Part 4: Creating Value

Chapter 9

Setting Product Strategy and Introducing New Offerings

In this chapter, we will address the following questions:

1. What are the characteristics of products, and how do marketers classify products? (Page 139)
2. How can companies differentiate products? (Page 140)
3. How can a company build and manage its product mix and product lines? (Page 142)
4. How can companies use packaging, labeling, warranties, and guarantees as marketing tools? (Page 145)
5. What strategies are appropriate for introducing new offerings and influencing adoption? (Page 146)
6. What strategies are appropriate in different stages of the product life cycle? (Page 152)

Marketing Management at Lexus

Since its inception in 1989, Lexus has emphasized top-notch product quality and customer care, as reflected by its long-time slogan, "The Relentless Pursuit of Perfection." As part of its "Lexus Covenant," it has vowed to "have the finest dealer network in the industry, and treat each customer as we would a guest in our own home." To this end, Lexus built its dealership framework from the ground up, hand-picking dealers committed to providing exceptional experience to customers, a system competitors acknowledge is the industry ideal. With its average buyer in his or her mid-50s, Lexus has set its sights on attracting younger buyers by emphasizing more aggressive styling, handling dynamics, and driver engagement. Social media and other promotions and events also create novel customer experiences around food, fashion, entertainment, and travel.[1]

At the heart of a great brand is a great product offering, which customers judge on three basic elements: product features and quality, service mix and quality, and price. In this chapter we examine product strategy, new product development, and the product life cycle. Chapter 10 explores services, and Chapter 11 discusses price.

Product Characteristics and Classifications

A **product** is anything that can be offered to a market to satisfy a want or need, including physical goods, services, experiences, events, persons, places, properties, organizations, information, and ideas.

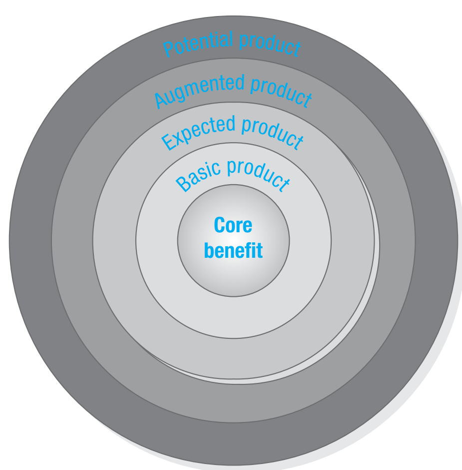
Product Levels: The Customer-Value Hierarchy

In planning its market offering, the marketer needs to address five product levels (see Figure 9.1).[2] Each level adds more customer value, and together the five constitute a **customer-value hierarchy.** The fundamental level is the *core benefit*: the service or benefit the customer is really buying. A hotel guest is buying rest and sleep. Marketers must see themselves as benefit providers. At the second level, the marketer must turn the core benefit into a *basic product*. Thus, a hotel room includes a bed, bathroom, and towels. At the third level, the marketer prepares an *expected product*, a set of attributes and conditions buyers normally expect when they purchase this product. Hotel guests expect a clean bed, fresh towels, and so on.

At the fourth level, the marketer prepares an *augmented product* that exceeds customer expectations. In developed countries, brand positioning and competition take place at this level. At the fifth level stands the *potential product*, with all the possible augmentations and transformations the product or offering might undergo in the future. Here companies search for new ways to satisfy customers and distinguish their offering.

Differentiation arises and competition increasingly occurs on the basis of product augmentation. Each augmentation adds cost, however, and augmented benefits soon become expected benefits in the category. As some companies raise the price of their augmented product, others

FIGURE 9.1 Five Product Levels



offer a stripped-down version for less. Marketers must be sure, however, that consumers not see lower quality or limited capability versions as unfair.[3]

Product Classifications

Marketers classify products on the basis of durability, tangibility, and use (consumer or industrial). Each type has an appropriate marketing-mix strategy.[4]

