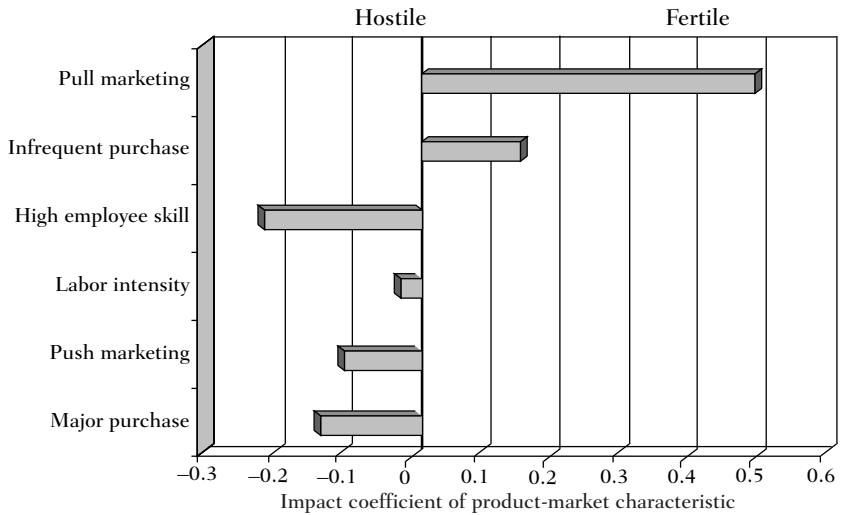
other theories of business-to-business marketing. Infrequent purchases typically involve the customer reassessing the attributes of product or service offerings. In this circumstance, there is a higher likelihood of attending to new information and possibly trying a new alternative product offering.

Figure 2.2 also shows four product/market characteristics that an entrepreneur should avoid, all other factors being equal. Those segments that require high employee skill and made to order supply are harder for entrepreneurs to succeed in. These segments may require extensive employee training and big investments in production assets—both luxuries that are difficult for a new entrepreneur to supply. The other two entrepreneurially hostile segment characteristics make it very difficult for the small player to target the segment effectively. Both highly fragmented customer bases and high-end customer dependence on channels make it relatively more difficult for the entrepreneurial marketer to reach her target customers. The Internet makes it easier to reach fragmented customer bases, since geography no longer plays a role, but even on the Web, if the base is too fragmented, the cost of customer acquisition may rise to unprofitable levels.

For corporate “intrapreneurs,” Hay, Verdin, and Williamson also report the product market segment types that were hostile and fertile for corporate ventures. The results are summarized in Figure 2.3.<sup>5</sup>

The only segment characteristic common to higher likelihood of survival for both corporate and independent ventures is infrequent purchase. Segments in which a customer is more likely to be receptive to new information are evidently fertile, regardless of the assets that the new venture brings to them. Segments that require high employee skill are also hostile to both independent and corporate entrepreneurs. Evidently, high employee skill is a barrier to entry of established competitors, regardless of whether the new entry is corporate or independent.

The other characteristics differentiate those segments which corporate resources can impact. Pull marketing requires resources for mass marketing and may also leverage the reputation of a corporate parent. Corporate subsidiaries seem to be at a disadvantage when infrastructure to support push marketing is required by the



**Figure 2.3** The impact of product and market characteristics on the survival of corporate ventures. *Source:* Hay, Verdin, and Williamson, "Successful New Ventures: Lessons for Entrepreneurs and Investors," *Long Range Planning*, vol. 26, no. 5, (1993), pp. 31-41.

segment. Perhaps long periods of experience are necessary to set up effective networks. This experience with the push marketing infrastructure can be an effective barrier to entry.

Even though these results can help an entrepreneur or corporate subsidiary to choose a more receptive product/market to enter, keep in mind that all of the positive and negative characteristics are only effective on the average. Certainly, not every entrepreneurial venture that attacks segments with the fertile characteristics will be successful. The results just show that the entrepreneur or corporate subsidiary will be more likely to not fail or to fail in those segments. These results are not a substitute for the careful concept testing we advocate in this chapter.





# CHAPTER 3

## Entrepreneurial Pricing Decisions

**P**ricing is typically the most difficult decision for entrepreneurs. It is also probably the most important since it ultimately determines how much money a company can make. In today's world, you not only have to price products that have significant manufacturing costs, or services with large human elements in delivery, but also intellectual property that can be replicated for essentially zero cost on the Internet. Unfortunately, some entrepreneurs think pricing is easy. These entrepreneurs use very comfortable, precise rules for pricing. These simple rules are usually one of two types—mark-up rules or competitive matching rules. Mark-up rules just take the product's or service's costs and mark them up by a margin percentage. This margin percentage may be standard for the industry, or related to what the entrepreneur is used to, or what she needs to make her forecasted profit at the forecasted revenue for her venture. The competitive "rules" usually have the entrepreneur planning on pricing just a bit lower than competition, or matching their prices. These rules make it very easy for the entrepreneur to make the pricing decision without having to do much work or careful thinking. However, like many things in life, "no pain, no gain." The problem with these "rules" is that they may leave too much money on the table.

Why? Very simply, because other prices may be more profitable to the venture. For example, if my widgets cost \$1, and I sell them for \$2, a “keystone” or doubling mark-up, why shouldn’t I be happy? You haven’t asked the proper question: *Of all the possible prices I can charge for my widgets, which price will maximize my profitability over my planning horizon?* If, when I price my widgets for \$2, I sell 400,000 units per year, is that the best possible price in terms of total profitability from the widgets over the product’s life? Selling 400,000 units at \$2 per unit brings in revenue of \$800,000. From that revenue product costs of \$1 per unit equals  $\$1 \times 400,000$  or \$400,000. This leaves \$400,000 as gross margin or contribution to fixed costs and profit due to the widgets.

What would happen to my units sold if I charged some other price? If a reasonable estimate can be made of units that would be sold at alternative prices (the “elasticity of demand”), you can find the price that maximizes profitability over the planning horizon. We will describe methods for getting estimates of demand at alternative prices later, after we show how valuable they can be if they are integrated into the cost structure of the venture. The reason that different customers will pay different prices is that they may have different perceived values for using the products. Let us assume that our widgets would sell the amounts indicated in Table 3.1.

The maximum revenue price is \$3 per widget for revenue of \$900,000, only \$100,000 greater than the original price of \$2. However, the contribution is 600,000, 2.4 times the profitability of the original \$2 price! However, there is even a better price—the price of \$3.50 per widget has a lower revenue of \$875,000, but

Price per Unit	Units Sold	Revenue (\$)	Cost at \$1/Unit	Contribution (\$)
1.0	600,000	600,000	600,000	0
1.5	500,000	750,000	500,000	250,000
2.0 (original)	400,000	800,000	400,000	400,000
2.5	350,000	875,000	350,000	525,000
3.0 (highest revenue)	300,000	900,000	300,000	600,000
3.5 (highest profit)	250,000	875,000	250,000	625,000
4.0	200,000	800,000	200,000	600,000
5.0	100,000	500,000	100,000	400,000

**Table 3.1** Contribution for Alternative Prices

has a higher contribution of \$625,000. This contribution is 2.5 times the contribution that would have occurred had the original price been used. This is an obviously simplified example, but not simplified in isolating how important the analysis of alternative prices is to most entrepreneurial ventures. The impact of the initial pricing decision on the venture's ultimate profitability is typically huge. We'll show some real examples later of what this decision has meant to some entrepreneurial ventures as well as how to estimate the revenue at alternative price levels. However, first it is time to give the quick entrepreneurial marketer's guide to *cost accounting!*

The reason for bringing up cost accounting is that the profitability of pricing decisions depends solely on revenue and *variable costs*. Fixed costs are almost irrelevant in deciding the best price to charge for the product or service. Why? Because if fixed costs, by definition, don't change when the number of units sold changes, they will be incurred *regardless of the alternative price that would be charged*. All of the "contribution" numbers in Table 3.1 should really be contribution to fixed costs and profit of the venture. The \$1 cost assumed in the simple example should be only the variable costs to produce, sell, and deliver an incremental unit. Fixed costs that will be incurred regardless of the price will be subtracted from the contribution to estimate the profitability of the widget product. If any constant number were subtracted from each contribution row, the price that maximizes contribution and profit will not change. Thus, fixed costs do not affect the best price to charge for a product/or service. There is only one exception to this rule: If the estimated contribution of the best price is *not enough to cover the fixed costs* associated with the product or service, then the product or service should *not be introduced*.

### **Getting Price Right Early—It's Hard to Raise Prices Later!**

It is even more important to get the pricing done well early in the product's life. If you lower a price over a product's lifetime, no one will complain (except possibly the customers who just bought it at

a higher price). However, it is much more difficult to raise a price significantly because you realize the product's perceived value is much higher than you thought. Human nature does not consider such price rises as "fair." If you can convince potential customers that your costs have gone up, that is usually perceived as a legitimate or fair justification for raising prices. Customers do not typically go through such fairness evaluations when they originally see a price for a new product or service. Human nature and fairness arguments take over only when prices are raised. Thus, it is even more important to have your initial price set at a very good level.

However, for many new products, it is usually the innovators who will take a risk on a new product or service. For taking this initial risk, the first customers want (and deserve) special pricing treatment. Sometimes they even deserve to get the product at no cost to try until they are convinced of its value. It is okay for the entrepreneur to give special pricing to these first innovative customers. However, the prices should be structured as *charter customer discounts* or *introductory discounts* from a *regular price* that is publicized as what will be normal after the introduction. This paradigm gives the entrepreneur much more room to determine marketplace reaction and adjust his actually selling prices by adjusting the introductory discount level and time period.

By having a regular price stated up-front, the entrepreneur is free to charge up to that level without generating market perceptions of unfairness. There are some entrepreneurs who have kept introductory prices for over a year after a product has been introduced.

### Survey Results on Pricing Methods

The graph in Figure 3.1 shows the survey results of how the entrepreneurs priced their first products and Figure 3.2 shows how they currently price their products. Notice that the Inc. 500 CEOs have learned to use perceived value-in-use pricing much better than the non-Inc. group. Part of the reason for the success of the Inc. 500 ventures is very likely associated with over half of them learning to do perceived value pricing, whereas the non-Inc. group did not learn over time to price more productively.

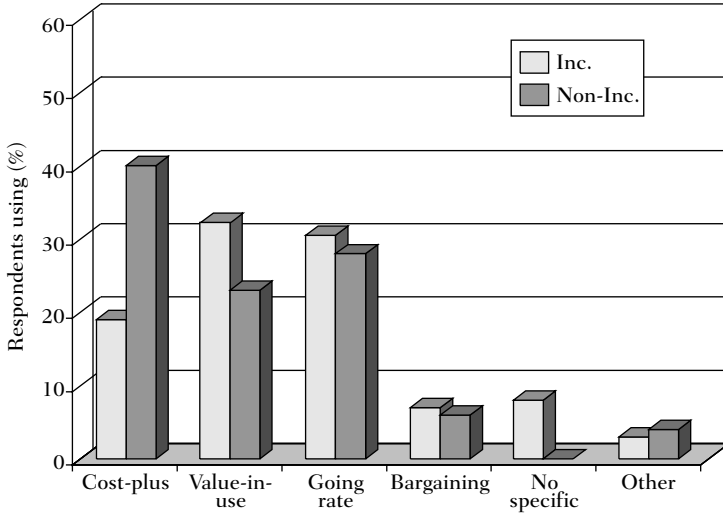


Figure 3.1 How did you price your first product?

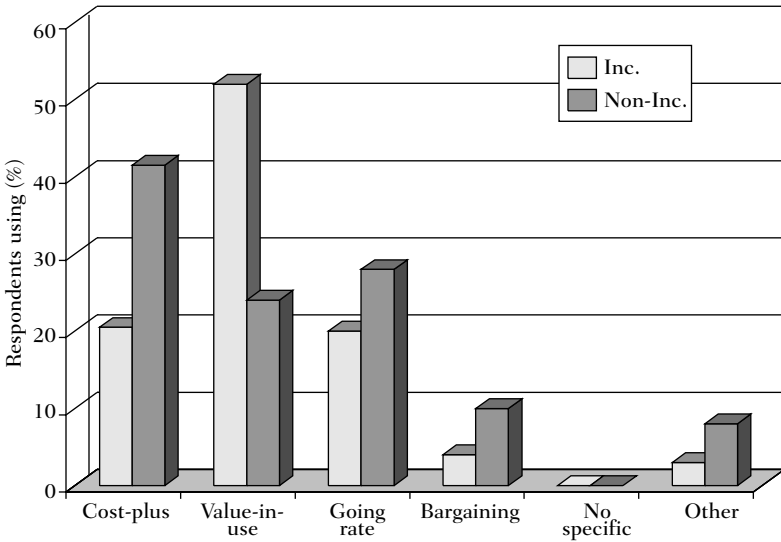


Figure 3.2 How do you price your products currently?

## Methods for Determining Revenue at Alternative Price Levels

The entrepreneur reading this is probably saying to herself—“Sure, it would be more profitable to price so as to get the most profit, but how can I get good estimates of the sales I would realize if I charged alternative prices?” There are a number of ways to do this that can be grouped into two categories—in-market and pre-market testing.

### In-Market Methods

The in-market method is usually preferable because it is typically a very valid predictor of what revenue would be at alternative price levels. However, it is not always practical to charge different prices for the same product or service in the marketplace. You cannot charge different prices for what is perceived as the same product bundle if market participants will communicate with each other. If one market participant finds out that another participant bought what they perceived as the same product bundle at a better price, they will feel cheated. Even though rationally, they got enough perceived value from their purchase or they would not have made it, psychologically they feel cheated. If they feel that way, they can begin saying bad things about your product. Bad word-of-mouth is very damaging to a new product or service that lives based on customer perceptions. If a potential customer hears bad things about a product from a respected source, it can undermine all the other marketing activities you do.

If the customer perceives the product bundle to be different, then the consumer will not necessarily be upset about hearing that someone else paid a different price. For example airline seats or concert tickets will be priced differently depending on when the customer decides to buy them or exactly where they are located. We will discuss more about yield management and other methods for charging different prices to different segments for different product bundles of the same physical product later in this chapter.

However, there are circumstances where it is highly unlikely for market participants to become upset. These are products or services that are purchased individually and usually not discussed

very much among consumers or products whose prices may be difficult to compare because they are customized to each potential customer. Many product/market combinations can be tested in market. For example if one of your primary marketing vehicles is personal sales and your product price is somewhat dependent on the potential customers characteristics, it is relatively easy to evaluate market reaction to different price levels. Have each of the salespeople involved in the test use different price levels for every  $n$ th potential customer on which they call. For example, if there were three alternative price policies to test, then every potential customer would be exposed to one of the three different pricing policies, and each customer would have a  $\frac{1}{3}$  probability of being exposed to each policy. As long as it's pretty difficult for the potential customer to compare the pricing algorithm actually used by your salesperson, it will be difficult to compare prices across different potential customers. Thus, even if two customers do talk who have been exposed to different pricing algorithms, they will not be likely to find out that they actually were quoted different pricing options. For example, if the pricing of software is developed based on a fixed charge for organizational training, another charge for installation, and another set of charges per "seat" or installed computer terminal, then it becomes difficult for two firms who have different needs to compare prices.

### **The Perfect In-Market Price Testing Vehicle**

Because purchasing is done individually on the Web, and each person can be exposed to a different, customized Web site, the Web can be an extremely effective and valid price-testing device.

The Internet offers one of the best vehicles for market and price testing ever invented. Immediate feedback, large sample sizes, and live customer reactions make it much more efficient and valid than focus groups or limited city tests. Idealab! will often test banner ads and pricing by using 1 to 5,000 banners to drive viewers to specific pages on a site, keeping cookies to track their behavior, and then examining the followthrough once they have reached a site.

With utility.com, a provider of deregulated electric power in a number of states around the United States, the pricing and



messages were honed through a series of tests. The vice president of marketing first stated that he thought they needed to offer 15 percent off to get customers to switch from their existing supplier. Perhaps, they could get away with only 10 percent off if they chose “green” (environmentally clean) power. There were a number of skeptics which led to the company using a test.

After testing a number of different banners to get the best colors, animation and messages, they tested offers of 5 percent to 15 percent off, each leading to a page that offered 0 to 5 percent additional if you signed up right away. The results were non-intuitive. The offers that drew the most people to the site were 7 percent off and 11 percent off. They were significantly higher draws than 15 percent off or 10 percent off. Once at the site, the best additional offers were 0, 1, and 3 percent off.

The best combined action came from a 7 percent offer to get visitors to the site, where they were offered 3 percent off for immediate signup—a total of 10 percent off. Green versus nongreen power had only a very small effect and is now offered as an option on the signup pages. Without the testing, the company would have used the “instinct” of 15 percent, with both higher cost and lower effectiveness.

The cost for the test was under \$5,000, since off-peak banner advertising can be purchased very inexpensively, and it only takes several thousand tests to make it work.

### **Survey Results on Web Price Testing**

Neither group in our survey do as much Web price testing as they probably should. Only 6 percent of the Inc. 500 and 7 percent of the non-Inc. group do much price testing on the Web. Perhaps their products are not suitable for such price testing, but more than likely, they are both missing out on an opportunity.

### **Premarket Methods—Pricing and Concept Testing**

Our discussion in Chapter 2 of concept testing before a product or service is introduced, mentioned that it could be used as a very effective vehicle for estimating the relative differences in sales that would occur at alternative price levels. The basic idea is very simple. Part of the concept description of the product or service is the

price. If you want to concept test four alternative prices, then have every concept description have only one of the four pricing alternatives, with each respondent being exposed at a .25 probability to one of the alternatives. So every fourth concept test will have the same price. The estimates of number of units that would be bought at different price levels can be calculated in the same way as any other concept test. What is very valuable to the entrepreneur is to analyze the resulting revenue implications from the alternative pricing policies.

Since any biases of the concept test would be constant over the four different prices, the relative differences in response of one price versus another will usually be quite valid. For example, if the concept test results indicate that 40 percent more widgets would be sold at a 20 percent lower price, that percentage difference will be the same regardless of what the base absolute sales of the widgets would be. Regardless of whether the actual sales of the widgets in market would be 1,000 units or 10,000 units at the base price, the estimate of 40 percent more units that would be sold at a 20 percent lower price should be valid.

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### A Price-Concept Testing Example

A small, non-U.S. manufacturer (who we will call ABLE) of faucets for kitchen sinks had been selling one model of faucet through a major do-it-yourself retailer for two years—and just barely breaking even, if all of the costs associated with the faucet were taken into account.<sup>1</sup> The manufacturer, ABLE, wanted to see if they could convince the retailer to change the retail price from \$98 to a higher price, enabling ABLE to raise the wholesale price to the retailer. As part of a larger study, a paired comparison concept test was administered in the retail store to customers who were about to buy a kitchen faucet. The customers were asked to choose which of two alternative faucets they would rather purchase and provided concept descriptions of each. The concept statements included a picture of the faucet and all of the descriptions of the product features and/or benefits that were on the respective faucet boxes. In the large do-it-yourself retailers, the box on the shelf was the major way in which the customer was able to

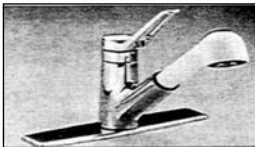
evaluate alternative products prior to making a purchase. The box's perception on the shelf is very important in most mass merchandisers. Each concept statement also had a price associated with it. Each customer that was tested received a concept test with one of four alternative prices for the ABLE faucet—\$98, \$127, \$141, or \$160. The other faucet they were given to evaluate was constant throughout the test. It was the major seller at the retailer with a price of \$141. An example of part of the concept test survey is shown in Figure 3.3, where the ABLE faucet is B.

Twenty-five percent of the people received the ABLE faucet concept description priced at \$98, a different 25 percent received the ABLE concept priced at \$127, and so on. The competitive faucet was always constant and priced at \$141. The results of this part of the concept test are shown in Figure 3.4.

From the results, demand seems to go down very significantly at prices over \$98. It falls from 40 to 5, a drop of 85 percent. If this pricing option was the only alternative ABLE could pursue, it would not make sense to raise the faucet's price. However, some


1. Looking at the photos and descriptions below, how much do you think each of these faucets sell for?

A. \_\_\_\_\_



- Pull-out spray for hard to reach places
- Adjusts from aerated stream to powerful spray
- Can be mounted without deckplate to accommodate accessories
- Easy do-it-yourself installation
- Water-saving aerator
- Washerless, one-piece cartridge
- Lifetime limited warranty

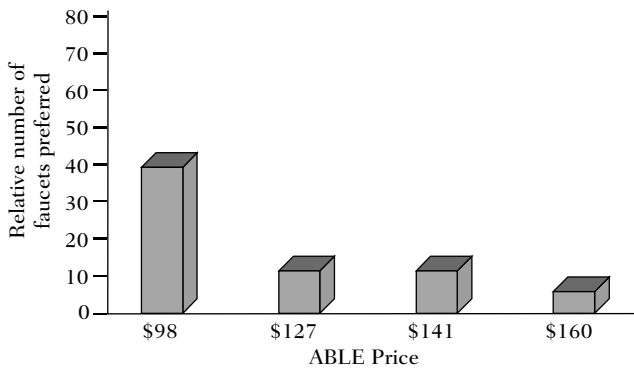
B. \_\_\_\_\_



- Pull-out spray
- European design faucet
- Matching deckplate
- Easy installation
- Flexible connector tubes
- Ceramic disc cartridge/washerless design
- 20-year limited warranty
- Solid brass construction

If the price for Faucet A was \$141 and \$98 for Faucet B, which would you purchase?

**Figure 3.3** Feature-Oriented Concept Test.



**Figure 3.4** ABLE Faucets Concept Test.

entrepreneurial marketers looked carefully at the ABLE box. They observed that the product description on the box was all stated as product *features* as opposed to product *benefits*. For example, flexible connector tubes probably don't mean very much to the typical faucet buyer. However, if the feature was translated into a benefit such as "flexible connector tubes to fit into tight spaces under the sink," it might have more value to a potential purchaser. How many potential purchasers would know the benefit associated with the feature "ceramic disc, washerless cartridge"? How much more valuable is "ceramic disc, washerless cartridge design eliminates leaks and ensures maximum control"?

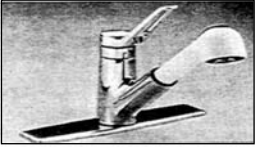
### *Price Response Depends on Perceived Value*

To estimate the impact on price response of describing the product on the box with benefits versus features, another cell was added to the concept test described in Figure 3.3. Half of the respondents saw a benefits-oriented concept statement while the other half saw the original feature-oriented copy. The concept statement for the benefits-oriented box is shown in Figure 3.5.

The benefits-oriented box copy was also shown to different respondents at one of the same four alternative price levels. The concept test was not only able to estimate the response of the new box copy at the four alternative price levels, but also to compare the *benefits*-oriented copy versus the existing *features*-oriented copy for the box at the different price levels. This is because the


1. Looking at the photos and descriptions below, how much do you think each of these faucets sell for?

A. \_\_\_\_\_



- Pull-out spray for hard to reach places
- Adjusts from aerated stream to powerful spray
- Can be mounted without deckplate to accommodate accessories
- Easy do-it-yourself installation
- Water-saving aerator
- Washerless, one-piece cartridge
- Lifetime limited warranty

B. \_\_\_\_\_



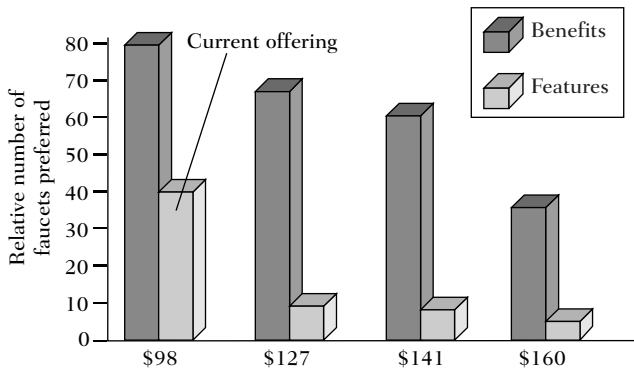
- Pull-out spray for multi-purpose use
- European design faucet
- Matching deckplate to cover sinkholes
- Easy step-by-step installation instructions
- Flexible connector tubes fit in tight spaces under sink
- Ceramic disc cartridge/washerless design eliminates leaks, ensures maximum control
- 20-year limited warranty
- Solid brass construction for long life

If the price for Faucet A was \$141 and \$98 for Faucet B, which would you purchase?

**Figure 3.5** Benefits-Oriented Concept Test.

control faucet was the same for all 8 versions of the concept test—two copies times four different price levels. The results for the responses to all 8 versions of the concept are shown in Figure 3.6.

Keep in mind that the concept test biases, whatever they are, are not typically going to affect any one cell of the eight test cells versus any other. The results add a lot of value and are a wonderful illustration of how important perception is to price response. They also illustrate how valuable it is to help the consumer understand product benefits that are associated with certain features. First, notice that *just by describing the product with benefit-oriented statements on its box, sales would double compared to the current box's feature-oriented statements*. Twice as many respondents chose the ABLE product versus its major competitor when it was described by relating the features to their consumer benefits. The benefits-oriented description added considerable perceived value to the customer. Approximately the same number of faucets would be sold at \$160 (a 60 percent higher price) for the benefits-oriented box copy compared to the original features-oriented



**Figure 3.6** ABLE Faucets—Demand estimates.

copy. Thus, just *changing the box copy to a benefits orientation added over 60 percent to the perceived consumer value of the same physical faucet!*

The other cells in Figure 3.4 are also quite valuable—both to ABLE and to the retailer. Notice that demand goes down much less severely for the benefits-oriented copy as the price goes up, compared to the existing features-oriented copy. When the retailer evaluated her costs and profit alternatives, the \$141 price made the most sense if ABLE were to raise its wholesale price for the redesigned benefits-oriented box. At \$141 with the redesigned box, the concept test shows a true win-win-win situation. ABLE gets to significantly raise its price to the retailer. The retailer sells more units of ABLE’s faucets. The consumer gets a faucet that they would value at \$160 for \$141. Everyone is happier. It doesn’t always work this way, but when it does, it is very gratifying to true entrepreneurial marketers.

### Survey Results on Pricing, Concept Testing, and In-Market Testing

Of the Inc. 500, 50 percent have done some concept testing at different price levels versus 33 percent of the non-Inc. group. Of the Inc. group, 33 percent has done some in-market price testing

versus 30 percent of the non-Inc. group. Here again, more than half of even the most successful ventures are not pricing as potentially profitably as they could.

### **Pricing, the Rest of the Marketing Mix, and Perceived Value**

As the example illustrates, managing pricing really is highly dependent on how well the entrepreneur manages the *perceived value* of her product bundle. This perceived value is affected or can be affected by *every* element of the firm's marketing mix. The price itself can be a big driver of how potential customers will perceive your product-offering bundle.

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#### **Price and Perceived Value**

Sometimes, a price that is too low, particularly for a new product, can have a big impact on how valuably it will be perceived. Our next example crystallizes this phenomenon. When one of the authors was in graduate school, his professor had started an entrepreneurial company to manufacture and sell educational kit machines for helping to understand how the binary logic and arithmetic of computers worked. The machines were composed of lights, wires, and switches, so that binary arithmetic and logic could be simulated by series of light bulbs being either on or off. The first kit machine in the entrepreneur's line was the red and blue MINIVAC 601, priced at \$79.95. The entrepreneur had three target market segments for the MINIVAC 601—home hobbyists, high schools and colleges, and computer and technology companies (for training their employees on how computers worked). The product did very well with the first two market segments. Home hobbyists bought the product at consumer electronic stores and some high-tech hobby shops. Many colleges and some upper socioeconomic high schools also bought the MINIVAC as an educational aid. However, no one in the third segment, the corporate sector bought the product. The entrepreneur interviewed some target customers to try to find the problem. He found out very quickly. The typical description of the MINIVAC by the corporate types was "Oh, that—it's just a toy!"

The entrepreneur was creative and he listened carefully. He also understood intuitive marketing. His next product was the same basic kit—with the switches upgraded to higher tolerances and the machine color changed from blue and red to gunmetal gray. The name was changed to the MINIVAC 6010 and he increased the price from \$79.95 to \$479. The MINIVAC 6010 sold very well to the corporate segment at \$479. The \$79.95 price was too low for the corporate buyers to take the product seriously. At such a low price, it had to be a toy and was not serious. The color and packaging of the original MINIVAC 601 amplified that perception. By changing the color, name, and packaging, and most importantly the price, the entrepreneur was able to change the perception in the corporate segment. The impact on his bottom line was just amazing! The price you put on your product offering, by itself, creates a very important part of the perceptual position.

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### **Pricing of Intellectual Property**

One of the most difficult things to price is something that has essentially no cost associated with another copy—intellectual property. On the Internet, much of what is being sold is information; once created (especially in electronic form), multiple copies can be recreated for no cost.

In physical goods, the price is most often related to the cost of producing the item, including some amortization of the intellectual property (research and development) used to create the design, as well as the raw materials and processing cost to turn those materials into the item for sale. Gross margins of 60 percent to 80 percent are not uncommon in high-tech industries, so that an Intel chip that sells for \$300 may have a cost (including marketing, R&D and production) of \$50 to \$60.

The marginal cost of providing news reports on Yahoo is effectively zero. The gross margins on the product are often above 95 percent, with the small cost of goods being associated with maintaining the servers that hold and transmit the information. How then, should one select the pricing?

One price that has often been successfully used on the Internet is *free*. Give away the intellectual property so that people will



come to a Web site and see the advertising, or take advantage of e-commerce opportunities. Most of the stock trading operations provide research reports and other products that way. E-Trade, DLJ Direct, Wit Capital are all examples. They also price their actual services—stock trading—as close to their real cost as possible, with only Schwab making a profit on the transaction costs.

Hotmail, ICQ, and other “virally marketed” services are all vehicles that provide a free service, which is purely communications or other nonphysical products, so that they can direct advertising and marketing to the users.

There are some groups that can successfully charge for intellectual property, usually through some form of subscription pricing. The *Wall Street Journal* online is one of the most successful subscription based services on the Web, with a \$69.95 per year price for people who do not also get the print edition, and a lower price for those who are already print subscribers. The *New York Times* charges \$9.95 per year for access to their Crossword puzzles online, getting a dedicated audience to whom they can also e-sell. And playboy.com is an extremely successful subscription site, where those so inclined pay annually for the ability to access photos, editorial material, and chats about sexually explicit material.

### **What Else Can Impact Price Response?**

Anything that can impact the perception of your product’s offering bundle can impact the price that potential customers will be willing to pay. Very simply, if the customer does not perceive that the value he perceives more than justifies the price, he will not purchase. We use the term “product’s offering bundle” here as we do in other places in this book in the widest interpretation possible. It includes anything that the customer can perceive impacts the value they get from the whole experience of buying and using your product or service. The first time the potential customer comes in contact with your firm or product or service, they begin to get impressions that will affect their value perception of the offering bundle. If it was an advertisement, did it connote the right positioning? If it was an e-mail, did it come across consistent with a high value positioning?

When a customer or potential customer calls in to your firm, is the phone answered in a manner consistent with a high value perception? If potential customers get put on hold for very long, they will get bad perceptions about how fast your firm might react to any problems that need to be corrected. If the phone people are not polite, considerate, and genuinely helpful to the caller, the firm and its products perception will suffer.

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### **An Example of Price Being a Symptom of Bigger Problems**

A 100+ year-old shipping company was concerned that they were losing business to competition and that their margins were continually being squeezed by what they thought was increased competitive price pressure on their routes. The firm retained a market research consultant who interviewed some of their customers and potential customers. The consultant found a number of problems that influenced how customers or potential customers perceived the firm and its product-offering bundle. One pervasive problem was that the firm's telephonic interface with customers was appalling compared to competition. If someone called into a regional shipping office to either ask about a price quotation or what the status of a shipment was, there were many instances when the phone just rang and rang and was never even answered! The increased price pressure the firm was facing was not brought about by competition, but more by the reaction of their potential customers to the perceived value decline in the product-offering bundle. The appalling telephone interface was just one example of the problems with customer treatment at the firm. Only after the customer sales and service operations of the firm were completely redesigned from the ground up, would the company be able to command what it considered reasonable prices.

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Other chapters have shown how all the elements of the marketing mix can affect perception that then affects price response. All of the channel management decisions affect how the end customer will perceive your product-offering bundle. The environment your product is in when the customer sees it can have a large

impact on its perceived value. The same product will have a higher perceived value if the consumer sees it at Tiffany's rather than at Wal-Mart. The dynamic management of distribution channels we describe in the channels chapter has as its major objective to achieve high contribution margin and prices. Once a product has been sold at low-end channels, it typically cannot be sold at premium prices at the higher end channels.

### Perceived Value in Use for Business-to-Business Products

A key way that an entrepreneur can market new products and services to businesses is to show the target business that they will be more profitable if they adopt the entrepreneur's new product or service. If the potential customer *perceives* that his business will be more profitable if your product/or service is used, then they will likely buy it. The key word here is *perceives*. If the customer understands and believes that your product can make the production, service, or delivery process more efficient or more valuable to the customer's customers, then the entrepreneur can make a nice sale. To use this value in use positioning, the entrepreneur must understand how the potential customers will want to calculate the value in use of the entrepreneur's new innovation. If there are certain measures that an industry uses to indicate efficiency or productivity, they will probably feel more comfortable if they see the new entrepreneurial innovation with data on that measure.

How does all of this relate to pricing? According to Irwin Gross of the Institute for the Study of Business Markets at the Pennsylvania State University:<sup>2</sup>

“Customer Value” is the hypothetical *price* for a supplier's *offering* at which a particular customer would be at overall economic *break-even* relative to the *best available alternative* to the customer for performing a set of functions.

“Customer Perceived Value” is a customer's *perception* of his/her own “customer value.”

While customer value can never be known precisely, it is a very useful idealized construct, similar to a “perfect vacuum” or a “frictionless plane” in physics.<sup>3</sup>

The best pricing situation occurs when there is a perceived win-win situation. The buyer perceives that including the price of the new product from the entrepreneur, he or she will have higher “customer value” when adopting the new entrepreneur’s product. The entrepreneur in turn makes much higher profit margins than normal because of her understanding of how to create perceived value better than her competition.

Your competition may not be as treacherous in many business-to-business situations as it may first appear. The concept of really going into depth to understand perceived customer value is not that common. According to Gross, who has studied business-to-business markets for over 20 years: “Customers spend more effort to know supplier’s costs than suppliers spend to know customer’s values.”<sup>4</sup> A really effective entrepreneurial marketer will spend her scarce time and resources to understand exactly how her target market participants develop perceptions of customer value and what methods are best for changing those values.

There are typical components that make up perceived customer value for new entrepreneurial product offerings. These can be grouped into product value, supplier value, and switching investments. According to Gross, the product value is the relative benefits delivered by the product itself, independent of the supplier, while the supplier value is the relative benefits delivered by the supplier, independent of the product itself. The switching investment is the costs and risks involved with the transition from the current practice to the implementation of the new alternative.<sup>5</sup> All of these benefits, of course, are *as perceived* by decision makers in the target market. Gross has categorized components of attributes that affect perceived customer value, dividing them into attributes that impact perceptions of immediate customer value versus those that will impact expected customer value in the future. Table 3.2 outlines the attributes that can impact perceived customer value.

A good entrepreneurial marketer will do whatever is necessary to make sure that her offering’s perceived customer value is higher than her competition. She will understand the components that are important to the members of the target market. She will then make sure her product offering and all of the marketing elements that support it are doing the best job possible in

	Immediate	Expected
Product	<ul style="list-style-type: none"> <li>• Product performance</li> <li>• Durability</li> <li>• Serviceability</li> <li>• Downstream performance</li> <li>• (Current risks)</li> </ul>	<ul style="list-style-type: none"> <li>• New technology</li> <li>• Product flexibility</li> <li>• Follow-on products</li> <li>• (Long-run risks)</li> </ul>
Supplier	<ul style="list-style-type: none"> <li>• Supplier performance Delivery tech, sales, services, etc.</li> <li>• (Promotional values, services)</li> </ul>	<ul style="list-style-type: none"> <li>• Supplier relationship</li> <li>• Technology access</li> <li>• Security of supply</li> <li>• Strategic</li> <li>• (Supplier power)</li> </ul>
Switching	<ul style="list-style-type: none"> <li>• New capital</li> <li>• Training</li> <li>• Transitional quality</li> <li>• Communications</li> </ul>	

Note: Parenthesis indicate negative attributes.

**Table 3.2** Attributes Affecting Perceived Customer Value

positively impacting the value perception. As Table 3.2 shows, it is not just the product/service offering itself that needs to be impacted. It's also much of the supporting services and impressions that the entrepreneurial venture leaves. The salesforce, the marketing communications, the channels used, the product packaging, the product's name, the service package, and so on, all are part of what can impact perceived customer value. For business-to-business markets, real entrepreneurial marketing can enable much higher prices than competition.

### **The SAS Institute, Inc.—Very Effective Management of Perceived Customer Value**

The SAS Institute, Inc. has become the world's largest privately held software company by creatively and uniquely applying many of the concepts in this chapter. The Institute provides data warehousing and decision support software to target markets in business, government, and education. The end result of this entrepreneurial marketing is a very unique software pricing strategy. All SAS Institute software products are licensed, not sold. According to their brochure: "SAS Institute's pricing strategy is designed to foster

Win/Win relationships with our customers which lead to building productive long-term partnerships.”<sup>6</sup> The Institute is not shy about the objectives of their pricing policy. “The strategy is to establish pricing consistent with the value received by SAS software customers, as they implement mission critical applications.”<sup>7</sup>

The SAS Institute pricing model is unique among major software vendors. The other vendors typically sell a software purchase along with a maintenance contract. Their customers buy each new software release and have the option to pay ongoing fees for technical support. These other software vendors, typically public, or with objectives of going public, want to maximize the short-term revenue they obtain with each sale. The suppliers of investments for software vendors in the financial markets do not necessarily let the software firm’s price for value over time as SAS does.

The SAS Institute license model has the customer pay a first year license fee and an annual fee to renew the license. According to SAS, the annual license model provides the customer with a number of valuable benefits:

- Low cost of entry (typically less than fees paid for entering a purchase/maintenance model)
- Rapid return on investment (ROI)
- The most current release
- Technical support
- The most current documentation
- All updates during the license period

Customer’s investments are protected by ensuring that they always have the most up-to-date technology.<sup>8</sup>

The customer is never locked in to more than a one-year commitment to SAS. The company must then be perceived by their customers as continually providing excellent technical support and on-going enhancements to the software. If the customers do not perceive they are getting value from SAS, they can go elsewhere. The customers can also easily add or delete components of the SAS software as their needs change over time. SAS even comes out and says in their own literature that: “The strategy is to establish

pricing consistent with the value received by SAS software customers as they implement mission critical applications."<sup>9</sup>

Let's compare SAS's pricing model to the typical enterprise software company. The typical company sells its software once, with a very big sales effort. They then charge annual ongoing maintenance fees of 15 percent to 18 percent of the initial purchase price. These maintenance fees sometimes include updates and improvements to the software. Is this pricing consistent with the customer's perceived value? Not really. The customer should receive increasing value as the software becomes implemented and tailored to the customer's specific situation and as it is improved and updated over time. The perceived value to the customer of software will almost always be higher after a successful implementation than before it. If the implementation is unsuccessful, then the reverse situation would hold. Because of these risks, customers are not willing to pay up-front as much for software as they would pay if they had continual successful experience to value. The amount the typical enterprise software company can charge up-front is thus less than the discounted present value that the customer would pay over time under the SAS Institute rental plan.

SAS's job becomes keeping its customers continually delighted so that they will continue to pay the relatively large yearly license fees. SAS does that very well. They renew 98 percent of their customers annually! Thus, 98 percent of their revenue is recurring. This is an astonishing statistic for any software company. They also have used their recurring revenue as a base for expansion. The latest public statistics available show revenue in 1997 of \$750 million, more than double that of five years earlier.<sup>10</sup> SAS also has enough gross margin to spend over 30 percent of revenue (*revenue, not profits!*) on research and development, to enable them to provide software improvements that continually delight their customers.<sup>11</sup>

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The SAS customer value orientation and their pricing model which captures more of that value than competition is supported by a superb employee group that is in turn supported by very marketing-oriented employee policies. SAS treats its employees in ways that foster excellent long-term performance and high loyalty.

Some of their policies include 32-hour work weeks, onsite day care, unlimited sick leave, and a fully supported gym on premise. In an extremely competitive market for software talent in the Raleigh Durham research triangle, SAS has a turnover rate lower than 5 percent compared to over 20 percent for many competitive software companies.

Why don't other software companies emulate the value-oriented pricing model of the SAS Institute? We can only speculate. One reason may be that too many U.S. companies (and their financial backers, including public shareholders) are too short-term oriented to pass up one time purchase prices for a longer term, but higher value rental revenue stream. The other reason may be lack of courage to look a customer in the eye and ask for a legitimate percent of the perceived value that your software is delivering. We hope that more entrepreneurs will be encouraged by the SAS Institute example to not be afraid to set pricing policies to receive some of the perceived value they are creating.