- **Durability and tangibility.** *Nondurable goods* are tangible goods (such as shampoo) normally consumed in one or a few uses. Because these are purchased frequently, the appropriate strategy is to make them available in many locations, charge a small markup, and advertise to induce trial and build preference. *Durable goods* are tangible goods (such as refrigerators) that survive many uses, require more personal selling and service, command a higher margin, and require more seller guarantees. *Services* are intangible, inseparable, variable, and perishable products (such as haircuts) that normally require more quality control, supplier credibility, and adaptability.
- **Consumer-goods classification.** Classified on the basis of shopping habits, these include **convenience goods** (such as soft drinks) that are purchased frequently, immediately, and with minimal effort; **shopping goods** (such as furniture) that consumers compare on such bases as suitability, quality, price, and style; **specialty goods** (such as cars) with unique characteristics or brand identification for which enough buyers are willing to make a special purchasing effort; and **unsought goods** (such as smoke detectors) that the consumer does not know about or normally think of buying.
- **Industrial-goods classification.** *Materials and parts* are goods that enter the manufacturer's product completely. *Raw materials* can be either *farm products* (wheat) or *natural products* (iron ore). *Manufactured materials and parts* fall into two categories: component materials (wires) and component parts (small motors). **Capital items** are long-lasting goods that facilitate developing or managing the finished product, including *installations* (factories) and *equipment* (tools). *Supplies and business services* are short-term goods and services that facilitate developing or managing the finished product.

Differentiation

To be branded, product offerings must be differentiated. At one extreme are products that allow little variation: chicken and steel. Yet even here some differentiation is possible: Perdue chickens and India's Tata Steel have carved out distinct identities in their categories. At the other extreme are products capable of high differentiation, such as automobiles, commercial buildings, and furniture.

Product Differentiation

Means for differentiation include form, features, performance quality, conformance quality, durability, reliability, repairability, style, and customization.[5] As discussed below, design is also a means for differentiation.

- **Form. Form** refers to the size, shape, or physical structure of a product. For example, aspirin can be differentiated by dosage size, shape, color, coating, or action time.
- **Features.** Most products can be offered with varying **features** that supplement their basic function. A company can identify and select new features by surveying recent buyers and then calculating *customer value* versus *company cost* for each potential feature. Marketers

should consider how many people want each feature, how long it would take to introduce it, and whether competitors could easily copy it.[6]

- **Performance quality. Performance quality** is the level at which the product's primary characteristics operate. Firms should design a performance level appropriate to the target market and competition (not necessarily the highest level possible) and manage performance quality through time.
- **Conformance quality.** Buyers expect a high **conformance quality,** the degree to which all produced units are identical and meet promised specifications. A product with low conformance quality will disappoint some buyers.
- **Durability.** *Durability*, a measure of the product's expected operating life under natural or stressful conditions, is a valued attribute for durable goods. The extra price for durability must not be excessive, and the product must not be subject to rapid technological obsolescence.
- **Reliability.** Buyers normally will pay a premium for *reliability,* a measure of the probability that a product will not malfunction or fail within a specified period.
- **Repairability.** *Repairability* measures the ease of fixing a product when it malfunctions or fails. Ideal repairability would exist if users could fix the product themselves with little cost in money or time.
- **Style.** *Style* describes the product's look and feel to the buyer and creates distinctiveness that is hard to copy, although strong style does not always mean high performance. Style plays a key role in the marketing of many brands, such as Apple's tablets.
- **Customization.** Customized products and marketing allow firms to be highly relevant and differentiating by finding out exactly what a person wants and delivering on that. Customized products include M&M's with specialized messages and Burberry coats with customer-selected fabric and accessories.[7]

Services Differentiation

When the physical product cannot easily be differentiated, the key to competitive success may lie in adding valued services and improving their quality. The main service differentiators are:

- **Ordering ease.** How easy is it for the customer to place an order with the company?
- **Delivery.** How well is the product or service brought to the customer, including speed, accuracy, and care throughout the process?
- **Installation.** How is the product made operational in its planned location? This is a true selling point for buyers of complex products like heavy equipment.
- **Customer training.** How does the supplier teach a customer's employees to use new equipment properly and efficiently?
- **Customer consulting.** What data, information systems, and advice services can companies sell to buyers?
- **Maintenance and repair.** How can companies help customers keep purchased products in good working order? These services are critical in business-to-business settings and with luxury products.

Design Differentiation

As competition intensifies, design offers a potent way to differentiate and position a company's products and services. **Design** is the totality of features that affect the way a product looks, feels, and functions to a consumer. It offers functional and aesthetic benefits and appeals to both our rational and emotional sides.[8] As holistic marketers recognize the emotional power of design and the importance to consumers of look and feel as well as function, design is exerting a stronger influence in categories where it once played a small role. To the company, a well-designed product is easy to manufacture and distribute. To the customer, it is pleasant to look at and easy to open, install, use, repair, and dispose of.

Product and Brand Relationships

Each product can be related to other products to ensure that a firm is offering and marketing the optimal set of products.

The Product Hierarchy

The product hierarchy stretches from basic needs to particular items that satisfy those needs. A **product system** is a group of diverse but related items that function in a compatible manner.[9] A **product mix** (also called a **product assortment**) is the set of all products and items a particular firm offers for sale. A product mix consists of various product lines. As shown in Table 9.1, a company's product mix has a certain width, length, depth, and consistency. The table shows these concepts for selected Procter & Gamble products.