## Summary

We began the chapter by showing how often cost-based or competitive-based pricing rules may be "precisely wrong." We showed that a "vaguely right" approach is to attempt to charge the price (or prices) that maximize the entrepreneur's profit return over her planning horizon. It also is very important to get the initial price level at a good level, because it is much more difficult to raise prices over time than it is to lower them. Next, we described methods for in-market and pre-market (concept testing) for determining the potential relationship between alternative prices and the sales revenue that those prices would produce. The Web is the perfect in-market price-testing vehicle for many products.

We then showed a number of examples of how the price you can and should charge is intertwined with all the rest of the elements of the marketing mix. The marketing mix and the product offering bundle all effect the perceived value for the potential customer. This perceived value in turn affects the price the consumer is willing to pay. For a consumer product, we demonstrated how a change in the product description on its box would double the



sales of the product. The box described valuable consumer benefits as opposed to the older box that described product features. We showed how perceived value in use affects the price response of business-to-business products. We concluded the chapter with the example of the SAS Institute's unique marketing mix and pricing structure that captures and creates more perceived customer value than competitive software customers. Our survey results show that the Inc. 500 CEOs price more productively than the non-Inc. group, but both groups could probably improve by adopting more of the concepts in this chapter.

# CHAPTER 4

## Public Relations and Publicity

**P**ublic relations include any publicity for your product or service that is perceived by the public as not being paid for. This differs from advertising that is perceived by the public to be paid for. As we will see, publicity is not really free. It does not happen by chance, but is the result of entrepreneurial activity and resources allocated to it. Public relations can be extremely valuable because, when used successfully, it may be perceived as much more credible than any paid advertising by your target market. The Merck and Company, Inc. Clinoril™ case shows how valuable public relations can be.

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### A Public Relations Success Story

Clinoril was a Merck prescription drug for arthritis that was one of a number of nonsteroidal anti-inflammatory arthritic drugs introduced a number of years ago, before any pharmaceutical firms did any direct consumer advertising or public relations. At the time of product launch, Walter Cronkite was still the dean of national television newscasters, one of the most trusted public figures. His version of the *CBS Evening News* was the clear broadcast news leader

and had been for many years. As it happens, the day Clinoril was launched, a public relations freelancer retained by Merck luckily got to Walter Cronkite's staff with a news release about the launch of the product. It was a slow news night and Walter Cronkite decided to do a story based on the news release. What came out on the news broadcast was Walter Cronkite saying something very close to: Merck and Company today introduced a new wonder drug for arthritis called Clinoril.

The viewer response to that announcement was unprecedented for any pharmaceutical product. Literally thousands of people called their doctors to ask them about this new arthritis wonder drug—Clinoril that Walter Cronkite announced. Merck's first year sales of Clinoril were more than four times their forecast. They credited all of the additional sales to the 30 seconds that Walter Cronkite devoted to a very credible announcement of their product launch. Doctors were pressured into prescribing the product by consumers who asked for it. Consumers got a very good (actually over-inflated) perception of how good the product really was. Clinoril was not a "wonder drug," but if Walter Cronkite said it was, many people perceived it. Merck's news release did not call it a "wonder drug." That was the Cronkite's news staff's interpretation. The value to Merck of that 30 seconds on the *CBS Evening News* was probably in the hundreds of millions of dollars.

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This Merck experience was the beginning of all of the direct-to-consumer advertising and public relations that now routinely occurs with the launch of new prescription drugs. The mass media impact on consumers for prescription drugs can be huge. Viagra is a recent very successful public relations campaign. We next discuss the crucial role of public relations and publicity in product launches and roll-outs.

### **The Role of Public Relations for Entrepreneurs**

Before people can buy your product or use your service, they have to know it exists, and how to get to it. Even more importantly, they should feel that they are going with a winner, if there is a choice

among products in the category. Proper use of public relations and publicity (as Clinoril did) can provide this “winner” feeling far faster, and at much lower cost, than a big national advertising campaign—one that an entrepreneurial company may not be able to afford.

In the Internet world, the key driver to quickly gaining leadership in a new category is the creation of “buzz”—the feeling that you are the winner. Netscape, Yahoo, Microsoft, and others have all been beneficiaries of this. Gaining the mind share of a user—so that he routinely tries your Web page before a competitor’s, quickly translates into market share. As Ann Winblad, general partner of Hummer Winblad Associates, and an extremely successful venture capitalist has said, “It’s the cheerleader approach, where you tell the world that we’re the winner even before the game has started, which is successful in the Internet space.” ePinions, for example, went with a very high profile *New York Times Sunday Magazine* story, long before their site launched. The article made it seem as if the management team was experienced, the best and the brightest, and that they were certain to be the leader in shared opinions. The fact that About.com had thousands of users and millions of page views doing the same thing did not stop ePinions from making its claims. The perception of leadership quickly becomes the reality. When Netscape first made its browser available, Spry, Quarterdeck, and Spyglass all had products in the marketplace—some of which were technically superior. But a concentrated public relations campaign, coupled with guerilla marketing tactics that we discuss in Chapter 9, got tremendous coverage in the trade press—which declared Navigator as the browser to beat. And it soon had the overwhelming market share to make the perception a reality.

### **Gaining the Perception of Leadership**

How can you achieve this perceptual edge? First let us understand how most users make their decision on which Web site to visit, which high-tech product to buy, or which complex, hard-to-understand product they should buy. Generally they ask someone they trust—an information gatekeeper in their organization or personal life, or they read a trusted source in a newsletter, trade or general publication. Thus, the key to gaining the perceptual edge

is to influence the influencers, or gatekeepers. And where do the gatekeepers get their knowledge? From a smaller set of influencers whom they trust. It is like a pool, where a stone thrown in the center creates waves that ripple outward, growing ever larger in diameter, until they reach the shore. You need to reach these groups:

- Gurus (e.g., key industry insiders, respected authorities)
- Influencers (e.g., key trade and business press, respected experts, or experienced users)
- Decision makers (key bellwether buyers)—those who can say yes
- Naysayers—people who can say no along the way
- Mass buyers—the masses who mainly follow what they perceive as the winning trend

In every industry, a few insiders are considered the industry experts or gurus. They are generally the ones quoted in *Business Week*, *Forbes*, *Fortune*, and the *Wall Street Journal* when key industry events occur. Often, they publish high-priced newsletters and run invitation-only conferences for CEOs of industry companies. In the Personal Computer industry during the 1980s and 1990s, Stewart Alsop, Esther Dyson, and Richard Shaffer filled this role. As the decade closed, Bob Metcalfe has taken over for Alsop, Chris Shipley and David Coursey have expanded into the space, and Dyson and Shaffer have each added personnel to help run their newsletters and conferences (Table 4.1). But reaching these players, and being covered in their newsletters or appearing at their conferences, creates some immediate buzz both with key industry buyers and partners and with key venture capitalists who can fund your entrepreneurial venture.

The telecommunications, semiconductor, database software, and applications software sectors all have additional gurus, letters, and conferences. And the same holds true for biotech, energy, and every other field we have examined. At the core of the industry are a handful of influencers, who spread the word about new ideas, products, and services, along with their opinions. These opinions are usually dispositive of success or failure in the first year after launch.

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Release 1.0—Esther Dyson, Kevin Werbach
Computer Letter—Dick Shaffer
DemoLetter—Chris Shipley
Softletter—Jeff Tartar
Agenda Conference—Bob Metcalfe
PC Forum—Esther Dyson
PC Outlook, Network Outlook, Enterprise Outlook—Dick Shaffer
Internet Showcase—David Coursey
Demo Conference—Chris Shipley
Investment Conferences—Morgan Stanley (Mary Meeker), CSFB/DLJ (Jamie Kiggen), Goldman Sachs (Michael Parekh)

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**Table 4.1** PC Industry Gurus, Conferences and “Must Read” Newsletters

After the gurus come the influencers—editors and writers at the key mass trade and business publications in the field. In the computer world, the Ziff Davis publications (*PC Week*, *PC Magazine*, etc.), and the IDG *Infoworld* and *Computerworld* newspapers have the broadest reach among decision makers. You must be sensitive to the lead times of each publication, to maximize the coincident coverage of your story. That is, if you want to launch a new product in May, you need to meet with the longer lead monthly magazines two to three months in advance of when you want the story to appear, with the weeklies two to three weeks prior, and with today’s daily e-mail “zines” (online magazines), a few days before the news should hit.

For products with a consumer focus, the key mass columnists can provide tremendous boost in product launch. Walt Mossberg, personal technology columnist for the *Wall Street Journal*, can make or break a product with an early review. He receives hundreds of requests each week, and has policies for filtering that good public relations agencies understand. He demands, and usually gets, to be the first to publish about your product. He likes to have them significantly in advance so that he can actually work with them and provide feedback. When Franklin Electronic Publishers and Starfish Software were launching REX, Mossberg was brought in almost a year prior to launch—under appropriate embargo agreements. His input on the early betas was invaluable in

making a better product. His review at the launch was a key factor in early product sales, and in helping the visibility of a product that had very little advertising dollar spending.

*Newsweek's* Steve Levy, *Business Week's* Steve Wildstrom, and *PC Week's* Michael Miller and John Dvorak also have earned the respect of their readers with their insightful reviews. It is necessary to view these influencers not just as targets for getting a message out, but as highly knowledgeable users who can help to improve the design and feature set of a product or service. Clearly, in today's world it is not only the print press, but television, radio, and the Internet that must also be attended to. It was, after all, the Internet's Matt Drudge who broke the Lewinsky story rather than *Newsweek*, which held it while awaiting further confirmations.

With the plethora of cable channels has come an opportunity for companies to provide short (30 second to 2 minute) video new releases (VNR) which are often picked up by local news or specialized cable services. The impact of such a piece shown on television, often with a voice over by the local news or science reporter, should not be underestimated. When MetaCreations announced its Power Goo consumer image funware, the VNR was picked up by dozens of stations, and sales were noticeably increased. *CNN Science Today* often does reports on products of interest. Miros Corporation's face recognition system appeared on the *Science Today* cable program, and Web site page views grew by thousands of page views for the seven-day period after the showing.

Reaching the decision makers is best done with focused direct marketing, and with special events, which are described in Chapter 9. But the more general positive buzz you can get with a product, the less likely the naysayers are to voice negative—against the crowd opinions.

### **Spokesperson/Evangelists**

One of the key tasks for a public relations effort is to help one (or at most two) people in the company create personal one-to-one relationships with the gurus. Most often the CEO and chief technical person are the ones who should build and nurture these relationships. They require visiting the gurus on "press tours," getting them

prerelease (beta) software or hardware, and oodles of technical support to ensure that any product usage goes smoothly. You should understand that this is a two-way street; the guru can't be a guru without being in on the latest product entries, and everyone likes to know a secret, or be in the know a little earlier than the next person. Often, if the relationship can be built early enough, the gurus can contribute to making the product more user friendly—and by having an emotional stake, are more likely to help declare the product a winner.

The evangelists who meet with the press need to be personable, knowledgeable about the company and its products, and sensitive to what can and can't be said regarding fund raising without triggering legal obligations in the case of public companies, or concerns about “hype” in private companies. It is important not to lie to the press or influencers—although spin is certainly acceptable and common. One of the biggest mistakes is talking in the “hoped for present” tense (i.e., “Yes, the product can do xxx,” when it can't). It's also important to plan the pitch in a way that is respectful of the available time of the person being wooed. Some training in public speaking—of the type that Power Presentations of San Jose provides to entrepreneurs going on a road show—can be very helpful in correcting typical mistakes. The wrong body language, too much hesitation when responding to questions, and other problems can leave a mistaken impression on the guru. Remember, in most of these cases, first impressions last.

The overall company and product pitch should be planned for at least three lengths: the “elevator story,” the 15-minute demo, and the 30 to 45 minute road show pitch. The elevator story is meant to be told in the time it takes to go a few floors next to someone in the elevator—typically 30 seconds to two minutes. It has to convince them that they should want to hear more. There are some iconic ways to do this, the most popular current one being “We're going to be the Amazon.com of . . .” eToys, for example, was planned to be the Amazon of toys and is achieving that goal. But this pitch needs to have some differentiation. “The REX has almost the same functionality as a Palm Pilot in a credit card size device, and synchronizes with your laptop by being a PCMCIA card.”



The 15-minute demo should be just that. No more than a minute or two to introduce the speaker and company—naming any credibility enhancers (advisory board members, directors, investors), followed by a demo that ideally allows for the person being briefed to get hands on with the product. Most of the gurus in high tech are gadget nuts at heart—they are the epitome of early adopters—even where, like Walt Mossberg, they try to put themselves in the mindset of the more average user. This puts the evangelist, be he CEO or CTO or just plain Marcom person, in a position of preaching to people who want you to succeed. But they need to make the product vision their own, so that they can preach it to others.

Finally, if there is lots of time available, a slide show (PowerPoint or equivalent), which can be quickly tailored to the specific audience, should be prepared. This should include sections on company history, financing, product rollout plans, advertising plans, partnering deals (quite popular with Internet companies), and, of course, the product itself.

Figure 4.1 shows how many hours per month our Inc and non-Inc. CEOs and their other managers spend on public relations in a typical month.

### Linkage to Fund Raising

For those entrepreneurial ventures that are also raising money (almost all of them), the public relations efforts serves two purposes—helping the product to be perceived and perform as a winner, and helping to fuel the fund raising. An additional set of influencers reach this community, and there is a feedback effect of strong venture capital support on the core gurus and influencers. A Kleiner Perkins funded venture has the credibility of one of the most successful partnerships behind it, and gurus take its investee company claims with somewhat less skepticism than those of an unknown company. For this field, David Bunnell of *Upside Magazine*, Rafe Needleman of *Red Herring*, Jason Calconis of *Silicon Alley* magazine, and Jonathan Weber of the *Industry Standard* have risen to the top ranks. Having the company mentioned prominently in these publications has helped get audiences not only with influencers,

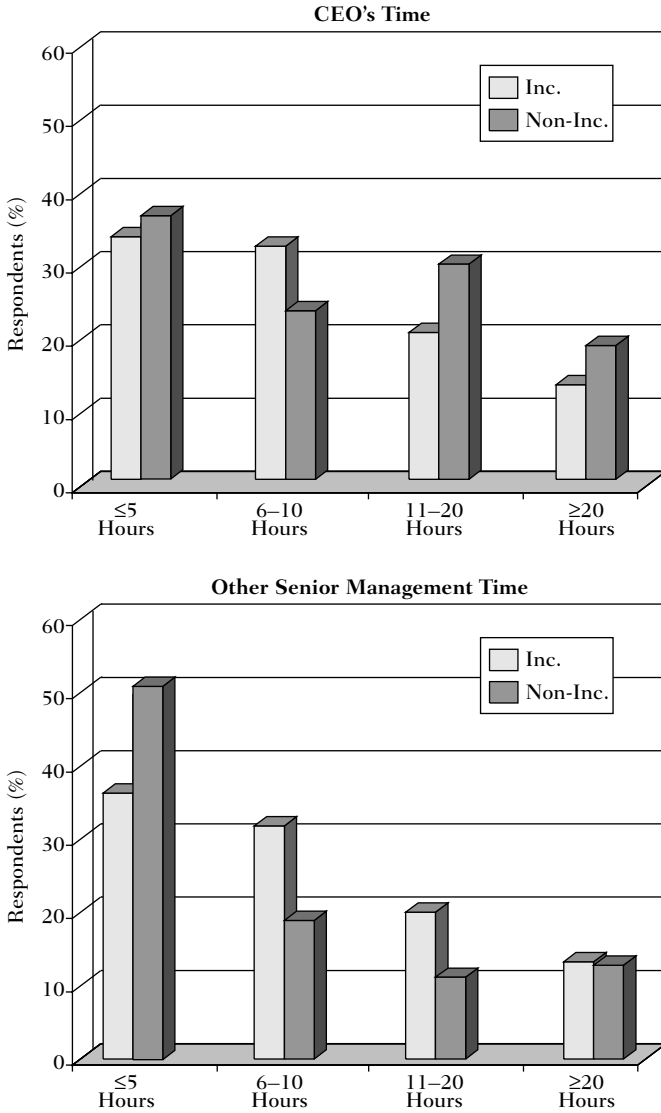


Figure 4.1 Time spent on public relations per month.

but also with targeted high-profile customers who might have otherwise waited.

Similarly, having the company mentioned in *Red Herring* may open doors that have been closed. Since most venture capitalists want to be seen as riding with a winner, the buzz which proclaims that acts like perfume to the investor.

## Public Relations Agencies

There is always a lot of controversy about the value that a public relations agency can bring to the table. Many small companies believe that they can get to the gurus and influencers themselves, and that the often-sizable cost of using an agency may not be worthwhile. Our experience is that, properly managed, public relations fees gain you a tremendous multiple on your investment in them, as long as your expectations are properly set at the outset. The agency provides three basic functions:

1. Creative—helping to define the message
2. Execution—getting the message out
3. Rolodex—knowing who to go to, and having the ability to get them to listen

While there are dramatic quality differences among agencies with respect to how they perform the first two functions, it is the third that distinguishes the top few agencies from the next tiers. Many of the very top agencies (Alexander Oglivy, Cunningham Communications, Connors Communications) have become very selective about taking on clients, and very expensive—in much the same way as successful lobbyists offer access to the right people as part of their value added.

Creating the positioning and its associated message in a form best suited to reach the various types of audiences is mainly a task for the company's top management. The agency can and should, however, guide the words and “spin” of the message so that it tells the story in a memorable, quick manner. With MetaCreations, the message became “The Visual Computing Company,” which tied together product lines in consumer and professional graphics. The

second part of MetaCreations message was “leading edge user interface,” using Kai Krause as the spokesperson and creative genius. As the public relations groups (both internal and external) found, it is sometimes hard to manage genius.

Once the press releases, press kit, and evaluation or demo software and hardware are created, the execution phase begins. The best agencies have good mailing lists of editors and other influencers. Each company must create their own contact lists, and maintain them internally so that they can continue follow-up even if they switch agencies or bring the function in house. Agencies often have direct access to public relations Newswire, Business Wire, and so on to get a story out there quickly. They are also more likely to know who has recently been assigned to which specific beats in the various periodicals, and which stock market analysts are willing to see nonpublic companies.

Measuring the effectiveness of public relations is something that should be done in as quantitative a manner as possible. A good clipping service can let you measure how many column inches of print, and radio or television air time, the public relations efforts have generated. One firm had a spreadsheet with the posted ad rates of most of the key periodicals, which allowed them to translate column inches into the equivalent cost, if they had run those inches as paid advertising. While not a perfect absolute number for value, it is quite useful if tracked over a period of time, and gives at least some handle on the advertising alternative. When possible, a good lead tracking system can be used to tell which mentions led to actual calls, Web site visits, or customer e-mails. At some companies, purchases are tracked all the way back to these types of leads—showing again the true value or the public relations effort.

As with most hiring, interviewing and reference checking are key in selecting the public relations firm. It is imperative to check out the work they have done for similar customers. Call the CEO or marketing counterpart and ask how easy they were to work with. Be specific about the staff that will work on your account—some junior people will normally be assigned, but make sure the supervisor is someone you trust, and will actually be on the account. Too often, the name partners at these firms are mainly out marketing, not

performing the actual work—although they will argue that they're keeping the influencer relationships strong, from which your company benefits.

### Timing Is Essential

The sequencing and timing of the public relations effort is crucial to getting maximum bang for the marketing dollar. Ideally, you are creating a crescendo that begins with buzz about the company, moves on to create buzz about the specific product, gets industry gurus and key influencers talking off the record about the product, and culminates in a blizzard of press coverage led by the daily mass and trade press, and followed up over each of the next two or three months with additional stories in the monthly magazines, radio, and television.

PayMyBills.com began as a project at the Wharton School and was entered into their annual business plan competition. As the judging proceeded, and the plan made it into the final eight, a leading Internet firm decided to fund it as a full-fledged business. The cofounders were brought out to idealab!'s Pasadena headquarters, and told that they had 60 days in which to launch the company and the business. The business plan competition provided the opportunity to get some buzz about the company. Since major media covered it, articles appeared in the *New York Times*, *Philadelphia Magazine*, and other locations. This helped the company in its initial hiring and fund raising.

The founders moved into idealab! on May 19. Ten days later, they had hired 10 people, mainly through a job fair and contacts on the net, that had heard of them through the articles, and the Industry Standard Internet online newsletter. Three weeks later, idealab! used the buzz to raise more than \$4MM for the company at a much more favorable valuation than would have been possible without the public relations. The Alexander Oglivy agency, which has a long relationship with idealab!, was hired to get a fast-track product launch. They created an interview schedule for trade press, business press, and radio that focused on a product launch date of July 19 (slipped from an original July 4 target). Meetings

were held with the *Wall Street Journal*, *LA Times*, *PC Magazine*, and others, for a focused print exposure at the launch.

In addition, spot radio was purchased in several cities, including advertising on the Howard Stern show for the first two weeks after launch. All of this orchestration led to a number of interviews, lots of customers, and acknowledgment as the leading player in this new field. This occurred notwithstanding that the two competitors, PayTrust and CyberBills, had been in existence much longer, but had not quite launched and were staying in stealth mode. By taking the aggressive route to public relations and product launch, PayMyBills.com tilted the playing field, and is now reaping the benefits.

As a counterpoint, if you are going to be that aggressive, you have to deliver. Boo.com, a luxury apparel site funded by Bernard Arnault of LVMH, orchestrated the public relations campaign and got the company buzz, but repeated delays in launching the site (more than eight months late), caused people to be skeptical. When it was launched, it was so slow and painful to use that the company will have negative public image to overcome as it improves the site.

## Summary

“On the Internet, no one knows you’re a dog,” says a famous New Yorker cartoon showing a dog at a keyboard. No one knows your company exists either, unless you take the proper steps to gain the perception, and then deliver the reality of leadership. This is just as true for other non-Internet businesses as well.

Using the above techniques for public relations to work through the various circles of influencers is many times the best way to quickly have that perception created. This perception of leadership will help not only in selling the product or service, but also in hiring and fund raising for the entrepreneurial venture.



# CHAPTER 5

## Entrepreneurial Distribution Channel Decisions

**N**owhere has technology had a bigger potential impact than in the standard functions that used to be considered under “distribution decisions.” Distribution encompasses all of the activities that need to be performed so that your product’s “offering bundle” is transferred productively from you the entrepreneur to the customer who will buy and benefit from the offering. The offering bundle includes not only the entrepreneur’s product or service, but all of the ancillary parts of the bundle that help to mold the perception of the end customer. Packaging, how the product is placed on the shelf, what the clerk says and knows about the product, the end user price, how the end customer is treated when she has a problem or a question before or after purchase, and how easy it is for the end customer to evaluate alternative product offerings, are all just some examples of ancillary parts of the offering bundle. The choice of which intermediaries are involved between the entrepreneurial venture and its final customers and how these intermediaries are managed has a big impact on the offering bundle.



The distribution decisions are now much more complex than they were even 10 or 15 years ago. The alternative ways for the different parts of the offering bundle to be “distributed” have been increasing at a very rapid rate. In this chapter, we give the entrepreneur some conceptual structure to generate and evaluate new, creative and possibly productive distribution options. We describe a number of options that other entrepreneurial firms have been able to use effectively. We also show methods for evaluating the options in terms of their impact on the perceived offering bundle to the entrepreneur’s target segment(s). Figure 5.1 puts the macro logic of distribution channel decisions covered in this chapter in perspective.

To help you make some good distribution decisions, we first look at the required functions any distribution system must perform. As shown in Figure 5.1, these functions are (1) re assortment/sorting, (2) routinizing, and (3) facilitating search. We next

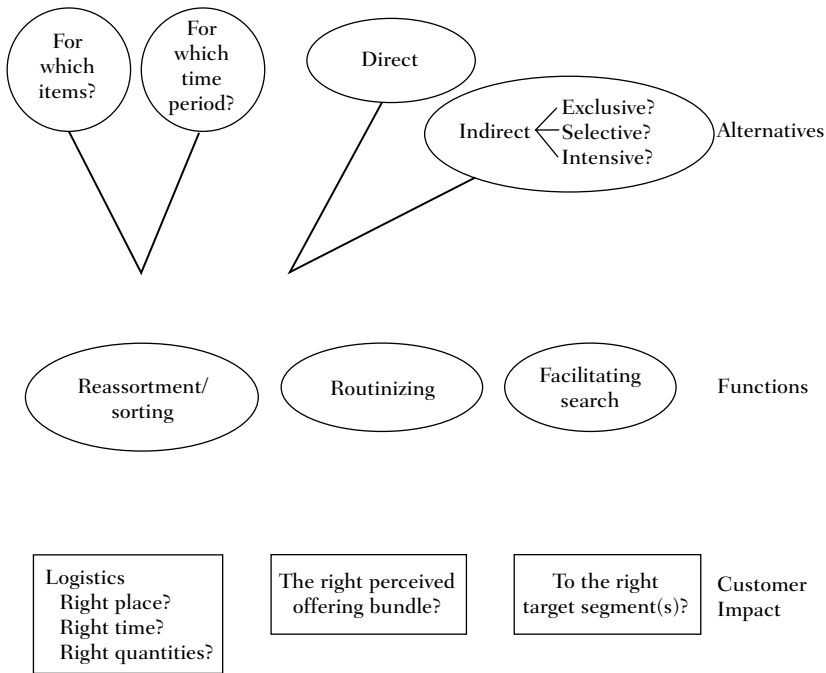


Figure 5.1 Entrepreneurial distribution channel decisions.

use the example of offering music directly over the Web to concretely examine how the distribution channel decision can significantly influence how the end consumer perceives your offering. We then look at options that need to be considered as part of the affect of the distribution channel decisions on the perceived offering bundle. These alternatives include direct or indirect or franchising. For indirect distribution, we also consider the alternatives of exclusive, selective, or intensive distribution. We examine the very important dynamic aspects of distribution channel distributions. Over the life of a product, the appropriate channel may change significantly. For franchising, we look at two points of view: (1) Should you offer a franchise for your venture? and (2) Should you buy a franchise to start your venture? We then examine what happens when the channel perceives you as competing with them when you didn't before—channel conflict—and provide some guidelines for managing and anticipating such conflict. We conclude with a plea to do concept testing with channel members in order to determine if your assumptions about their reactions to your actions are valid.

### Required Functions of Any Distribution System

First, physical distribution will always need to be performed. The product or service somehow has to get to the end customer or end consumer. It should be the right *product* or *service* at the right *place* at the right *time* in the right *quantities*. Along with physical distribution, distribution strategy also impacts the offering bundle that the end consumer sees. The offering bundle can be a critical element of your success as an entrepreneurial venture. Who the consumer is and what the consumer perceives when she is making her evaluation and purchasing decision should be the embodiment of your positioning and segmentation strategy.

Distribution intermediaries (e.g., wholesalers, jobbers, retailers, value-added resellers) possibly can be used to perform some of the required functions more efficiently and/or more profitably to the entrepreneur. Pitt, Berthon, and Berthon outline three basic functions that intermediaries can perform to improve the productivity of a distribution channel:<sup>1</sup>

1. Reassortment/sorting
2. Routinizing transactions
3. Facilitating search

*Reassortment/sorting* refers to all of the typical intermediary activities that need to happen for physical distribution from a producer that likes to supply relatively large quantities of a relatively small assortment to an end consumer who will typically want relatively small quantities of a large assortment of offering bundles. These activities may include arranging the products, sorting them into groups that are relevant to consumers, aggregating goods from different suppliers, breaking bulk by providing the right, smaller quantities to the end customer, and putting together new packages of goods from different suppliers. Your supermarket is an example. Somehow from a Procter and Gamble who ships a container of toothpaste to a central distribution point or to a wholesaler, the goods get on the shelf for you as a consumer to compare with other competitive toothpastes on the same shelf.

*Routinizing transactions* are activities that standardize products and services and automate transactions so that bargaining is not needed for each small transaction and it makes it easier for the end customer to compare alternative offerings. In some instances, resupply of products is completely automated so that orders are entered and products replenished when inventories reach a certain minimum level.<sup>2</sup> For example, there is a complete electronic connection between Wal-Mart cash registers and the Procter and Gamble (PG) logistical and production system. When the sales at the Wal-Mart cash register indicate that store inventory of a PG product is in need of replenishment, the PG system is notified and production and shipping is initiated at the optimal time. There are no negotiations between PG and Wal-Mart for each replenishment. There is implicit trust that neither party will take advantage of the other.

Not only large firms can take advantage of automated resupply. Penguin Software is an entrepreneurial venture that supplies Linux based servers with installed software for businesses. Penguin sells on the Web and has an outsourced manufacturer who actually puts together the servers. Penguin has an automated linkage with its

manufacturer so that as orders are entered on the Web, an automated request is generated to the manufacturer. The customized servers are then shipped to Penguin so that the software can be installed. Penguin keeps little inventory.

*Facilitating search* is the classic aid by intermediaries to make it easier for sellers to find buyers and to make it easier for buyers to find their best alternative product or service to purchase. The traditional retailer puts products from different suppliers on the same shelf so that the consumer can make a less uncertain purchase than he would if he didn't have the alternative products right in front of him. In general, intermediaries can reduce uncertainty for both buyers and sellers. A good intermediary can help an entrepreneur do a better job of understanding and responding to customer needs, and can simultaneously help consumers to be surer that their purchases will indeed satisfy their needs.

It is clear that the Internet is becoming a major influencer of how this search process is being performed. The search function is made to order for the Web. The Web has spawned a number of ventures that have used its capabilities to make search more effective for matching needs of buyers and sellers. These would include eBay, Carpoint, eCost, Mysimon, and Verticalnet as examples. In all of these sites, the consumer can evaluate many alternatives on criteria that she dictates. She can sort potential purchase options by any criteria she chooses (e.g., cars by horsepower and then economy).

### **Evaluating Distribution Options—Disintermediation**

Technology is making more alternatives available for the entrepreneur to consider for fulfilling the discussed functions. The distribution of products whose physical makeup is digital is being revolutionized by the Internet. It is now feasible (and some musicians have begun to do this) for an artist to produce a digital recording and distribute it directly to consumers over the Web (or for an author to directly publish a novel as did Steven King). For music, *disintermediation* (replacing traditional channels and going direct) is replacing a record company, record distributor, rack jobber, and retailer with a direct artist-customer relationship. If the

customer knows which recording of which artist they want, direct distribution may be very attractive.

It would seem at first blush, that all artists should jump aboard the disintermediation bandwagon and distribute their music directly. They would not have to pay all of the middlemen their cuts, and would be able to establish a direct relationship with their customers. This direct relationship would enable all kinds of activities to create more value (and thus make more money eventually). The artist could create loyalty programs to reward and encourage his best customers. The loyalty rewards might include special seats for concerts or special memorabilia. The artist could also reward current customers for referring new customers with similar added-value offers. However, the disintermediation decision is not this simple. There are other sides to this story.

First, how will consumers find out about the artist's Web site? Many Web sites are spending tens of millions of dollars to get people to their sites. Does it make sense for each artist to go it alone to try to get customers to his or her site? Second, do all potential consumers know they want a particular artist's song(s) or do they want to listen to a number of options before they make a purchase? Some consumers may also be concerned about the quality of the digital recording they will download. How do they know it's of high enough quality? What about consumers who are not able to play digital music or to receive digital music over the Web? Should they be ignored? These are just some of the myriad of issues that need to be considered in developing a distribution strategy. The entrepreneur's decisions on distribution can be at the same time the most difficult and the most important decisions she makes when launching a new business.

All of the functions described must be evaluated before choosing a distribution option. If the entrepreneur has really done her homework on the positioning and market segmentation issues, then the distribution options to be evaluated may be self-evident. However, as technology and the environment change the characteristics of existing options and generate new options, the entrepreneur has to constantly review these options. Let's look at our digital music example in more depth to illustrate some of these issues.

Does the artist have her segmentation determined? Is she trying to reach a very small cult group, or does she want to add value to a larger market? The answer to the targeting question will have a very big impact on the distribution strategy. However, the strategy decision is even more complex. How do the members of the alternative target groups want to buy music? Even if the cult group is the target, the direct Web site may not be appropriate. Do the “cult” consumers know where the Web site is? Do they have the technology available to download and play digital music? Do they want to buy music over the Web? How will they be reached? All of these issues can at least be evaluated by concept testing distribution options as part of the offering bundle that is concept tested by consumers before the entrepreneur makes this decision.

The distribution decision is the one that has the most impact typically on market segmentation. With the distribution channel, the entrepreneur can implement plans with more than one target segment, if the plans are cost effective. Conceptually, it makes sense to use the distribution channel(s) that are preferred by each of the target segments. Consumers will typically find it pretty easy to tell you where they would go or look to try to find your new product or service. If it is consistent with your desired positioning and cost effective, then multiple distribution options for multiple segments may make sense. However, another big issue comes up that needs a different evaluation methodology. How will existing and parallel distribution channel members react to the new direct offering?

The existing distributors may get very upset if you try to eliminate them. If they are powerful, they may severely impact your music sales through traditional channels, if they become upset with you. They may refuse to carry music that is also available directly in digital form. If you want to sell your music on classic CDs and tape as well as on the Web digitally, then you will need to have the cooperation of these distributors. To add even more complexity, if you use some distributors, they may conflict with other retailers and distributors, for example, Web-based versus store-based. Issues of channel conflict in which two intermediaries perceive themselves as competing needlessly can be big problem sources for entrepreneurs.

A whole set of other issues comes from your positioning. Your positioning should be embodied in the offering bundle that ends up being shown to the end customer. A good distribution strategy enables your offering bundle to be perceived by the end customer as you have planned. The distribution decisions can greatly impact how the end customer perceives you. Does the end consumer need to make a choice among a number of alternative artists, or do they feel okay just evaluating your offerings? Do they want to choose among different forms to buy the music (e.g., digital downloads, compact disks, digital audiotape)? How will they want to evaluate the options? Will they want to listen to everything? Will they want to read or hear unbiased reviews of the music before they buy it? How will they prefer to pay for it? Is credit card number on the Web acceptable? What about shipping? How fast do they want their music, if it isn't downloaded? How long will they wait for a digital download?

What typically happens is that the entrepreneur never gets exactly the optimal offering bundle by the distribution system she has assembled. She makes tradeoffs of less than optimal offering bundles versus the costs of the available distribution options. She is trading off potential revenue from getting the offering bundle perfect versus lower costs from less than perfect distribution options. If she has done a good job with her concept testing with target market participants and of considering the important concepts in this chapter, she should be able to make productive decisions on these distribution tradeoffs.

### **Distribution System Design—Direct versus Indirect**

The disintermediation example of using the Web to distribute music directly to consumers is only one example of direct distribution. Similar to manufacturers' representatives and your own salesforce, distribution options can run the gamut from direct to indirect systems in which there are many layers of middlemen who handle your goods before they are bought and used by the end customer. The entrepreneur is making different tradeoffs depending on how direct or indirect her distribution system is designed. Some impacts on the business effected by distribution

options include fixed and variable costs, efficiency versus effectiveness of contacts, amount of control, mass coverage versus targeting ability, and level of customization provided to the end customer. Table 5.1 lists some of these tradeoffs as a function of whether the distribution system is direct or indirect.

Because distribution intermediaries typically take title to your goods and then mark them up, or else take a fee for each item they handle, their costs are typically mostly of *variable* nature. They do not usually charge the entrepreneur for the fixed costs of their operations. However, some intermediaries do have minimum quantities that they may handle—effectively imposing some fixed costs. On the other extreme, direct distribution typically involves *fixed costs* for warehousing, billing, and other administrative costs. Fixed costs add more *risk* to the venture because they will be incurred regardless of what level of sales actually occurs in the market place. Variable costs lower risk because they are only incurred when sales are made. So direct distribution typically entails more risk than indirect distribution. However, that lower risk comes with other attributes that may or may not be worth lowering risk.

Indirect distribution is typically more *efficient* in terms of physically getting goods from the entrepreneur to the final consumer. By combining your product or service with other products and services, the middlemen are able to more efficiently perform the kinds of functions described above. However, the middleman also takes some *control* over the offering bundle and may not provide the offering bundle that is best for your product, because he is combining your product with others. When the entrepreneur is more in control, he will be able to portray his product in the best way he can—this is typically more *effective* in adding perceived

Indirect	Direct
Variable costs	Fixed costs
Efficiency per contact	Effective per contract
Control	Control
Coverage	Targeting
Customization	Customization

**Table 5.1** Indirect versus Direct Distribution Options



value to the offering bundle. The added control also enables direct distribution options to develop a more customized offering bundle for each potential customer. The indirect distributor will not typically have the flexibility, or ability to make changes for each customer because the indirect distributor has to keep the needs of all of his products in his offering bundle strategy.

### **Distribution Exclusivity Alternatives**

Many entrepreneurs do not even consider distribution exclusivity options. They assume that they should use the same channels in the same way as everyone else in their industry. Options regarding exclusivity are not considered nearly as often as they might be by entrepreneurs. The exclusivity options vary by how selective your distribution channel is and how it may vary over time. The two extremes are exclusive distribution and intensive distribution. In the middle is the selective distribution option. Exclusive distribution gives a retailer or other intermediary the exclusive right to sell your product in a defined “area” for a defined time period. Area used to mean geographical area—such as a country or metropolitan area. However, areas in cyberspace can also be exclusive to one or a select few “e-tailers.” Selective distribution gives the right to distribute your product to some entities in a defined area, but limits the number to a select group. Intensive distribution lets anyone who wants to distribute your product. There are a number of tradeoffs that the entrepreneur needs to evaluate when she considers her choice of distribution channel exclusivity. First, as with almost all entrepreneurial decisions, creativity in terms of options is crucial. Exclusivity is just a subset of the distribution options that should be generated and evaluated as part of the venture initiation process. Table 5.2 shows elements of the tradeoffs that are involved with different levels of distribution exclusivity.

#### **Exclusive Distribution**

The exclusive distribution option has a number of advantages that most entrepreneurs do not realize. The first advantage is that it is usually easier to sell into a distribution channel if you are able to offer exclusivity. Exclusivity adds value to your offering bundle to most intermediaries. Using the Internet as an example, if you can

Exclusive	Selective	Intensive
Possible easier sell in	Resellers compete	High coverage
Higher control	Less reseller loyalty	Convenience
Higher margins for all		Lower control
Less competition at point of sale		Less push to the end consumer
More push to the end consumer		More mass pull needed
Less coverage		More coverage
More association with channel members' attributes		Faster sales cycle possible
Possible guaranteed minimum sales		

**Table 5.2** Distribution Exclusivity

offer your product to only one Web site for resale, then that Web site operator does not have to worry about any price competition from other Web sites. This price competition is made easier on the Web by the robots that automatically find the lowest price for purchasers among the competing sales sites on the Web. Not only can you sell the product easier with exclusivity, but also in many cases you can extract valuable benefits for a struggling entrepreneur. Typically exclusivity is negotiated with either some payment in advance for it, or some guaranteed minimum sales quantities that the distributor will have to sell in order to retain the exclusivity.

**Information Resources, Inc.—Funded by Exclusivity**

In the early 1980s, John Malec and Gerry Eskin had developed a potentially valuable way to help major packaged goods companies evaluate the incremental revenue impact of changes in their television advertising. They were able to fund their venture by offering exclusivity to their potential customers at a time when they were having trouble getting funding from traditional sources. They had developed and patented technology to use to target cable television viewers in smaller markets without access to television signals over the air. Their concept was to put boxes on the top of cable household television sets, and to put computer systems into the “head end” where the cable system got the microwave programming signal. This technology would enable Information Resources to have viewers of the same television show on cable get different advertisements than the other viewers of the same show.

This ability to target ads was combined with a consumer panel of households who were given cards that were scanned at all of their area's food and drug stores. The Behaviorscan® system was able to very validly evaluate television advertising changes by performing the changes in an experiment where the experimental groups were matched by prior purchases of the brand and category. The matching of the experimental groups was done with the household panel data that was collected every time the household made a purchase at any of the food or drug stores in the metropolitan area.

The Behaviorscan concept was very attractive to many packaged goods advertisers, because it was the first way they had seen to validly get a handle on the productivity of their very large television advertising expenditures. For example, if one group of matched households were given 50 percent more television advertising for a brand than another group of matched households, the experiment was designed so that all other possible effects on sales were controlled for, and a valid measure of advertising productivity—its incremental impact on revenues—could be obtained.

Information Resources leveraged the interest of these major packaged goods firms to fund their development. Before they had any of their markets instrumented, Malec and Eskin presented their design and patents to the major packaged good's firms. They offered *category exclusivity* in return for up front payments that would pay for the development and implementation of the instrumented market technology. The packaged goods marketers were so worried that their competitors would get a competitive edge, that Malec and Eskin were able to fund their development *without any* outside funding. At the same time, Malec and Eskin were actually having problems getting funding from traditional sources. Exclusivity to potential customers turned out to be a very creative, extremely cheap, way to finance the venture.

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### Evaluating Channel Exclusivity

By giving exclusivity, you enable the channel member to associate your product more closely with the channel member's other products. In many cases, this can be a win-win situation for both

parties. If the positioning of your product is consistent with that of other products the channel member carries, then your product will reinforce the positioning of the other products and simultaneously benefit from the association. For example, many upscale products will have exclusive retailers in each geographical area who are “authorized” to sell their product exclusively. Even the adjective “exclusive” has been used to describe this kind of product. “Exclusive,” very high priced watches and certain high-end designer fashions are examples of products that use exclusivity as one of their distribution leverage points.

If a channel member has exclusivity, she will typically have more motivation to “push” the product to the next level of distribution, or to the final consumer. “Push” involves promotion, distribution attention (e.g., shelf space, display in store, advertising). Because she has exclusivity, the channel member can push the exclusive product and not worry about a competitive channel member capitalizing on the “push” by selling the “pushed” product without paying for any of the “push expenses.” On the other hand, if the exclusive product is very attractive to consumers, advertising the exclusive product may get new people into the channel member’s business and cause them to buy other products while they are there. Some very powerful retailers have begun to understand the value of having unique, high-perceived value products on an exclusive basis. Home Depot, for example, has a number of products made especially for them that can bring in new customers or cause existing customers to come visit the store more often. Home Depot’s exclusive line of dehumidifiers was very well rated by a consumer magazine and thus brought new customers in. Home Depot did not have to share those new customers with any competitors because of their exclusive arrangement with the manufacturer.

Because of the lack of interchannel competition, the margins on exclusive goods are usually higher, not only for the channel members, but also for the manufacturer. The manufacturer typically has some more control over what the channel member does with her product if she has an exclusive arrangement. In many cases, the exclusivity contracts will not only have guaranteed minimum purchase quantities, but also stipulations about how much and what kind of “push” will be performed by the channel member.

However, the granting of exclusive distribution is not a one-way street.

If you give an exclusivity contract for a long period, you may end up at the mercy of the channel member to whom you have given exclusivity. During the contracted exclusivity period, as long as all of the exclusivity contract provisions are being observed, you may have very little leverage over the channel member. This happens often when an entrepreneur enters a foreign country using a full service importer/distributor. These importer/distributors typically assume all responsibility for the product once the container leaves the entrepreneur's country. The entrepreneur is typically not very knowledgeable about the sales potential and/or the potential perceived value of her offering to the end consumers in the foreign country. The importer takes advantage of this by negotiating a contract that has a competitive price that the importer pays for your product, but does not specify the price or other marketing mix elements that the importer will use in his country. There are also typically annual minimum purchases that are required to retain the exclusivity. The agreements can be very long in duration 10 to 20 years, or even lifetime. The importer/distributor is thus free to do whatever he wants with the product as long as he buys his minimums from the entrepreneur. Sometimes, the importer will second source an inferior version of your product to distribute along with your product and unfairly leverage your brand equity. In other cases, the importer will develop a competing version of your product and limit his competition to the minimums he has to sell of your product.

One author has been working with foreign companies entering the U.S. market for over 20 years, including a number of Israeli firms. A number of Israeli firms wanted to enter the U.S. market and found someone in the United States who spoke Hebrew. That person became the exclusive importer/distributor and told the Israeli firm that "standard practice" was to have very long exclusivity terms—20 to 30 years in many cases. The Israeli firms lost millions of dollars in opportunity costs because of the treatment of their exclusive distributors for whom they had no operational recourse. Many American entrepreneurs have had similar experiences when they attempted to enter other countries—especially

those with very different languages and culture. Just as it makes sense to generate and evaluate a number of alternatives for other elements of your marketing plan, it is at least as important for the distribution channel decisions.

Before getting into long-term exclusivity agreements, you should know your market, how the product offering should be perceived, and have some reasonable ideas about its perceived value and pricing options. The long-term exclusive distributor is crucial to your business—it's like a marriage. You should check out all alternatives and be sure of the ethics of your chosen distributor, if you choose the exclusive route.

### **Item Exclusivity**

Some firms use exclusivity by item to help lower price competition between competing channel members or competing retailers. They will make small differences between models and give retailers or channel members exclusive rights to one model for a geographical area. This exclusivity by item does not help as much with all of the advantages of exclusivity in Table 5.2. However, in a number of industries, it has become the way most firms go to market. For example, the medium and high-end furniture manufacturers will have different models that are exclusive to different retailers in a U.S. metropolitan area. The biggest advantage the furniture retailers see from this tactic is that their potential customers cannot easily compare prices from one local dealer to another. Now that furniture is beginning to be sold on the Internet, it will become even more important for local retailers to attempt to insulate themselves by having exclusive items.

### **Intensive Distribution**

Intensive distribution is the opposite extreme in the options described in Table 5.2. Anyone who wants to carry your offering is encouraged to do so. The objective is to be everywhere the end customer might be and possibly buy your product offering. Impulse purchases such as candy, snacks, and so on are typically well suited to intensive distribution. However, in order to be successful, the consumer needs to know your product is there and perceive its value. The product needs to be pulled off the shelves

by the customer compared to all the other competitive products. The classic, non-entrepreneurial way for that pull to happen is for a company to spend millions of dollars on advertising and promotion. As entrepreneurs, we know better ways. Our chapters on advertising, promotion, and public relations cover creative cost-effective ways to pull products through intensive (and other) distribution channels. One of the most creative ways to use intensive distribution is with *fad* products.

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### Wallwalkers

Ken Hakuta was the master user of intensive distribution to support his launch of “Wacky Wallwalkers” in concert with the rest of his ingenious, creative marketing plan that he executed in the mid-1980s. Because of the amazing demand built up by his fortuitous national public relations “Blitzkreig,” every store in the United States wanted to sell Wacky Wallwalkers. Wacky Wallwalkers were exactly what their name hinted. They were little plastic octopuses that if thrown against most walls, would slowly walk down the wall, one leg over the other. Every retailer wanted to sell Wallwalkers after they were featured as the “newest fad” on the *CBS Evening News*.

Ken knew that time was of the essence and that he should take advantage of the extraordinary consumer demand by getting as many Wallwalkers into as many storefronts as possible as fast as possible. He was aware that cheap knockoffs would soon arrive to compete, even though he had an “exclusive license” from the Japanese manufacturer. To accomplish mass distribution as quickly as possible, Ken authorized toy and novelty distributors to sell his product to the trade rather than have his own sales and distribution team. The distributors had the entire infrastructure in place to quickly get the product to all of the retailers who were demanding to be part of the Wallwalkers action. Ken gave an additional markup to these distributors to compensate them for their part in the distribution chain. He thus made less on *each* Wallwalker that he sold than he would have earned had he used his own sales and distribution system. However, he correctly estimated that his total number of units sold would be much higher with the indirect distribution system. The total profits he earned by selling over 200

million Wallwalkers in less than one year were much higher than he would have earned had he struggled to develop his own sales and distribution system. He also was able to capitalize on the consumer demand before the knockoffs were able to become a big factor.

The use of intermediary sales and distribution resources was appropriate for Ken for another reason. He correctly viewed Wallwalkers as a product with limited life and did not plan to follow Wallwalkers with any other products targeted at similar mass-market customers. If he were planning a long-term business where retailer relationships were going to be important, than more direct contact between Ken's people and the mass retailers would possibly make sense. He was right to view Wallwalkers as a once in a lifetime opportunity. He made "tens of millions"<sup>3</sup> of dollars on the Wallwalkers—not bad for a year's work and virtually no assets before he started!

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### **Selective Distribution**

Selective distribution is in the conceptual middle between exclusive and intensive distribution. Here, some, but not all, resellers are authorized to resell your product and/or service. By not allowing everyone to carry your product, you retain some control as to how it will be resold. The control mechanism is the implied threat to take away the product from those resellers who do not follow your rules for your product. You also may have a higher say in how the end consumer may perceive you. The selective distribution option is best if it is integrated with the rest of the marketing mix to underlie a sound positioning and segmentation plan. Brooks Sports found a way to compete with Nike that includes selective distribution as an important, integrated element of its marketing mix.

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### **Brooks Sports—Integrating Selective Distribution with Effective Positioning and Segmentation**

When Helen Rockey came to Brooks in 1994 after 11 years at Nike, Brooks was a mess. Brooks had been successful during the running boom of the late 1970s, but in the 1980s they tried to chase Nike.



They expanded into other categories like basketball, aerobics, and baseball, and signed big name athletes like Dan Marino and James Worthy to sell its \$70 shoes.<sup>4</sup> Brooks, like Superscope (discussed below) had committed the classic error of trying to move down the prestige of distribution channels to maximize revenue. According to *Forbes*:

But in trying to become a mini-Nike, Brooks was stretched too thin. When business began to slow, it began using cheaper materials and selling its sneakers at rock-bottom prices to discount retailers like Kmart, which sold them for as little as \$20. Brooks lost credibility with joggers, and between 1983 and 1993 it lost some \$60 million. "I don't think I really knew what I had gotten myself into," Rockey says.<sup>5</sup>

Helen developed a completely different marketing strategy to differentiate Brooks from the rest of the competition. She went back to Brooks' running heritage and decided to be perceived as the shoe for serious running enthusiasts. This revived positioning and implied segmentation dictated all the elements of her new marketing mix, including distribution. This new strategy was consistent with what was left of Brook's distinctive competence—relationships with Far-East suppliers, design capability, and a new CEO who herself was a running enthusiast.

The best outlet for the newly positioned Brooks line was the specialty running stores that catered to the running enthusiasts. Helen had to make her product attractive, not only to the end purchaser, the running enthusiast, but also to the specialty running store retailers. She did that with all the elements of her marketing mix—especially her product and pricing, and very selective distribution. She first limited the Far-East suppliers from 20 to the 3 best at producing high quality shoes and redesigned the line to be attractive to serious runners. She next boosted the suggested retail prices significantly—to as high as \$120. The margin to the running specialty stores was about 45 percent. This was a good margin for the stores—as long as the prices were not undercut by other retail competitors. This is where Brooks' selective distribution was critical. Helen had to control all of the retail outlets to ensure that no

one was undercutting each other. She did this by ensuring that only specialty running shops got the shoes and that the discounters were not able to carry the line. In the beginning of the repositioning, she had personally visited the major retail specialty running stores to convince them that she really was dedicated to having a brand that both Brooks and their partner selective retailers would make very good money on.

The other elements of Brooks' marketing mix also supported the new segmentation and positioning. Their salesforce helped their retailers to run running clinics and trained the retail salesforce about how to get the right shoe for the store's runner clientele. Brooks also had an extensive and professional presence at the major running trade shows. There are no more celebrity endorsements. Instead the company has over 200 competing runners who are given free shoes. These runners are icons within the serious running community.<sup>6</sup> Because the target segmentation made mass media unnecessary, Brooks was able to take advantage of media that reached its target audience very efficiently. Brooks spends less than a million dollars per year in niche publications like *Runners World* and *Running Times*. This reinvented positioning and segmentation has been very productive for Brooks. According to *Forbes*: "Brooks' sales have been growing at a 30 percent clip for the past 4 years and should hit \$100 million by next year (2000). Operating income (net before depreciation, interest, and taxes) last year (1988) topped \$4 million, from \$3 million in 1997."<sup>7</sup> Some brands may not be suited for intensive distribution. Brooks was one of them, as it was developed over time. Brooks does not have the potential to out compete or out muscle Nike or Reebok. However, it does have the potential to make a lot of money for its entrepreneurial owners if they continue to understand its limitations and have a marketing mix (including selective distribution) consistent with its revised positioning and segmentation.

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### Value-Added Resellers

Many business-to-business products are marketed through a form of selective distribution. They often will form relationships with

*value-added resellers* (VARs) who bundle their product with other products and services to solve their customer's problems. The conceptual logic that supports a decision to use VARs is very similar to that of evaluating manufacturers' representatives as a sales mechanism. The VARs value added is their relationships with their customers and the other synergistic products and services that they may bundle together to solve customer problems. Many technical products that need to be used together with other products in an integrated solution are best marketed through VAR, selective, indirect distribution channels. For some component product categories, the end customer does not expect to buy directly from the manufacturer, but wants to buy an integrated solution from a VAR. In those categories, the VAR can almost become the end customer to the entrepreneurial manufacturer. The entrepreneur's job is to understand the needs of the VAR and provide more perceived added value than competitors.

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#### **Nice Systems—A VAR Example**

Nice Systems, Ltd. is an entrepreneurial company started in Israel that has used the VAR channel all over the world to grow from less than \$10 million in 1991 to over \$100 million in 2000. Their major product line has been integrated digital recording and quality control systems for telephonic voice applications. These are systems that digitally record phone or other voice sources and provide technology so that the customer can easily search for and access conversations that were recorded over time. The markets for Nice Systems' products include call centers, trading floors, air traffic control, and public safety and security. Even though the product is very similar, or even identical for each of these markets, Nice has wisely chosen to have selective distribution with different VAR partners in each market. For trading floors, Nice has authorized firms like British Telecom, Siemens, IPC Information Systems, and so on. For call centers, they have associated with Alcatel, Aspect Telecommunications, Rockwell, Lucent Technologies, and so on. In each of these markets their objective is for the VAR associates to integrate the Nice Systems products into their total communications offerings to their target markets. Nice could not have grown

nearly as rapidly nor have as good a base of business had they not utilized a VAR strategy. The drawback to the strategy (if there is one) is that Nice must make sure that its offering bundle is not only attractive to the end customers in the call centers and air traffic control centers, but also attractive to their VARs as well.

Selective distribution is very important if aspects of the place the product is bought are important to the perceived value of the entrepreneur's offering bundle. The entrepreneur can use the concept testing procedure to check whether the potential customer views the product offering any differently if it is carried in one store versus another. If a product is described as available at Sharper Image or Neiman Marcus, it will be perceived differently than if it is described as available at Wal-Mart and Kmart.

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### **Preservation Hall Jazz Bands—A Selective Distribution Example**

Alan Jaffee, the entrepreneur who founded the Preservation Hall Jazz Bands in New Orleans understood the importance of selective distribution in determining how his product offering was to be perceived. He founded the Preservation Hall Jazz Bands by personally finding old Dixie Land jazz stars and rehabilitating them and caring for them so that they could recreate Dixie Land jazz as it was in its hey day. His objective was to have the Preservation Hall Jazz Bands perceived as art, not just as entertainment. To ensure that potential consumers received the correct perception, Mr. Jaffee only let the bands perform in venues that were perceived as mainly artistic as opposed to entertainment. For example, the bands would perform at the Tanglewood or Wolftrap music festivals, but not at stadium rock or jazz concerts. If they performed on television, it was on the Bell Telephone Hour, not on a weekly variety or entertainment show. For those readers who saw the Preservation Hall Bands perform in the late 1980s or early 1990s, Alan Jaffee was the rotund white man playing the tuba in the all-Black band. Their home venue, Preservation Hall on Bourbon Street, New Orleans, also reinforced their artistic, authentic positioning. The "hall" is very simple with benches for the audience to

sit on, with no alcoholic beverages served. You are supposed to go to Preservation Hall to listen to Dixie Land Jazz and appreciate it as an art form. Their home venue, their venues on the road, and their media appearances all support and are synergistic with that positioning. Alan Jaffee did marketing at Gimbels Department Store before he founded Preservation Hall, and that may have prepared him to position his “offering” so well.

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### **Dynamic Distribution Management**

Many entrepreneurs need to understand that distribution channels can sometimes be more valuable if they are changed over time. This is true especially for product lines that continually have innovation and change a lot and/or have new products or models that are introduced. The distribution channels need to change because the prestige you want to associate with your newest and most innovative product may be very different from the prestige you are able to associate with an existing product. If the existing product has been sold for a length of time and is no longer considered as state of the art, it will not command as much prestige and status as the “newest and most advanced.” Consumer electronics and fashion items are those for which changing distribution *by item* over time is often an excellent strategy. If you can associate the high prestige items with the high prestige distribution channels, and the lower prestige items with the lower prestige (and typically lower margin) distribution channels, you can often create win-win situations for both you and the distribution channels.

The reason this item change over time works has partly to do with examining the needs and values of the various types of channel members. The high-end channel members (Sharper Image, Bloomingdales, Hammacher Schlemmer) want to sell exclusive, high perceived value items. They do not want to sell the same items that the lower end, mass market channel members (Wal-Mart, Kmart, etc.) sell. The high-end retailers do not want to have to compete on price with the same item in a lower end, lower margin store. The high-end stores perceive that their better service and the store ambiance justify higher markups than their mass-market competitors. They

also do not sell the kind of mass volumes that the lower end stores do. This also justifies their higher profit margins because their fixed costs are higher per unit of sales.

The lower end channel members have just the opposite set of needs. They would like nothing better than to be able to sell the same items that the high-end stores do. They want to advertise that they have the same items as the high-end stores, but for less. Managing the delicate balancing act of the different channel hierarchies is a real challenge for many entrepreneurs. However, with careful planning and a bit of *chutzpah*, an entrepreneur can successfully manage these conflicting channel priorities. We cover two examples next—one of an entrepreneurial company Superscope, Inc. that mismanaged the balance of their distribution channels and Franklin Electronic Publishers that has managed the process very well for 12 years.

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#### **Superscope, Inc.—Couldn't Achieve Balance**

In the late 1980s, Superscope, Inc. bought the right to the Marantz label for high fidelity components. When Superscope bought them, Marantz was a premier manufacturer of very high-end audio components—tuners, amplifiers, speakers. Marantz's distribution was consistent with their high-end image. They had a very selective distribution channel—only the most prestigious and best audio/video “consultants”/dealers in each metropolitan area of the United States. The Marantz business had good profits, but was not very large in terms of sales volume. The Marantz positioning and pricing limited their target market to the high-income audio file market segment. With a limited, but very profitable target market, Marantz was growing with the high-end audio market—around 10 percent per year.

Superscope was not satisfied with the growth potential of Marantz. They reasoned that the brand's perceived value was so high that it could sell much more if its distribution were broadened and its advertising budget increased. When Superscope talked with mass-market retailers and distributors, they got big intentions of purchasing and promoting the Marantz line. Retailers like Wal-Mart and Kmart or Circuit City would like nothing better than to

get a very high-end, high-gross profit product line. Their modus operandi would be to discount the list price to build volume and sell very large numbers of units. They might even use the Marantz line as a loss leader to build store traffic. They reasoned that middle market consumers would love to have an opportunity to buy high-end products at a good discount.

Superscope thus began a very ambitious program to sharply increase the sales of Marantz by significantly broadening the line's distribution. They began offering the line to the mass-market retailers. They encouraged them with coop advertising programs to advertise Marantz in their weekly circulars and newspaper inserts. Most of the circulars of retailers like Circuit City or Kmart advertise temporary price reductions and other kinds of special pricing. Initially, the sales results of the increased distribution program were extremely strong. For the next two years, Superscope's Marantz sales volume more than doubled and their corporate profits were up even higher because of economies of scale. Superscope was a very hot stock in New York for about a year.

Then things began to unravel. The high-end, exclusive retailers got very upset that they were being undercut on price and out promoted by the mass retailers. The high-end clients were very sophisticated and were willing to go to Kmart to buy for much less what they used to buy at the high-end specialty retailers. So the high-end retailers began to lose business. What did they do? The high-end specialty retailers began refusing to carry Marantz and changed allegiance to other audio equipment makers who would respect the selective distribution to only high-end specialty channels that would not compete with each other on price. For a while Superscope did not care about these distribution losses, because the high-end business was more than being made up for by large orders from the mass retailers. However, once the majority of the high-end retailers stopped carrying Marantz, its cachet and prestige began to really suffer. The high-end retailers began to bad mouth Marantz as "the cheap brand" that was being sold through Kmart. The mass marketers began to also shy away from paying good wholesale prices for Marantz because it began to no longer fly out of their stores as it used to. This wholesale price pressure made a big impact on Superscope's profit margins. Superscope

then decided to increase their profit margins by making Marantz offshore at much lower costs and somewhat lower quality. This manufacturing change held up Superscope's profits for a time, but it also added even more fodder for the high-end "Marantz Bashers" who created much word-of-mouth about the decline in Marantz quality. The mass-market retailers then began to cut back their orders because the consumer demand for Marantz was deteriorating. Superscope's volume began to drop precipitously. They tried to introduce a line of Marantz "Gold," made domestically, that would only be sold in the high-end stores. The high-end stores turned Superscope down flat because they felt betrayed by their Marantz experience. They would not trust Superscope not to do the same with Marantz Gold that they did with Marantz. Superscope is no longer in business and the Marantz name lost most of its former value.

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Superscope made a number of mistakes. They did not create long-term value for any of their distribution and retailing channels. They used the Marantz reputation partially built by the high-end retailers to hurt the same high-end retailers when they broadened distribution to price oriented competitors. They lost the trust of the high-end retailers by not treating them with the exclusivity that they rightfully expected. They lowered the quality of the brand as they lowered the prices. They sacrificed their long-term positioning and perceived value for a short-term big revenue and profit spike. Their short-term thinking killed the company.

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### **Franklin Electronic Publishers**

Franklin Electronic Publisher's core business is handheld reference products like dictionaries, thesauruses, wine guides, and so on. Over the years, Franklin has had a spotty record with other product lines, but they have continually been able to slowly grow and make good returns on their core product line. Their dynamic distribution channel management by item is a big part of their long-term success with this core line. They use a tried and true formula to provide a win-win situation for all of their channel partners—from the



high-end Sharper Image and Bloomingdales to the lower end Wal-Mart and Kmart. They give each of them what they want without alienating anybody. Sharper Image and other high-end catalog retailers, as well as the high-end retailers and e-tailers, all want exclusivity to the high end for items that they sell. Sharper Image does not get too upset if Hammacher Schlemmer sells the same new Franklin translator at the same price. However, if Kmart or the Damark catalog are each selling the same item at 30 percent lower *at the same time as the Sharper Image*, the upper-end retailers get very upset.

Franklin handles this conflict by *cycling its items* through the distribution channels over time. Their newest models get very selective distribution to the high-end retailers for about six months. They then are released to the mid-level retailers, like Radio Shack, Macy's, and so on for another six-month period. After that period, the items are released to the mass-market retailers, the Wal-Marts' and Kmart. If Franklin has its plan working perfectly, they have new items every six months to feed into the channel to replace the items that have been released to the next prestigious levels. When they release the item that has been at Sharper Image for six months to the next level, they should have another brand new item to take its place. Sharper Image and other high-end retailers are happy because they are always the first to have the newest and most advanced items that they can price at high margins because of their very selective distribution. The mid-level retailers are also relatively happy because they get to carry items at a discount that had just been in the Sharper Image at higher prices. The lower level mass-market discounters are also happy because they get to carry items at a further discount that had just been in the department stores and other mid-level retailers at higher prices.

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### **Franchising: Still Another Distribution Option**

Many entrepreneurs have used franchising to accelerate their revenue growth. However, as is the case with all distribution alternatives, franchising is better for some product/market situations than for others. We first describe what franchises are and which types might be useful for entrepreneurial ventures. We then

evaluate the advantages and disadvantages of the different types and how a decision to offer franchises should be evaluated. We also look at franchises from the point of view of buying a franchise because more entrepreneurs consider buying franchises as a way to get their venture started than any other business form. We next consider the unique conflicts that occur between franchiser and franchisee and how they might be managed.

### Different Types of Franchising

A franchise is usually permission or a license granted by the franchiser to the franchisee to sell a product or service in an agreed-upon territory. Franchising is typically a continuing relationship in which the franchiser provides assistance in organizing, training, merchandising, systems, and management in return for payments from the franchisee. Franchises are a big part of business in the United States. Approximately 1 in 12 businesses is a franchise and \$1 trillion in revenues come from franchises.

The different types of franchises depend on what rights are licensed to whom. Different forms of franchising are cropping up all the time. The following forms are examples of those that have been used by entrepreneurs. These forms are not mutually exclusive. Many franchise forms can have elements of these different prototype forms:

1. *Manufacturing Franchise.* Here, the franchisor provides the right to a franchisee to manufacture a product using the franchisor's name and trademark. The most prevalent examples of this form are soft drink bottlers. Other examples include companies who manufacture private label goods that have a retailer's label on them and firms that manufacture fashion apparel under license to a designer label. The Callanen Watch company (now a division of Timex, Inc.) had a license to manufacture watches under the Guess™ label.
2. *Manufacturer-Retailer Franchise.* In this form, the manufacturer gives the franchisee the right to sell its product through a retail outlet. Examples of this form include gasoline stations, most automobile dealerships, and many businesses found in shopping malls.

3. *Wholesaler-Retailer Franchise.* Here, the wholesaler gives the retailer the right to carry products distributed by the wholesaler. Examples of this form include Radio Shack (which also manufactures some of its products), Agway Stores, Health Mart, and other franchised drug stores.
4. *Business Format Franchise.* This is the most popular form and includes elements of the other forms. It is typically more all-inclusive. Here, the franchisor provides the franchisee with a name, an identity, and a complete, “proven,” way of operating a business. Examples include Burger King and McDonald’s fast-food outlets, Pizza Hut and Dairy Queen restaurants, Holiday Inn and Best Western hotels, 7-Eleven convenience stores, and Hertz and Avis car rentals.

#### **From the Franchisee’s Point of View**

For the franchisee, these franchise forms can be very helpful for some entrepreneurs who want to start a business, but may not have the vision, creativity, resources, or skill to start a completely new venture. All of the forms provide for the franchisee to benefit from the market power of large-scale advertising and marketing expenditures. These large marketing budgets typically come from the collective resources of all the franchisees. Many franchises also enable franchisees to band together and buy products and supplies at better prices than they could as individual entrepreneurs. Probably the biggest value of these franchises is the brand name value and equity that has been built up over, in some cases, many years by the franchisor. The different forms may also add unique advantages.

For manufacturing franchises, the franchisee may get a well-protected market that they have exclusively. Many manufacturing franchises may also permit the franchisee to obtain licenses from more than one company. For example, the Callanen Watch Company also had a license to manufacture Monet brand watches. Having multiple licenses can lower risk levels for franchisees, especially for items that may go in and out of favor. For Callanen, if the market for Monet watches was waning, perhaps the Guess brand could take up the slack.

The business format franchise adds a number of benefits to the franchisee that has little business experience. The best business format franchises have encapsulated all the relevant knowledge and experience of the franchisor into training and operating systems that take most, if not all, of the guess work out of operating the franchise. McDonald's is famous for its "Hamburger University" that trains its franchisees in all elements of running a successful outlet. The franchisee basically gets to leverage on all the other experience of other franchisees and the franchisor in the past. The franchisee is helped in setting accounting procedures, facility management, personnel policies, business planning, and actually starting up. Most franchisors also help with outlet location and help arrange financing. Many business format franchises are in businesses like fast food, and convenience stores that are not very sensitive to business cycles and can make it easier to weather a poor economy. This franchise form is also available for a wide range of prices. Some business format franchises can also be operated from home-like aerobics instruction or direct marketing of cosmetics.

The typical advantages of becoming a franchisee include:

- Lower risk of failure
- Established product/service
- Experience of franchisor
- Group purchasing power
- Instant name recognition
- Operational standards assure uniformity and efficiency
- Assistance in setting accounting procedures, facility management, personnel policies, and so on.
- Start-up assistance
- Location assistance
- Help with financing arrangements
- Power of national and regional marketing

However, there is another side to being a franchisee. Many readers of this book want to be entrepreneurs at least partly in

order to be their own boss. All of these franchise benefits come at the cost of sacrificing much autonomy. For most franchises, the franchisee has little, if any control over the product/service they sell, or the marketing decisions on advertising, public relations, or location. It may be impossible, for example, to drop or add products that may be more or less suitable to the particular needs of your market area. Local public relations may be under the franchisee's control, but with constraints from the franchisor. The franchisees may have a cooperative governing organization that decides on national advertising and promotion policies together with the franchisor. Each franchisee is limited to one vote in these organizations. There are also usually very strict rules and regulations on all aspects of operating the business.

Aside from autonomy, there are other typical disadvantages of becoming a franchisee. You pay for the privilege. There usually is an initial franchise fee, ongoing royalty payments as a percentage of revenue, as well as a percentage of revenue to a cooperative marketing fund. The marketing fund is administered by the cooperative franchisee-franchisor organization. These fees are all "off the top." The franchisor gets paid before the franchisee may make any profits. The franchise agreements may also impose restrictions on selling the franchise if things go badly, and may also restrict how the business may be passed on to your heirs. Because the business depends on the franchisor's success, there is also a risk that the franchisor may fail. Visible franchisor failures recently have been Arthur Treacher's Fish & Chips, and Boston Market.

Disadvantages of buying a franchise include:

- Payment of an initial franchise fee
- Ongoing royalty payments "off the top"
- "Off the top" payments for cooperative marketing fund
- Cannot add or drop products unilaterally
- Little say on national marketing policies and tactics
- Must conform to operating procedures—even if you have a better way
- You depend on the franchisor for much of your success
- Some large franchisors have failed

- May be restrictions on selling the franchise
- May be difficult to pass the business to your heirs

Besides considering all of the benefits and disadvantages, before selecting a franchise, the potential franchisee should carefully read the “Uniform Franchise Offering Circular” (UFOC) for each franchise being evaluated. The U.S. government requires this document. It contains the information that typically is needed to make a well-informed decision about the franchise as well as some not as useful information. The UFOC document is much like a prospectus that is required as part of an initial public offering for a company’s securities. Its major purpose is to keep the company making the offering from getting sued by people who buy the securities (or in this case the franchise). The lawyers thus make the issuing company disclose any possible risks that the franchisee might be taking when they buy the franchise. Because of this bias in the way the document is written, it should be read in a special way. If one took all of the possible risks the lawyers put in these documents literally, you would not buy any franchise or any new public security. The lawyers get paid to invent risks to worry about. Most of the risk stuff is “boilerplate” that can be found in most of these documents. There is, however, much very important information in the UFOC that is crucial for evaluating a franchise. Table 5.3 highlights the important information in the UFOC that should be scrutinized before entering into a franchise agreement. Because there are many “fly by night” franchisors around, it really pays to do your homework before buying any franchise. The UFOC can be very helpful. *Under no circumstances should you buy a franchise without scrutinizing the UFOC.* Some franchisor sales people can be over zealous. From the franchisees point of view *caveat emptor* (let the buyer beware!) is the point of view that is necessary.

## From the Franchisor’s Point of View

### Advantages for the Franchisor

Franchising is a distribution option that should be considered by more entrepreneurs. Many of the aspects of franchising can be very attractive.<sup>8</sup> Franchising enables rapid expansion without large investments by the entrepreneur. The alternative ways of expanding

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Business experience of the franchisor and its affiliates
Qualifications of franchisor's directors and managers
Any lawsuits against the company and/or managers
Any bankruptcies of the company and/or managers
Initial franchise fee and other initial payments
Description of all required continuing payments
Any restrictions regarding purchasing from the franchisor or its affiliates
Any restrictions on the quality of goods and services that the franchisee can use
Any financial assistance available from the franchisor
Restrictions on goods and services the franchisee is permitted to sell
Restrictions on customers with whom the franchisee may deal
Territorial protection for the franchisee
Conditions under which the franchise may be:
1. Repurchased
2. Refused renewal
3. Transferred to a third party
4. Modified
5. Terminated by a third party
Description of training programs provided
Description of involvement of celebrities or public figures in the franchise
Financial statements and history of the franchisor
Basis of potential franchisee earnings projections made by the franchisor
Percentage of franchisees that have achieved the projected results
Names and addresses of other franchisees to contact for their point of view
Statistical data on:
1. Present number of franchisees
2. Numbers projected for the future
3. Number of franchisees terminated
4. Number of franchisees repurchased by the franchisor
Copy of the franchise contract

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**Table 5.3** Important Information for the Franchisee in the UFOC

involve both selling equity and losing some control, or borrowing money, which adds leverage and may encumber some assets. When the entrepreneur successfully franchises, she effectively leases a sliver of the business and in return receives the franchisee's capital, energy, and entrepreneurship. The more rapid expansion that franchising enables may allow the franchise to take advantage of some scale economies. Large networks mean collective buying power. Franchisees can compete with other chains because they can buy in larger quantities and vendors recognize and reward the franchise's growth. Franchisees often also set up their own advertising and promotion cooperatives to obtain scale economies.

The scale economies also increase the ventures access to real estate. Single location businesses have difficulty obtaining access and credibility with mall developers, leasing agents, and limited access locations such as stadiums and contract food feeding operations. These landlords are looking for name brands and consumer recognition, as well as repeat leasing in multiple locations. Franchising eliminates these entry barriers.

The "employees" that become franchisees are typically highly motivated to succeed because their own money is on the line. For most entrepreneurial companies, recruitment, retention, training, and retention of great managers are key to successful expansion. The best managers are typically hard to retain unless they are offered equity. Franchising gives managers their equity with their own investment. The franchisees' investment is always at risk. This causes commitments of time and energy that typically cannot be bought with a salary. If particular skills are needed for the operation of the venture, franchisees can also be sources of highly skilled employees.

As discussed, the franchisor typically gets paid "off the top" as a fraction of revenue and also gets an initial franchise fee. This is typically a more predictable cash flow source than profits from an owned business. Thus, the franchisor can make profits, even if her franchises may not be profitable. It is this inherent conflict between the franchisor's incentives versus the franchisee's that causes some of the questionable and unethical franchises to arise. Conflicts between franchisees and the franchisor also come from this potential conflict of interest. Franchising works best when the



entrepreneur has a proven business model that can be replicated in different areas or venues, and in which both the franchisee and franchisor are better off financially than they would be if they were not together.

Franchises are typically easier to sell than the equivalent business that is not franchised. Think first about a traditional business with 50 managers with hundreds of employees in 10 cities with 100 leases. Contrast this with a franchise business that has 10 managers responsible for 50 franchisees with 100 locations. The franchise business is more attractive for an outsider to buy and becomes an easier exit strategy than a traditional business.

### **Disadvantages for the Franchisor**

There are also drawbacks to franchising. To attract many franchisees and generate good long-term word-of-mouth, the franchisees should do well financially. These franchisee profits are sometimes sacrificed when the franchise form is chosen. If the entrepreneurial venture is really best suited for franchising, the franchise fees should more than make up for these foregone profits as returns on resources invested in the venture. Because the franchisees are independent businesses, the franchisor has only the control given explicitly by the franchise agreement. The franchisor is thus banking the image and positioning of his franchise on the franchisees. The franchisor cannot just fire those “employees” who do not keep up the firm’s image and positioning. This is the same conceptual problem that users of independent sales representatives also have. It takes constant vigilance and many programs to convince the franchisee partners to handle the image and positioning as if it were their own—which it really is. Successful franchises have reduced the fundamentals of operating their businesses to a cookbook, or operations manual. Their training programs succeed in transmitting the founder’s intended positioning through the franchisee to the ultimate consumer.

The franchisor also must put in suitable systems and controls to ensure that the franchisees pay the correct amount of ongoing franchise fees based on revenue of the outlet. When in doubt, the franchisee would rather report lower revenues. In many franchises where large amounts of cash change hands, this control problem can be very big.

The franchisee and franchisor will typically have different incentives for pricing. For the franchisor who gets paid as a fraction of revenue, maximizing revenue becomes the objective. For the franchisee, profits are the objective. The franchisee may want to raise prices in order to increase profits at the expense of lower revenues. These pricing conflicts add a constant level of tension to many franchises.

As a franchisor, it is not as easy to change the channels of distribution because you no longer own them. Your franchisees will get very upset if they think you are going into another channel of distribution that may compete with the franchisees. For example, GNC franchises natural food and herbal remedy stores around the world. GNC has not been able to successfully use the World Wide Web as a distribution channel because their franchisees rightfully objected to the company competing with its franchisees. This is just one example of a *distribution channel conflict* that needs to be managed and planned for very carefully. We discuss management of these conflicts later in this chapter.

Another potential disadvantage of franchising is that you may be creating a new set of competitors that learn the business through your franchise and then replicate the operation under another name. In this case, it is very important for the franchisor to maintain brand positioning, image, and other proprietary assets that would make it difficult to replicate the franchise under a different name.

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### Rita's Water Ice—A Successful Franchising Venture

Rita's Water Ice is an entrepreneurial venture that has succeeded very well using the franchise form. They have been able to leverage the benefits of the franchise form and minimize the impacts of most of the disadvantages. Robert Tumolow, a retired Philadelphia fire fighter, started Rita's in the summer of 1984. Bob and his mother, Elizabeth, experimented with various new recipes for Italian Water Ice—an ethnic summer refresher that was very popular in Philadelphia. Their first store was opened in Bensalem, Pennsylvania, a suburb of Philadelphia, in May 1984. According to Rita's Web site, "the response was overwhelming—people really seemed to love it. Word of mouth spread like water ice on a hot

summer sidewalk.”<sup>9</sup> The next year Bob’s brother John Tumolow joined the business and in 1987 they opened their second location. In 1989, the company made the decision to franchise.

For a small entrepreneurial venture begun with little capital, franchising made sense from a resource requirement point of view. Rita’s could not afford to rapidly expand to more stores without going out and raising equity capital. Each franchisee invests between \$135,000 and \$242,000 initially to start a new Rita’s outlet. That investment includes an initial franchise fee, finding and leasing a site, constructing the store layout, equipping the store, and working capital. At the end of 1999, Rita’s has approximately 225 outlets in the Northeast and Florida. The capital needed to open all of those outlets at minimum would have been \$100,000 per outlet or  $225 \times \$100,000 = \$22.5$  million. In 2000, the Tumolow interests held all of the Rita’s assets privately and had not had to take in public funding to expand. In addition, the firm took in over 200 franchise fees from each newly opened franchise. They also get an ongoing 6.5 percent of the gross sales of each franchisee. Their sales are proprietary. However their Web site says that Rita’s sold over 30 million water ice cups in 1999. If we assume that their total sales per water ice cup (including pretzels, and other products) is \$1, then the total gross sales across their system might be close to \$30 million. Since Tumolow gets 6.5 percent of \$30 million in sales, that is \$2 million. That’s not bad annual revenue. The franchisees also have to contribute 2.5 percent of revenue to a collective advertising fund. If we assume that the initial franchise fee covers the costs of selling and starting up franchises, and that the cooperative advertising fee really covers the Rita’s corporate marketing budget, then the \$2 million of ongoing royalties that Rita’s collects is probably very profitable. Franchising was a very good distribution channel choice.

Rita’s also developed a very smart way to collect their ongoing franchise and collective advertising fees, without having to audit or monitor their franchisee’s sales. They just add a charge of 9 percent (6.5 percent royalty fee + 2.5 percent advertising fee) of the calculated gross sales for each gallon of Rita’s mix that is shipped to each franchisee. The only way franchisees can get around paying the royalty would be to buy their mix from another supplier. All

Rita's personnel need to do for control is to spot check to make sure that each outlet has only Rita's authorized mix in use. Many franchisors must put in elaborate control systems to make sure that they are getting the right amount of ongoing revenue-based franchise fees.

Another constraint for expansion of company-owned stores was the ability to find, retain, and motivate real competent help to run the stores and serve customers. The stores were not open all year—just in the spring through early fall. (Most people don't crave water ice in the winter in the Northeast United States.) As hard as it was to get restaurant and fast-food employees, it was even harder if you weren't going to be open all year. An unwritten requirement for getting a Rita's franchise is that family members want to work in the outlets. One of the neat benefits of owning a Rita's franchise was that the franchisee and his or her family only needed to work during the late spring through early fall. The franchisee had the late fall and winter to relax. Rita's was not only selling franchisees a business. They were also selling a lifestyle.

Rita's, like most franchises, had two (at least) target markets it needed to satisfy to be successful. The first was the ultimate consumers who bought the water ice experience at its outlets. The second target segment was the franchisee who must invest in many cases their life savings to buy a Rita's franchise. It is not inexpensive to sell franchises. The first few franchises were sold by word-of-mouth to customers at company-owned stores who really liked the Rita's product. However, to expand to areas outside of metropolitan Philadelphia, Rita's had to get its franchise offering bundle exposed to potential franchisees. In any new area, the first Rita's to open was a company-owned store. This company-owned store attempted to replicate the original Philadelphia experience, using word-of-mouth to expose customers both to the end product at the Rita's outlet, and also to the possibility of becoming a franchisee. Just as most business-to-business products need a salesforce to help close the big sales, Rita's required a franchise salesforce to follow up and close all of the leads that came into the new areas.

Like most franchises and other distribution channels, it is very important for the franchisor to continually manage the channel

relationships so that each franchisee continues to perceive the value proposition that it is getting from the franchise relationship. Rita's, like most successful franchisors, attempts to have franchisees perceive themselves as members of Rita's extended family. If you as a franchisee perceive yourself as a "family member" of a very successful family, then many conflicts between franchisor and franchisee don't crop up. Franchisees who perceive themselves in this way are going to be the best source of positive word-of-mouth for attracting new franchisees. Good entrepreneurial marketers know that word-of-mouth is the most powerful, cost-effective marketing lever a venture can have.

Rita's franchise has been able to counter one possible disadvantage of franchising in the best way. Rita's is not very worried about its franchisees opening up competitive outlets for a very simple reason. According to Bob Tumolow, Rita's CEO, the average Rita's has almost twice the revenue of competitors in the same area.<sup>10</sup> This is because the product's reputation, the expanded product line (including gelati and crème ice), and the cooperative marketing campaign have created perceived value for consumers that is much higher than Rita's competition. Rita's has been able to create a win-win situation in which *both the franchisor and the franchisee are better off with each other than they would be if they were not together*. This synergy objective should be the essence of not only effective franchise management, but also effective management of all distribution channel relationships.