The *width* of a product mix refers to how many different product lines the company carries. Table 9.1 shows a product mix width of five lines (only a portion of what Procter & Gamble offers). The *length* of a product mix refers to the total number of items in the mix. The *depth* of a product mix refers to how many variants are offered of each product in the line. The *consistency* of the product mix describes how closely related the various product lines are in end use, production requirements, distribution channels, or some other way.

These product mix dimensions permit the company to expand its business in four ways. It can add new product lines, thus widening its product mix; lengthen each product line; add more

TABLE 9.1 Product Mix Width and Product Line Length for Procter & Gamble Products (including year of introduction)

	Product Mix Width				
	Detergents	**Toothpaste**	**Bar Soap**	**Disposable Diapers**	**Paper Products**
Product Line Length	Ivory Snow (1930)	Gleem (1952)	Ivory (1879)	Pampers (1961)	Charmin (1928)
	Dreft (1933)	Crest (1955)	Camay (1926)	Luvs (1976)	Puffs (1960)
	Tide (1946)		Zest (1952)		Bounty (1965)
	Cheer (1950)		Safeguard (1963)		
	Dash (1954)		Oil of Olay (1993)		
	Bold (1965)				
	Gain (1966)				
	Era (1972)				

product variants to deepen its product mix; and pursue more product line consistency. To make these product decisions, marketers conduct product line analysis.

Product Line Analysis

In offering a product line, companies normally develop a basic platform and modules that can be added to meet different customer requirements, the way car manufacturers build vehicles around a basic platform. Product line managers need to know the sales and profits of each item in each line to determine which ones to build, maintain, harvest, or divest.[10] They also need to understand each line's market profile and image.[11] Marketers can use a *product map* to see which competitors' items are competing against their own items and to identify market segments so they can gauge how well their items are positioned to serve the needs of each segment.

Product Line Length

Companies seeking high market share and market growth will generally carry longer product lines. Those emphasizing high profitability will carry shorter lines of carefully chosen items. However, consumers are increasingly weary of dense product lines, overextended brands, and feature-laden products (see "Marketing Insight: When Less Is More").[12]

marketing insight — When Less Is More

With thousands of new products introduced each year, consumers find it ever harder to navigate store aisles. One study found the average shopper spent 40 seconds or more in the supermarket soda aisle, compared with 25 seconds six or seven years ago. Although consumers may think greater product variety increases their likelihood of finding the right product for them, the reality is often different. According to research, when presented with too many options, people "choose not to choose," even if it may not be in their best interests.

Similarly, if product quality in an assortment is high, consumers actually prefer fewer choices. Those with well-defined preferences may benefit from more-differentiated products that offer specific benefits, but others may experience frustration, confusion, and regret. Also, constant product changes and introductions may nudge customers into reconsidering their choices and perhaps switching to a competitor's product. It's not just product lines making consumer heads spin—many products themselves are too complicated. Technology marketers need to be especially sensitive to the problems of information overload.

Sources: John Davidson, "One Classic Example of When Less Is More," *Financial Review*, April 9, 2013; Carolyn Cutrone, "Cutting Down on Choice Is the Best Way to Make Better Decisions," *Business Insider*, January 10, 2013; Dimitri Kuksov and J. Miguel Villas-Boas, "When More Alternatives Lead to Less Choice," *Marketing Science*, 29 (May/June 2010), pp. 507–24; Kristin Diehl and Cait Poynor, "Great Expectations?! Assortment Size, Expectations, and Satisfaction," *Journal of Marketing Research* 46 (April 2009), pp. 312–22; Joseph P. Redden and Stephen J. Hoch, "The Presence of Variety Reduces Perceived Quantity," *Journal of Consumer Research* 36 (October 2009), pp. 406–17; Alexander Chernev and Ryan Hamilton, "Assortment Size and Option Attractiveness in Consumer Choice Among Retailers," *Journal of Marketing Research* 46 (June 2009), pp. 410–20; Richard A. Briesch, Pradeep K. Chintagunta, and Edward J. Fox, "How Does Assortment Affect Grocery Store Choice," *Journal of Marketing Research* 46 (April 2009), pp. 176–89; Susan M. Broniarczyk, "Product Assortment," Curt P. Haugtvedt, Paul M. Herr, and Frank R. Kardes, eds., *Handbook of Consumer Psychology* (New York: Taylor & Francis, 2008), pp. 755–79.