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From franchising, we next turn to a different aspect of channel management—how to manage and anticipate channel conflict.

### **Managing and Anticipating Channel Conflict**

Entrepreneurs can get in major trouble if their channel members perceive the entrepreneur as beginning to compete with them when they had not been competing before. Channel members are used to relating to their competitors and usually consider it "part of the game" to compete with their channel counterparts. For example, the specialty running stores that sell Brooks running shoes

are used to competing with each other on the basis of service, location, and assortment, but typically not on price. If Brooks were to try to sell directly to runners and bypass the retail channel (using a catalog or the Internet), its retailers would get upset and many would probably stop supporting Brooks. The retailers would feel that the implicit rules by which they had been operating had changed without their consent. Understandably, that gets them very angry.

Managing channel conflicts leverages all of the marketing concepts we discuss in this book. The entrepreneur needs to define roles for every channel member that are not conflicting and easily understood. These roles should be consistent with the venture's segmentation and the offering bundle that is appropriate for each segment. The benefits that are added by different channel partners will not be valued the same by all of the target segments. The channel partners will end up making the most money if they are matched with the segments that value the channel partner's benefits the highest. The channel partners also want to perceive that they are being treated fairly—which means being adequately compensated for the value that they add.

There is a big difference between channel conflict management at the beginning of a venture and when the entrepreneur wants to change the rules in the middle of the game. When a venture is beginning, the channel members should understand their role and any potential conflicts before they become a partner. If the entrepreneur has done his job well of marketing the role of the channel member, and the channel member signs up, there usually will not be any conflict problems. As long as the channel member perceives that his role has not changed and that the entrepreneur has not done anything to change his role or competitive situation, he will feel that he is being treated fairly. Human beings are comfortable when their expectations are fulfilled and not changed. However, if the entrepreneur wants to change the roles of the channel members after all the expectations have been fulfilled, there can be very big problems.

For example, when vineyards began to supply firms like Virtual Vineyards that sold wine directly to consumers over the Internet, the existing distributors and brick-and-mortar retailers became

incensed. They pressured state legislatures all over the United States to outlaw alcohol sales over the Internet. So far, Florida, Georgia, and Kentucky have made it a felony to ship alcohol directly to consumers and at least 17 other states prohibit such sales.<sup>11</sup> Rumors also go around that some distributors will refuse to support those vineyards that sell over the Internet. These distributors felt that the Internet e-tailers jeopardized their positions as exclusive representatives of vineyards in each state. If the e-tailers were already part of the picture when the distributors were signed, it would not have been a problem for the vineyards. Depending on the strength of the distributors and their importance to the venture's success, the entrepreneur may have to creatively pacify the existing distribution partners to change or update the channels. The Internet will be causing many entrepreneurs to creatively deal with channel conflicts as they try to leverage the Internet's benefits.

The best alternative is if the entrepreneur can restructure the roles of all the distribution partners so that every member of the channel becomes more productive and adds more value. This is the best win-win scenario. Herman Miller, Inc. seems to have found this win-win scenario in the way it has restructured its distribution channels to take advantage of the Web to target a new segment.<sup>12</sup> Herman Miller's core business is selling its sleek, ergonomic premium cubicle office furniture systems to major corporations under big contracts at volume discounts. According to *Sales and Marketing* magazine,

The emphasis is on *big*. The company's network of more than 250 contract dealers typically nab five-year purchasing contracts to configure, deliver, and install millions of workstation components to thousands of a single customer's employees. They also go to extraordinary lengths to serve those customers. Dealers reupholster furniture, reconfigure workstations as needs change, move employees' workstations to new offices, and provide ergonomic consultations.<sup>13</sup>

These big dealers are not able to sell ones and twos of chairs or workstations very economically. The burgeoning small office-home office (SOHO) market was not being served well by the big partners

Herman Miller had for their core business. To serve the SOHO market, beginning in 1994, Herman Miller put a few items in Office Depot and other retailers targeted at that market segment. In June 1998, Herman Miller introduced its full-fledged online store targeted at selling to the SOHO segment. Before Herman Miller management communicated with its core dealers and released its programs to help its core dealers using the Web, the dealers were furious. When the Web site was first started, the dealers' perceptions were very different than Herman Millers. Because Herman Miller had not done the appropriate marketing with their dealers, the dealers assumed that Herman Miller was out to directly compete with them. Herman Miller, to their credit, quickly realized they had a problem and began an intense program of communicating to the dealers that the online SOHO customers were a very different market segment from the major corporations in their core dealer market. They also communicated to the dealers that the same underlying configuration engine of their Web site was also available to help corporate customers more easily and efficiently deal with their Herman Miller partner dealer. The site was designed so that corporate customers, through their own customized Intranets would be able to develop their own configurations and price them in a much more efficient and productive manner. The dealers would still handle this corporate Intranet business, but it would lower their costs significantly.

"But even if they don't go after new business, the system will significantly lower operating costs, because information only needs to be entered once," says Gary Harmsel, senior vice president of distribution. "A dealer's average operating expense level runs in the 16 percent to 18 percent range, and this system can help [him] lower it to 12 percent. If you can take six points out of your operating expenses, pass some of that on to the customer, but also keep some for your future investment purposes, it's a win for everyone."<sup>14</sup>

Sometimes it is not possible to segment your market clearly so that different channels can be used for the different segments. If you are changing channels, to go on the Web and sell direct for example, it may be the best policy to make your existing channel your partner in the new channel. Ethan Allen is typical of many ventures



that have been selling through very selective retail distribution and decided that the Web was too big of a potential channel to ignore. Ethan Allen owns 25 percent of its bricks-and-mortar retail outlets. The other 75 percent are independently owned and operated under license. To use the Web effectively and to not alienate their licensees, Ethan Allen had no choice but to make their licensed retailers partners in their Web operation. If they had opened up an independent Web operation, their retailers (to whom Ethan Allen is their sole supplier) would have been very upset with the new competition. The Ethan Allen CEO, M. Farooq Kathwari, made the only reasonable decision under the circumstances. "In exchange for a cut of the Internet revenue, the store owner would deliver much of the merchandise, accept returns, and handle the minor repairs often needed when furniture comes out of the crate."<sup>15</sup> Stores were also to be encouraged to make contact with people in their area who visit the Web site and express an interest in having decorating help.

Kathwari also realized that his dealers needed to correctly perceive the new role of the Web in their partnership with Ethan Allen. Before the Web site was launched, he met personally with each of the dealers (in groups) to explain to them how "We'll do this in a partnership. . . . We don't want to bypass you."<sup>16</sup>

For established ventures with existing exclusive distribution, it is very difficult to bypass them without doing something like Ethan Allen. On the other hand, if Ethan Allen did not have well defined territories for its dealers, the above partnership would have been very difficult to implement. However, if Ethan Allen had multiple dealers in an area, then the dealers would be used to competing with each other, and adding a Web competitor would not have been seen as such a direct threat to each dealer. Auto companies, for example, are not having as much trouble dealing with Web retailers for this reason.

### **Survey Results on Channels**

Of the Inc. 500, 38 percent are integrating the Web with bricks-and-mortar operations versus only 13.9 percent of the non-Inc. group. Of the Inc. 500 47 percent are doing e-commerce on the Web versus only 23 percent of the non-Inc. group. Here again in

their channel decisions, the Inc. 500 CEOs seem to be farther along in adopting productive paradigms.

### **Concept Testing to Channel Members**

If the entrepreneur uses all the concepts and paradigms in this chapter and decides on her “optimal” distribution strategy and tactics, she still may not be successful. If the distribution channel members you have chosen won’t do the part you expect, then the plan and venture may fall apart. It is at least as important to get channel members’ reactions to your new entrepreneurial product(s) or services, as it is to get the reactions of the ultimate consumers. Just like consumer concept testing is best when the consumer is exposed to the product in the most realistic manner possible, concept testing to the channel members is completely analogous. The channel member should be exposed to your concept as realistically as possible. A brochure mock-up and descriptions of all the services you will supply to the channel member should typically be part of the concept. You also should let the channel member know explicitly what functions you expect him to perform as well. All tentative prices and terms should also be shown. If you have done concept testing with customers of this channel member, it can be helpful to summarize those results as part of the concept. Consumer concept testing results can be powerful arguments for convincing a retailer to carry your product.

The channel member should answer a similar type of question to that the end consumer is asked. “How likely will you be to buy and carry this product or service?” “What do you like best about this concept?” “What about the concept could be improved?” If the channel members are all “extremely likely” to buy and carry your product, then you can feel very confident that the distribution channel plan will work as you hoped. On the other hand, if your offering excites only a small fraction of the channel members, you have problems that need fixing before introduction. Just as testing a product with real consumers can give the entrepreneur excellent feedback that may be very different from her logic and planning, the concept testing to the channel members can be even more valuable. There may be aspects of your offering bundle that you never even considered that are very important to the channel members.

## Summary

The concepts, options, and examples in this chapter are designed to encourage entrepreneurs to give the attention, creativity, and resources to the distribution channel decisions that they deserve. The creative juggling of different items for different time periods juxtaposed with decisions on direct, exclusive, selective, or intensive distribution can make big differences in how the entrepreneurs' offering is perceived by his or her target segment(s). These differences in perception can have large impacts on the venture's ultimate profitability. Just as with the end customer, concept testing the offering with channel members is typically a very cost-effective way to "reality check" all of your major distribution plan assumptions.

# CHAPTER 6

## Product/Service Rollout

**T**he most crucial time in the marketing of a new product or service is the initial rollout. Since first impressions last, it is essential for an entrepreneurial venture to successfully launch its product. In fact, in the world of Internet mania, the difference between an initial rollout being a success or a dud can mean literally billions of dollars in market capitalization. Much can be learned even before the launch of a new idea, using a beta test to gather feedback and jump start the customer acquisition process. This means choosing the most appropriate reference accounts, gaining those reference accounts, getting the press onboard, and ironing out the bugs in the several months, weeks, or in Internet time, days before a formal product launch. Most importantly, it means getting great referrals from delighted, influential reference accounts.

### **Reference Accounts**

In selling software (or any product that the potential user sees as possibly risky), nothing helps as much as strong reference accounts. For customers to believe your advertising or promotional materials takes a great leap of faith. For them to believe what they hear from

other experienced users is merely an act of trust that those users have no incentive to lie about your product's virtues and faults. Reference accounts provide for an organized word of mouth campaign, so that when the press and key targeted accounts need to hear from noncompany sources, there are users to call.

The benefits to the company from a good reference account are great—credibility with peers of that account, spokespeople to talk with the press, and examples to use in advertising and public relations. To gain these advantages, the reference accounts themselves need to be provided with benefits of their own. These often take the form of reduced pricing (at least for a long initial period), increased training, and far greater and more responsive support than later customers may find (although hopefully the product's bugs will have been ironed out and less support will be needed).

Sometimes, the benefits are important enough to make a deal with a customer that otherwise pains the CFO of the start-up. In the 1970s, an MBA student at Wharton who had developed a time-shared computer program to automate the trust accounting process for banks started what became the SEI Corp. He wanted to commercialize the software and an associated support service for bank trust departments to use. His competition during that time was in-house accounting machines and manual calculations for the most part. Without his product (called Trust-Aid), when IBM declared a dividend, someone manually had to go into each different trust account to enter that event so it was accounted for correctly. Conceptually, adopting Trust-Aid should have been a very easy decision for any bank based on very high value in use. However, as the student quickly found out, no bank was going to put its "family jewels"—its trust accounts—onto a system that no one else had shown to be reliable and to actually work. He asked his teacher, one of this book's authors, for advice. The advice was simple: "You need to get a very credible reference account, and even if you have to give the software and service away for free, it'll be worth it." That is exactly what the student did to get his first customer. He gave it free for over a year to his first "customer." He was not very happy about not having any initial revenue for a year, but it was probably the only way the company (now with a market cap in the billions) would have gotten started.

It wasn't until that first customer had run the system for nine months without using the old manual system as a back up, that the student got his first paying customer (at still, reduced "charter rates"). The first customer was really only a credible reference after he had put his trust department "family jewels" in the care of the Trust-Aid software and service and had stopped using the old manual system. Even when the reference account had both systems running (with Trust-Aid running very successfully), he was not a credible or convincing reference site until he had demonstrated his own faith in the software and service.

### **Choosing Initial Reference Accounts**

For those products or services that are very innovative or likely to be perceived as "risky," the choice of who to get as initial reference accounts can have a huge impact on how fast (or whether) the product is adopted by the market. For Trust-Aid, if the initial reference account had been a bank that other banks looked to for guidance on new technological innovations, the sales progress of Trust-Aid would have been much faster.

In most markets, there are individuals and entities that are known as early adopters and leaders in technology application. If these leaders are first to adopt your product, then the going will be much easier than if your first reference accounts are not respected as leaders. The medical market is probably the best defined in this dimension. For most new prescription drugs or new medical devices, who the first users are is crucial to whether they may become successful. Doctors have a "pecking order" of prestige and respectability. They will be much more likely to try a new innovation if it is first adopted by the physicians they perceive as highly influential in their field.

General Electric has been very successful in the MRI and CT Scanning businesses, not because they've had the best technology, but because they've had very strong relationships with the most influential doctors, hospitals, and health centers. The most influential people in the market always test their new machines. It is very hard for a competitor to enter the U.S. market with a new machine because most of these influential and respected early adopters are associated with General Electric (G.E.). For example, Elscint, an

Israeli-based competitor of G.E. with arguably better technology, has not been able to make a major dent in the U.S. market, because they have not been able to get the most influential people and institutions in the market to sacrifice their long-term relationship with G.E. G.E. has been doing all the right things to continue to cement their relationship with the highly respected market innovators. G.E. supports their research and conferences, puts them on advisory boards, and so on.

### The Beta Process

Most products go through many revisions between the concept and final versions. The changes are often stimulated by real user feedback to the engineering and product management teams. The process that helps this to happen is the beta process. The terminology is in common use in engineering hardware and software areas, where the first versions of a product are called “alpha” versions, the first versions that can go to customers for testing are called *beta*, the almost final versions are called *release candidates*, and the final versions are called the *released product*.

At each stage, successively more users and/or customers have the product in use and are making comments to the product management team. This process is normally run by and of benefit to the engineering department. Properly managed, however, it can be a great help to the marketing of the product.

In today’s Internet world, beta users provide the buzz discussed in Chapter 4, and amplify the presence once the service is launched openly to the world. Where beta testing was usually limited to a few customers, or a few dozen, there are now cases where the number of beta users is in the tens of thousands. Microsoft Windows 95 had over 100,000 beta users, and Netscape Communicator usually has a beta version and a shipping (frozen) version available for download most of the time.

When a customer agrees to join a beta program, they usually agree to spend some minimum amount of time using the product, to respond to questionnaires about the features and benefits of the product, and to be available for calls from the press or other customers. In return, their questions and problems should be dealt

with at high priority, and they can gain visibility to their peer groups as thought leaders, and the psychic income of seeing their name in print in interviews and articles about the product.

Choosing the right customers is very important since they will not only influence the press, but provide the most cogent feedback at a key time when the offering may still be changed. Customers whose needs are not aligned with a majority of intended users could skew product features in an undesirable direction. In the software world, beta customers are often chosen from existing users of previous products. Such customers are already predisposed to a company, and can get the extra benefits of additional support and relationships to help if they have problems with any product.

On the Web, many offerings are completely new, and there is no customer tradition. In this case, one should make a list of the key target customers—be they Fortune 500 companies, Inc. 500 new comers, consumers of certain demographics, or others. One then networks into a decision maker who is willing to listen to the benefits of a new product, and convinces her that her company will benefit from being a first mover—not only through discounts, but also through having a several month advantage over any competitors. For consumer sites, there may be specific discounts, and the ability to say “I’ve been there first.”

iExchange.com, a site that permits people to share stock market advice and rates them on the accuracy of their predictions, needed to beta test for two reasons. The first involved the usual issues of making sure the programming was properly done and that the servers could handle the loads. Second, in order for the site to be attractive to general users, there needed to be enough predictions, about enough stocks, to give interesting content to new users. As an idealab! company, iExchange.com first called on all the people in the idealab building (about 150) and asked them to post recommendations. The incentive offered was free pizza and T-shirts. After two weeks of building several thousand recommendations, these people were asked to virally expand the beta test to their friends and family members, by sending them e-mails promising prizes for their entries.

During this beta period, users were periodically asked for comments about the user interfaces, their interactions, and their overall



comments about the site, including look and feel, mission, and effectiveness. Their movements through the site were tracked with software that could show each successive click and determine when they were leaving the site. All this information was fed to the product managers and developers each day, and changes were made to improve the length of time and number of page views per visit, as well as the overall performance of the site.

As you reach the later stages of the beta process, it is important to have critics, as well as friends, test the site or the new product. People with a real need and use for the product will provide a less filtered set of responses than those who are merely friends doing a favor. It is often the harshest critic who provides the spark for a feature change that turns her into a fan—and makes the site that much better for all other users.

For B2B products or services, finding initial customers may be more difficult. One has to convince them to try something that may not succeed, and hence could leave them stranded if they are not careful. And the growth may be much slower. This is why it is so important to choose influential innovators and early adopters to be the initial customers. It also is critical to market to them in the best way.

## **Marketing to the Initial Customers**

Because the initial B2B customers will be those who are innovators and should be influencers, they may need to be marketed to differently than the more mainstream customers. It is very useful to ask the potential lead customers how they prefer to be treated. We have found that in some industries that are normally served by distribution intermediaries, such as resellers or manufacturers' representatives, that the innovators would prefer a different relationship—at least in the beginning. The innovators know they may be taking a risk in trying a new product or service. To mitigate that perceived risk, these innovators want to deal directly with the company without going through intermediaries. If you are dealing in such a situation, it is important to treat the customer the way she wants to be treated. You may have to either hire a direct salesforce if the number of innovative initial customers requires it, or

as the entrepreneur, you and other senior managers may assume the sales role directly.

Geoffrey Moore, in his excellent book *Crossing the Chasm*, also recommends a small, top-level salesforce as a way to deal, in particular, with those innovators he terms “visionaries,”<sup>1</sup> to manage their expectations during the sales and initial usage process.

Because controlling expectations is so crucial, the only practical way to do business with visionaries is through a small, top-level direct sales force. At the front end of the sales cycle, you need such a group to understand the visionaries’ goals and give them confidence that your company can step up to those. In the middle of the sales cycle, you need to be extremely flexible about commitments as you begin to adapt to the visionaries’ agenda. At the end, you need to be careful in negotiations, keeping the spark of the vision alive without committing to tasks that are unachievable within the time frame allotted. All of this implies a mature and sophisticated representative working on your behalf.<sup>2</sup>

This salesperson’s role does not stop when the sale is finally closed. She must also make sure that whatever happens, the initial client’s expectations are exceeded. The referral of these initial users is what the business will live on. If this initial salesperson is not a senior manager, this person should have direct authority from the CEO to do whatever is necessary to exceed this customer’s expectations.

A very successful Israeli high-tech company had established a very nice North American business selling products and services to call centers through VARs and large equipment vendors. They had a different new product targeted toward security departments of large firms. The firm originally planned to use the same type of sales and distribution to introduce the new security product—VARs and large equipment vendors. However, after interviewing the potential innovators, the company had to change their initial marketing plan. The innovative potential initial customers were not receptive to dealing with intermediaries. They wanted to deal directly with the company. The company used their senior managers as direct salespeople and began a very successful rollout of

its new, innovative, security product. If they had not asked their initial target customers how they wanted to be treated, they would have had significant problems in penetrating the market.

### **Partnering for Rollouts**

When Intel or Microsoft announce a new product, they release a list of companies that are “supporting” the new platform or processor. These partners help validate the eventual success, and hence make it easier for a large company customer to take a chance. Once they know that others will be using it also, they feel less afraid of being left stranded, or of being unable to convince the supplier to fix the product if it isn’t working.

Smaller companies can also improve their chances of success on a product launch, by including the testimonials of a number of key strategic and tactical partners in their announcement.

When Metastream.com prepared to launch its new Metastream 3D format, which allows low bandwidth streaming of 3D content on the internet, it wanted the credibility that strong partners bring to a new effort. Two months prior to launch, a concerted effort to sign up partners, who could participate in the launch event, was undertaken. Microsoft, Intel, and AOL all had an interest in seeing 3D proliferate on the Web. For Intel, it meant a need for more processing power, for Microsoft, a leg up for its Internet Explorer 5.5 browser, and for AOL, better e-commerce. In addition, a number of companies that wanted to use the technology on their Web sites, including Nike, Sony, and CBS, all agreed.

Each of the partners got strong press exposure, the ability to add to their own leadership and forward thinking images, and early use of the technology. MetaStream.com, because it was linked with such powerful partners, got coverage in the *New York Times*, on CNBC, and other prime media venues that probably wouldn’t have covered the story, or featured it, because of the names associated with the launch.

The business development and technical organizations, rather than the straight marketing and salesforces, had to make the introductions and connections to the partners, since those organizations had to be convinced that the technology would succeed before they

could approach their own marketing and public relations operations. The lead time for such endorsements is longer—typically two to three months—and it pays to create the relationships between your company and possible partners even sooner.

### **Summary**

A strong product rollout can set the tone for success, and dramatically reduce the time needed to gain customer and market acceptance. Planning for this requires sufficient time prior to launch, choosing the best reference accounts, treating them well, and sufficient feedback from a well run beta program. Rolling out a Web site, or Web-based business, can be done more rapidly, but still requires testing and trials to see how consumers react to each piece of the Web site.



# CHAPTER 7

## Entrepreneurial Sales Management

**A**ll the elements of the marketing mix should be derived from the marketing driven strategy of the entrepreneurial organization. The salesforce decisions must be consistent and derived from the positioning and segmentation decisions that are the core of strategy. In particular, the positioning and segmentation usually imply a role for the salesforce in the marketing mix as part of the product's position and as a mechanism for implementing part of the market segmentation targeting.

For example, the Tandems East firm uses the owner, Mel Kornbluh, as its prime salesperson. His perceived expertise and experience with tandem bicycles, and willingness to satisfy customers are the bulk of his offering to potential customers. He also performs part of his firm's targeting functions by asking qualification questions during his first interactions with potential customers. On the other hand, some e-commerce companies have no role for personal sales in their marketing mix. Amazon.com customers have no interaction with any human salespeople when they make their purchase evaluations. However, the information and very personalized software Amazon.com has developed imitates what might happen if a customer went into a good bookstore and

asked an experienced salesperson for information and recommendations. Dell Computer uses a mix of online sales and personal sales depending on customer preferences. Some Dell customers feel more comfortable interacting with a real person and value the salesperson's perceived problem-solving ability. Some bigger Dell customers feel that they deserve special prices and/or have special circumstances that need a personal touch.

The question the entrepreneur needs to answer is: Given my positioning and segmentation strategy, what perceived value needs to be added by a personal salesforce in order to most productively implement the strategy? If your thinking has been clear and your research has been good in the segmentation and positioning process, the role of the salesforce is usually obvious.

Once the role of the salesforce has been determined, then the other salesforce decisions are easier to make. This chapter will follow the logic as outlined in Figure 7.1.

### The Role of the Salesforce in the Marketing Mix

Your creativity is really the only limitation to alternative ways a salesforce can possibly contribute to your perceived product offering. There are a number of traditional roles that the salesforce may fulfill. The salesforce may find leads and qualify those leads



**Figure 7.1** Entrepreneurial salesforce issues.

to determine if they would get value from your offering. These roles can obviously be fulfilled by other marketing mix elements such as the Web or direct mail. You need to evaluate what will work best for your venture. Possibly experimentation would make sense to test some of the options.

Other salesforce roles impact how the potential and current customer may perceive your offering. Many salesforces are consultants to their customers. They solve their customers' problems by recommending appropriate products and possibly showing the customers how to use them. The apocryphal stories of medical equipment salespeople helping with medical operations are actually true. The best medical equipment suppliers have as a key asset well-trained salespeople who know at least as much as the orthopedic surgeons about how to use their equipment. The salespeople are a big part of what the surgeons are buying.

Similarly, in the financial services marketplace, the salesperson can provide a big part of the perceived value of the financial firm's product offering. Stockbrokers may in fact be what many customers perceive they are buying when the brokers are performing advisory services. For this reason, many customers will switch brokerage firms when their broker moves to a different firm. The customers perceive more value from their broker than from the firm's research and investment products.

The salesperson may also negotiate prices with customers as in the traditional auto dealership. Other roles include following up after the sale to make sure that the customer's expectations are exceeded and to solve any problems that arise by being an advocate for the customer with the entrepreneurial venture. In general, a good salesperson-customer relationship can generate trust and loyalty that can be a very important, competitive advantage.

In the age of electronic commerce, many firms are finding that the role of their salesforce needs to change. For VWR Scientific Products, the salesperson in many cases no longer actually takes orders. She used to drag around catalogs and order forms and would sell replacement and new laboratory supplies and equipment. She would also keep the customer apprised of the order status. All of that work is automated. That salesperson makes a sale by convincing her client to go to the VWR Web site to place an



order, rather than to a competitor's. The VWR salesperson's role is most importantly to build customer trust and loyalty. The salesperson helps to customize each client's VWR Web site to reflect corporate agreements or negotiated pricing. Most importantly, the salesperson is on site to help if any problems occur and to give personal service. As Mark Quigley, a VWR regional sales manager said, "We still like to give personal service. . . . The customer still likes to see a body."<sup>1</sup>

The most obvious and very important role of the salesperson is sometimes neglected. Someone has to ask for the order and close the sale. It's amazing how many entrepreneurs forget that many customers will not part with their funds without a salesperson asking them for the order. Based on the logic of Figure 7.1, once the role of the salesperson is determined, you need to examine whether you want to outsource the function to representatives or hire your own direct salesforce. In our survey, 82 percent of the Inc. 500 CEOs had a direct salesforce versus 56 percent of the non-Inc. group. Of the Inc. 500 group, 12 percent used an indirect salesforce versus 9.3 percent of the non-Inc. group.

### **Should We Outsource to Representatives or Go Direct?**

Many entrepreneurs (and larger corporations also) neglect to even evaluate the option of outsourcing part or all of their sales function. In many circumstances, an independent representative can fulfill the salesforce role better and more efficiently than can a direct salesforce. Before we look at some of the tradeoffs, we should quickly outline what representatives are and what they are not.

Typically, manufacturer's representatives (Reps) are independent companies that sell on a commission basis and bear all of their own sales expenses. They are generally a local or regional entity with a defined territory that they cover. They generally do not carry competing lines and their representation contracts with their principals are not usually guaranteed for a long term. Their role is to either replace or in some cases, supplement the direct salesforce. Reps are not a substitute for a distributor, however. They do not hold inventory or take title, invoice or ship, or take credit.

The decision on whether or to what extent to use reps depends on tradeoffs of a few advantages and disadvantages reps bring to the table. These advantages and disadvantages have to be interpreted in terms of the role the salesforce should play in the positioning and segmentation of the company and its products. Let's first look at the advantages.

### **Rep Advantages**

The assets reps have are relationships with their customers. In many cases, they have been providing their customers a number of products for many years. The good reps have achieved positions of perceived trust and reliability with their customers and understand their customer's needs very well. The rep may be able to achieve synergy by bundling your product with other products she's already selling. Also, because of the economies of combining products, a rep can typically call economically on smaller buyers or call more often on a single buyer than can the typical direct salesperson. Because their asset is their customer relationships, reps typically are more permanent and have less turnover than direct forces. Reps also pay more than direct salespeople and may retain their salesforces longer. Reps are also likely to be pretty nimble, sales focused, and very conscious of their sales costs. Reps also add a lot of flexibility—their low overhead, almost all variable costs make it easy to forecast sales costs, and provide downside cost protection if revenue is lower than anticipated. It is also much easier to terminate reps than an internal salesforce.

### **Rep Disadvantages**

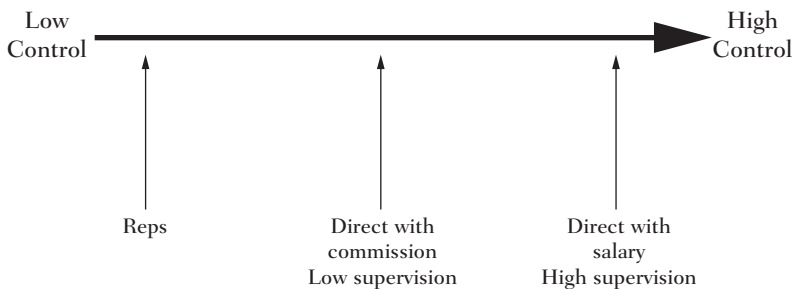
However, reps also have disadvantages: Because they have many masters (principals) whose products they must juggle, getting focus on your product may be difficult. The reps may also be too diversified to devote appropriate attention to the subset of their accounts that find value in your products. Some products may not have existing rep networks that are appropriate for your product. In other cases, the really good reps may already be taken by a competitor. The biggest tradeoff that needs to be evaluated, however, is the loss of control that is part of being with a rep.

## The Control Issue

When your firm directly employs the salesperson, theoretically you can direct the salesperson to do whatever you wish. However, in actuality, there's a continuum of realized control that depends on the kind of compensation and supervision system the entrepreneur chooses (Figure 7.2).

Figure 7.2 underscores the relation between compensation method and the ability to control the salesperson. If your salespeople are on a straight commission with a low or nonexistent base salary, they will also not be easy to control. If you suggest a salesperson compensated by commission do something she does not feel will add to her commissions, she will not want to do it. The rep is even harder to control because she has many masters and possibly conflicting activities she can do for each principal. On the other hand, if you pay the salesperson some kind of base salary, you can expect him or her to do some noncommission activities in return for his or her salary.

Control is important depending on the product positioning and segmentation and the appropriate role of the salesforce. If your salesforce plan requires activities that have unspecified pay-off, then rep organizations (or straight commission) are probably not appropriate. If you have a product that requires single-minded dedication, then a rep may not be appropriate, but straight commission might be a viable option.



**Figure 7.2** Control continuums.

## What Situations Favor Direct versus Rep?

A very interesting study by Anderson<sup>2</sup> analyzed how 13 firms in the electronic components industry decided on the rep versus direct decision in 159 different sales district/product combinations. These companies had a broad range of products from commodities to new, innovative, glamour products. The companies used reps when in doubt between rep and direct and they used reps for the normal, nondescript sales situations. However, there were many situations in which companies went direct, including:

1. Situations where it's difficult to evaluate the salesperson's results "by the numbers," for example:
  - a. Measures of sales results are inaccurate.
  - b. It's difficult to assign credit for the sale because of multiple influences on the customer.
  - c. Performance means much more than current sales, for example, there are long-term implications to short-term sales.

One example of these situations might include selling pharmaceutical products to managed care organizations. Since independent doctors who may belong to more than one managed care organization may prescribe drugs, the influence of the managed care organization may be tenuous. However, if a drug is not one that is preferred by the managed care organization, it may be more difficult for some of a doctor's patients to fill a prescription for your drug.

2. Situations where product and applications knowledge are difficult to learn, important, and/or complex. These include:
  - a. Highly complex, unusual, or difficult to understand or explain products.
  - b. Highly complex, unusual, or difficult to understand or explain applications.

Mainframe computers, enterprise software, consulting, and corporate legal services are typically this type of situation. The "rainmakers" of legal and consulting firms are the firms' direct salesforces.

3. Situations with highly confidential information in which salespeople come to learn sensitive information about their company and customers.
4. Situations where support activities are critical, for example, marketing research, trade show participation, after sales service, engineering support before the sale.

### Choosing Reps

The decision on which reps to choose is very important and should not be taken lightly. What you are buying with the rep is market reputation, relationships, and positions with complementary products. There are two criteria to tradeoff when choosing a rep. The first criterion is the rep's market position—is he or she top in the market or does he represent the less attractive products? The second criterion is whether the rep will have enough resources and use them to push your product or service versus the other products he sells. The best reps may not take enough time to push your new product, especially if the new product is small compared to the reps' current line. On the other hand, if your new product is really innovative and valuable, it may be used by the rep to gain more access to his target accounts by introducing accounts to a new, valuable product.

How can you efficiently get the information to make these tradeoffs? The way is similar to other recommendations in this book. *Talk to market participants*. Specifically, as part of the concept testing for a new product or service, ask also about which reps the target market prefers to buy from. Most market participants are quite willing to recommend people they prefer to buy from. Finding out how well the rep will push your product, if you choose him or her, is not so easy. Finding out how excited a rep firm will be with your product is comparable to finding out if the end customer will buy your product. Concept testing can be very helpful. You should interview rep principals from alternative rep firms and show them your product, tentative sales aids, and any possible advertisements for the product. You want to present your product to the rep in its most positive light. Then monitor the rep's reaction and compare

across all the reps you interview. Your ideal rep is one that is very excited about how your product will help the rep's business, and a rep who is highly valued as a resource by the marketplace for your product. The entrepreneur's judgment after having talked both with alternative reps and with a sample of market participants should provide a very productive rep choice.

An important caveat: The rep choice is crucial to the financial viability of many businesses and should not be taken lightly. Above all, choosing a rep should *not* be done opportunistically. *Do not choose the first rep that approaches you.* It is almost always very productive to invest some time and money to find the best rep. Even when time and money are very scarce for the entrepreneur, it makes sense to get information *from market participants* before making a decision like choosing a rep that has very long-term and pronounced effect on your venture.

### Effective Rep Management

If you have decided to use reps, they will not be successful without you thinking very carefully about how they will be managed. Reps are another group that needs marketing attention. Just like the end customer, you need to understand what makes the rep tick—what her objectives and goals are and how your product offering can add perceived value for the rep. Anderson, Lodish, and Weitz studied how 71 independent reps actually allocated their time to their principals' products.<sup>3</sup> They found that, in general (and no surprise) reps allocated time to maximize their commission income from their principals. However, reps also deviated from solely resource allocations that maximized their commission income to favor principals who they perceived had similar goals, good communication, and mutual trust. Reps also favored principals who had active involvement in the rep's activities. The authors' findings imply some specific tactics that help obtain more of a rep's attention:

1. Make your products easier for the rep to sell. Make its price/perceived value better for the end user. Provide sales training for reps. Develop and implement promotions toward the end user that the rep can use to make his job more efficient.

2. Increasing commission rates will increase the sales effort toward your product, but it will have diminishing returns.
3. Reps favor products that are synergistic with other products in the rep's portfolio.
4. Principals should develop very trusting relationships with their reps.
5. Principals should improve communication through recognition programs, product training, consultation with the reps, as well as by informing reps of plans, explicitly detailing objectives, and providing positive feedback.
6. Principals that have a hands-off approach to reps lose time for their products.
7. Even interfering in the management of the rep with negative feedback results in greater time for your product.<sup>4</sup>

### **Rep Management and the Perceived Value Proposition**

The struggling entrepreneur should be noticing that many of the above tactics cost either money (e.g., end user promotions, sales training), or margin points (e.g., improving the price/value relationship, increasing commission rates). If you have an excellent business plan that has a positioning strategy that succeeds in creating incremental perceived value to the end user compared to the competition, then you should have room to share some of that value with your outsourced intermediaries in the channel.

Franklin Electronic Publishers, Inc. manufactures electronic handheld reference tools—spelling correctors, dictionaries. For the past 15 years, they have successfully used reps to sell their product in the consumer electronics channel. Especially when they began as an entrepreneurial company with little resources, but a new unique product, the Spelling Ace spelling corrector, reps were a crucial part of the marketing plan. Because the Spelling Ace was able to be sold to the consumer at prices that gave very good manufacturing margins, Franklin was able to share some of those high margins with their reps and their retailers. The reps got very good commissions for selling the products and the retailers got better margins than

comparable products that competed for scarce shelf and display space.

This Franklin example underscores the importance of including all elements of the marketing mix as part of the initial business plan. The positioning and segmentation decisions have a big impact on the viability of the venture partly because they have a big impact on what is possible for other elements of the marketing mix. The management of reps is only one element in which the positioning and segmentation decisions have a crucial impact.

### Personal versus Telephone versus the Web and other Nonpersonal Sales

It is not obvious that a personal salesforce is appropriate for all situations. The telephone, the Web, and other activities may be more efficient for accomplishing needed tasks in the marketing and sales process. The entrepreneur should first determine the tasks and activity that are required for each step in the sales process. Then she should evaluate the costs and the benefit of alternative ways to accomplish those sales tasks. Tables 7.1 and 7.2 show the evaluation of two alternative sales processes for a venture. Table 7.1 evaluates a field sales-oriented sales process and Table 7.2 evaluates how the same process might be accomplished by telemarketing instead of field sales. These are disguised real examples.

Sales Activity	Prospects Remaining	Delivery Vehicle	Elapsed Time (wks)	Activity Cost (\$)	Total Cost (\$)
1. New lead	100	Mail/telephone	0	25	2,500
2. Literature fulfillment	100	Mail	1	10	3,500
3. Quality prospect	100	Telephone	2	15	5,000
4. Initial meeting	30	Field visit	4	200	11,000
5. Follow-up call	20	Telephone	5	15	11,200
6. Demonstration	10	Field visit	7	250	13,700
7. Proposal	5	Overnight service	8	100	14,200
8. Additional follow-up	3	Telephone	12	50	14,350
9. Approval/purchase	3	Telephone	16	10	14,380
10. Postsale follow-up	3	Telephone	20	30	14,470

**Table 7.1** Field Sales-Oriented Sales Process



Sales Activity	Prospects Remaining	Delivery Vehicle	Elapsed Activity		Total Cost (\$)
			Time (wks)	Cost (\$)	
1. New lead	100	Mail/telephone	0	25	2,500
2. Initial literature	100	Mail	1	10	3,500
3. Quality call	100	Telephone	2	15	5,000
4. Second literature	30	Mail	3	10	5,300
5. Consult/sales call	30	Telephone	4	25	5,800
6. Payback worksheet	20	Telephone	6	5	5,850
7. Configuration call	10	Telephone	6	10	5,950
8. Proposal	5	Overnight service	8	100	6,450
9.-12. Additional follow-up	3	Telephone	12	100	6,750
13. Approval/purchase	3	Telephone	16	10	6,780
14. Postsale follow-up	3	Telephone	20	30	6,870

**Table 7.2** Telemarketing-Oriented Sales Process

In Table 7.1, the entrepreneur has estimated the sales funnel for her typical personal sales process. Starting with 100 prospects, she estimates how many will remain after each stage in the process. For example, of each 100 prospects who have been qualified, 30 will remain as prospects after the telephone qualification call. She also estimates the elapsed time for each activity and the costs of each activity. It is usually pretty easy to get good estimates for the timing and costs of the various activities and sales calls. The most difficult estimate is the success rate for each activity, that is, what fraction of the people in the funnel will proceed to the next stage. For example, above there is an assumption that 5 out of 10, or 50 percent of prospects will ask for a proposal after a demonstration. Before one begins their business, it will be pretty difficult to get good estimates for that kind of response percentage. However, once the business is going, it is conceptually easy to measure these percentages by keeping track of the number of people in the funnel at different stages, their treatment by the sales process, and the fraction who go on to the next stage after each task is performed. The challenge is to keep track of the data in the middle of launching a new product or service.

Notice that in Table 7.2, there are different activities in the telemarketing oriented sales process. The funnel also has different costs and different fractions progressing from stage to stage.

However, if the assumptions are reasonably correct, for this case, the telemarketing oriented sales process will be much more efficient for accomplishing the sales process. The personal sales approach may convert more prospects per 100, but it costs over 50 percent more to get each completed sale. Only if the number of prospects is very limited does it make sense to use a personal sales approach for this example.

What these examples should illustrate is how important it is to determine all of the stages of the sales process, and then to estimate the costs and benefits of performing them by different vehicles. In many cases, it will be very difficult to construct funnels like Tables 7.1 and 7.2 with no sales experience. What then makes sense is, as you begin your operations, to *experiment* with the sales process alternatives that make a priori sense. As the sales process is performed, keep track of the number of prospects in the funnel for each stage along with elapsed costs and timing. After a suitable length of time, you should be able to infer which approaches to the sales process are most efficient and use those on an ongoing basis.

It is very important to evaluate many options for accomplishing the sales process. Not every prospect should necessarily be put through the same sales process. Some market segments may respond differently to different sales processes. Depending on the costs and potential value, in many cases, it makes sense to experiment with different sales processes for different market segments. Again, depending on the circumstances, some potential prospects may wish to choose the sales process that they prefer.

Indymac Mortgage Holdings has developed technology to automate the underwriting and risk-based pricing process for home mortgages. The technology is being distributed and sold in two ways to capitalize on two types of consumers that the Indymac management has defined: low tech + high touch, and high tech + low touch. The first segment is much more comfortable with a personal intermediary to help them apply for and go through the home mortgage purchase process. So a mortgage broker (personal salesperson) sits with the client and types information about the proposed loan and the loan applicant. Within 5 minutes, the

Indymac e-MITS system comes back with an underwriting decision and a price for the mortgage that has been uniquely determined for the potential purchaser based on his or her credit history, and so on. The system also prints out right at the computer, all of the closing documents that will be needed for the loan to be closed.

The same e-MITS technology is used in Loanworks.com, the direct to consumer Web site that Indymac has introduced for the other high tech + low touch segment. The Web site performs almost the exact same functions as the technology available on the Web for the mortgage brokers, but it is presented directly to consumers who feel confident enough to apply for and close on a mortgage without relying on a mortgage broker intermediary. These customers get to pay less for their mortgages because they are not paying the sales commissions for the mortgage brokers.

Many other creative entrepreneurial marketers have also realized that one sales/distribution system may not fit all of their customers. Just as product and service offerings should be tailored to the needs of market segments, so should the sales and distribution process that is a part of what the end consumer finally perceives. Barnes and Noble did the same thing as Indymac. They sell the same books at stores with personal assistance and over the Web at BarnesandNoble.com. Their competitor, Borders, did not take advantage of this segmentation opportunity and lost much potential business to Amazon.com and BarnesandNoble.com.

### **Salesforce Size, Deployment, and Organization**

If you have decided to use a personal salesforce, a number of questions quickly surface. How big should the force be and how should it be organized and deployed? The conceptual answer to these questions is easy. A salesforce is like any other investment the entrepreneur makes. If adding resources to the salesforce is the most profitable place to use the scarce capital, and if the use is more profitable than putting the money in the bank, then the funds should be added to the salesforce. Funds should be added until it is no longer the most profitable place to put capital. The salesforce is

the right size when the “last person added” brought in more of a return on investment than any other investment opportunity.

In many cases, the appropriate salesforce size can be dictated by the market segment(s) that are being targeted and the costs and incremental benefits associated with the role of the salesforce. In many cases, a salesperson is a necessary part of what the channel expects from the entrepreneur. For example, if you expect to sell through retailers such as department stores or mass merchandisers, these firms have expectations about terms of sales and service from their suppliers. As a small, entrepreneurial organization, you will not typically be able to change the customary way in which other suppliers have set the retailer’s expectations. Interviewing buyers from the retailers as well as salespeople (or reps) who service the retailers can get you enough information to roughly estimate the sales time associated with the various activities that are required by the potential customers. You can then also estimate the incremental revenue associated with those activities. It’s then straightforward to calculate the marginal revenue and marginal costs of this salesforce activity.

For other sales situations, it makes more sense to evaluate the activities by estimating directly the impact of sales calls on the revenue of clients and/or prospects. For example, what would happen to the revenue of a typical customer of type A if we called four times per quarter instead of twice? This kind of question should be asked for alternative levels of salesforce size and deployment levels that you are evaluating. Once the revenue associated with the alternative levels of sales efforts has been estimated, then the incremental revenues and incremental costs can be applied to roughly determine the appropriate salesforce effort to use toward each type of client and prospect.

There are three ways to estimate the sales response to alternative call frequencies. Judgment of the salesperson along with her manager (who may be the entrepreneur) has been shown to be better than deploying salespeople without considering sales response to different levels of call effort. By evaluating judgments of the sales impacts of different call effort levels to different segments of accounts, it is straightforward to allocate time to those

segments where it adds the most incremental profit contribution, and then continue to add time to that segment and/or other segments until the incremental return does not justify the salesforce costs. Before the business begins operations, judgment is probably the only way to determine the best salesforce size along with some guidelines on deployment over account segments.

### Survey Results on Determining Salesforce Size

The Inc. 500 CEOs gravitated toward two methods—47 percent used forecasted sales and average revenues per salesperson and 35 percent used gut-feel. Of the non-Inc. group, 16 percent used both of these methods. Only 5.9 percent of the Inc. 500 and none of the non-Inc. group used forecasted incremental revenues to compare with incremental costs.

### Naturally Occurring Salesforce Experiments

Once the venture has begun and the sales process has begun, the entrepreneur can evaluate any naturally occurring experiments that may have happened. These naturally occurring experiments happen when different accounts in the same segment get different amounts of sales effort. If the entrepreneur has planned her information system to keep sales as well as salespeople call reports, she can evaluate to what extent different levels of salesforce effort have seemed to cause sales changes. The problem with this procedure is that the salesforce may be choosing who to spend more or less effort on within a segment based on other factors such as prior relationships or specific knowledge about that account's situation. The analysis may attribute sales changes to the wrong causes. The most accurate, unbiased estimates come from the third way of getting sales response to alternative levels of sales effort—experiments.

Instead of letting naturally occurring changes happen to salesforce effort levels on accounts, it can be very valuable to *randomly assign* different levels of effort to different accounts within a segment. If there really is a random assignment of different levels of sales effort to accounts, then other possible causes are mitigated by the randomization. The same concerns and issues for designing experiments that we describe for advertising decisions are also appropriate for salesforce experiments (see Chapter 9).

### **Deployment with Limited Salesforce Size**

Many entrepreneurs do not have the luxury of evaluating many different levels of salesforce sizes and appropriate deployment levels as we described. They are very limited in resources and cannot afford to have many salespeople. In these cases, it is crucial to “skim the cream.” Using the judgmental method described above, the entrepreneur must only spend her salesforce effort where it contributes the highest amount of incremental revenue and profit contribution. However, keeping track of the sales effort and associated incremental sales generated from it, can be an excellent way to show a source of financing what to expect if more resources were made available for increasing salesforce effort.

Travel costs and entertainment expenses also need to be considered when the size and salesforce resource decisions are made. If the location of some accounts will necessitate extra trips, then these costs should be prorated over the accounts to be called on during the trips. The salesforce organization decision will also impact travel costs if it means that different people will be calling on different accounts in the same geographical area.

### **Salesforce Organization and Travel Costs**

Salesforce organization generally relates to markets and geography. The trade-off of most alternative organizations is conceptually simple. Is the specialization of sales effort achieved by having salespeople specialize in one or more market segments more beneficial to the firm than the increased costs associated with the specialization? The increased costs of segment specialization are typically travel costs and the opportunity costs of time spent traveling. For small entrepreneurial companies with their own salesforces, the organization that is appropriate is usually obvious. If there is only one target market, then a geographical sales organization is the only reasonable option. A geographical sales organization has territories that are geographically determined, with each salesperson covering accounts in one territory. If there is more than one target segment, another possible organization is to have a salesforce for each segment. Each segment salesforce then would have its own geographical organization. It would then be possible

to have more than one salesperson covering the same geographical area with each salesperson calling on accounts in different segments. The more specialized the salesforce is, the larger geographical area each salesperson's territory will cover.

## Compensation

### Matching Incentives

If you remember one idea from this salesforce chapter, it should be this one: People (and especially salespeople) do what they think will make them the most money for the time they spend at their jobs. Your compensation system should make sure that you and your salespeople have *matching incentives*. If you both are trying to do the same thing, then it's difficult to get into situations in which your salespeople do the wrong thing. The appropriate compensation also depends on the role of the salesperson. For example, if the salesperson has some control over the price she charges, then the compensation should have the salespeople negotiate as good a price as you, the entrepreneur, would negotiate. Auto dealers are classic examples of this type of compensation. The salespeople at most car dealerships who negotiate a price with each consumer have a commission that is based, not on the sold car's sale price, but on the gross margin (sale price – variable costs) for the car. If the commission were on just the sales price, the salesperson would likely be selling cars to maximize revenue by selling more cars at the lowest price she could quote.

This same argument is very pertinent to situations in which your salesforce is selling more than one product. If each product has quite different contribution margins, you want the salesperson to be incented, not on revenue, but on contribution margin (revenue – variable costs). In these multiproduct situations, the entrepreneur does not have to actually share her gross margins with the salesforce. All the salesforce needs to know (and have incentives based on) is the relative profitability of one product versus another. The entrepreneur can have sales compensation based on points for each product. The points just need to be proportionally correct; that is, if product A has 4 points per sales

dollar, and product B, 2 points, then product A should have twice as much gross margin per sales dollar as product B. The salespeople don't have to know the exact margin figures to allocate their effort to where they will get the most margin per hour of their time. Many firms have not compensated their salespeople in this way and have foregone some profit by not treating revenue differently from different products. In extreme cases, firms have given sales awards to the top revenue producing salesperson. After some analysis, it was determined that that person was actually *losing money* for his company. He was selling products that were not profitable after his sales costs were considered.

The salespeople will visit customers who are perceived to be most likely to value the products they can sell. If the salespeople are trying to find accounts that will most likely buy the products with high contribution margin, then the salesperson and the firm have matching incentives and the salespeople will naturally gravitate to the accounts that will be most profitable for the firm.

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### **Outback Steakhouse—Perfectly Matched Incentives**

Outback Steakhouse has been very successful in an extremely competitive restaurant industry. One reason for their success is how they compensate their store managers. Each store manager invests \$25,000 in "his or her store." For that investment, they get 10 percent of the profits that store generates. These store managers report to regional managers who have made similar investments in return for a piece of their region's profits. The incentives here are matched perfectly. These managers will try to use the resources in their control to maximize their income—that is exactly proportional to the income of the Outback Steakhouse Corporation. By maximizing their income, the managers are simultaneously maximizing the income of their "parent" corporation. This compensation scheme is a very creative blend of some aspects of franchising with corporate control. If the managers leave, there are prearranged values for buying back the manager's equity interest in the restaurant.

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## Incentives versus Control versus Time Horizons

The Outback example points out one concern about matching incentives. Profit can be short term or longer term. You as an entrepreneur may have different time horizons in mind than members of your salesforce. Even if you both are trying to maximize profits, a salesperson may want to maximize short-term profits, whereas you, the entrepreneur may be more concerned with longer-term profits and building the value of the company. Some salesforce activities may be very helpful to long-term profits, but take away from short-term profits. These include market research and call reporting. Our experience is that it is easier to have some portion of the fixed component of the salesperson's compensation specified as payment for these kinds of activities. You thus tell the salesforce that they are being paid to do market research and/or fill out call reports. Most salespeople will not see the value to their future income of these kinds of activities and need to perceive that they are being directly paid to perform them.

It is important to set these expectations at the beginning of the relationship. If the salesperson is told when he is hired, that part of his base salary is for call reports and other paper work, he will feel that this becomes part of his job for which he is being adequately compensated. The base salary can also be used as a way to control the salesperson to do activities that may not be maximizing his short-term income. You may want the salesperson to call on some accounts that will not be ready to buy now, but you need their feedback for the next generation product or service design.

Just as our discussion of reps had control as an issue, the same issues occur in compensation. The more straight commission you have, the lower your control. Our experience has shown that for many businesses, it makes sense to have some element of base salary as a justification for requesting the salespeople do activities that may not be maximizing their short-term commission income. Many of the suggestions throughout this book for continually experimenting with different elements of the marketing mix will be thwarted if the salesforce will not cooperate. By its nature, experimentation will show that some activities are more productive than others. You don't want your salesforce to feel that they are being

penalized if they happen to be in one experimental treatment that doesn't perform as well as another treatment. You need to set these expectations at the outset of the relationship. You should tell new salespeople that they are joining an entrepreneurial, adapting, learning, and continually experimenting organization. By their nature, some experiments will work better than others will, and the salespeople should expect that. If you couch their base salary as compensation for these learning and experimental activities, you will avoid possible problems later on.

### **Compensation for New versus Existing Customers, a Possible Festering Problem**

Many entrepreneurs will start their businesses with a straight commission salesforce. This option has the lowest variable costs. If more than one product is involved, the commission rate should be proportional to the gross profit margin of each product. However, another phenomenon is happening with straight commission salesforces that most entrepreneurs don't realize until it has begun to affect their growth and profitability. By then, it is typically too late to solve easily.

If the commission is high enough, and the product potential large enough, a straight commission sales incentive plan can result in amazing salesforce effort and motivation—up to a point. The first salesperson to sell your product will typically work hard to open up many accounts in her territory. She will view this as an opportunity to be entrepreneurial and develop these accounts as her “own little business.” However, in her mind she has an idea of what she needs to make in order to “make a good living.” Once the salesperson has gotten the territory to the point where her commissions generate this “good living,” the salesperson will then tend to coast with her established accounts and protect them from any management gerrymandering.

It is usually much easier to maintain accounts than to get new ones. The straight commission salesperson will get to a point where she will be content to just maintain her current accounts and not spend much effort generating new accounts. The above scenario has been validated as typical by over 1,000 sales managers that have attended the Wharton School's executive program in salesforce management.

One solution to the problem is to have different rates of commission for generating new accounts than for maintaining the business. The commission rate would thus be higher for the first year's business with an account and lower on succeeding years. Alternatively, some firms will have a different commission rate on sales until last year's level is reached and a different level on sales higher than last years.

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### **The Shadow Broadcasting Services**

The Shadow Broadcasting Services story, in which one author (Lodish) was a minority investor and advisor, provides examples of a number of the concepts we discuss in this book. Not only are the salesforce compensation issues faced by Shadow illustrative of the discussed concepts, but the business model and product offering decisions applied some of this book's other paradigms.

#### *Shadow's Initial Business Model*

Shadow Broadcast Services began as an entrepreneurial organization in New York and Chicago. The business model at first was to gather traffic information using planes, helicopters, police scanners, part-time drivers, and cell phone messages from citizen volunteers. This information was then synthesized, cross-validated, and then broadcast from Shadow's studio to a radio station over high-quality communications lines. Even though Shadow's announcers were remote to the radio station, to the radio listener the Shadow announcer sounded just like he was at the station. The Shadow announcer could banter with the disk jockeys, and participate as a member of the station's broadcast team. Depending on the station, the Shadow announcer could either say he was giving a "Shadow Traffic" report, or be reporting from the "WXXX Traffic Center." One Shadow announcer could be the traffic reporter for a number of stations. Depending on the frequency each station wanted to broadcast traffic reports, a Shadow announcer could handle as many as 10 stations.

The beginning business model was borrowed from Shadow's main competitor, Metro Traffic that operated in over 30 major U.S. markets, almost as a monopoly in the traffic business.

Shadow's beginning business model was to barter the traffic reports for advertising time in the traffic reports that Shadow would sell to advertisers. The Shadow advertising was typically a 10-second spot read at the end of the traffic report along with a lead in. The lead in was typically something like "this report brought to you by Chrysler." Shadow obtained most of its revenue from selling advertising time.

The attractiveness to stations of Shadow was that they didn't have to gather and report their own traffic information. Shadow took advantage of economies of scale by sharing the gathering and reporting costs over a number of stations. However, the way revenues actually occurred showed very insightful entrepreneurial marketing thinking. Another way Shadow and its competitor could have generated revenue was by selling the traffic reports to the stations for cash. There were very different perceptions of radio station managers and Shadow of the value of the 10-second spots that Shadow ended up selling. To stations, they did not feel that they could get much value from selling 10-second spots, when all of the other advertising time on their stations was sold to advertisers in units of 30 and 60 seconds. Stations were also becoming part of big, highly leveraged entities that were valued by the financial markets in terms of multiples of their broadcast cash flow. Cash flow was "king" to most radio station general managers. Thus, paying out cash had a high negative value to most station managers. They would much rather pay for the traffic reports with bartered airtime that they felt they would have difficulty in selling.

Another variable to this perceived value calculation is that to the advertiser, 10-second advertisements were perceived as much more valuable when they were broadcast on a network of stations in an area versus on one or two stations. The 10-second traffic ads were great for announcing temporary promotions or very simple announcements of new features or items. Timeliness of the traffic ads as well as being able to reach large numbers of people quickly was potentially very valuable to advertisers. Shadow was able to deliver a network of stations in a city that an individual station could not match. Thus, what Shadow was bartering to the stations had different perceived value to each party—Shadow and each

radio station. Both parties perceived that they were getting better value than the other side in the barter deals.

Another factor that helped Shadow in the beginning was some research they had by chance come across. This research showed that listeners paid more attention to traffic broadcasts than to any other element of a radio show. The research was actually done by a firm that was trying to determine listener preferences for all program content—mainly different music and disk jockey patter, and so on. The firm would play recordings of yesterday’s radio program and ask respondents to turn a dial to indicate how much attention they were paying to what they were hearing. The dial went from 1 to 10. The researcher could then monitor the average attention “paid” to various elements of the station’s programming. For different disk jockeys, their patter would get scores of anywhere from 2 to 9, the music would also get highly varied scores from 1 to 10, and the normal 30 or 60 second commercials would typically get low scores of 1 to 3. The news, weather, and sports segments were moderately well attended. Scores ranged from 3 to 8 depending on the content. The amazing thing to Shadow was that *yesterday’s* traffic report always got an attention score of between 8 and 10! Because most radio listening is done in the car, evidently most listeners are conditioned to pay attention to the traffic reports as they come on. It was useful for the Shadow managers to know that their medium was likely to work for advertisers much more efficiently than the typical radio spot.

An interesting aside—over time, some of the stations began to perceive the high value of 10-second ads delivered with traffic information. These more entrepreneurial station managers started to keep some of the traffic spots to sell themselves and began to charge Shadow and Metro fees for the privilege of providing traffic services to their stations. The differences in perceived value of the 10-second spots acted like many other competitive advantages, they lose value over time if not enhanced in some way.

#### *Shadow’s Subsequent Business Model*

Shadow management innovated the Shadow product in two major ways. Both innovations had much to do with entrepreneurial marketing thinking about differentially perceived value to different

market segments. The first innovation was a response to the increased cost pressure the radio stations were facing. One source of costs was their gathering and reporting of local news, sports, and weather. If Shadow used its already existing infrastructure to not only gather and report traffic information, but also to gather and report local news, sports, and weather, it could do it at a much lower cost per report than could a typical station. Some Shadow announcers would do traffic on one station, local news on another, and sports on still another. Shadow also bartered the new news, sports, and weather reports for 10-second spots instead of selling them to the stations. The stations again perceived this as lower end cost compared to paying for the service. To Shadow, it gave them an even bigger, higher reach network to sell to advertisers with lower incremental costs for the inventory. Because the infrastructure for reporting news, sports, and weather was already in place, the incremental costs per spot of advertising inventory from providing the newer services were lower.

The second innovation did not work out exactly as anticipated, but was pretty valuable. A major expense to Shadow was the helicopters used to gather and report the information. Not only were the helicopters expensive (over \$300 per hour), but also they could not be used in inclement weather—just when you really need them. Shadow management evaluated the costs and benefits of installing remote controlled video cameras that could zoom in to observe all the major traffic arteries in a city. If the cameras could replace helicopters, it seemed that the payback on the camera investment would be less than six months! A bonus was that the cameras were to be available 24 hours per day, seven days per week. The cameras would also be useful additions to the television news programs that had started broadcasting reports prepared in Shadow's studios. The cameras were installed and the use of helicopters curtailed.

Over time, the camera additions did not create as much cost reductions as hoped for. The radio stations were reluctant to diminish their number of helicopter broadcasts because of reactions from their listeners. Radio listeners wrongly perceive the helicopters to be the most accurate source of traffic information and prefer to listen to stations that broadcast reports directly from

helicopters. An expensive educational campaign was required to convince radio listeners of the better information provided by cameras. Before they made the camera investment had Shadow concept tested the camera innovation with a sample of radio listeners, they would have been able to better plan for the real costs that were associated with the camera program. In planning product/service changes, it is very important to evaluate whether to concept test the changes with all segments and stakeholders who might react to the change.

After about a year, Shadow's major competitor copied these innovations. However, this just increased the profits of both competitors by increasing the size of the market and lowering the acquisition costs of advertising inventory.

#### *The Shadow Salesforce Role and Compensation*

The radio stations did not want to add another competitor when they took on a traffic service. Almost all stations stipulated that the advertisers that the traffic service obtained for their network should not overlap with either the radio stations current advertisers or any advertisers to whom the radio station had made a recent pitch. The stations were told that the money for traffic ads would come from different budgets than for traditional spot radio advertising—things like promotion funds, or coop vendor funds.

The shadow salesforces' role was pretty difficult. They were charged with convincing nontraditional radio advertisers to use a new kind of ad (10-second) in a new submedium (within live traffic reports) in a new network. This role is quintessential missionary selling—taking the gospel out to convince new people to convert. In order to attract and motivate the best people for this role, Shadow and Metro paid pretty big draws against commission and pretty high commissions (around 10 percent) on revenue. The really effective salespeople were making several hundred thousand dollars per year. However, many salespeople could not accomplish the job adequately and were asked to leave.

After a few years in the first two cities, New York and Chicago, Shadow managers began to see the "coasting" phenomena set in on some of the best, most experienced salespeople. Once these

salespeople had gotten enough accounts so that the commission on those accounts gave them the standard of living to which they aspired, they cut down severely on their new account prospecting and spent whatever time was necessary to maintain the revenue (and commission) from their current accounts. They also spent less time selling, but maintained their income and even improved their standard of living because they had more leisure time. Maintaining revenue from current accounts typically requires less sales effort than getting an equivalent amount of new business. This was definitely true for Shadow.

To improve the situation, Shadow changed its compensation to a higher commission rate for the revenues from an account for its first year (over 12 percent), but a lower commission rate on succeeding year's revenue (less than 8 percent). Theoretically, the commission rates for new versus existing business should be roughly proportional to the effort required for each task. In this way, the salesperson should be indifferent to spending time with current accounts or trying to penetrate new accounts. A compensation system like Shadow's new one helps to control the "coasting" problem. If the salesperson coasts and just services existing accounts, she will get a lower income level. As the reader might have forecast, convincing the experienced salespeople to adopt the changed commission plan was very difficult. The salespeople rightly were concerned that their initial expectations to which they had agreed had been changed. A number of the experienced, best salespeople had performance problems adjusting to the new arrangement. They had to work hard again!

When Shadow expanded to other cities, management initiated the tiered commission plan from the beginning—paying a higher commission for the first year of revenue and lower on succeeding years. It was no problem to get salespeople to buy in to the scheme when it was introduced *at the beginning* of their relationship with Shadow. In fact, the better salespeople were able to accelerate their compensation growth. If they ended up "coasting," they at least did it at a much higher revenue level and had to work harder to keep a compensation level. Hindsight and experience in the newer markets convinced Shadow management that it was



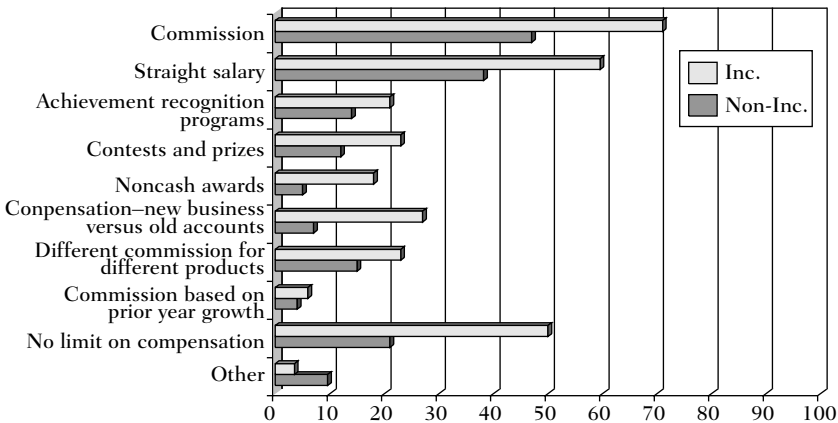
much more productive to *introduce the differential commissions at the beginning.*

Salespeople, like any other person (or buyer of something), are much more satisfied if their experience matches or exceeds their prior expectations, than if they are told to change their expectations in the middle of an experience. This is one example of using marketing thinking to manage more than your relationships with customers. Your salesforce also needs to be approached with careful marketing thinking. Just as it is crucial to manage the buyer's expectations when you or your salesforce sell your product or service, it is also just as important to manage your employee's expectations when you "sell" them on working for your company.

**Survey Results on Salesforce Compensation**

The Inc. 500 group was much more likely to use productive techniques mentioned previously. Figure 7.3 shows the percentage of the survey respondents who used different compensation and motivation methods.

The Inc. 500 CEOs are much more likely to have different compensation for new versus different business and different commission rates for different products. The most striking difference



**Figure 7.3** Salesperson compensation.

between the groups is that 50 percent of the Inc. 500 firms have no cap on what their salespeople can earn, versus only 21 percent of the non-Inc. group. We have heard of no entrepreneurs who report that their salespeople work harder when their compensation is capped.

### **Recruiting, Training, and Retention Strategies**

Once you have made all of the planning decisions about your salesforce, recruiting the right people is a very difficult job. Chapter 10 on hiring looks at this process as another marketing problem to solve. For most entrepreneurial ventures, you will not be able to have the luxury of training raw recruits from scratch. You just won't have the time or available resources to train them. Raw recruits won't have the market contacts to "hit the ground running." Thus, most initial salesforce hires will come from other companies that have operations in markets related to yours. Chapter 10 discusses entrepreneurial approaches to this hiring/marketing problem.

Training of the salesforce will be very idiosyncratic to the role of the salesperson in your marketing mix and the role of the salesperson in the "product offering bundle" that you offer. As a small, entrepreneurial company, you will typically do better with someone who already knows how to sell. Your job is to make sure that this person knows your product inside and out and how the market will benefit from the product. Anything you can do to help the new salesperson to learn about the buying process at her customers and prospects, the competition, and any other meaningful parts of the positioning of your offering bundle will usually be beneficial.

When to not retain salespeople is a decision that is not made nearly as well as it should be by entrepreneurs (and other managers as well). There is a tradeoff to be made that most managers and entrepreneurs rarely consider. If they have a limited sales budget and/or limited prospects on which to call, then they have a limited size of salesforce to deal with. One way to possibly improve sales productivity is to fire lower performing salespeople and replace them with new recruits who might prove to be higher performing. The tradeoff is costs of hiring and training plus the "burn in" time of the new recruit, plus the chance that the new recruit

may also not be very good. In the only analysis we've seen of this phenomenon (on navy recruiting salespeople), the answer was clear. The venture was keeping mediocre people when they would have been much better off "raising the bar."

## Summary

In this chapter, we discuss concepts and paradigms that have been demonstrated as useful for entrepreneurial marketers. This has not been a complete compendium of management techniques for salesforces, only those that have been demonstrated to help entrepreneurs. We have shown entrepreneurial ways to handle the rep versus direct issue, and how to decide which functions to do in person versus which sales functions to handle impersonally. We have described methods for improving salesforce productivity by analyzing alternative options for salesforce size, deployment, and organization. We then discussed compensation options and proposed some criteria for more productive compensation and motivation systems. Shadow Broadcast Services was used as an example of not only a good compensation system, but also entrepreneurial thinking about its product positioning and perceived value to its different market segments. Shadow also exemplifies how much easier for the entrepreneur it can be if he or she gets the compensation system correct in the beginning, and manages employee expectations appropriately.

# CHAPTER 8

## Promotion and Viral Marketing

**W**hereas public relations or advertising can get people to hear about your company or product, promotion gets your product itself in front of the customers, channel intermediaries, or the press. It also may provide some temporary inducement for taking an action—like buying or trying your product. Promotion is usually considered to be paid activities or events that provide inducements to customers to do something. However, the delineation of which activities should be called promotion, public relations, or advertising is becoming blurred. As long as we help the entrepreneur with productive activities to market and sell a product, we will not worry about what the activities are called. You can get products in front of the consumer in several ways. This chapter will discuss direct marketing promotions, viral marketing, event marketing, and other guerilla marketing techniques that entrepreneurial companies are likely to use. Please keep in mind that all of these techniques must first and foremost solidly reinforce the positioning and target segmentation decisions that underscore all of the tactics that a successful entrepreneur should use. *If any tactic will jeopardize the perception of your product held by your target market, do not do it!*

## Give It Away

Giving free samples of products has been a promotion tactic for a long time. If the lifetime value of the customer that is obtained by the promotion is greater than the cost of the promotion, then it may make sense to give it away. The more repeat purchases the initial customer will make and the less likely she will switch to another product, the higher the lifetime value. For products with high switching costs, free samples to get them started may be very productive.

That's the reason pharmaceutical companies give physicians free samples to get their patients started on certain medications. Many of those drugs are used for the patient's lifetime and the drug's lifetime costs can easily run into thousands of dollars. As long as the drug works, and there are no adverse side effects, the physician is not likely to change the medication and the patient is also not likely to ask for a change.

In the new Internet world, giving the product away has also become a key, long-term strategy, not just a short-term promotion. Even a trial bottle of shampoo should be justified by the long-term value of the customer versus the total cost of producing and distributing the sample. We discuss the lifetime value concept in more detail, however, just because it's free, doesn't mean it's cheap. Users have also become savvier about accepting free software, and understanding what it may cost them to operate and maintain it. The Open Source software revolution has spawned companies like Cygnus Solutions, whose slogan is "Making free software affordable."

Netscape popularized the current Internet craze for giving away software by making its Navigator browser software freely downloadable for nonprofit users, and downloadable for 90-day trials for other personal or corporate use. After Netscape had achieved 90 percent market share, Microsoft made their Internet Explorer browser completely free—forcing Netscape to do the same for their browser. Once all of the key competitors had free as the price tag, it became almost impossible for anyone else to enter.

The Netscape strategy actually had two parts to it. The first was to encourage usage among the college and university students

who had high-speed access to the Internet within their dorms and schools. The word-of-mouth generated by this group spread rapidly to their professors, who, as consultants to industry and sources for the press, were able to certify that Netscape was the winner. At the time it was launched, Spry, Quarterdeck, and Spyglass all had licensed versions from the University of Illinois National Center for Supercomputing Activities (NCSA), where the original Mosaic had been developed. Netscape had also realized that if they captured the space on the user's desktop, they could turn that into later revenue (monetize the users, in today's Internet terminology), by selling advertising and other items on their home page, which most browsers pointed to when the program was started. And, the user base would drive the corporations to believe that Netscape's winning position translated to their Internet servers, for which large sums could be charged.

### **The Lifetime Customer Value versus Acquisition Cost**

As with any direct marketing, be it direct mail, electronic mail, telemarketing, or door-to-door sales, you have to compute the value of each customer acquired over some lifetime (with appropriate discount rates), versus the cost of acquisition. This value should take into account that some customers will leave. The opposite phenomena also should be considered—that for many innovative products or services, initial customers may influence other potential customers to join. See the viral marketing discussion that follows. In today's public markets, the value can also be inferred from the stock market "proxy valuation" for each customer. Thus, AOL has been valued the way that cable television systems are—at so many dollars per customer served, even though it takes years to realize that value.

Microsoft has chosen to follow the give-it-away-free strategy, with a small twist. It is only given away to those who have other Microsoft products—with the minor exception that they have free IE browsers for Unix and Macintosh operating systems. In addition, they bundled a free Internet server with Windows NT (now Windows 2000), to add value to that system, and, the Department of Justice contended, to keep pressure on Netscape by denying them some of the server revenue. Fighting free Navigator with free

IE has enabled Microsoft to regain 30 to 40 percent of market share for the browser, which also translates into market share for their mail systems Outlook and Exchange.

But giving software away on the Internet is not a simple task. If something becomes popular, you need to be prepared for hundreds of thousands of downloads each day. This requires servers and infrastructure, some of which can be outsourced from such companies as [downloads.com](http://downloads.com) or [software.net](http://software.net).

### **Giving Free Trials**

Making it easy for a user to try a software product or Internet service is a key factor in creating demand. If several software products perform similar functions, users will stick with the first one they learn, since perceived switching costs are high. It is important to get them to install and use your new service, come to your Web site, and so on. They need to play with the user interface and learn your offering's benefits, so that they can make the purchase or switch decision.

America Online (AOL) achieved their large user growth by carpet-bombing the United States with diskettes (and later CDs) so that users could install and try 10 hours on their service. Even though they had far lower market share in the online world than CompuServe (which they later bought), or Prodigy (which had been supported by IBM and Sears—using Sear's technological prowess and IBM's consumer marketing skills), their market research showed that if they could get people to log on and try some of their online communications (chat, message boards, and e-mail), they could turn them into subscribers. But people who were not already online could not download software to get online. They decided to direct mail diskettes with the installation kit, and later to not only bind them into trade and general circulation magazine, but also to have barrels of diskettes available at many consumer stores and outlets.

The key was their knowledge that every user who logged on for their 10 free hours was equivalent to approximately 25 percent of a 3-month customer, and about 15 percent of a "lifetime (42-month)" customer. Since those revenues were (at the early

days) \$9.95/month, the value of a person who actually used the disk to log on was close to \$100.00. The cost of the package was around \$1.00, so even a 1 percent to 2 percent trial rate could yield very profitable results. In addition, the stock market valuation of AOL, as a multiple of the number of subscribers, was several hundred dollars (today it's over \$1,000 per subscriber). So in terms of market capitalization and the ability to use that value to raise money for marketing programs, a much smaller trial rate was valuable to AOL. In fact, it has been such a successful promotional vehicle that its use continues to this day.

Getting the disks to the users en masse was costly, so AOL went searching for an even cheaper method—having all the software preinstalled on new PCs. Until Microsoft created the Microsoft Network (MSN), AOL got most major vendors to put all the software for an AOL trial on the computer in return for a bounty for each subscriber who lasted three months. This was a win-win for both AOL and manufacturers such as Dell, Compaq, and Gateway, since AOL also provided (in the pre-Web days), good support forums that could cut down on end-user support calls.

Free trials are not just useful for software. They also may be a valuable tool for other products and services as well. The physician free samples discussed are one example. For products whose benefits may be difficult to describe, providing free trials may be an effective marketing tool. The *Investor's Business Daily* newspaper has been using free two-week trials quite effectively for a number of years as a new business generator. They believe that all the benefits of their paper are best perceived by actually reading it and that it is worth it to make it very easy for their target customer to experience those benefits.

## Viral Marketing

The rise of the Internet and the Web has given rise to even faster and cheaper forms of promotion, and the term *viral marketing*. In a viral situation, each user tells his or her friends to download the software, because it will enable them to communicate or work together. Thus, each new user “infects” many of his friends with the product, and an exponential growth can be achieved.



The best-known product of this category is ICQ (“I seek you”) which made instant messaging available on the Web. Instant messaging had been one of the most attractive features on AOL—it permits a user to see if a friend is simultaneously online, and if so, to pop up a message on the friend’s screen and get a response in real time.

ICQ required Web users to download a piece of software, which took several minutes on normal modems, and to register their e-mail and alias information with ICQ. Within a year, they had over a million users and have grown in three years to more than 15 million users. As AOL moved into the Web, they purchased Mirabilis, ICQ’s Israeli parent for almost \$300 million, and continued to operate it. All this before ICQ had figured out how to monetize their users.

An equally successful viral marketing campaign was started when one of the Draper Fisher Jurvetson venture capitalists backing Hotmail asked them to put “Get free e-mail with Hotmail” as a tag line on every message sent out by a Hotmail user. Within less than a year, the company had several million users, and was sold to Microsoft for several hundred million dollars. Having not only every user, but also every use of their system be an advertisement for themselves was an extremely cheap way to spread the word. The marginal cost for increasing each e-mail transmission by less than 50 characters was so close to zero as to be almost immeasurable. The marginal return from an extra customer was several hundred dollars in market capitalization when the company was sold.

All of these successful viral marketing and free offer examples are consistent with the positioning and target segmentation of their firms. For example, AOL is targeting the masses with a position of being fun and easy to use. ICQ is almost the embodiment of that positioning.

### **When Do Giveaways Work?**

Clearly, not every product or service is suitable for the “free” strategy. The four key elements needed to make it an efficient way to build customers are:

1. Low product cost
2. Low switching cost

3. Easy distribution
4. Relatively high lifetime customer value

Any software product, by its nature, has low cost of goods. Especially if the documentation is presented online, the marginal cost of reproduction is at worst the cost of a CD-ROM (under \$1.00 in volume), and at best the cost of maintaining FTP or Web servers from which potential users can download the software and documentation. Services, such as AOL or other Internet Service Providers, have a cost less than 10 cents per hour. Offering 10 free hours may cost less than \$2.50. And many software providers have “crippled” versions, which only work for a limited time period (usually 30 days), a limited number of uses, or have certain functions disabled (can’t save files). Software.com, whose PostOffice program is one of the most successful e-mail servers, allows people to use the software for up to 10 user accounts free of charge.

Free trials have long been used in other media, even where cost is high, as long as the customers are well qualified (have a large lifetime value). Bomardier will give you a free trial ride on a corporate jet to convince you of the FlexJet program’s benefits. To qualify for the trial, however, you have to do more than send an e-mail.

A key factor in deciding whether or not viral marketing can work is the cost to the user of switching to the new product or service. In the Internet world, this can be equated to the amount of time (or number of forms) a user must spend to set up his new account, software, and so on. For example, there are a large number of portfolio management sites, which keep you updated on your stock holdings. For someone with two or three stocks, the setup is usually very fast—but for users with extensive holdings, who may be the best customer targets, this can often take a half hour or more. This often leads to the good driving out the best, that is, the first reasonable solution a user adopts may be good enough to keep him or her from switching to a better, even much better, solution.

One can help this problem by automating the switch or minimizing the user work necessary to perform such a switch. Jump.com, for example, which offers automated Web-based calendaring, created a synchronization program to import Palm Pilot or Franklin REX data. If a user already had a calendar program

running, they merely had to point Jump to their data file, and it would populate its databases without the user having to reenter data. Similarly, portfolio management programs should be able to read Quicken files so that the user doesn't have to do data entry, and can see the value of the new service.

Broad giveaways may often reach too many uninterested users, so it is important to try and target the campaign to maximize the conversion ratio, that is, the number of users who move from trials to real (paid) users. AOL initially distributed disks within computer user magazines, since those were the people who were able to go online. After the success with that target group, disks were mailed to lists of people in the right age/economic demographic—whether or not they had a computer.

Finally, the AOL product was bundled with as many computers as possible. The computer vendors, such as Dell, Compaq, and others were induced to include the AOL software and free trial offer by being paid a bounty on users who actually stayed with AOL for at least three months. In some cases, those bounties were \$25 to \$50, and the cost to the vendors was a megabyte of software being loaded on an otherwise mostly empty drive during the burn-in phase of production. AOL's success drove others, such as Prodigy, Earthlink, AT&T Worldnet, and most notably, MSN the Microsoft Network, to adopt the same tactic.

## **Event Marketing**

Everyone loves a parade. The excitement of an event can create good feelings about a product or service and lead to a time-focused set of articles and press interviews that generate the all-important buzz about the new idea. Even a small company can generate a large amount of hoopla through a well-planned event—often enough to sound like a much larger company to the customers and competitors. The goal of event marketing is to have the press use editorial ink and space to promote a product, rather than paid advertising. And the press can not only write about the features and functions of the product, but also about the level of excitement surrounding the launch—which will often convince skeptical users to try it.

The Microsoft Windows 95 launch is one of the best examples of event marketing. Not only did Microsoft host some key events at their Redmond, Washington, headquarters, they also held major promotional events around the world, including Sydney, Australia, London, and New York. The press coverage of these events dwarfed the advertising spending that was going on in the initial launch phase, and made most of the general public, as well as computer-oriented consumers, aware that something major and new was happening. Microsoft, unlike a small entrepreneurial venture, also had the wherewithal to continue the press through advertising expenditures post launch.

While product public relations can be gained from event marketing, so can general corporate image and view. The current trend to paying for the naming of football stadiums (3COM Park, Qualcomm Stadium), and post-season games (the IBM Aloha Bowl) is meant to associate the corporate name with certain images. This is not an option open to small start-ups, although advertising on the Super Bowl, as hotjobs.com did in 1999, does tie a sports event and a marketing event together. However, hotjobs.com was the only Web site to advertise on the Super Bowl in 1999, and got a lot of free press as part of its participation. In 2000, however, more than 20 different Web companies advertised on the Super Bowl. The only press that the great majority of these Web sites got was about how much money they wasted by advertising there.

Industry conferences offer some of the best opportunities for event marketing. The key influencers and press representatives are usually present, as are many potential customers, distributors, and agents (not to mention competitors). Getting noticed above the clutter of exhibit booths and trade press ads may not be easy. Events can be as small and simple as the press conference, where company spokespeople announce a new product and invite the press to listen, or as elaborate as the big evening parties and entertainment events.

MetaCreations Corp. was a small computer graphics software company with some interesting new products. It was searching for a method of getting lots of press attention at Comdex—the country's largest trade show—with only a small amount of money in the bank. John Wilczak, the CEO, decided to hold a large party (500 key

people from the industry) at a location like the Hard Rock Café or House of Blues. He created the Digital Media Players Party, which would let several companies, including MetaCreations, showcase their newest technologies by having demo stations around the nightclub. The cost for throwing the party was a little over \$250,000 that the company didn't have. Wilczak called on some of the biggest players in the industry—Kodak, Adobe, and so on, and sold them on being “sponsors” of the party. As sponsors, they would pay a fraction of the cost \$25,000 to \$50,000, and get an allocation of invitations and demo stations.

When the invitations went out, they read MetaCreations Corporation (big letters) invites you to the Digital Media Players Party, sponsored by (small letters, Adobe, Kodak . . .). This party was held at three to five major conferences a year for the next several years. MetaCreations managed it and got most of the public relations credit, with a net cost to the company of zero dollars. In addition to being able to be identified with the big guns of the industry, and getting the new products in front of the press and influencer community, the fact that it was seen as the entity throwing the party caused most of the customers to assume it was a much larger company than its sales would have indicated. This increase in customer confidence definitely helped the sales effort.