A company lengthens its product line in two ways: line stretching and line filling. *Line stretching* occurs when a company lengthens its product line beyond its current range. A firm may choose a down-market stretch—introducing a lower-priced line—to attract shoppers who want value-priced goods, battle low-end competitors, or avoid a stagnating middle market. With an up-market stretch, the firm aims to achieve more growth, realize higher margins, or simply position itself as a full-line manufacturer. Companies serving the middle market might stretch their line in both directions.

With *line filling*, a firm lengthens its product line by adding more items within the present range. The goals are to reach for incremental profits, satisfy dealers who complain about lost sales because of items missing from the line, utilize excess capacity, try to become the leading full-line company, and plug holes to keep out competitors.

Line Modernization, Featuring, and Pruning

Product lines need to be modernized. In rapidly changing markets, modernization is continuous. Companies plan improvements to encourage customer migration to higher-value, higher-price items. Marketers want to time improvements so they do not appear too early (damaging sales of the current line) or too late (giving the competition time to establish a strong reputation).[13] The firm typically selects one or a few items in the line to feature, possibly a low-priced item to attract customers or a high-end item for prestige. Multi-brand companies all over the world try to optimize their brand portfolios, ensuring that every product in a line plays a role. This often means focusing on core brand growth and concentrating resources on the biggest and most established brands.

Product Mix Pricing

Marketers must modify their price-setting logic when the product is part of a product mix. In **product mix pricing,** the firm searches for a set of prices that maximizes profits on the total mix. The process is challenging because the various products have demand and cost interrelationships and are subject to different degrees of competition. We can distinguish six situations calling for product mix pricing, as shown in Table 9.2.

TABLE 9.2 Product Mix Pricing Situations

1. ***Product line pricing.*** The seller introduces price steps within a product line and strives to establish perceived quality differences that justify the price differences.
2. ***Optional-feature pricing.*** The seller offers optional products, features, and services with the main product, the way automakers offer different trim levels. The challenge is which options to include in the standard price and which to offer separately.
3. ***Captive-product pricing.*** Some products require the use of ancillary or *captive products.* Manufacturers of razors often price them low and set high markups on razor blades, the captive product. If the captive product is priced too high, however, counterfeiting and substitutions can erode sales.
4. ***Two-part pricing.*** Many service firms charge a fixed fee plus a variable usage fee. Cell phone users often pay a monthly fee plus charges for calls that exceed their allotted minutes. The challenge is deciding how much to charge for basic service and variable usage.
5. ***By-product pricing.*** The production of certain goods (such as meats) often yields by-products that should be priced on their value. Income from the by-products will make it easier for the company to charge less for its main product if competition forces it to do so.
6. ***Product-bundling pricing.*** *Pure bundling* occurs when a firm offers its products only as a bundle. In *mixed bundling*, the seller offers goods both individually and in bundles, normally charging less for the bundle than for the items purchased separately. Savings on the price bundle must be enough to induce customers to buy it.

Co-Branding and Ingredient Branding

Marketers often combine their products with products from other companies in various ways. In **co-branding**—also called dual branding or brand bundling—two or more well-known brands are combined into a joint product or marketed together in some fashion. One form of co-branding is *same-company co-branding,* as when General Mills advertises Trix cereal and Yoplait yogurt. Other forms are *joint-venture co-branding, multiple-sponsor co-branding*, and *retail co-branding.* For co-branding to succeed, the brands must separately have brand equity—adequate brand awareness and a sufficiently positive brand image.

The main advantage of co-branding is that a product can be convincingly positioned by virtue of the multiple brands, generating greater sales from the existing market and opening opportunities for new consumers and channels. It can also reduce the cost of product introduction because it combines two well-known images and speeds adoption. And co-branding may be a valuable means to learn about consumers and how other companies approach them. The potential disadvantages are the risks and lack of control in becoming aligned with another brand. Consumer expectations of co-brands are likely to be high, so unsatisfactory performance could have negative repercussions for both brands. Also, consumers may feel less sure of what they know about the brand.[14]

Ingredient branding is a special case of co-branding.[15] It creates brand equity for materials, components, or parts that are necessarily contained within other branded products. For host products whose brands are not that strong, ingredient brands can provide differentiation and important signals of quality.[16] An interesting take on ingredient branding is *self-branded ingredients* that companies advertise and even trademark.[17] Westin Hotels advertises its own "Heavenly Bed"—an important ingredient for a guest's good night's sleep. Ingredient brands try to create enough awareness and preference so consumers will not buy a host product that doesn't contain it.