## Consumer Events

Not all event marketing needs to be directed at the influencers. There can be great benefit from events focused on end consumers. During the Windows 95 launch, stores such as CompUSA held special midnight launch parties, designed to draw consumer traffic into the stores, so that you could be among the first to get the exciting new product.

Bikini.com, a Web site devoted to the surf and swimsuit culture, holds the bikini.com world tour, sponsored by various large companies, to generate awareness of the site, and to drive traffic to the site. They've used some of the supermodels whose work is shown on bikini.com to judge local contests. Some of these are tied to spring break events in various parts of the country, or in conjunction with other key local events such as college opening weeks.

## Winning the Chotchka Wars

Getting your company's name, logo, and message into the mind space of as many people for as long as possible is a major goal of any public relations effort. One way of doing this is with *chotchkas* (Yiddish word for a small freebie)—T-shirts, key chains, coffee mugs, and so on. These are given away at trade shows, fairs, public events. After a typical Comdex show (the largest computer conference with over 200,000 visitors), we come home loaded with half a dozen T-shirts, a few key chains, some mouse pads, note pads, a logoed Swiss Army knife, and so on. In fact, at the past few Comdex conventions, Jim Louderback of *PC* magazine has run a television show displaying the best chotchkas.

Articles of clothing are common types of chotchka—hats, T-shirts, and so on get your message out to only a few people at a time, and are more effective when given to your own employees. The employees are likely to wear them proudly and, if asked about the company mentioned on the shirt, to provide real information. The people working a trade show should be given hats and shirts so that they are advertising the company not just at the trade show booth, but throughout their stay in the trade show location. Customers who get the clothing often give them to their kids, diluting the multiplier value of the gift, although there is goodwill created with the prospect or customer.

For long-term mind share, mouse pads can keep a company's name, logo, URL, and 800 number continually on the desk of current and potential customers. And they have all the contact information at their fingertips, quite literally. In a similar vein, pads of various types, for example, post-it notes, cubes with the logo on the side and top, binders that hold 8½" by 11" pads, and so on often last for a long time on the desk, and within the sight lines of the prospect. By contrast, pens and pencils, even with the company's name, phone, and URL, are often kept in a pocket or purse, and hence do not get the number of exposures that a desk item would. If the prospect is a coffee or tea drinker, a large coffee mug or travel mug will also stay visible on the desk for long periods of time.

There are always new items being touted—water bottles in various shapes, fanny packs, Frisbees. Most of these have the

same drawback that clothing does—they are not often kept around the office, where they can affect the decision and speed the ability of the prospect to get in contact with the company. In addition, their cost is often high relative to their value.

On the other hand, using a chotchka to get a more detailed prospect form, either on the Web, over the phone, or at a trade show is a time-honored tradition. “Fill this out and get a free . . . ,” still works better than a plea without the bribe. Again, items with longevity such as a small flashlight, a key chain, a telephone rest, are better than the classic T-shirt or hat.

### Summary

Every day some entrepreneurial marketer is creatively coming up with new methods for getting her product in front of her target market. The examples in this chapter should be viewed as just that—examples, not as a prescription for repeating promotions that were successful in the past. Using the principles discussed here, along with creatively developing something new and unique, is where the entrepreneurial breakthroughs will occur. Your job is to develop a number of possible promotion and marketing options, evaluate their potential incremental revenue and cost, and choose to execute the ones with the highest return on marketing investment. As with advertising, if there is a lot of uncertainty in the evaluation of either incremental revenue or incremental costs, it may be best to test some options before executing them broadly. Also, the entrepreneur needs to keep in mind that all promotion *must* be consistent with the firm’s product positioning and target market.

# CHAPTER 9

## Entrepreneurial Advertising Decisions

**A**dvertising is probably the most misused (and misunderstood) marketing instrument by entrepreneurs (and managers of larger firms as well). As we discuss next, many entrepreneurs and other managers believe that advertising is too difficult to evaluate on a cost-benefit basis. Using many large frequently purchased packaged companies as examples, many entrepreneurs have adopted many of those larger firms' approaches to advertising. These advertising approaches have a number of "rules" that help a firm or its advertising agencies to make some advertising management decisions. Examples of some of these "rules" include:

1. The incremental revenue produced by advertising is not worthwhile to measure, so don't even try.
2. If an area or market segment has  $x$  percent of revenues, it should get  $x$  percent of the advertising exposures—its "fair share."
3. If you want to achieve a market share of  $x$  percent, you must maintain an advertising budget which is greater than  $x$  percent of the amount spent by all the competitors in the category.



4. You should pulse advertising expenditures into periodic flights that will cut through all of the competitive clutter.
5. You need at least three advertising exposures on a consumer to have an effect. Any less than three has no impact.
6. Advertising takes a long time to work and its long-term effect is difficult to measure, but it is there.
7. If you believe television advertising works, then more television advertising is obviously better than less.

These “rules” become mental models that many firms use as rules of thumb to make their advertising decision making easier. Many companies have repeated these and other similar rules so often that they have become analogous to a religion. Many advertising decisions are thus made on faith.

Entrepreneurs can't run their businesses on faith. They must allocate scarce capital resources to maximize their value to the venture. Advertising is only one alternative use of scarce resources. Other marketing elements like promotion, public relations, and the salesforce compete for resources with other uses such as working capital, new production equipment, and so on. We will show in this chapter that it *is* possible to evaluate the potential incremental return versus cost for advertising, especially for smaller entrepreneurial ventures. These returns can then be compared with other uses of scarce capital resources to enable the entrepreneur to make the most productive use of her available resources. However, as we will show, these methods for estimating returns are imprecise, but they are the best that can be done under the circumstances. We will show that it is better to be “vaguely right,” rather than using rules such as the ones above which are “precisely wrong.”

To emphasize how misunderstood advertising is, even by the large “sophisticated” firms, we first show some recently published research that analyzes the incremental sales effectiveness of their television advertising. We then describe methodologies that entrepreneurs can use to make decisions on advertising so as to be able to at least roughly analyze advertising's return and compare it to other uses for the scarce resources.

## Even Large Firms Waste a Lot of Their Advertising Expenditures

Two recently published articles provide convincing evidence that even the largest television advertisers can significantly improve the productivity of their television advertising.<sup>1</sup> The study, sponsored by all the major packaged goods marketers, analyzed almost 400 in market, split-cable, year-long television advertising tests using the Behaviorscan® system, a service of Information Resources, Inc.

Behaviorscan is a household purchasing panel comprising of approximately 3,000 demographically representative households from each of six geographically dispersed markets. All supermarket purchases are recorded via scanners and linked to individual household identification to measure precise purchasing behavior.

In addition, households receive all of their television transmissions via cable technology, and advertising can be directed to or removed from individual households on a targeted basis. This capability has allowed the execution of numerous carefully controlled advertising experiments. Media weights, media plan configuration, and many other advertising variables have been experimentally tested using this technology.

The tests that were analyzed were those in which some panelists received a different level of television advertising than others for a year. These tests give very valid estimates of the incremental revenue impact of the tested campaigns. The study showed that only 33 percent of television advertising for established brands was showing a statistically significant incremental sales response to this television advertising. On the other hand, when television ads worked, they produced big volume effects (a mean increase of 18 percent in sales), the effects lasted for a period of over two years, and they emerged surprisingly fast (within six months in most cases). The difference between the ads that worked and those that didn't was mostly idiosyncratically related to the copy that the campaigns used. There were more smaller brands ads that worked, and ads that promoted the status quo did not work as well as ads that tried to change something or impart new "news." "What you say" was much more important than "how much you say it."

A key finding from the research related to the long-term impact of the advertising: If the advertising had an incremental sales impact in the first year, it had (on the average) a long-term impact that doubled its initial year's incremental effect over the next two years. On the other hand, if the advertising had *no* incremental impact in the initial year, it had *no* long-term impact in the next two years. Thus if advertising does not produce incremental sales when it is first run, it is unlikely that it will produce incremental sales in the longer run. Many consumer oriented Web e-commerce sites learned this lesson the hard way during 1999 and early 2000. They spent millions of dollars to "brand" their sites and got little, if any, incremental sales from the expenditures. The research indicates that it is very unlikely that there will be incremental sales in the future that will accrue to those firms as a result of that "branding" advertising.

These 400 in-market tests also cast much doubt on each of the "rules" in this chapter's introduction. All of these "rules" were not supported by the incremental sales response to television advertising shown in the tests.

### **How Entrepreneurs Can Improve the Productivity of Their Advertising**

The advertising decisions are typically categorized as budget (how much should I spend?), media planning (where and when should I place the advertising?), and copy (what should I say?). Many books have been written on how best to make these decisions. However, the entrepreneur does not have the luxury of trying all the different theories (most of which have not been shown to be fully validated to help entrepreneurs make more productive advertising decisions). Instead, the entrepreneur must do the best with what he has—little money and little time. In that spirit, the following methods and concepts should be helpful.

Typically, the entrepreneurial business gets an idea for an advertising and/or promotion campaign from someone (the owner, an employee, an agency, a customer, a friend, or an advisor). The "campaign" is typically a combination of media, copy, and budget. Examples might be: "Let's run ads on the radio to announce our

new line of auto accessories,” or “Let’s put out circulars in the new office building that just got finished with our menu and a coupon for a free drink.” Conceptually, what is needed is a way to evaluate whether the campaign will generate enough incremental revenue so that the incremental margin contributed by the incremental revenue will more than cover the advertising and promotion expense. As long as this return is better than other uses for the campaign funds (including other possible different campaigns), the campaign should be continued.

The big problems are evaluating the incremental return of the campaign and generating campaigns that are even better. We first describe concepts and methods for evaluating incremental returns and next discuss methods for improving the campaigns before they are evaluated. We should emphasize here that the procedures to help with these evaluations are not as precise as evaluating some other uses for capital. However, they are the best that the entrepreneur can do in the typical circumstances in which she finds herself. This situation calls for being “vaguely right” versus being “precisely wrong.” The “rules” above are examples of the “precisely wrong” way to approach advertising or promotion decisions. These rules are easy to apply and can be calculated very precisely, but they have been shown not to generate campaigns that are incrementally profitable. We next show some ways to handle campaign evaluation.

### **Evaluating Campaigns—“Vaguely Right” versus “Precisely Wrong”**

For many entrepreneurial businesses, the incremental impact of campaigns is obvious, if the entrepreneur is intelligently watching the daily revenues and either consciously or subconsciously relating daily revenues to the advertising and promotion that is occurring. If the business is direct to the customer, she can also ask customers coming in, calling in, or logging on to the Web site, if the advertising or promotion was involved in their decision to purchase. The entrepreneur has to estimate one number to compare to the actual achieved revenue. That number is “what would revenue have been without the advertising or promotion campaign.”

This number can be “vaguely” estimated by using combinations of differences in revenue in prior periods and differences in revenues from the area getting the campaign versus the same time periods in other areas which were not subject to the campaign. If the data is available, the best comparison to use for evaluating a campaign is the difference between revenues per week during the campaign versus before the campaign started compared to the same numbers for areas in which the campaign was not used over the same time periods.

For example, if a campaign ran during May only in Cleveland, and sales per week increased by 25 percent in May compared to the prior three months, the first estimate you might make would be that the campaign increased sales by 25 percent. However, the next thing to look at would be: How did a comparable area without the campaign do in May? You could use the rest of the United States as a comparison, or a market you judge to be similar, perhaps Detroit or Pittsburgh. If Detroit was up 5 percent in May, Pittsburgh was up 7 percent, and the rest of the United States was up 3 percent, you could reasonably estimate that the campaign might have increased revenues by about 20 percent more than they would have been had the campaign not run. The big assumption you are making when using such an estimating procedure is that *no other causes were responsible for the difference between the area with the campaign and the other areas*. For example, was something else also going on in Cleveland that might have caused the sales increases—such as competitive activities, weather, public relations activities, and so on. The same questions need to be asked about the areas used for comparisons—the “pseudo” controls for this “pseudo experiment.” This kind of estimating and analysis is called pseudo experimentation because there is not random assignment of the campaign to one area versus another. Without random assignment, you can never be sure that there wasn’t some other reason than the campaign that was affecting the revenues.

It has always been amazing to see how many firms, large and small, don’t take the simple necessary steps to even attempt to determine the impact of campaigns. If they don’t keep the data, they can’t do any evaluation. If you don’t do any evaluation, you can’t improve the campaigns or discontinue the ones that aren’t

working. Businesses should keep track of exactly what is occurring daily in each campaign and put it in the same place electronically as the revenue numbers.

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### **An Example**

As an example, a national retailer of consumer electronics thought it was keeping track of its advertising and promotion programs. The way the data was stored could best be described as “market status reporting” (Little 1979).<sup>2</sup> The data was there for managers to find out what they did in each market each day of the week. However, as the data was structured in the computers, it was impossible to do any kind of analysis of the incremental impact of the advertising or promotion programs that the firm ran. An example of how the data looked as it was stored in the computers is in Figure 9.1.<sup>3</sup> After the situation was analyzed, the data was restructured into a spreadsheet that looked like Table 9.1.

Using standard regression analysis, we were able to estimate the incremental sales impacts of the firm’s advertising. The software used for the analysis was Microsoft Excel, which is widely available and very inexpensive. If doing statistical analysis is difficult for you, any statistics graduate student at a nearby university could help you out at very nominal costs.

The regression model related each day’s total sales to print, radio, and television advertising during that day and each of the prior seven days as well as sales during the same day last year, and the number of stores in operation that day. The analysis was able to show the impact of one dollar spent in a Sunday newspaper insert on incremental sales for each day of the following week (see Figure 9.2).

The analysis was able to estimate the average incremental revenue per \$1 spent in all of the media options analyzed (see Table 9.2).

The relative impact of the various media and days of the week were very helpful to the firm in scheduling their next campaigns. They used more television on Sunday and cut back on other print. They did more weekday radio and less weekend radio.

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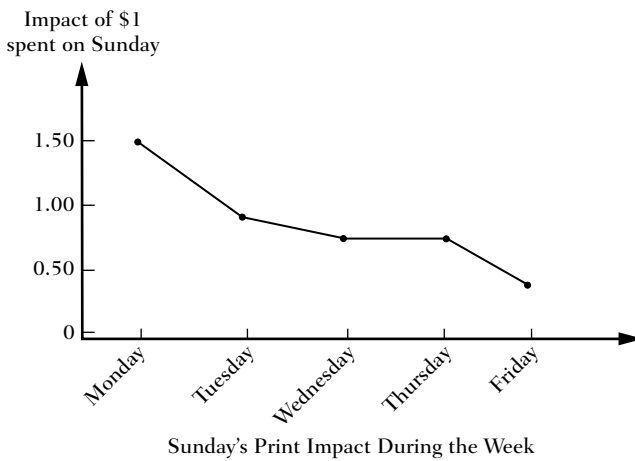
Element:		Advertising Schedule		Plan PD:		5		Planning		Page:						
Accountability:		Actv Director		Meeting:						Version: 12/06/89						
Market:																
Week No. 1	Sunday	8/20/89	Monday	8/21/89	Tuesday	8/22/89	Wednesday	8/23/89	Thursday	8/24/89	Friday	8/25/89	Saturday	8/26/89	Week 1	
Holiday	/ - Super Sale / - Back to School ROP / - Endless Summer 8 Page Tab / / 1-Day Sale /															
Event	/ - Endless Summer 8 Page Tab / / 1-Day Sale /															
TY	/ - Endless Summer 8 Page Tab / / 1-Day Sale /															
LY	/ - Endless Summer 8 Page Tab / / 1-Day Sale /															
Activity	AM (6X18)	6000		PM / (6X18) C									AM (6X18)	7500		
	TV 195 Pts.	8000	Radio (100 Pts.)	3000	TV		TV							7500	24500	
Total Exp.	TY	14000	0	0	0	0	0	0	0	0	0	0	0	0	0	28344
	LY	8700	56	56	43	46	47	30	42	325	60	84	58	84	344	
Sales*	TY	50	40	32												
	LY															
BGT																
HPF																
A/S	TY															
		0.0754														
Week No. 2	Sunday	8/27/89	Monday	8/28/89	Tuesday	8/29/89	Wednesday	8/30/89	Thursday	8/31/89	Friday	9/01/89	Saturday	9/02/89	Week 2	
Holiday	/ - End of Month Clearance Sale / - Endless Summer / - Labor Day BOS ROP / - Labor Day BOS ROP w/Radio /															
Event	/ - Endless Summer / - Labor Day BOS ROP / - Labor Day BOS ROP w/Radio /															
TY	/ - Endless Summer / - Labor Day BOS ROP / - Labor Day BOS ROP w/Radio /															
LY	/ - Endless Summer / - Labor Day BOS ROP / - Labor Day BOS ROP w/Radio /															
Activity	AM (6X18)	9500		(6X18) C									AM/PM (6X18) 5605			
			Radio (200 Pts.)	6000												
Total Exp.	TY	9500	0	6000	0	0	0	0	0	0	0	0	5605	0	21105	
	LY	6700	0	0	0	5200	10200	43	47	83	334	72	369	0	22100	
Sales*	TY	44	38	43	46	48	55	35	42	43	47	83	334	72	369	
	LY	54	53	46												
BGT																
HPF																
A/S	TY															
		0.0632														

\* In \$000

Figure 9.1 The original data.

Day Number	Day of Week	Sales (\$)	TV (\$)	Print (\$)	Radio (\$)
1	Sunday	50,000	8,000	6,000	0
2	Monday	56,000	0	0	3,000
3	Tuesday	43,000	0	0	0
4	Wednesday	46,000	0	0	0
5	Thursday	30,000	0	0	0
6	Friday	42,000	0	0	0
7	Saturday	58,000	0	7,500	0
8	Sunday	44,000	0	0	0
9	Monday	38,000	0	9,500	0
10	Tuesday	43,000	0	0	6,000
11	Wednesday	48,000	0	0	0
12	Thursday	35,000	0	0	0
13	Friday	43,000	0	5,605	0
14	Saturday	83,000	0	0	0

**Table 9.1** The Restructured Data



**Figure 9.2** Model: Sunday's print impact on Monday to Friday.



TV Sunday	12.07**
Radio during week	5.91*
TV during week	5.27**
Print Sunday	5.06**
Print during week	Non-significant
Radio Saturday	Non-significant
Print Saturday	Non-significant

\*  $p < .10$

\*\* $p < .01$

**Table 9.2** Estimated Incremental Sales Associated with \$1 of Advertising

This example utilized naturally occurring experiments to determine the incremental revenue impact of the advertising campaign, after the campaigns had run. The statistical analysis used a multiple of last year's sales in each store as an estimate of what might have occurred had the advertising campaign not been run. A better approach to campaign evaluation is using planned experiments instead of naturally occurring experiments.

### “Vaguely Right” Entrepreneurial Marketing Experimentation

The basic idea behind planned experiments is very simple. You want to try a campaign on subsegment(s) of the market and be able to estimate what the revenue would have been had the campaign not been run, by comparing the areas in which the campaign ran to those in which it didn't. To be as confident as possible that your valuation of the campaign is as “vaguely right” as possible, there are five ideal characteristics that an experiment should have. As an entrepreneur, you will not be able to execute perfect experiments, but they don't have to be. The experiments only need to help you go with the campaigns that work best and not spend money on campaigns that are not productive. The five characteristics that you want in designing market tests or experiments are:

1. The assignment of which areas or subjects will get the campaign or the control (nothing different) should be random.

Flipping a coin or throwing dice are fine ways to fulfill this requirement.

2. Nothing else could have caused the results observed except for the campaign you are testing.
3. The results can be logically projected to the firm's real marketing situation in which the campaign would be used.
4. The experimental campaign must precede the sales effects it is supposed to cause.
5. There must be a comparison group that did not receive the campaign or received a different campaign.

The most important characteristic is number one—random assignment. If this does not happen, there is a persistent danger that those exposed to the campaign may in some ways be different from those not exposed.

### Evaluation Before Is More Valuable than After

If the evaluation of the incremental revenue attributable to the campaign is not sufficient to justify its opportunity costs, the campaign should not have been run. The funds for that campaign would have been better used in other ways. If the entrepreneur can find ways to evaluate campaigns *before* they are executed in the whole market, then he can only execute campaigns that will justify their expenditures. The *planned experiments* described in the previous section are a very good way to evaluate campaigns using a *sample* of the market instead of the whole market, *before* the campaign is executed for the entire market. The entrepreneur needs to balance costs of the evaluation before the campaign is widely executed versus the value of only executing those campaigns that are very likely to be productive. This balancing act can be very difficult for large consumer packaged goods firms, but for the typical entrepreneur, it is relatively easy. He just has to think about evaluating the campaigns in a reasonable way before they are widely executed.

For any one to one marketing vehicles, such as direct mail, telesales, or the Internet, it is very feasible to test campaigns on

selected samples and only broadly execute those that return more than their opportunity costs. For direct mail, for example, it is easy to test a campaign on every  $n$ th name on a list, before sending the advertisement to the whole lot. For broader reach media such as radio, television, magazines, or newspapers, more ingenuity is needed. If the firm has operations in more than one metropolitan area, it can test campaigns in some areas, using some other areas as controls. What is very important in these experiments is to match the areas based on forecasted revenues for the test period and to *randomly* decide which areas are the test and which are the control. Flipping a coin or rolling dice to make the choice is perfectly appropriate. The use of chance makes it much more likely that the differences in revenues that are seen in each market are really due to the advertising campaign versus some other reason that caused a person to choose one market versus another. An example of how matched market experiments helped Franklin Electronic Publishers, Inc. to evaluate alternative media and campaigns prior to national roll out is shown in Figure 9.3.

The following are excerpts from a presentation which describes Franklin Electronic Publication's advertising test of three alternative campaigns before a choice would be made of which, if any, was to be run. The three campaigns were spot television, cable television, and radio.

### **Survey Results on Advertising Budgeting**

We asked our entrepreneurs how they determine their advertising budgets. The answers showed big differences between the Inc. 500 and the non-Inc. group. Of the non-Inc. group, 65 percent decided advertising budgets based on what the company could afford, versus only 29 percent of the Inc. 500 group. Conversely, 41 percent of the Inc. 500 group used current or anticipated sales and profits versus only 16.3 percent for the non-Inc. group. Finally 21 percent of the Inc. 500 group used these techniques and tried to estimate incremental sales due to the advertising, versus only 5 percent of the non-Inc. group. Here again the Inc. 500 group is more likely to use more productive techniques. But even for them, there is room for improvement.

## Improving Campaigns before Testing

Whatever can be done so that campaigns that are developed are more likely to be productive is beneficial to the process. There are a number of steps that the entrepreneur can take to improve the campaigns as they are being developed.

### Copy Strategy

First and most important, the entrepreneur must make sure that every campaign that she uses is *supportive* and *consistent* with her *positioning* and *segmentation* strategy. At every opportunity, the entrepreneur should be asking, “Is this campaign going to improve our perception in the direction of our positioning strategy and is it targeted at the right market segment?”

As long as the campaigns are consistent with the strategy, then it's the entrepreneur's job to have the *most widely varied copies* generated and evaluated. Profitable copy generation can be compared to a lottery. The differences in incremental revenues between alternative copies and creative strategies can be very large. Some campaigns can really add large amounts of incremental sales, while other campaigns (with similar budgets) will do nothing or might even hurt sales. Conceptually, the entrepreneur should be generating a number of very different campaigns, evaluate the potential incremental revenue impact of each of them, and only run the best one—as long as the best one is incrementally profitable and pays for its opportunity costs (including being more productive than the current campaign).

However, in reality, it's just not that simple. Managing the advertising process involves a real balancing act for the entrepreneur. A number of advertising management decisions are very interrelated and should be determined simultaneously. These decisions include the answers to the following questions: How many different campaigns should I have generated? How much should I spend for the alternative campaigns? Should I retain an advertising agency? Who else should be tapped to generate new campaign alternatives? Each of these decisions depends on the answers to the other decisions. If one manages a huge organization with plenty of time and resources, it is possible to think

- **Purpose:** To evaluate the impact of advertising on retail movement of Franklin product, especially Franklin BOOKMAN
- **Methodology:** A controlled test will be conducted to evaluate the following:
  1. **\$4MM Spot television plan.** If successful, this plan would be implemented in approximately 30 percent of the United States, representing a combination of high impact retail markets and more highly developed Franklin markets, as measured by warranty card returns. It is believed that these markets would yield a 95 reach and a 7+ frequency in the advertised markets. See theoretical plan.
  2. **\$4MM Cable television plan.** If successful, this plan would be implemented nationally. Implementation of this plan would yield a 60 reach and a 6.6 frequency in the advertised markets. See theoretical plan.
  3. **\$3MM Radio plan.** If successful, this plan would be implemented nationally. Implementation of this plan would run approximately 100 announcements per week.
    - The Franklin marketing manager had done a very careful job of developing pay back criteria.
- **Measures of Success**

To be deemed a success the adjusted unit volume increase within the test markets would need to rise sufficiently to pay back the advertising investment. Based upon current volume, this would translate to an increase of approximately 200,000 units or an 11 percent increase in volume on an annualized basis. Volume increases would be measured across all Franklin volume—not just BOOKMAN.
- **Evaluative Criteria in Reading Test Results**

Adjustments must be made to data in test versus control to reflect the following:

  - Seasonality
  - Market strength
  - Only portion of entire media plan implemented
  - Translation of national theoretical plan especially in cable markets: buying specs issued to deliver overall reach and frequency and not number of spots. Desired Daypart Mix would include a greater degree of prime and weekend than could be purchased on local cable basis.
- **Payback Criteria by Market**

**Sacramento (\$4MM Cable):**  
 $200,000 \text{ annual units} \times 0.72\% \text{ US} / 1.32 \text{ Index} \times 0.60 \text{ half the schedule} \times 0.60 \text{ (seasonality index for April/May)} / 12 \text{ months per year} \times 2$   
 (May/June)

Volume increase over two months in Sacramento would have to be 54 units over control.

**Portland (\$4MM Spot):**  
 $200,000 \text{ annual units} \times 0.84\% \text{ US} / 1.28 \text{ Index} \times 0.60 \text{ half the schedule} \times 0.60 \text{ (seasonality index for April/May)} / 12 \text{ months per year} \times 2$   
 (May/June) / 0.85 adjustment for spot only control

Volume increase over two months in Portland would have to be 77 units over control.

**Bakersfield (\$3MM):**

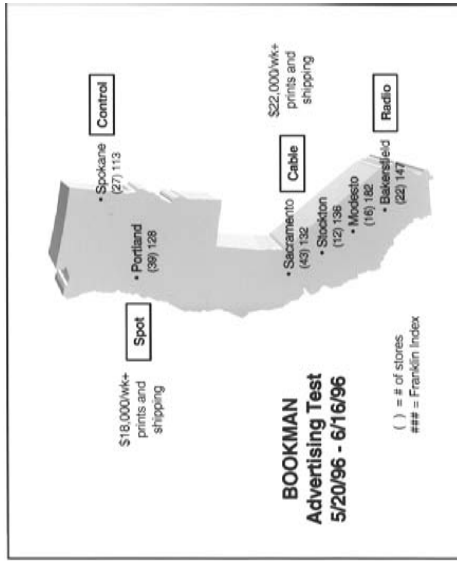
150,000 annual units  $\times$  0.25% US / 1.45 Index  $\times$  .60 half the schedule  $\times$  .60 (seasonality index for April/May) / 12 months per year  $\times$  2 (May/June)

Volume increase over two months in Bakersfield would have to be 13 units over control. The test design was structured with the three test areas and a control area.

**Test Results**

The test results showed that the spot television campaign increased sales 66 percent higher than the control, better than the productivity of the cable or radio options.

However, because the number of reporting stories was small and sales per week were small, there was a higher variability than the company anticipated in the sales estimated from the tests. There was still a big probability that was the spot television campaign could have been no better than the control. There was not enough upside for the company to risk its resources on such a risky payoff.



**BOOKMAN Advertising Test  
Franklin Weekly Store Movement Data**

Performance Summary-Ad Month	Cable	Control	% Change	Radio	Control	% Change	Spot	Control	% Change
Average sales per week-prepost	27.91%	-19.23%	47.14%	4.17%	-19.23%	23.40%	46.75%	-19.23%	65.98%
Sales per store per month-prepost	27.91	-19.23	47.14	4.17	-19.23	23.40	46.75	-19.23	65.98
Sales per store per week-prepost	27.91	-19.23	47.14	4.17	-19.23	23.40	46.75	-19.23	65.98
Sales per point of distribution-4 weeks	27.91	-19.23	47.14	4.17	-19.23	23.40	46.75	-19.23	65.98
Weekly sales per point of distribution	27.91	-19.23	47.14	4.17	-19.23	23.40	46.75	-19.23	65.98

**Figure 9.3** Franklin BOOKMAN Advertising Test.

about an “optimally” profitable answer to these decisions. For the rest of us entrepreneurs, the best we can do is a “vaguely” right approach to the process. A discussion of the directional tradeoffs that exist between the alternatives follows.

First:

More campaigns should be created as:

- The cost of generating the campaigns is lower.
- The cost of evaluating each campaign is lower.
- The validity of the campaign evaluation method is higher.
- The reliability of the campaign evaluation method is higher.
- The variability of the sales impacts of the different campaigns that would be generated is higher.

What the entrepreneur is trying to do is only run with the most effective campaign. The more variability there is among the campaigns generated and evaluated, the more likely the best or most effective campaign will be more effective in increasing sales. However, if we chose the campaign that isn't really going to be the best, we will not do as well. Thus, the reasoning for being concerned about the reliability and validity of the evaluation technique. Also, the more costly the evaluation or generation of campaigns is, it's obvious that the profitability of the process goes down faster as we generate and evaluate more campaign options.

More should be spent on evaluating campaign options:

- The more valid and/or reliable the evaluation methods are.
- The more variability in sales success the entrepreneur believes will occur among the campaign options that will be generated.
- The lower the costs of generating and evaluating each campaign option are.

If it is very inexpensive to generate and evaluate each campaign option, and it is likely to be a big impact on revenue from one campaign to the other, and the evaluation is likely to differentiate the best campaign, then it pays to generate and evaluate a lot of different campaign options.

For the typical entrepreneur, the biggest leverage can come from increasing the variability of the campaign options she evaluates. Increasing the variability of the creators of the campaign option does this. The more different are the people and their approaches that create the campaign options, the more likely is it that the best of those options will have more revenue impact. How do you get more varied campaign option creators? Encourage option ideas from everyone who possibly can help in the creative process. Your employees and customers know the business and sometimes can generate very productive ideas. Also many times friends and relatives with whom you discuss your venture can also be a source of creativity.

This reasoning goes against the “standard” way advertising is handled by the entrepreneur. Many entrepreneurs will hire an advertising agency and give them the job of creating and placing their advertising campaign. The agency will do its own creative development and media planning. After the agency has completed its work, they make a presentation to “sell” their campaign idea to the entrepreneur. The entrepreneur either accepts their recommendations or sends the agency back to try again. This approach has been shown to generate campaigns that are not very different from each other in sales impact.

It is much more effective to *separate* the *creative* and *media* functions of advertising agencies. Our logic would imply that more than one creative agency should submit proposed campaigns to be evaluated and be paid for their time. The best campaign among those evaluated would be the one that is broadly executed. If for some reason you have trouble getting more than one creative agency to work for you, another option is to ask for separate, independent, creative teams from one advertising agency to each develop alternative campaigns to evaluate. Then run with the campaign that is evaluated as most likely to increase sales the most.

It is not necessary to have advertising developed only by traditional advertising agencies. Other sources would include freelance people who work part-time for ad agencies, advertising and marketing students at local universities, and art students at local art schools. The conception that artistic production quality for



advertising has to be excellent for the advertising to be “great” is not borne out by the existing research. The definition of “great advertising” is where an entrepreneur and the typical advertising professional will differ. The consumer who sees or hears advertising is typically not sophisticated enough (nor cares enough) to be influenced by very subtle artistic touches in advertising. Professionals judge most advertising competitions and awards (such as the Cleo awards). Their judging criteria do not include the sales impact of the advertising. Most of the sometimes large amounts of money that is spent to make advertising (especially television) artistically beautiful is of very questionable productivity.

If you are typical of most entrepreneurs, you are now asking yourself “How can I afford to spend all this money generating and testing alternative campaigns, most of which I’ll never even run?” The answer is very simple—you will make more money doing that than with “normal” ways of generating and evaluating advertising. A great advertising campaign that is really effective at increasing sales may be contributing 5 or 10 times as much incremental revenue as a typical campaign. It’s worth it to spend money to try to find the exceptionally productive campaigns.


For example, Metacreations Corp. used radio advertising on Howard Stern’s radio program to ask listeners to go to their Web site or call an 800 number to order a new software program to manipulating computer images. They let Howard Stern have poetic license to do whatever he wanted to advertise the product. In fact, the advertising cost was cheaper if Stern was free to extemporize his commercials.

This campaign generated more than *10 times* the incremental revenue versus the campaign cost. It was evaluated on a daily basis because it was very simple to watch the big increases in calls and Web site visits every time the “commercial” ran on Howard Stern’s show. The campaign was orders of magnitude more effective than any other campaigns the company had run.

Sometimes, it doesn’t even have to cost very much to generate productive alternatives. Synergy, Inc. is an entrepreneurial company that does administration of complex incentive compensation plans. They had an advertising agency that they used in the traditional way. The advertising that the agency came up with was run for a

period of six months in print media that their target audience—senior salesforce managers and administrators—would read. The objective of the advertising was to bring good leads for their salesforce to follow up. Figure 9.4 shows a typical ad.

This ad campaign brought in from 2 to 5 leads per week either over the phone or to the company's Web site. One of the company's employees (a graphic artist) approached Mark Stiffler, the founder



**IS MANAGING YOUR INCENTIVE  
COMPENSATION PLAN AN EXPENSIVE PAIN?**

Processing and validating data. Figuring payroll. Reporting individual results. Handling constant change using inflexible systems and processes. No wonder you need an aspirin.

**Let us manage your incentive compensation plan.** We'll handle all the complex calculations. Reduce errors. Speed information delivery. Improve communications. And give you remarkable flexibility and control.

**We'll save you money.** Outsourcing to Synegy costs much less than doing it yourself or buying software—saving as much as \$1,000 per person. It also converts fixed costs to variable costs. Increases EVA. And gives our clients—like Johnson & Johnson and DuPont—a real competitive advantage.

Get some relief with a **FREE Cost Comparison Analysis**. Stop by [www.synegy.com](http://www.synegy.com) or call us at (610) 864 7433 x7952.

**SYNEGY.**  
The Incentive Compensation Company™

Figure 9.4 The original ad campaign.

and CEO with a mock up of a very different print ad. Mark directed the employee to make it into a print quality ad and tested the ad by running it once instead of the old ad. The new ad is in Figure 9.5.

The ad was so much better than the old ad, that it was obvious by monitoring the inquiries generated that it was orders of magnitude more productive. Synygy began using the new ad exclusively—both in their print media and their direct mail brochures.

"hello my name is Tom  
and I am a spreadsheet abuser"

**Introducing the  
Incentive Compensation Lifecycle™ –  
A Twelve-Step Program For CFO's**

**You may be so addicted to the way you've been doing things that you're missing one of the few opportunities you have to significantly increase revenue, enhance margins, and reduce costs.**

The opportunity is the Incentive Compensation Lifecycle.

Our free white paper, "Incentive Compensation: A Strategic Tool for Increasing Both the Top Line and the Bottom Line," shows you how to turn the Lifecycle into a strategic advantage.

If you're not managing the Lifecycle properly, you could be losing profits in ways that are unforeseen and significantly underestimated—usually many times greater than the total amount of incentive compensation you're paying to plan participants.

Synygy can help—with a complete spectrum of solutions for turning your incentive compensation plan from a "spreadsheet farm" into a strategic advantage:

- Business Process Outsourcing
- Application Service Provision
- Enterprise Software

Synygy has implemented hundreds of incentive compensation plans and currently manages the plans for over 20,000 participants. Our clients include industry leaders like American Home Products, Fleet Mortgage Group, Johnson & Johnson, Sun Microsystems, Inc., and DuPont.

We can make the Lifecycle work for you too.  
Visit [www.synygy.com](http://www.synygy.com) today, or call 610-664-7433 x7950.

SYNYGY  
The Incentive Compensation Company™

"Hi Tom..."

Synygy helps you leverage the Incentive Compensation Lifecycle to turn your incentive compensation plan into a strategic tool for improving both the top line and the bottom line.

Figure 9.5 The new ad.

In the six months that the new campaign ran, inquiries averaged 67 per week! With no change in media budget or media plan, the new campaign was at least 15 times more productive than the old campaign! It was certainly worth the nominal investment by Syngy to test the employee ad! The quality of the new “Tom” ad is probably not wonderful from an artistic point of view. However, *advertising for entrepreneurs is not an art form, it’s a way to generate inquiries and sales.*

## Media Planning

If the discussion of campaign creative and evaluation was not enough to get the reader’s entrepreneurial juices flowing, the next discussion of choosing media should do it. Just as there are big opportunities for increasing revenue with “nonstandard” campaigns, there are also big opportunities for increasing revenues by choosing the most productive among a wide variety of creative media options. The key in media planning is finding the media option that has the most likelihood of generating incremental revenue per dollar spent. We call this “bang per buck” analysis. Again, here the problem is not simple. There are a number of factors that should be considered in generating and evaluating media options. We have been able to distill experience and research over the past 30 years to develop a methodology that can guide the entrepreneur toward “vaguely right” choices.

Again, here the *market segmentation* and *product positioning strategy* of the firm needs to *drive the process*. Any options that are inconsistent with the firm’s basic strategy should be eliminated. The media chosen can be an excellent way of implementing a segmentation strategy. One of the reasons for Tandems East’s success is the availability of targeted media that reach their target customers very cost effectively. Aside from reaching the targeted segment(s) cost effectively, the media options chosen should also be able to convey the firm’s advertising message in an effective manner. For example, even though the audience of *Hustler* or *Playboy* magazine may be very appropriate targets for life insurance products, they would probably not be good environments for the typical life insurance ad. The male reading these magazines is probably not

thinking very long-term or is not very receptive to arguments against current pleasure.

The media chosen need to be evaluated not only on who will likely see or hear your ad, but on how potentially effective the option will be in motivating people who will hear or see the ad. Thus, the media options chosen will be directly related to the campaign that will be used. Some campaign options will be more effective in some media options than others. Again, this is not a simple problem. We have developed a relatively simple ranking and evaluation procedure to get right at the basic trade-offs that are essential for evaluating the relative worth of the available options. The methodology considers the relative value of reaching different target market segments, the probabilities of members of each segment actually seeing or hearing the ads, and the appropriateness of the media vehicles as motivators of people who are actually exposed to the ads in them.

### **Sample Template for Media Evaluation**

The first step in evaluating media options is to divide the market into segments that will have different value to you. This is not as simple as it seems, because you will need to estimate how those segments break out the audience of the media options you are considering. Most media audience ratings are typically only broken out by age and/or sex and sometimes other demographic variables. There is a balance between finding segmentation that is relevant to your venture and segmentation that has media audiences available. Sometimes the segments used for the media planning purposes can be as simple as “my target group” and all others. The entrepreneur can then estimate media audiences in the target group for all the options she is considering.

For our sample, we assume that the entrepreneur has divided his target into three segments: younger males with high income, younger females with high income, and all other adults as illustrated in Table 9.3. The next step is to estimate the population of each segment—column A in Table 9.3. Column B answers the question: How valuable to me is reaching a person in one segment versus another? This is an important judgment that will depend on the advertising’s objectives, the potential of the segments, and so

Sample Segments	A Segment Population	B	
		Segment Weight = Potential per Person in Segment (Relative)	C = A × B Segment Potential
25–49 Males with income > \$35K	2,000,000	10	20,000,000
25–49 Females with income > \$35K	2,000,000	4	8,000,000
All others	10,000,000	1	10,000,000

**Table 9.3** Segment Data

on. It is a per capita estimate that only has to be done on a relative basis. The numbers in column B could be just as easily 100, 40, and 10 instead of 10, 4, and 1. What is important is the relative judgment of how valuable reaching a person in one segment is versus reaching a person in another. Column C is just the multiplication of Column A times Column B to obtain a segment relative potential.

Table 9.4 describes some of the required numbers and estimates needed for each of the media options that are being evaluated. For our sample, we evaluate four vehicles, one Internet advertising option, a radio ad, a taxi ad on the back of the front seat of a set of taxis, and an ad in a newspaper. It is very important to generate many options to evaluate, even if you have to make

Sample Media Vehicle Options	D Cost/Insertion	E	
		Probability of Ad Exposure Given Audience Membership	F Media Weight = Relative Value of Ad Exposure (Judgment or Experimentation)
City Internet banner ad for 1 week (Internet A)	\$100 per week	0.6	1.0
Radio 30-second spot classic rock station— drive time (Radio A)	\$150 per week	0.6	1.5
Taxi seat banners for 1 week (Taxi A)	\$ 50 per week	0.8	1.0
City newspaper ad ¼ page financial section (Newspaper A)	\$800 per ad	0.3	1.5

**Table 9.4** Media Data

rough, “vaguely right” judgments about some of the numbers needed for the evaluation. Creative media options can not only help you sell more stuff, they can position you as different from your competition.

The first column (D) in Table 9.4 is the costs per insertion for each option. The next column, E, is an estimate of the probability that someone who is counted as “in the audience” of the media will actually be exposed to the ad you would run. This estimate depends on how the audience number is determined for each media vehicle. It is absolutely true that your advertising can only work if the potential consumer is exposed to it. Just being in the media vehicles’ audience and not seeing your ad does not help. For example, if a person reads the newspaper, but does not see your ad in the financial section, this does no good for your business. Column E estimates the fraction of audience members who will actually be exposed to your ad.

The last column (F) is probably the most *difficult* number to estimate for each media vehicle, but also the most *important*. It answers the questions: How much do I care to have a good potential customer be exposed to my ad in one media vehicle versus another? This number really only needs to be estimated on a relative basis. The best way to think about this estimate is to arbitrarily assign a one dollar value to one media option (A). For the other options, you then answer the question: If it costs one dollar for me to have a good prospect be exposed to my ad in media vehicle A, how much more or less than one dollar would I be willing to spend to have my ad seen instead in each of the other options? In the example in Table 9.4, the radio and newspaper ads are estimated as roughly 50 percent more valuable *per person actually exposed* than the other two media options.

Table 9.5 shows the fraction of each segment that is counted as being “in the audience” of each of the media options being evaluated. The audience numbers come from the syndicated research that is used to estimate who watches, reads, or listens, for how long. The definition that is used by each media option to define “being in its audience” is very important to understand. For example, for television, the definition of audience is typically having the television set in the audience member’s household turned on to the channel

Media Vehicle	G	H	I
	1. High-Income Younger Males	2. High-Income Younger Females	3. All Others
Internet A	0.04	0.02	0.01
Radio A	0.08	0.06	0.05
Taxi A	0.03	0.02	0.005
Newspaper A	0.25	0.15	0.10

**Table 9.5** What Fraction of Each Segment Is Counted as the Audience of Each Media Vehicle Option?

on which your ad appears. Whether the audience member actually watches you ad is a whole other story which is handled by column E in Table 9.4. In Table 9.5, Column G for example, 25 percent of the high-income younger males are estimated to be in the audience of the financial section of the newspaper, but column E of Table 9.4 says that only 30 percent of those audience members actually see the quarter page ad we plan.

The next step in the evaluation is to multiply the total segment potential in column C by the audiences in Table 9.5. The mechanics of this computation are shown in Table 9.6. For each media option, column M is the total audience of each media weighted by the importance of that segment to the firm.

Table 9.7 puts all this together by combining the media audience potential, ad exposure probabilities, and the relative media values. This amount is divided by the costs per insertion of the media to get a relative “bang per buck.” In our example, Radio A is most productive, followed within about 17 percent by Taxi A. The other two options are deemed less than half as potentially productive as Radio A and Taxi A.

The template in Table 9.7 for media planning should be used to screen options to then either run in the market place and evaluate, or test in a test market and evaluate. The Franklin Electronic Publications media test described earlier is a good example.

The entrepreneur should continually be evaluating the incremental revenue performance of his advertising options as they are used in the market. Over time, the incremental revenue contribution may begin to decline because of diminishing returns. When this happens, it may be time to try some new options.



Segment	J = G × 20,000,000 High Income		K = H × 8,000,000 High Income		I = I × 10,000,000 All Other	M = J + K + L Total
	Younger Males	Younger Females	Younger Males	Younger Females		
Internet A	0.04 × 20M = 800,000	0.02 × 8M = 160,000			0.01 × 10M = 100,000	1,060,000
Radio A	1,600,000	480,000			500,000	2,580,000
Taxi A	600,000	160,000			50,000	810,000
Newspaper A	5,000,000	1,200,000			1,000,000	7,200,000

**Table 9.6** Relative Amount of Segment Potential in Media Audiences

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$$\frac{\text{Total potential in media audience} \times \text{Individual ad exposure probability} \times \text{Relative media value}}{\text{Media insertion costs}} = \text{A relative "bang per buck"}$$

$$\text{Bang per buck} = \frac{M \times E \times F}{D}$$

Internet A	=	636,000/\$100	=	6,360
Radio A	=	2,322,000/\$150	=	15,480
Taxi A	=	648,000/\$50	=	12,960
Newspaper A	=	3,240,000/\$800	=	4,050

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**Table 9.7** "Bang per Buck"

### Summary

Though this chapter has discussed copy and media separately, it should be obvious that they are very interrelated. Some copy will obviously work better in some media than others. If your copy changes, it means that the media options need to be reevaluated with the new copy and visa versa.

This chapter has introduced a number of nontraditional ways of tackling advertising decisions in a "vaguely right" way. All of these ideas have been tested by entrepreneurs and are also consistent with proven relevant advertising phenomena. The concepts and paradigms are not consistent with the "religion" practiced by many large firms who can afford to treat their resources with less respect than an entrepreneur can. However, it is still paramount that every campaign that you use is *supportive* and *consistent* with your *positioning* and *segmentation* strategy. At every opportunity, you should be asking: "Is this campaign going to improve our perception in the direction of our positioning strategy and is the media plan targeted at the right market segment?"



# CHAPTER 10

## Hiring Is a Marketing Problem

**T**he three key items that fuel entrepreneurial growth are ideas, people, and money. We discussed ideas in the previous chapters and discuss raising capital in Chapter 11. All successful companies need a continuing supply of great people to bring their ideas to fruition. Selling to potential recruits is a marketing problem like any other, and many of the same elements need to be considered. Particularly, you should keep in mind that in this chapter we are trying to show how entrepreneurial marketing can help you to hire the best people. There are many other aspects of the hiring and human resources function that are beyond our scope.

### **Positioning**

Great people want to work with winners. One of the key marketing challenges for the human resources (HR) group in a company is to generate the perception that your company is going to be the winner in your product/service space. The same public relations techniques discussed in Chapter 4 can be applied to this dimension. Have the influencers meet the founders and describe the company as a sure winner, and recruits will flock to your door.

People usually like to work in compatible environments. That is, they want to work with people who are more like them than not.

Microsoft, for example, has created the perception that the world's smartest people work there. They use intelligence measures as a key determiner in the hiring process and foster those stories that tell of the "brain teasers" they use in interviews, and the verbal sparring that occurs during Microsoft meetings. As a result, they are able to hire many of the world's smartest folks, not just programmers, but also writers, marketers, salespeople, and so on.

Apple Computer, Inc. has fostered the perception that people who work there "think different" and are not afraid to challenge the status quo. Their consumer advertising campaign and their hiring speeches make the same point. When Steve Jobs was trying to lure John Sculley away from his senior post at Pepsico, he asked, "Do you want to change the world, or just sell soda the rest of your life?" Jobs successfully put forth the message of Apple, in its hiring as well as its operations.

For other large companies, there are specific positioning messages—McDonald's is "everyone's first job," and, as they try to hire more senior citizens, maybe everyone's last job as well. Goldman Sachs, Disney, and McKinsey & Company are perceived as the best places to learn strategic thinking and to become part of the American corporate elite. Procter and Gamble is the place to learn all about brand marketing.

For the entrepreneurial start-up, positioning to prospective employees should be simple and straightforward. They are, after all, going to have to work very long hours, usually for low pay, with most of the rewards coming psychically in the early stages, and through stock options much later. The company's mission and culture must come through in a few sentences or images. Just as important as "the elevator speech" that you should be able to give to a prospective funder, is your firm's first encounter with a prospective employee. The prospective employee should know exactly why your company is a different and better place to work. Use Steve Jobs one-sentence description of Apple as an example.

## **Segmentation**

Almost every market segments itself along certain dimensions. The hiring market is no exception, and is segmented by functional specifications, geography, skill level, and experience level required.

In addition, the risk propensity of applicants causes the more conservative folks to shy away from entrepreneurial start-ups.

*Functional segmentation* is the seemingly obvious differentiator. You need to market differently to find accounting personnel than manufacturing workers. Yet in the early stages of entrepreneurial companies, each person may have to take on several jobs and functions. The CFO may also run operations, be a purchasing clerk, and work on sales of company equity. It is hard to decide between a candidate with several years of direct experience as a CFO who has come up through the accounting and finance ranks, and someone with the CPA who has also been an operating officer or perhaps run their own business.

*Geographical segmentation* is an especially difficult one to overcome. There are different lifestyles in Boulder, San Jose, New York City, or Atlanta. People who are attracted to a particular place to live can color the applicant pool for your new venture. It is much easier to find people willing to work all day and night in Silicon Valley than in Atlanta—not that the Georgians are any less productive, just that their culture is built around more family time. Similarly, locating your office where most employees have long commutes (train or auto), puts bigger limits on total time in the office.

Hiring people who have to change locations in a significant way is fraught with risks for both parties. For the applicant, there is great risk that they simply won't like the new location—or their accompanying family members won't. For the company, such employees are subject to the stresses of a young, fast-growing venture on top of the difficult home situation. Infonautics, Inc. found it difficult to recruit people into the Philadelphia suburban area. Even though applicants saw that the housing and school opportunities were far superior to other cities, they remained reluctant, because there were too few other companies to go to if the venture did not succeed. Now, as more Internet companies have located in the "Philon Valley," it has become much easier to convince potential employees that even if the job that moves them here doesn't work out, there will be ample opportunity for them in their specialty.

With the advent of the Internet, companies can now hire some people who break the geographic boundary limits via telecommuting.

With one or two visits a month to the corporate facility, the telecommuter can retain enough personal contact and credibility for the rest of his or her work which is arriving via e-mail. Hiring telecommuters means marketing to them where they live—on the Net. Jobs.com, Monsterboard, and the other services provide a way to reach this key group of innovative and hardworking technical and creative people.

*Experience* also segments the marketing job. Entrepreneurial companies often have the luxury of hiring not on the basis of experience, since they are going into business and product areas in which there may be no relevant experience, but more on the basis of “raw” skill. Young MBAs who can serve as Jacks or Jills of all trades may be more responsive to the hiring message of an Internet start-up than someone with 5 to 8 years of experience and career track at a bigger company. But there really is no substitute for experience. The less training a company needs to provide, the faster they can get their product to market.

While some recent, relevant experience is critical, many of the jobs that seek 5 to 10 years of time in related positions are not appropriate for the Internet space. Few people were on the World Wide Web much before the mid-1990s, narrowing the pool of such applicants too severely. What is most important in an entrepreneurial company is the right mix of experienced people, who have some idea how things can be done, with entry-level talent, who know no limits to what can be accomplished.

### **Building a Team and Corporate Culture**

While every hiring decision is critical and needs to be looked at on an individual basis, the collection of early hiring decisions determines what type of team spirit and corporate culture will be created. For a corporation to be successful, it needs to have each of the key personality types as well as each of the critical skills. One needs people who enjoy the detail-oriented administrative tasks, entrepreneurs and visionaries who can work at the 50,000 foot level and not be deterred by small uphill battles that occur each day, people who will grind out the work, and those who can manage and integrate the people and processes of the organization.

Showing a new recruit that the team works together, with common purpose, is a key marketing element in successfully hiring the best. Having the applicants come on days when there are pizza parties or other social occasions is a good way for them to meet many more people than the interviewing schedule permits and to get a sense for the community that they'll be joining in a less pressured manner.

## **Reaching the Prospects**

Traditional want ads and classified job ads are rarely the mainstay of the start-up. Most of the candidates are reached via networking, job fairs, headhunters, and online media. Often, if the publicity surrounding the company is strong enough, resumes will flow in unbidden, from those who want to latch onto the hot new company.

Every employee, from the founder down, must be told to keep watch for any good talent, and encourage them to apply, even when a specific job is not open. Your own employees are great judges of the “chemistry” fit of a candidate, and since one of the keys to successful organizations, and to job satisfaction, is having a best friend at the office, letting people recommend and potentially hire their best friends is a good way to ensure success. Such hires have lower turnover rates and better prospects. They also cost the company far less than standard headhunter fees.

Job fairs are an efficient way to focus your start-up on hiring. Post at local colleges and universities, advertise on the Internet, and hold an open house for 2 to 3 hours late some afternoon (typically 5 to 8 P.M.). This allows those who have jobs to get there and talk with people from many different functional areas in the company. In the idealab! incubators, where there are always 5 to 10 companies, we have held job fairs in which each of these incubating companies, and the other 20 companies we have created that have moved away, sets up a table with a few of their people. As a control mechanism, we only allow each applicant to talk with a limited number of companies—usually 3 to 5. That way, the number of competing offers is limited, and the amount of duplicate processing is cut down. The applicants sort themselves by degree of risk averseness by the companies they choose to talk to, since



those that have been in business for years (CitySearch, GoTo.com) get the lower risk takers, and the ones that have started in the past week get the high risk takers.

Networking with local faculty members is crucial to seeing the best talent before it is preemptively taken off the market. If the professors know what you're looking for, they can recommend people to you long before they would think of themselves as being in the job market. One good way to get access to this talent pool is the use of students as interns. There are many well-defined tasks—market research, for example, that can be done by a student or student team during a semester course. This allows the student/prospect and the company to evaluate one another, with no obligations, and without having to make the hiring decision until after you have really seen both the work and work ethic of the candidate.

## **Pricing**

Compensation packages at entrepreneurial companies vary widely. Especially in the first few months of the company's existence, offers may be custom tailored to match the applicant's needs for cash, deferred compensation, equity, and other benefits. The perceived value of a package of salary, options, and perks will vary widely with the age, maturity, stage of life, and relocation status of the employee.

The idealab! formula is to try and keep all salaries below \$100K per year in the first 6 to 12 months. To balance this, employees get faster vesting on a portion of their options than is typically industry norms. This is an especially important recruiting tool when dealing with senior people who are leaving highly paid positions, since it ensures that they will have a stake in the company even if their own job doesn't work out. It is much easier for a CEO who is taking a small amount of cash compensation to convince his or her subordinates to stay below the CEO salary level.

## **Reaching the Prospect**

There are many people who play a role in the hiring process, and each needs to be trained in the marketing and sales function

associated with recruiting. When the Human Resources person (or department as a company grows) starts out, they should have the mission statement and position description clearly in mind. A key differentiator in entrepreneurial companies, however, is that whatever the position description says, there are likely to be other responsibilities, since there are never enough employees to fill all the roles in a new venture. This message has to be put across to the recruit.

In the army, it is “unit cohesion,” the sense of belonging to a small tightly knit group, that makes men and women willing to give their lives to save their fellow unit members. Entrepreneurial companies are also fighting key battles, and unit cohesion is critical. Hence, it is very important to have any potential hire interview not only with HR and the specific workgroup manager, but also with most members of the group in which they’ll work. Each of these members has to market not only the company’s mission and vision, but also the ethos of their own unit; and has to be convinced that the recruit will contribute to the cohesion and success of the unit.

Programmers each have their own style. Development departments—so important to success in the Internet area—create their own sets of rules and conventions. Making sure that a new entrant into an existing group can work within, and perhaps extend, the group’s styles can be the difference between the success and failure not only of the recruit, but of the company. In one open-source software venture, the head of the group was a maverick, who defied most standard programming rules to create a much more efficient e-commerce engine. When hiring for his group, he made sure that he kept a mix of maverick’s and traditionalists, so that the creative energy led to productive code, not chaos. This involved meetings and votes among all the existing team members, who ranked each new recruit on several scales, along with an overall “I’d like to work with this person” rating.

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### Examples

EPinions is a Silicon Valley Internet start-up which is creating a Zagat-type guide to almost anything. They will provide convenient places on the Web for people to input their opinions, will

aggregate them and make them available to the Web community. Product reviews, movie reviews, and so on are all in the plan. It was started by a small team who had all done successful start-ups (NetScape, Oracle). They faced one interesting hiring challenge, however. They were unwilling to tell potential recruits about the business plan until after they were hired. This meant having the recruits completely believe in the team, and be excited about working with the team on whatever they chose.

They were able to tell the recruits that there was going to be nothing illegal, no pornographic or gambling related stuff, and little else. What helped was that they could say they were funded by Benchmark Ventures, one of the most successful Silicon Valley backers (eBay, etc.). They could also say that they hoped to launch within six months, so there would not be a long delay in finding out if they could be successful.

Microsoft has grown from 12 individuals in 1978 to over 30,000 today, yet it still considers each hire as carefully now as it did 20 years ago. It has kept a strong marketing effort up both to convince entry-level personnel that Microsoft hires the smartest people, and to convince them that they can still become millionaires when their options vest. The company has very high standards for whom they'll hire as full-time employees. This cachet has also been spread around the college campus recruiters.

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## Summary

As these examples show and we hope this chapter has shown, hiring and keeping good people needs Entrepreneurial Marketing to make the process as productive as possible. All the concepts we cover in this book for helping improve the interface between the venture and its customers are also important for improving the interface between the entrepreneurial venture and its current and prospective employees.

# CHAPTER 11

## Marketing and Raising Capital

**O**ne of the most important jobs of marketing is to help an entrepreneurial venture show its best side when raising money. In fact, in the world of Internet mania, when profits for many companies may be a distant hope, and the key is customer acquisition and market share, raising capital is a constant and crucial factor in a company's success. In all cases, but especially for Internet companies, investors are most likely to provide funds, at good valuations, to companies perceived as winners that will eventually be very profitable. It is marketing's job to position the company as a (the) winner, leader, and most advanced, world-class competitor in its space. It is also important to be able to create a sense of urgency, to counteract the oft given venture response of "I'll put money in if you have a lead investor." Everyone wants to be the last one in the pool and looks to a lead investor who will commit and help in negotiating the specific terms of the investment deal for all investors. The lead will usually end up with a seat on the board of directors, representing the investors in that round.

The marketing group often plays a key role before, during, and after the fund-raising process. Marketing works with the CEO and CFO in creating the investor presentation. Pitches driven solely by

the finance department tend to be too detailed and too dry to generate the investor excitement necessary for a successful sale of stock. Marketing may err too far on the side of hyperbole. Working with investment bankers, lawyers, and others to control the hype tendency, marketing's function is to craft both the "book" (business plan and summary) and the pitch (slide show and presentation) that will be used as the selling documents for a stock offering. Later on, marketing may work with the CFO in the investor relation's function—providing information and the "spin" on that information to the investors, whether public or private. Finally, the marketing department will work with investment bankers.

### **Product versus Financial Marketing**

There are many differences between product marketing and financial marketing, but the similarities are even more numerous. In both, one needs to target the consumer of the goods and services, by working through the chain of influencers and key decision makers, gatekeepers, and naysayers to have maximum impact. In both, getting key benefits understood by all is crucial.

One major difference between product and financial marketing is timing. While the product marketing campaign can often be postponed to coincide with completion of a set of product features, failure to execute financial marketing may mean loss of funds and nowhere to turn—shutting down the business. The key elements of naming, pricing, and positioning still apply, but to the stock, not the product itself.

### **Naming**

It is easier for people to remember who you are, and what your company does, if you have a well-thought through name. eToys, for example, is a name that immediately says toy sales to most consumers—having the name made it easier for investors to remember as well. At idealab!, names may be crucial—in more than one instance the fact that a sufficiently catchy URL was not obtained stopped the investment into the company. The URL for Tickets.com, along with the 1-800-TICKETS phone number, were

purchased for a substantial sum to get the benefits of quick consumer and investor recognition and remembrance of the company's business area. Similarly, even though eToys.com also owns toys.com, the use of e before Toys.com gives an investor the idea that this is an e-business—a Web-based version of a more traditional business.

As with any nonfunctional name (e.g., Amazon.com), both product and investor marketing are required to attach the business plan to the name in the minds of customers or investors.

### **Pricing—Your Venture's Evaluation**

Just as product pricing is an art as well as a science, the pricing of offerings in companies is even more so. Once a company is public, and there is a "free market" for its stock, the price will be set in that marketplace. We will come back to this in the discussion of investor relations. In the private markets, there are two types of prices—those set by the buyer (low), and those set by the seller in the face of excess demand (high). What permits a company to get into the latter category is superior marketing.

The key elements that need to be marketed to investors, in addition to the product/service offering, are the people (management team), the financial model, and any strategic relationships that the company may have entered into. Since the investor is buying a fraction of the company, not an instance of the product, it is the expected exit value that is most important. When there is an Internet stock mania, this value may be projected higher by some investors, and lower by others.

As we write this, an idea from a new, untried entrepreneur and group of qualified engineers, marketers, and so on may be worth 30 percent to 65 percent of the equity of a company for an initial cash investment of \$250,000 to \$2,000,000. With a seasoned team of entrepreneurs, located in Silicon Valley, raising \$5 million for 30 percent of the equity would not be unusual. The marketing message around a successful team is clear—"They did it before, they'll do it again." Particularly if the team has either taken a company public, or sold at a good price to a major player (e.g., Cisco), their "product" has a seal of approval.

## Segmentation of Potential Investors

The customers for fledgling company stock fall into several categories: angels, venture capital companies, incubators, corporate strategic buyers, or institutional investors. Each has a particular place in the investment food chain and is matched to certain types of companies. By far the largest share of investment funds for new business comes from angel investors. These are friends, family, and retired executives who have extra cash and are willing to take risks and back someone they know. Over 60 percent of the money raised is in this category.

### Angels

While angels used to be approached one at a time, the high-tech world has organized this channel, so that it can be more easily reached. Ron Conway, founder of Palo Alto's Band of Angels, manages monthly dinners in which entrepreneurs can present their plan to almost a hundred current and retired high-tech executives. If they like the plan, they can invest from \$25,000 to several hundred thousand dollars. And the companies get the network and expertise of senior people at such firms as Hewlett Packard, Apple, Netscape, Sun, and the like. The Band has been so successful that it has spawned a true venture fund, so that the members can participate in more investments with a little less time.

MIT Entrepreneur's Forums are held in several cities, Philadelphia has the League of Retired Executives (LORE) and the Pennsylvania Private Investor Group (PPIG). Los Angeles has the Tech Coast Angels, and the New York New Media Association has the NYNMA Breakfasts. In each of these, members agree to invest at least \$25,000 in a start-up each year. They get to make the choice. Negotiating valuation with angel groups is very idiosyncratic, and often results in higher valuations than the venture capital firms would provide.

To get the opportunity to reach these organized angel groups, a company must find a member to sponsor them. Lawyers, accountants, professors, or other successful entrepreneurs can make the introductions for new start-ups that don't already have a link to this community.

### Venture Capital Firms

The most visible and helpful investments come from the established venture capital firms. There are more than 4,000 funds that belong to the National Venture Capital Association, and undoubtedly hundreds of others. The typical venture partnership has \$50 to \$500 million to invest over a three- to four-year period, and assumes that their initial investment will require at least as much in later rounds. Since the scarce asset of these firms is partner time, they need to put \$2 to \$10 million into each deal. (The most recent megafunds are trying to put five or ten times that amount). Firms such as Benchmark Capital, Kleiner Perkins or idealab! Capital Partners want to take an active role in helping the investee companies grow, and provide a *keiretsu* (Japanese for a corporate family) to help their companies help one another.

The largest venture firms now see tens of thousands of business plans each year, and fund only a handful (typically fewer than one per month). How can a company work to maximize their chances against these 1,000 to 1 odds? First, almost all of the venture firms only fund plans that have been referred to them by someone they know and trust. This first screen is extremely important and requires that a company have an advisor (lawyer, accountant, technologist, professor), who is known to the venture firm. That person can make a telephone call or send an e-mail that describes the key business idea or differentiator in a few sentences. If the venture firm has any interest, they'll then request either a plan or a meeting. Here the entrepreneur's marketing skills are put to the test. A few slides and a prototype must tell the story, show how the market being attacked is large enough to be worth the venture firm's valuable time, and transmit the passion of the entrepreneur to the partners. Venture firms are looking for markets that can get to between \$100 million and \$1 billion in a few years, while angel investors can fund companies that may only do \$25 to \$100 million.

### Incubators

The incubator is a more recent innovation in sources of help, capital included. idealab!, CMGI, eCompanies in Santa Monica, Softbank's Mountain View Hotbank, eHatcheries in Atlanta, and Innovation



Factory near Philadelphia are all business incubators, which provide space, infrastructure, and funding to help entrepreneurs get a fast start. Pitching to these incubators is similar to the venture capital presentation, but the business team does not have to be as well-formed. An incubator often provides accounting services, general office services, and some technical consulting to the various companies, as well as overall business advice. Many are funded through industrial development funds, to try and heighten job creation in a particular region.

### **Corporate Strategic Partners/Investors**

Many large corporations have started venture type funds, partly for the financial gains that can be earned, but mainly to keep a strategic eye on new developments in their sphere of interest. Many of the innovations that change industries start in the smallest, rather than the largest companies. Intel, Cisco, even AT&T all have venture funds so that they can benefit from the technologies and business models that new companies have started.

If your entrepreneurial venture has received any visibility at trade shows, in the trade press, and so on, you may be contacted by these groups. They are often brought in as co-investors by the established venture firms.

### **Exclusivity from Potential Customers**

As discussed in Chapter 5, it is sometimes possible to get your future customers to fund the efforts, in a different way than the strategic partners mentioned earlier. In return for limited exclusivity, some companies will make up-front payments sufficient to help you develop and begin marketing your products. These types of arrangements, while rare, are very favorable to the entrepreneurs, since they minimize dilution and maximize the probability of success. Since there is already an interested customer, the feedback in early stages is likely to be highly valuable and can tune the product or service offering to truly match customer needs.

### **Institutional Investors**

Finally, there are hundreds of investment bankers and finders who will try and help you raise money from qualified institutional buyers.

These sources usually want to make large investments (\$10 million and up). These investors are willing to pay placement fees. Early stage companies that don't have the large cash requirements may find this market hard to tap.

### The Buying Center

Just as every product customer has a set of hoops to jump through, so too do the CFO and CEO when selling the image of the company. For many venture firms or investors, the first test is the analyst or associate who screens the business plan. They are hired to keep too many plans from cluttering the partners' desks or minds, and get points for saying no early. However, they lose double points if a competitor gets a deal they should have bid on. Thus, telling the analyst at Firm A that Firm B is preparing a bid can short circuit the turndown.

After the analyst, the venture firms will often bring in outside "experts" to help them in fields in which they are not knowledgeable. These consultants have their own agendas, along with the formal assignment from the venture fund. It is quite common for them to offer their services directly to the company, after they have made a positive recommendation. They may facilitate the communications between a technically oriented founder and the financially oriented venture capitalist. The company should use their review time as an opportunity to gain valuable competitive intelligence, since these experts have a broader view of the competitive space than most founders.

### The Marketing Process for Capital Raising

In the prepublic stage, reaching investors can be done by getting mentioned in the key influencer magazines (and online e-zines) such as *Red Herring*, *Upside*, and *Wired*. The technologic publications are also a source that many venture capitalists use to try to find deals.

In each region of the country, there are also weekly and monthly business magazines that cover start-up firms. *Crain's New York Business*, *Philadelphia Business Journal*, and *TechCapital* magazine are

examples of publications that can get a young company noticed by potential private (prepublic) investors. After Vindigo was mentioned, more than 60 angels and venture firms called to see if they could participate in the next financing round.

## **Initial Public Offering**

For many companies in the software and Internet world, much of the reason for going public is marketing related. As Jamie Kiggen of DLJ said recently, “The IPO is the premier branding event for an internet company.” In fact, the amount of publicity and brand recognition that can be generated by a successful, high-profile IPO is enormous. Planning for an IPO is an arduous task, and the actual road show and offering are several of the most grueling months that a CEO and CFO will ever face. But each meeting and luncheon presentation is selling the company’s products, message, and positioning as well as its stock.

The first part of getting the message out is accomplished during the underwriter selection phase. At this stage, the various investment bankers are trying to sell the company on choosing their firm to participate in the lucrative fees associated with the IPO. From the company’s point of view, however, this is a chance to familiarize many of the Wall Street analysts who might later cover, or be asked to comment on the company’s business and stock prospects.

Too many companies make the mistake of talking to only a small set of bankers. If they want a “first-tier” or “bulge bracket” firm, such as Goldman Sachs, Morgan Stanley, or Merrill Lynch, they may feel it isn’t worth their time talking with 10 to 15 smaller players that want to be part of the offering. In fact, just as you wouldn’t tell a potential good customer to go away without speaking to him, you shouldn’t do the same to the bankers. It is often best to hone the pitch that will be given to the first-tier folks on some of the other firms. Their analysts can constructively criticize the positioning, projects, and passion that your company is using to try and get the highest valuation from these firms. It is common to have one or two smaller, boutique firms, as part of the offering underwriters. More and more, online trading firms such as Wit Capital, e\*Trade, or DLJ Direct are also participating. And you

can build relationships that may well be needed in later months, after the IPO, if there is any slip in the company's performance.

Just as you wouldn't run a television ad that wasn't professionally scripted and produced, the IPO road show pitch itself requires the same care and professionalism. Power Presentations' Jerry Weissman, whose company helps create road show presentations and then coaches the speakers in dealing with audiences—large and small—in the most effective way, says “[this training] can help add a few dollars to the stock price . . .”

The buyers for the IPO fall into several groups: institutional investors focused on momentum, long-term institutional holders, retail holders, and flippers. A balanced mix of all of these types are needed to have the company's stock in strong enough hands, yet trade enough to be interesting to market makers who support the stock.

## Investor Relations

Once the IPO has been completed, a company has to communicate with its investors to keep them informed, and to keep the stock price consistent with the company's performance and promise. While there are a number of firms that can help, in the same way that traditional public relation firms help with product positioning, most companies should have an in-house designee to handle investor queries, provide copies of reports, and coordinate the company's release of information on quarterly basis, as well as its conference calls with analysts.

The conference call gives the company a chance to present itself to 30 to 100 key influencers each quarter. Many of the analysts on the call will be writing a report or set of comments for their clients—recommending whether or not to buy, sell, or hold the stock. We recommend following four simple rules for these communications:

1. Tell the truth, the whole truth and nothing but the truth.
2. Tell the bad news first.
3. Don't over “spin” the good news.
4. Don't get on the message boards.

While point one should be obvious, the temptation to omit some of the bad news, or to hold back or spin the positive news, can sometimes feel overwhelming. Don't succumb! There is a large group of plaintiff's lawyers just waiting for any misstatements they can use to successfully sue you. (Note "successfully," they'll often sue anyway on bad news, whether or not you've been telling the truth.)

Dealing with bad news is never easy. Getting it out of the way of the market, so that its impact on stock price has been felt, and then allowing the price to recover on good news, is far better than wasting some good news immediately before the bad news comes out. It is also important that everyone gets all the bad news at the same time—avoiding the selective disclosure that could give an unfair market advantage to those who hear it before others. Most companies schedule their press releases and conference calls outside of market hours. Now that the markets are moving toward 24-hour trading, this is becoming more difficult, but it still makes sense to schedule outside the standard 9:30 A.M. to 4:00 P.M. Eastern time window when the bulk of the trading takes place.

Finally, we are also tempted to add some "spin" to good news. A small contract may be touted as a harbinger of much bigger ones, or a move from losses to breakeven may be spun as a major turnaround. It is better to let the investors draw their own positive conclusions.

Over the past few years, there has been a dramatic rise in the availability of information on public companies, which has been good for investors. At the same time, the message board phenomenon has cropped up. On Yahoo, Raging Bull, Silicon Investor, AOL, Motley Fool, and other sites, there are places where "investors" (usually rank amateur speculators) can post any comments they want about your stock. While there are occasional nuggets, most of it is drivel—uninformed, meant to hype or cut the price when a smarter speculator has gone short, or wants to go long. The SEC has been working with the providers to curb the worst of the abuses—outright lies meant to manipulate a stock—but there is still far too much misleading information.

When your Investor Relations executives read these, they, or other employees or officers, may be tempted to correct the

misstatements. *DON'T*. Once you start correcting, the public may feel that you have taken on the obligation to always correct them, a task that the company should not, and may not legally, be able to do. False merger rumors, for example, abound on these boards. Companies must say “No Comment” to any questions about unannounced merger activity or, the courts have ruled, they must always respond accurately. This makes it difficult to have secret negotiations, since any leaks would have to be dignified by the company’s comments.

You can get help from Yahoo and the other providers if there is harm being done. In one case, a message poster falsely took on the name of the company’s CEO. Since Yahoo generally allows anyone to get any unregistered e-mail, they didn’t stop this until they were informed of the ruse. At that point, they took away the e-mail address. But the anonymous nature of posting makes it too easy to lie and deceive.

## Summary

Each company has its basic product or service, and a separate product called *shares*. Treating the customer base for those shares with the same care and attention as those customers for products and services is crucial to success. In terms of cash flow, most Internet companies take in far more cash in their first five years through financing activities than through product sales.



# CHAPTER 12

## Building Strong Brands and Strong Entrepreneurial Companies

**I**n previous chapters, we have shown how to tackle all elements of the marketing mix for entrepreneurial ventures. All of these marketing mix chapters had very similar formats. Regardless of whether the decision was pricing, public relations, advertising, distribution channels, salesforce, or product or service design, the format of the decision-making process was similar. The process began with a given positioning and target market and then asked the role of the marketing mix element in furthering the positioning toward the target market segments? Each marketing mix decision process then described various paradigms for developing mix elements that contributed to the incremental revenue of the venture in comparison to the incremental costs of the marketing mix element. Each chapter emphasizes that the marketing mix elements must be justified based on revenue that they contributed over and above the incremental costs of gaining that revenue.



Given this orientation toward incremental revenue and incremental cost, a reasonable question to ask is: Do these marketing mix procedures contribute to the long-term health of the entrepreneurial venture? Are we performing marketing activities for the short-term that help short-term sales for our products or services, but that will hurt the long-term revenue and profit potential of our venture? These are legitimate questions. To try to answer them, we will turn to an expert on brand equity and building strong brands—David Aaker. Aaker has written two books and many articles on how to manage brands for the long term. His most recent book *Building Strong Brands*<sup>1</sup> has as its goal to guide managers in how to build brands that are strong and will endure and prosper over time. We will examine two major concepts that he uses in the book and see how compatible they are with the entrepreneurial marketing approach we advocate. The two Aaker concepts we will examine are: (1) Why it is hard to build brands, and (2) his ten guidelines for building strong brands. To make our examination come alive, we will use an example of an entrepreneurial company that has been very successful in building a strong brand and strong company.

### **Syngy, Inc.—a Strong, Enduring, Entrepreneurial Company**

The company is Syngy, Inc., “The Incentive Compensation Company.” Mark Stiffler, an MBA from MIT’s Sloan School, founded Syngy in 1991. The firm began as a service to automate the analysis of sales data for pharmaceutical companies. This experience in automating sales analysis led the firm’s customers to ask if Syngy could help in managing their salesforce incentive compensation plans. It was a perennial problem for the pharmaceutical firms and their large salesforces. The compensation plans developed by the sales managers were very difficult to implement because of the large amounts of sales data that needed to be processed to tell whether the salesperson had met a quota or what his or her commission or bonus should be. This was the same sales data that Syngy had been analyzing. Most firms were using mostly manual

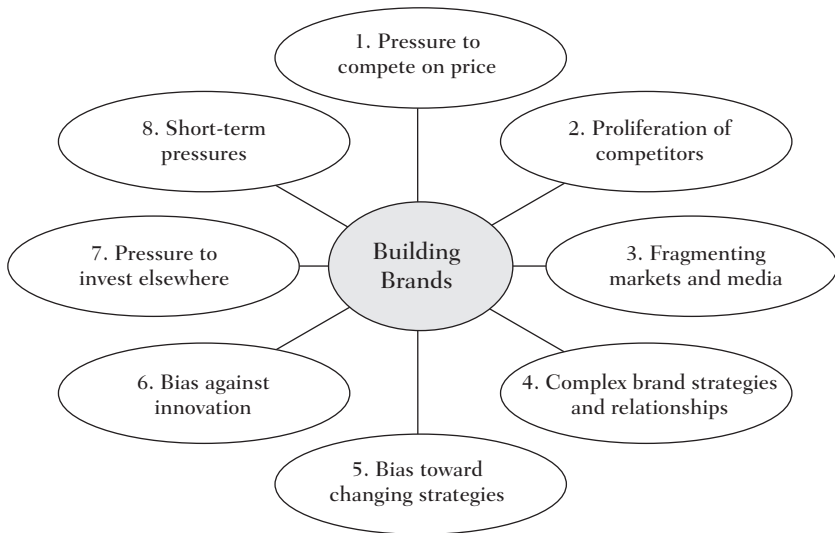
processes that lead to late reports, inaccurate compensation calculations, and salespeople who did not trust the veracity of the numbers on which they were paid. It was a problem that no one had built a business on nor spent much effort against. Many companies were using home-grown systems that were very expensive to build (when all of the real costs were calculated), and very complex to modify if the compensation plan were to change. There was a real need for a more efficient, more valuable approach to the management of compensation plans. Mark and his firm began to develop more and more expertise by becoming the outsourcing vehicle for the administration of plans. They became a group whose expertise grew with each plan they administered. They also developed generalizable computer and information systems to reproduce what their people were doing manually. These systems also were continuously improved. By being very close to their initial customers, they understood how important it was for the plan calculations to be right, but even more importantly to be understandable. The salespeople needed to be able to relate their own actions and effort to how their compensation would be affected. The Synygy team developed over time a series of graphical reports that communicated extremely well to salespeople. Their experience kept building into better and better systems to handle compensation plan administration with a very effective combination of computer systems and expert people. They now do the complete outsourced administration of incentive compensation plans. Since 1991, Synygy has grown fast enough to be on the Inc. 500 list of fastest growing private companies in 1997, 1998, 1999, and 2000.

The only real competition to challenge Synygy (aside from in-house home-grown solutions) has been the recent entry of enterprise software vendors who sell software, but do not provide ongoing plan management services. From its beginnings in the Pharmaceutical industry, Synygy has begun expanding into other industries that employ many salespeople and have incentive compensation as an important part of their plans. As we examine how hard it is to build brands, we will use Synygy, Inc. as an example of a successful strong brand. We will try to understand why Synygy has been able to overcome the obstacles to building an enduring brand and an enduring company.

## Why Is It Hard to Build Brands?

Aaker outlines eight reasons that many companies find it difficult to build strong, enduring brands. His orientation is more toward mass-market consumer products, but the concepts are appropriate for any entrepreneur to consider. Figure 12.1 shows these eight reasons.

We shall reinterpret these reasons from the viewpoint of the entrepreneur who is beginning a new venture or has been operating an entrepreneurial venture. The first reason, *pressure to compete on price*, can cause an entrepreneur to make decisions that are counter to building her brand. A lower price, all other things being equal, signals to the marketplace that the value of the product offering is going down also. However, if the perceived value of the offering compared to competition is not going down, then the entrepreneur should not change her price compared to the competition. Many high-tech market categories have price levels that are continuously decreasing as technology lowers costs for all of the players. However, the strong brands within the category will



**Figure 12.1** Why is it hard to build brands? *Source:* Aaker, David A., *Building Strong Brands* (New York: The Free Press, 1966).

have aspects of their offering that add incremental perceived value versus the competition. This price premium compared to competition based on perceived incremental value is the essence of what excellent entrepreneurial marketing enables. There is no reason to lower this premium unless something else in your marketing mix is changing the perceived value of your offering by the market participants. Dell is an excellent example of a strong brand that has prospered in the face of severe price reductions in its personal computer marketplace. Dell's offering bundle includes several attributes that continue to add perceived incremental value versus their competitors. These attributes include customization of the computer's attributes, simple, easy ordering on the web, an excellent quality and service reputation, and a personal salesforce that has developed a reputation for trust and service in the major business markets that Dell serves. If anything, the price premium that Dell receives is probably increasing over time because the competition has not succeeded in duplicating many of the attributes of Dell's offering that the market values.

Syngy really does not compete on price with anyone for the total outsourcing solution. They do compete with some enterprise software vendors for the software portion of the implementation. However, in order to capitalize on their distinctive competence in complete plan management, Syngy has partnered with their major software competitors to offer the implementation and ongoing administration of the plans using their competitor's software. So, potential customers can buy either a complete solution from Syngy or they can buy software from someone else and pay Syngy to manage the plan. Syngy bases their pricing on a value in use argument. According to a Syngy brochure:

Don't buy software. Don't build systems yourself. Outsource to Syngy. Syngy's incentive compensation solution costs less than building, maintaining, and running a homegrown system, or buying, customizing, and operating packaged software.

Many of our customers have saved millions of dollars. That's because outsourcing to Syngy increases the top line, improves margins, cuts costs, and improves cash flow by eliminating the huge up-front investment in software and hardware.<sup>2</sup>

The second reason for it being hard to build strong brands, *proliferation of competitors*, always makes entrepreneurial life interesting. However, if you are managing the perceived value of your offering versus these competitors, you should fare well. Also, if your initial positioning strategy is soundly based on your distinctive competence that is the source of sustainable competitive advantage, then you should be ready for proliferating competitors.

Syngy was ready to compete when late in 1998 major enterprise software developers such as Oracle Corp., Siebel Systems, or Trilogy began to offer software to manage incentive plans. Because Syngy's software and operating methods had been continuously improved by their experience and because the operational issues of actually managing the plans on an ongoing basis are so difficult, no competitor has yet challenged Syngy for the complete outsourcing solution. These new competitors are also not finding it easy to finish applications that are referenceable. However, that does not mean that Syngy can sit still. As this is being written, they need to increase their salesforce and public relations presence to counteract the lack of perception that Syngy may have in their target markets outside of pharmaceuticals. They have to be concerned as to how the target markets *perceive* Syngy's offerings as opposed to how much better they actually are. In this situation, word of mouth from satisfied customers is the best weapon Syngy has. As long as Syngy continues to build its distinctive competence and increases its ability to be perceived as adding the most value to its target markets, it may be able to stay ahead of its competitors.

We can combine reasons three and four for why it is hard to build brands for an entrepreneur. These relate to *keeping the positioning of the brand consistent regardless of which media or market that is used* and considering *the brand's relationship to other of the firm's brands*. These reasons should typically not be very salient for most entrepreneurial marketers. Most successful ventures are targeting niche markets, not mass markets, so they should be using very targeted media vehicles and public relations. Most entrepreneurial ventures also have only one brand, their first. In many cases, their brand is their company. As they grow, some of these issues may become more salient.

For Synogy, a key strategic issue they faced was the best way to grow. They could expand their services to existing clients by performing other analyses on the same sales data they used for their incentive plan management. These would help the marketing and sales managers to understand the impact of elements of their marketing and sales decisions. They could alternatively expand their incentive plan management offering to other markets than pharmaceuticals. Both of the options were somewhat consistent with the firm's initial positioning and distinctive competence. However, the potential perceived value and distinctiveness of their incentive plan offering was much higher than the analysis services. Synogy correctly decided to prioritize the expansion of their core incentive plan management offering to other target markets. For their current users, they will do further analysis of the sales data as a value-added service. However, Synogy's marketing budget and sales resources are used primarily toward expansion to new customers and new markets, leveraging their core distinctive competence. The tag line "The Incentive Compensation Company" was adopted after Synogy made this strategic decision to strengthen their company and "brand." If Synogy would have known this strategy decision when they named their firm, it would have been more productive to name the company more consistent with its positioning. However, hindsight is clearer than foresight.

In Chapter 9, we used the change in advertising copy that Synogy recently made that increased their short term advertising productivity by over 15 times. This new advertising copy was still consistent with the basic positioning and segmentation strategies of the firm. The advertising just got the point across much more effectively.

Reasons six—*bias toward changing strategies*—and seven—*bias against innovation*—are issues with which entrepreneurs constantly struggle. For many entrepreneurial companies, the issue of developing a scaleable marketing-sales-business model is very difficult. The really successful firms succeed in developing a way of going to market, and getting and serving new customers that becomes routinized and scaleable, like a formula. The founding entrepreneur no longer has to go to close each sale. The company's positioning and perceived value become known well enough in the

market so that sales come somewhat easier. Growth can accelerate quickly when this happens.

However, the entrepreneur can become bored and lose focus. He may want the firm to move into other more interesting products or markets. This changing of strategies can seriously harm the venture; especially if the new products and/or markets are not leveraging the distinctive competence and positioning that have become the heritage of the company. Scarce resources need to be allocated to where they can provide the most long-term value to the firm, not necessarily to the most interesting new idea.

On the other hand, the entrepreneur cannot stand pat with the formula without continuously seeking to improve the firm's perceived value to its customers and leverage its distinctive competence. He must constantly keep ahead of current and potential competition. However, all the innovation should be leveraging the existing positioning and distinctive competence of the firm. If the marketplace needs are changing, then sometimes the positioning and associated product offering needs to adapt to the changing needs. However, the adaptation to the market changes always should be done to leverage the firm's distinctive competence relative to the competition.

Syngy's market needs and competition are constantly changing. We already discussed the new software competition. The market is also moving toward web based systems and applications service providers as new ways to solve information systems problems. The information technology officers at their potential client companies are causing this movement. Syngy is broadening its offering to include different ways of delivering their service. They will provide either a complete outsourced solution, or be an application service provider, or provide just the enterprise software for purchase, or provide the ongoing management and implementation of someone else's software. However all of these options are consistent with its core positioning and leverage their distinctive competence. Syngy knows the "nitty-gritty" of implementing incentive plans to improve their customers' productivity better than anyone. All of their new, broadened offerings are consistent with and leverage that core competence.

The next reason for being hard to build brands, *pressure to invest elsewhere*, may not be as salient for entrepreneurs whose

companies typically have only one brand. The big problem is getting enough to invest in the company's main product offering. Many new Internet companies are spending on their core brands, but they are spending it ineffectively. They are not evaluating the incremental revenue due to the different marketing mix options they can use.

As this is being written, Syngy is taking steps to significantly increase its resources to attack some new market segments before some of their new software competition is able to claim a beachhead.

The last reason is *short-term pressures*. It is sometimes very tempting to sacrifice positioning and the brand's perceived value to do some activity that will help short-term sales and profits. For consumer products, the activities that can cause the most problems are temporary price oriented price promotions. If these promotions are not reinforcing the product offering's targeted perceived value, they can harm this perceived value. If consumers see a brand as always "on sale," it may cheapen its perceived value. Even if such promotions cause some incremental short-term sales and profits, if they are not consistent with the positioning of the brand, they should not be done.

In Chapter 5, we documented what happened to Marantz when they brought in the discount stores to augment their then high-end retail distribution channels. The tactic was very successful short-term, but ruined the company and brand for the long term.

Probably the most common short-term pressure for entrepreneurs in business-to-business markets is from their salespeople to discount their product in order to "close the sale." Here, if the customer does not perceive enough incremental value to justify the normal price, then the salesperson has not done his job, or the customer is not in the target market. Unless the entrepreneur can be confident that the "special" price reduction will not become widely known, then it does not make sense to reduce the price to "close" this one sale. The other potential customers who would have been willing to pay the normal price will no longer be willing, if they learn that someone else has gotten a lower price. Thus, the price received will trend down to match the "special discounts" over time and hurt the long-term profitability of the venture. It is very hard for most entrepreneurs to lose sales, but sometimes it



is the right thing to do, especially if the potential customer will not receive as much value as some other customers. As we show in Chapter 3, a good pricing policy implies that not every potential customer will buy our offering.

Syngy has been able to rapidly grow its business without having to resort to “special” price reductions to get certain clients. They have a given price list to which all companies are subject. Obviously, there are different prices for different numbers of salespeople and for the different levels of service that Syngy can provide.

### **Can Entrepreneurial Marketers Overcome These Eight Difficulties in Building Brands?**

The answer to this question should be obvious. If the entrepreneur has followed the prescriptions in the previous chapters, she will always be building the long-term health of her company and its brands while she simultaneously contributes to the venture’s short-term revenue and profits. Every marketing mix activity and in fact, all venture activities must be consistent with the perceived value the firm wants to deliver to its customers and potential customers. The venture must be dedicated to continuously improving this perceived value versus competition by building and leveraging its distinctive competencies and communicating this value to its target markets.

### **Ten Guidelines for Building Strong Brands**

Aaker provides ten guidelines for building strong brands.<sup>3</sup> These are good guidelines for entrepreneurial marketers in general. However, some of them need to be modified to the circumstances in which most entrepreneurs find themselves. The last guideline, in particular, merits significant modification for entrepreneurs:

1. *Brand identity.* Have an identity for each brand. Consider the perspectives of the brand-as-person, brand-as-organization, and brand-as-symbol, as well as the brand-as-product. Identify the core identity. Modify the identity as needed for different market segments and products. Remember that an image is

how you are perceived, and an identity is how you aspire to be perceived.

2. *Value proposition.* Know the value proposition for each brand that has a driver role. Consider emotional and self-expressive benefits as well as functional benefits. Know how endorser brands will provide credibility. Understand the brand-customer relationship.
3. *Brand position.* For each brand, have a brand position that will provide clear guidance to those implementing a communication program. Recall that a position is the part of the identity and value proposition that is to be actively communicated.
4. *Execution.* Execute the communication program so that it not only is on target with the identity and position but achieves brilliance and durability. Generate alternatives and consider options beyond media advertising.
5. *Consistency over time.* Have as a goal a consistent identity, position, and execution over time. Maintain symbols, imagery, and metaphors that work. Understand and resist organizational biases toward changing the identity, position, and execution.
6. *Brand system.* Make sure the brands in the portfolio are consistent and synergistic. Know their roles. Have or develop silver bullets to help support brand identities and positions. Exploit branded features and services. Use subbrands to clarify and modify. Know the strategic brands.
7. *Brand leverage.* Extend brands and develop cobranding programs only of the brand identity will be both used and reinforced. Identify range brands and, for each, develop an identity and specify how that identity will be different in disparate product contests. If brand is moved up or down, take care to manage the integrity of the resulting brand identities.
8. *Tracking brand equity.* Track brand equity over time, including awareness, perceived quality, brand loyalty, and especially brand associations. Have specific communication objectives. Especially note areas where the brand identity and position are not reflected in the brand image.

9. *Brand responsibility.* Have someone in charge of the brand who will create the identity and position and coordinate the execution over organizational units, media, and markets. Beware when a brand is being used in a business in which it is not the cornerstone.
10. *Invest in brands.* Continue investing in brands even when the financial goals are not being met.

The above guidelines are self-explanatory and should be helpful to entrepreneurs as well as the consumer products corporate types to whom Aaker's book is directed. Guideline 6 about the brand system and 7, brand leverage to new products, may be overkill for most entrepreneurs that have one brand that keeps their hands full. Guideline 8, tracking brand equity, should be observed more in spirit by many entrepreneurs. They should remain close to their existing and potential customers to assess how their product offering's value is being perceived. They should put cost effective means in place to check whether the perceived value of the offering is changing over time. Usually, this would be in the form of customer satisfaction surveys as well as getting periodic readings from potential customers on how they perceive the value of the offering versus its competition.

The last guideline needs some modification for entrepreneurs. In fact, depending how one interprets it, the guideline may not be consistent with research we discussed in Chapter 9. The guideline says to continue to invest in the brand even when the financial goals are not being met. We have discussed research that needs to be considered in this investment decision. That research (on television advertising) basically said that *if the advertising didn't work short term, it had no long-term revenue impact*. It also said that *if the advertising worked in the short term, it had a long-term impact that more than doubled the short-term impact on the average*. There is no academic research that says that this conclusion would be any different for other elements of the marketing mix such as public relations or different media. Thus, the key determination that the entrepreneur needs to make is: Does the investment in my brand have an *incremental impact* on the short-term revenue of the product offering? This incremental impact must be determined relative

to *what revenue would have been had the investment not been made*. If the brand would be going down if the advertising were not done, and its revenue would *go down less* with an advertising program, then the advertising program has a *positive incremental impact*.

Thus, for entrepreneurs, we would modify the last guideline to read: *Continue to invest in the brand as long as the investment has a positive incremental impact on the brand's revenue*. If your brand marketing investments are not impacting revenue compared to what the revenue would have been without the investment, then it won't help either the long-term or the short-term sales for the brand. The entrepreneurial marketing challenge is to continually find investments in the brand that will have short-term incremental impact. In Chapter 9, we outline methods for managing these marketing investments so that they will more likely have the required impact.

## Summary

In this chapter, we have shown how the entrepreneur can simultaneously build short-term revenue and a strong entrepreneurial venture by following the prescriptions in the previous chapters. Entrepreneurs cannot be satisfied to spend money just brand building without having an impact on their revenue. Many advertising and marketing agencies would advocate this unproductive brand building activity. The entrepreneur must resist this advocacy and insist on brand building programs that have an incremental impact. If not, the entrepreneur is throwing her money away with a very high probability. As this is being written, many of the new Internet ventures are throwing away lots of money in "brand building" spending that they have no idea whether is working or not. Effective entrepreneurs should not let this happen. Chapter 9 shows how to manage this process.



# CHAPTER

# 13

## Summary and Conclusions

### **Key Lessons in Entrepreneurial Marketing**

The over-riding concepts that pervade every chapter of this book are those of positioning and target segmentation. At the highest level, the market segments into those two groups who give a company money—customers and investors, and those groups to whom the company gives money—employees, suppliers, and channels. Entrepreneurial companies must use the positioning and segmentation concepts for each of these target markets. The decisions on who is the target market and how the target market will perceive the product/service offering versus the competition is the most important that the entrepreneur will make. These positioning decisions should leverage the entrepreneur's distinctive competence and provide a basis for sustainable competitive advantage. All marketing/sales decisions should support and leverage the positioning and segmentation. This implies focus and discipline—characteristics that entrepreneurs sometimes lack.

Because the perception and reaction of the target market to your product offering is so crucial, concept testing or in-market testing of new product or service ideas is almost always a very

profitable entrepreneurial investment. In today's Internet world, it can be done relatively inexpensively. Often you can combine concept testing with price testing to obtain estimates of market response to different prices.

You should price your product offering to produce the maximum stream of profits over the product's life. It is easier to lower prices over time than to raise them. The initial pricing policy is a crucial decision. Concept testing alternative prices or in-market testing of alternatives is another generally profitable entrepreneurial investment. Pricing is intertwined with the perceived value in use versus competition for B2B and many other products and services. Thus, pricing needs to be supported by all the other elements of the marketing mix. Pricing decisions are typically not given the attention they deserve.

Public relations activities can result in publicity that is perceived as more credible than paid advertising or promotion. For many markets, creating "buzz" is key and needs to be carefully managed. Timing of public relations activities is crucial in the new product/service diffusion process. Professional public relations firms can be very productive versus learning all of the ropes and making all the trade and general press contacts by yourself.

Distribution channel choices can have a very big impact on how your product "offering bundle" is perceived by your target market. Decisions such as direct versus indirect, or exclusive, selective, or intensive distribution channels need careful evaluation. Concept testing with possible channel partners can be a very profitable way to assist in making this evaluation. You must anticipate channel conflict and manage it creatively. Distribution channel decisions should be managed dynamically over time as the markets, competition, and product diffusion changes.

Decisions on how to roll out your product or service are also very important. Choosing the appropriate reference accounts, gaining them, and generating the right referrals is crucial, especially for technology, B2B products, and the newer, or more disruptive product innovation. Using a high-level direct salesforce (usually including the entrepreneur) can be very productive for these situations.

The salesforce should always be adding and reinforcing the perceived value of your product offering. Many times the salesforce is

perceived as part of the offering by your target market. Many of the salesforce decision alternatives (direct versus indirect, deployment, etc.) can be evaluated using in-market experimentation. The direct, personal salesforce should be evaluated versus other options such as telephone sales, or Web sales. There is a big opportunity for both the Inc. 500 CEOs and other entrepreneurs to improve their performance by attempting to evaluate the incremental short- and long-term revenue versus incremental costs of alternative salesforce sizes and deployments. Salesforce compensation needs to match incentives of the salespeople and the entrepreneurial venture. In particular, compensation for obtaining new accounts should usually be different than that for gaining business from existing accounts.

You should resist the temptation to do any promotion, event, or other marketing tactic that will jeopardize your offering's perception in your target markets. Like all other marketing vehicles, these tactics are justified only when the lifetime incremental revenue for the tactic is greater than the lifetime incremental costs attributable to the tactic. Creativity is crucial for these activities and new unique promotional ideas should be sought from very diverse sources. However, before running them broadly, they should be tested and evaluated for their impact on your positioning and on incremental revenues and costs.

Advertising options should be evaluated like other marketing mix elements—incremental revenue produced versus incremental costs over your planning horizon. For advertising, this evaluation may be imprecise, but is almost always better than using out-dated “rules” for managing advertising. In-market advertising testing and carefully evaluating naturally occurring advertising experiments can add much value and productivity. However, the analysis needs to be planned for and the appropriate data gathered and stored so that the analysis can be done. It's best to find very different advertising options by going to creative sources that will be very different from each other.

Many of these marketing concepts and paradigms can be used to hire and retain the best people. Positioning, segmentation, pricing, and marketing mix are all valuable for improving the recruitment and retention processes.

The impact of marketing activities on capital raising can be more important than on incremental revenue for the early stages



of many entrepreneurial ventures. Positioning concepts can impact your perception by potential investors as well as your name and all of your other marketing activities. Segmentation of potential investors is also productive. Exclusive distribution contracts may be a low cost source of investment capital.

In our last chapter, we showed how all of the concepts and paradigms for generating and evaluating marketing mix elements by incremental revenue versus incremental costs are consistent with building strong, enduring brands and companies. Everything the venture does should be consistent and support the “offering bundle” perception by the appropriate target segments.

### **The Best Marketing Decision and Biggest Marketing Mistakes—Survey Results**

Table 13.1 lists all of the responses to the open-ended survey questions on the best marketing decision and the biggest marketing mistakes broken out by Inc. 500 CEOs and local entrepreneurs. Let’s look at the first four groups of answers—those that had the largest percentage of responses. The contrast between the Inc. 500 CEOs and the other entrepreneurs is striking.

Of the Inc. 500 CEOs, 23.2 percent considered their most important marketing decision (either best decision—16.1 percent, or biggest mistake—7.1 percent) to be related to consistently applying good positioning, targeting, and brand development. Only 5 percent of the non-Inc. group had similar concerns. Similarly, 23.2 percent of the Inc. CEOs (17.8 percent + 5.4 percent) put great importance on hiring professional people for sales, marketing, and public relations who were expert in their target markets. Only 10 percent of the non-Inc. group had similar concerns.

On the other hand, 40 percent of the non-Inc. group (32.5 percent + 7.5 percent) were concerned about getting the right marketing tactics—media, public relations, seminars, brochures, direct sales, and so on. Only 14.8 percent of the Inc. 500 CEOs considered these tactical decisions as their best (8.9 percent), or worst (5.9 percent) decisions. Last, 8.9 percent of the Inc. 500 CEOs thought that getting market reaction before broadly introducing their products was their best marketing decision versus none of the

	<b>Inc. 500</b> ( <i>N</i> = 56 responses)	<b>Non-Inc. 500</b> ( <i>N</i> = 40 responses)
Good targeting, positioning, brand development consistently applied	16.1	2.5
Not being consistent/or effectively positioned	7.1	2.5
Hiring professional for marketing, sales, public relations expert in their target markets	17.8	5.0
Not hiring expert professionals	5.4	5.0
Getting the right marketing vehicles (media, public relations, seminars, brochures, direct sales, etc.)	8.9	32.5
Not getting the right vehicles—not testing alternatives early enough	5.9	7.5
Getting market reaction to new products/services, including market research	8.9	0
Not getting market reaction to new product/services	1.8	10
Using the Web well	5.4	10
Using references sells	3.6	5
Spending too much on marketing and sales	1.8	5
Spending enough on marketing and sales	1.8	2.5
Not spending enough on marketing and sales	1.8	5
Good customer service	1.8	0
Not good enough customer service	1.8	2.5
Using indirect distribution channels including strategic alliances	3.6	2.5
Using trade shows a lot	1.8	5
Using direct marketing a lot	1.8	5
Pricing well	1.8	2.5

\* Percentage of Responses for Those Who Answered the Questions—Segregated by Inc. 500 and Non-Inc. 500 Entrepreneurs.

**Table 13.1** The Best Marketing Decisions/The Biggest Marketing Mistakes

non-Inc. group. On the other hand, 10 percent of the non-Inc. group regretted not getting market reaction before introducing their products versus only 1.8 percent of the Inc. 500 CEOs.

How do we interpret these results? First, more of the Inc. 500 CEOs have learned how important targeting and positioning are as cornerstones to all of their marketing and strategy decisions. This is the main point of this book. Positioning and segmentation are the drivers of strategy and marketing tactics. Second, more of the Inc. 500 group have learned that it pays to get market reaction to products and services before spending a great deal of money on them. Third, more of the Inc. 500 CEOs have learned that it pays to hire professional help for key marketing and sales roles.

The non-Inc. group is more concerned with getting a magic, short-term marketing tactic that will work, and not realizing how important it is to have those tactics consistently reinforce the firm's positioning and targeting.

However, just because the Inc. 500 CEOs were more likely to understand the basic messages of this book, does not mean that even they can't improve. The survey responses showed plenty of room for both groups of entrepreneurs to significantly improve their profits by adopting the concepts, methods, and paradigms of this book. We hope that this book will encourage other entrepreneurs to adopt them.

## **The Top Ten Lessons of Entrepreneurial Marketing**

We leave you with a simple summary of the top ten lessons you should bring away from this book:

1. Positioning and target segmentation are the key decisions.
2. In-market testing provides the truest indication of perception and reaction to offerings.
3. Price to maximize total profit stream over the product life.
4. Public relations creates buzz with higher credibility than the same dollars spent on advertising.
5. Anticipate and manage channel conflicts—avoiding them means you are probably missing some channels.

6. Marketing may impact raising capital more than sales in a company's early life.
7. Hiring the best talent pays off—market to potential employees with different messages than products.
8. Events and promotions should be used carefully to avoid jeopardizing the primary offering in the target markets.
9. Advertising options should be tested and evaluated—don't be overly swayed by creative material.
10. Positioning and target segmentation are the key decisions (yes, we've said it twice)!



# Appendix A

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## A Segmentation Audit

	Completely Describes Us (A)	Somewhat Describes Us (B)	Does Not Describe Us At All (C)	Don't Know (D)
1. Our business strategies recognize the need to prioritize target segments.	_____	_____	_____	_____
2. Our marketing plans include specific plans for each of the selected segments.	_____	_____	_____	_____
3. We have specific product and service offerings for each target segments.	_____	_____	_____	_____
4. We have detailed information about segments, including:	_____	_____	_____	_____
a. Current size of the segment	_____	_____	_____	_____
b. Potential size of the segment	_____	_____	_____	_____
c. Key business needs of the segments	_____	_____	_____	_____
d. Information systems needs of the segment	_____	_____	_____	_____
e. Their prioritized needs/benefits sought	_____	_____	_____	_____
f. Their prioritized preference for product and service features	_____	_____	_____	_____
g. Demographic characteristics of the segments	_____	_____	_____	_____
h. Product ownership and usage	_____	_____	_____	_____
i. Competitor's strength in each segment	_____	_____	_____	_____
j. Perceived positioning of each competitor by the members of the segment	_____	_____	_____	_____
5. We have a process for updating the information on our segments on an ongoing basis.	_____	_____	_____	_____
6. Our segments are developed across countries, but recognize unique country requirements and subsegments.	_____	_____	_____	_____

	Completely Describes Us (A)	Somewhat Describes Us (B)	Does Not Describe Us At All (C)	Don't Know (D)
7. Information about the target market segments are incorporated effectively into the following strategies:				
a. Positioning	_____	_____	_____	_____
b. Product and service offering	_____	_____	_____	_____
c. Pricing	_____	_____	_____	_____
d. Promotion	_____	_____	_____	_____
e. Public Relations	_____	_____	_____	_____
f. Advertising	_____	_____	_____	_____
g. Distribution	_____	_____	_____	_____
h. Salesforce	_____	_____	_____	_____
8. We ave an effective process for implementing segmentation research.	_____	_____	_____	_____
9. We have an effective process for implementing segmentation strategies.	_____	_____	_____	_____
10. We have P&L reports and accountability by segment.	_____	_____	_____	_____

Adapted from correspondence of Yoram J. Wind, 1997.





## **Appendix B**

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### Summary of Survey and Findings

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**Summary of Survey Findings**

## 1. Company size.

<b>Number of Employees</b>	<b>Inc.</b>	<b>Non-Inc.</b>
< 50	39.4%	90.7%
51–100	24.2	4.7
101–500	33.3	4.7
501–1000	—	—
1001–3000	3.0	—
> 3001	—	—

## 2. Expected revenue for calendar year 2000.

<b>Expected Revenue</b>	<b>Inc.</b>	<b>Non-Inc.</b>
< 250,000	58.1%	—
250,000–999,999	—	4.7
1,000,000–4,999,999	6.1%	27.9
5,000,000–49,999,999	72.7	9.3
50,000,000–999,999,999	21.2	—
1,000,000,000 or more	—	—

## 3. Years of operation.

<b>Years</b>	<b>Inc.</b>	<b>Non-Inc.</b>
< 1	—	23.7%
1–< 3	—	18.6
3–< 5	11.8%	11.6
5–< 10	79.4	23.7
> = 10	—	23.7

## 4. Revenue growth dynamics.

Percent in 1999 compared to 1998.

	<b>Inc.</b>	<b>Non-Inc.</b>	<b>p-value</b>
Mean	61.44%	71.84%	.7932
Standard Deviation	87.16	195.27	

Percent projected for 2000 versus 1999.

	<b>Inc.</b>	<b>Non-Inc.</b>	<b>p-value</b>
Mean	64.97%	79.88%	.5192
Standard Deviation	81.96	115.43	

Average percent growth for the past 5 years.

	<b>Inc.</b>	<b>Non-Inc.</b>	<b>p-value</b>
Mean	279.94%	32.81%	.0025
Standard Deviation	427.59	66.48	

5. Frequency of marketing activities.

	<b>Inc.</b>		<b>Non-Inc.</b>	
	<b>Not at All</b>	<b>As Many Times as Possible</b>	<b>Not at All</b>	<b>As Many Times as Possible</b>
Product positioning	17.7%	52.9%	41.8%	25.6%
Segmentation studies	52.9	11.8	60.5	2.3
New product testing	29.4	38.2	39.5	20.9
Prelaunch forecasting	32.4	29.4	55.8	13.9
In-market testing of marketing mix elements	52.9	8.8	69.8	11.6

6. Internet use.

	<b>Inc.</b>		<b>Non-Inc.</b>	
	<b>Not at All</b>	<b>As Many Times as Possible</b>	<b>Not at All</b>	<b>As Many Times as Possible</b>
New product testing	58.8%	5.9%	62.8%	16.3%
Promotion offer testing	50.0	17.7	55.8	4.7
Activities that incorporate the Web with bricks and-mortar operations	23.5	38.2	46.5	13.9
Price testing	64.7	5.9	62.8	7.0
Competitive analysis	20.6	29.4	37.2	20.9
Consumer feedback	29.4	32.4	32.6	20.9
Advertising testing	50.0	8.8	46.5	11.6
Promotion of our products	2.9	67.7	30.2	39.5
Promotion of our company	5.9	88.2	25.6	39.5
Distribution of product/company information	0.0	88.2	20.9	46.5
E-commerce	17.7	47.1	44.2	23.3

## 7. Pricing of the very first product or service.

	<b>Inc.</b>	<b>Non-Inc.</b>
Cost-plus	17.7%	39.5%
Value-in-use	32.4	23.3
Going rate	29.4	25.6
Bargaining	5.9	4.7
No specific pricing system	5.9	0.0
Other	2.9	4.7

## 8. Current pricing.

	<b>Inc.</b>	<b>Non-Inc.</b>
Cost-plus	23.5%	41.9 %
Value-in-use	52.9	23.3
Going rate	20.6	27.9
Bargaining	2.9	9.3
No specific pricing system	0.0	0.0
Other	2.9	7.0

9. Did you use concept testing for your *first* product?

- a. 32.4 percent of Inc. companies said yes.
- b. 32.6 percent of non-Inc. companies said yes.

## 10. Do you typically test your concepts at different price levels before introduction?

	<b>Inc.</b>	<b>Non-Inc.</b>
Always	0.0%	9.3%
Sometimes	17.7	20.9
Never	50.0	67.4

## 11. Do you test alternative prices in test markets before introduction?

	<b>Inc.</b>	<b>Non-Inc.</b>
Always	0.0%	4.7%
Sometimes	29.4	23.3
Never	67.7	69.8

## 12. Determining the advertising budget.

	<b>Inc.</b>		<b>Non-Inc.</b>	
	<b>Never</b>	<b>Most of the Time</b>	<b>Never</b>	<b>Most of the Time</b>
What my company can afford	14.7	29.4	7.0	65.1
Current or anticipated sales and /or profits	14.7	41.2	30.2	16.3
Competitors' expenditures	55.9	0.0	60.5	0.0
Market tests	52.9	2.9	58.1	4.7
Analysis of past successes and failures	8.8	26.5	14.0	23.3
Advertising goals	20.6	23.5	30.2	18.6
Forecasted incremental sales versus incremental advertising costs	29.4	20.6	58.1	4.7
Other	0.0	5.9	0.0	4.7

## 13. Number of campaign alternatives generated for the last ad campaign.

	<b>Inc.</b>	<b>Non-Inc.</b>
0	17.7%	14.0%
1	14.7	11.6
2	8.8	4.7
> 3	20.6	21.0
Average	1.52	1.57
Standard deviation	1.25	1.29

## 14. Type of salesforce.

	<b>Inc.</b>	<b>Non-Inc.</b>
Direct	82.3%	55.8%
Indirect	11.8	9.3
No salesforce	11.8	27.9
Other	0.0	0.0

## 15. How did you decide on the number of salespeople needed?

	<b>Inc.</b>		<b>Non-Inc.</b>	
	<b>Never</b>	<b>Most of the Time</b>	<b>Never</b>	<b>Most of the Time</b>
Selling expense as percentage of sales and average cost of salesperson	38.2%	17.7%	27.9%	16.3%
Forecasted sales and average revenues generated per salesperson	17.7	47.0	23.3	16.3
Market response	23.5	17.7	32.6	7.0
Forecasted incremental sales versus sales costs	11.8	5.9	32.6	0.0
Gut feel or judgment	11.8	35.3	16.3	16.3
Other	5.9	2.9	7.0	11.6

## 16. Salespeople compensation.

	<b>Inc.</b>	<b>Non-Inc.</b>
Commission	70.6%	46.5%
Straight salary	58.8	37.2
Achievement recognition programs	20.6	14.0
Contests and prizes	23.5	11.6
Noncash awards	17.7	4.6
Compensation—new business versus old accounts	26.5	7.0
Different commission for different products	23.5	14.0
Commission based on prior year growth	5.9	4.7
No limit on compensation	50.0	20.9
Other	2.9	9.3

## 17. CEO's monthly time spent on public relations.

	<b>Inc.</b>	<b>Non-Inc.</b>
< = 5	32.4%	34.9%
6–10	29.4	21.0
11–20	17.7	27.9
> 20	11.8	16.3

## 18. Senior management monthly time spent on public relations.

	<b>Inc.</b>	<b>Non-Inc.</b>
< = 5	35.3%	48.8%
6–10	29.4	16.3
11–20	17.7	9.3
> 20	11.8	11.6

## 19. Yearly public relations budget as a percentage of annual revenues.

	<b>Inc.</b>	<b>Non-Inc.</b>
Mean	1.04%	3.5%
Standard deviation	1.23	5.53

## 20. Yearly marketing budget as a percentage of annual revenue.

	<b>Inc.</b>	<b>Non-Inc.</b>
Mean	5.41%	8.05%
Standard deviation	5.4	7.5

21. Is marketing budget increasing or decreasing over the years?

	<b>Inc.</b>	<b>Non-Inc.</b>
Increasing	82.4%	67.4%
Decreasing	5.9	7.0
Steady	11.8	18.6

22. How confident are you about the contribution of these marketing components to your incremental revenue?

	<b>Inc.</b>		<b>Non-Inc.</b>	
	<b>Very Confident and Confident</b>	<b>Not Confident and Very Uncertain</b>	<b>Very Confident and Confident</b>	<b>Not Confident and Very Uncertain</b>
Salesforce	82.4%	0.0%	55.8%	14.0%
Advertising	35.3	23.5	53.5	9.3
Public relations	47.0	29.4	51.2	9.3
Branding activities	52.9	14.7	23.3	16.3
Trade shows	38.2	17.7	44.2	16.3
Promotions	50.0	20.6	34.9	16.3
Web	58.1	5.9	44.2	18.6
Market research	17.7	47.0	30.2	20.9
Concept testing	8.8	64.7	20.9	34.9

\* Findings based on e-mail survey of CEOs of 400 companies on the 1999 Inc. 500 list and mail survey of 250 CEOs from the Wharton School's SBDC network. Results summarized for 34 Inc. respondents and 43 SBDC (non-Inc.) respondents.



**Entrepreneurial Marketing Inc. 500 Study**

Thank you very much for your interest in our study. Please complete the following form to participate in the study. We would like to assure you that the information you give us will be completely confidential and only data at the aggregated level will be reported. Data on individual companies will never be released without prior written consent from the company concerned.

We are interested in your opinions and application of various marketing concepts, methods, and paradigms. Your answers will be used to help other entrepreneurs to learn from your experiences.

As a thank you for your help, we will promptly send you a summary of the results of this study. We hope you can also learn from the experiences of other entrepreneurs. Please be as honest to yourself in your answers as possible.

This survey takes less than 15 minutes to complete. Please try to complete the whole survey. We really appreciate your cooperation and thank you in advance.

First, some information we will use for statistical purposes only.

1. The size of your company is:
 

<input type="checkbox"/> \$250,000 to less than \$1 million	<input type="checkbox"/> \$50 million to less than \$1 billion
<input type="checkbox"/> 50 employees or less	<input type="checkbox"/> 501 to 1,000 employees
<input type="checkbox"/> 51 to 100 employees	<input type="checkbox"/> 1001 to 3,000 employees
<input type="checkbox"/> 101 to 500 employees	<input type="checkbox"/> More than 3,001 employees
  
2. The expected revenue for the calendar year 2000 is:
 

<input type="checkbox"/> Less than \$250,000	<input type="checkbox"/> \$5 million to less than \$50 million
<input type="checkbox"/> \$250,000 to less than \$1 million	<input type="checkbox"/> \$50 million to less than \$1 billion
<input type="checkbox"/> \$1 million to less than \$5 million	<input type="checkbox"/> \$1 billion or more
  
3. Number of years your company has been in operation:
 

<input type="checkbox"/> Less than 1	<input type="checkbox"/> 5 to less than 10
<input type="checkbox"/> 1 to less than 3	<input type="checkbox"/> 10 years or more
<input type="checkbox"/> 3 to less than 5	
  
4. Revenue growth dynamics of our company (i.e., +200%, -50%)
 

	% 1999 compared to calendar year 1998
	% projected for calendar year 2000 versus 1999
	% approximate average annual growth for past 5 years
  
5. How often do you conduct the following marketing activities?

	Not at All	Sometimes	As Many Times as Possible
Product positioning	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Segmentation studies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
New product testing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Prelaunch forecasting	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
In-market testing of marketing mix elements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

6. How do you use the Internet? Please check the appropriate answer.

<b>We use Web-based:</b>	<b>Not at All</b>	<b>Sometimes</b>	<b>As Many Times as Possible</b>
New product testing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Promotion offer testing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Activities that incorporate the Web with bricks-and-mortar operations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Price testing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Competitive analysis	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Consumer feedback	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Advertising testing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Promotion of our products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Promotion of our company	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Distribution of product/company information	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
E-commerce	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

7. Let us discuss pricing decisions made by your company. How did you price your *very first* product or service? Please select the most suitable letter from the choices below:

- a. Cost-plus (cost oriented)
- b. Value-in-use (perceived value pricing)
- c. Going-rate (imitative) pricing
- d. Bargaining, price negotiations
- e. No specific pricing system
- f. Other (please specify) \_\_\_\_\_

8. And how do you price your product currently? Please select the most suitable letter from the choices above: \_\_\_\_\_

9. For the very first product/service that you launched, did you do concept testing? (Concept testing is exposing the product concept to consumers and asking purchasing intent.)

- Yes                       No

10. Do you typically test your concepts at different price levels before introduction?

- Always                       Sometimes                       Never

11. Do you market test alternative prices in test markets before introduction?

- Always                       Sometimes                       Never

12. Let us now discuss your company’s advertising. How do you usually determine your advertising budget? Select the most appropriate answer.

	Never	Sometimes	Most of the Time
Based on what my company can afford	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Based on current or anticipated sales and/or profits	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Based on the expenditures or competitors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Based on market tests	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Based on analysis of past successes and failures	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Based on advertising goals and required tasks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Based on forecasted incremental sales versus the incremental advertising costs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other (please specify) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

13. Consider the last advertising campaign you ran: (Skip this question if you didn’t do any advertising). How many other alternative ad campaigns were generated and evaluated before the one campaign was chosen?

0 \_\_\_\_\_ 1 \_\_\_\_\_ 2 \_\_\_\_\_ 3 or more \_\_\_\_\_

14. Let us now discuss your sales force. Which of the following best describes your salesforce?

- Direct  Don’t have a sales force (please skip the next two questions)
- Indirect
- Other (please specify) \_\_\_\_\_

15. How do you decide on the number of salespeople you need?

	Never	Sometimes	Most of the Time
Based on selling expenses as percentage of sales and average cost of salesperson	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Based on forecasted sales and average revenues generated by a salesperson	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Based on market response (e.g., inquiry calls per year)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Based on forecasted incremental sales versus incremental sales costs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Gut feel or judgment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Other (please specify) _____	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

16. How do you compensate your salespeople? Please select all that apply.
- Commissions
  - Straight salary
  - Achievement recognition programs
  - Contests and prizes
  - Noncash awards
  - Compensation is different, depending on whether new business is being generated or existing accounts are being serviced
  - Different commission rates for different products
  - Different commission rates depending on growth from prior year
  - Salespeople compensation is not limited to a maximum
  - Other (please specify) \_\_\_\_\_
17. If your estimate, how much of the CEO's time is typically spent on public relations activities per month?
- 5 hours or less       11 to 20 hours
  - 6 to 10 hours       more than 20 hours
18. In your estimate, how much other senior management time is typically spent on public relations activities per month?
- 5 hours or less       11 to 20 hours
  - 6 to 10 hours       more than 20 hours
19. Approximately, what is your yearly public relations budget (as a percent of annual revenue)?  
 \_\_\_\_\_ %
20. Approximately, what your yearly marketing budget (as a percent of annual revenue)?  
 \_\_\_\_\_ %
21. Would you say that your marketing budget is increasing or decreasing over the years?
- Increasing
  - Decreasing
  - Steady
22. How confident are you about the contribution of these marketing components to your incremental revenue?

	<b>Very Confident</b>	<b>Confident</b>	<b>Neutral</b>	<b>Not Confident</b>	<b>Very Uncertain</b>
Marketing research	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Salesforce	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Advertising	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Public relations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Branding activities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Trade shows	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Promotions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Use of the Web	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Marketing research	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Concept testing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

23. Do you think you have made any *marketing* mistakes while running this business? If so, please describe your biggest *marketing* mistake.

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24. Please describe what you think is the best *marketing* decision you have made.

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25. Is there anything else you would like to add?

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To complete this survey, please provide us with the following information that will help us for identification purposes only.

Company name \_\_\_\_\_

Address \_\_\_\_\_

City \_\_\_\_\_ State \_\_\_\_\_ Zip \_\_\_\_\_

Phone \_\_\_\_\_ Fax \_\_\_\_\_ Your e-mail \_\_\_\_\_

Company URL (if applicable) \_\_\_\_\_

**Thank you very much for your help.  
We will send you a results summary shortly.**

# Notes

## Chapter 1

1. Some of these segmentation questions come from personal discussions and correspondence with Professor Yoram Wind of the Wharton School.
2. Robert McMath and Tom Forbes, "Look Before You Leap," *Entrepreneur*, April 1998, pp. 135–139.
3. *Ibid.*, p. 135.
4. Susan Greco, "Reeling Them In," *Inc. Magazine*, January 1998, p. 52.
5. *Ibid.*
6. R.W. Keidel, *Wall Street Journal*, June 16, 1997, p. B1.

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2. *Ibid.*
3. Michael Hay, Paul Verdin, and Peter Williamson, "Successful New Ventures: Lessons for Entrepreneurs and Investors," *Long Range Planning*, 1993, 26, no. 5, pp. 31–41.
4. *Ibid.*, p. 36.
5. *Ibid.*, p. 38.

## Chapter 3

1. This is a disguised real example from the author's experience. The data have been slightly altered to protect confidentialities.
2. Irwin Gross, Presentation at the Wharton School, March 1999.
3. *Ibid.*
4. *Ibid.*
5. *Ibid.*
6. SAS Institute white paper, "SAS Institute Business Model," 1998, Cary, NC, p. 3.
7. *Ibid.*, p. 4.

8. Ibid.
9. Ibid.
10. Charles Fishman, "Sanity, Inc.," *Fast Times*, January 1999, p. 87.
11. Ibid., p. 96.

## Chapter 5

1. Leyland Pitt, Pierre Berthon, and Jean-Paul Berthon, "Changing Channels: The Impact of the Internet on Distribution Strategy," *Business Horizons*, March–April 1999, pp. 19–28.
2. Ibid., p. 20.
3. Jillian M. Marcus, "Eight Legs and an Amazing Feat," Harvard Business School, 1994, Note 394-044.
4. Leigh Gallagher, "Runner's World," *Forbes*, February 22, 1999, pp. 96, 98.
5. Ibid., p. 98.
6. Ibid.
7. Ibid.
8. Some of these advantages and disadvantages come from discussions with Craig Tractenberg, an experienced franchise attorney with Buchanan, Ingersoll in Philadelphia, 1999.
9. Ritasice.com Web site, 1999.
10. Personal communication with Leonard Lodish, 1999.
11. Rochelle Garner, "Mad as Hell," *Sales and Marketing Management*, June 1999, p. 55.
12. Ibid., p. 58.
13. Ibid.
14. Ibid., pp. 58, 59.
15. James R. Hagery, "Ethan Allen's Revolutionary Path to Web," *Wall Street Journal*, July 29, 1999, p. B1.
16. Ibid.

## Chapter 6

1. Geoffrey A. Moore, *Crossing the Chasm* (New York: Harper Business, 1995), p. 37.
2. Ibid.

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