What are the requirements for successful ingredient branding?[18]

1. Consumers must believe the ingredient matters to the performance and success of the end product. Ideally, this intrinsic value is easily seen or experienced.
2. Consumers must be convinced that not all ingredient brands are the same and that the ingredient is superior.
3. A distinctive symbol or logo must clearly signal that the host product contains the ingredient. Ideally, this symbol or logo functions like a "seal" and is simple and versatile, credibly communicating quality and confidence.
4. A coordinated "pull" and "push" program must help consumers understand the advantages of the branded ingredient. Channel members must offer full support such as consumer advertising and promotions and—sometimes in collaboration with manufacturers—retail merchandising and promotion programs.

Packaging, Labeling, Warranties, and Guarantees

Many marketers have called packaging a fifth P, along with price, product, place, and promotion. Most, however, treat packaging and labeling as an element of product strategy. Warranties and guarantees can also be an important part of the product strategy.

Packaging

Packaging includes all the activities of designing and producing the container for a product. Packages might have up to three layers: a primary package inside a secondary package, with one or more packaged units sent in a shipping package. Packaging is important because it is the buyer's first encounter with the product. A good package draws the consumer in and encourages product choice. Distinctive packaging like that for Altoids mints is an important part of a brand's equity.

Packaging must achieve a number of objectives: (1) identify the brand, (2) convey descriptive and persuasive information, (3) facilitate product transportation and protection, (4) assist at-home storage, and (5) aid at-home consumption. Functionally, structural design is crucial. Aesthetic considerations relate to a package's size and shape, material, color, text, and graphics. The packaging elements must harmonize with each other and with pricing, advertising, and other parts of the marketing program. Color can define a brand, from Tiffany's blue box to UPS's brown trucks. Packaging updates and redesigns can keep the brand contemporary, relevant, or practical, but they can also have a downside if consumers dislike the new package or confuse it with other brands. Companies must also consider environmental and safety concerns about excess and wasteful packaging.

Labeling

The label can be a simple attached tag or an elaborately designed graphic that is part of the package. A label performs several functions. First, it *identifies* the product or brand—for instance, the name Sunkist stamped on oranges. It might also *grade* the product; canned peaches are grade-labeled A, B, and C. The label might *describe* the product: who made it, where and when, what it contains, how it is to be used, and how to use it safely. Finally, the label might *promote* the product through attractive graphics.

Labels eventually need freshening up. The label on Ivory soap has been redone at least 18 times since the 1890s, with gradual changes in the size and design of the letters. Legal and regulatory requirements must also be considered. For example, processed foods must carry nutritional labeling that clearly states the amounts of protein, fat, carbohydrates, and calories as well as vitamin and mineral content as a percentage of the recommended daily allowance.[19]

Warranties and Guarantees

All sellers are legally responsible for fulfilling a buyer's normal or reasonable expectations. **Warranties** are formal statements of expected product performance by the manufacturer. Products under warranty can be returned to the manufacturer or designated repair center for repair, replacement, or refund. Whether expressed or implied, warranties are legally enforceable. Guarantees reduce the buyer's perceived risk. They suggest that the product is of high quality and the company and its service performance are dependable. They can be especially helpful when the company or product is not well known or when the product's quality is superior to that of competitors.

Managing New Products

A company can add new products through acquisition (buying another firm, buying patents from other firms, licensing or franchising from another firm) or organically through development from within (in its own laboratories, contracting with independent researchers, or hiring a new-product development firm).[20] New products range from new-to-the-world items that create an entirely new market to minor improvements or revisions of existing products. Most new-product activity is devoted to improving existing products. In contrast, new-to-the-world products incur the greatest cost and risk. And while radical innovations can hurt the company's bottom line in the short run, if they succeed they can improve the corporate image, create a greater sustainable competitive advantage than ordinary products, and produce significant rewards.[21]

The Innovation Imperative and New Product Success

In an economy of rapid change, continuous innovation is a necessity. Companies that fail to develop new products leave themselves vulnerable to changing customer needs and tastes, shortened product life cycles, increased domestic and foreign competition, and especially new technologies. Most established companies focus on *incremental innovation*, entering new markets by tweaking products for new customers, using variations on a core product to stay one step ahead of the market, and creating interim solutions for industry-wide problems. Newer companies create *disruptive technologies* that are cheaper and more likely to alter the competitive space.

New-product specialists Robert Cooper and Elko Kleinschmidt found that unique, superior products succeed 98 percent of the time, compared with products that have a moderate advantage (58 percent success) or minimal advantage (18 percent success). Other factors include a well-defined product concept, well-defined target market and benefits, technological and marketing synergy, quality of execution, and market attractiveness.[22]

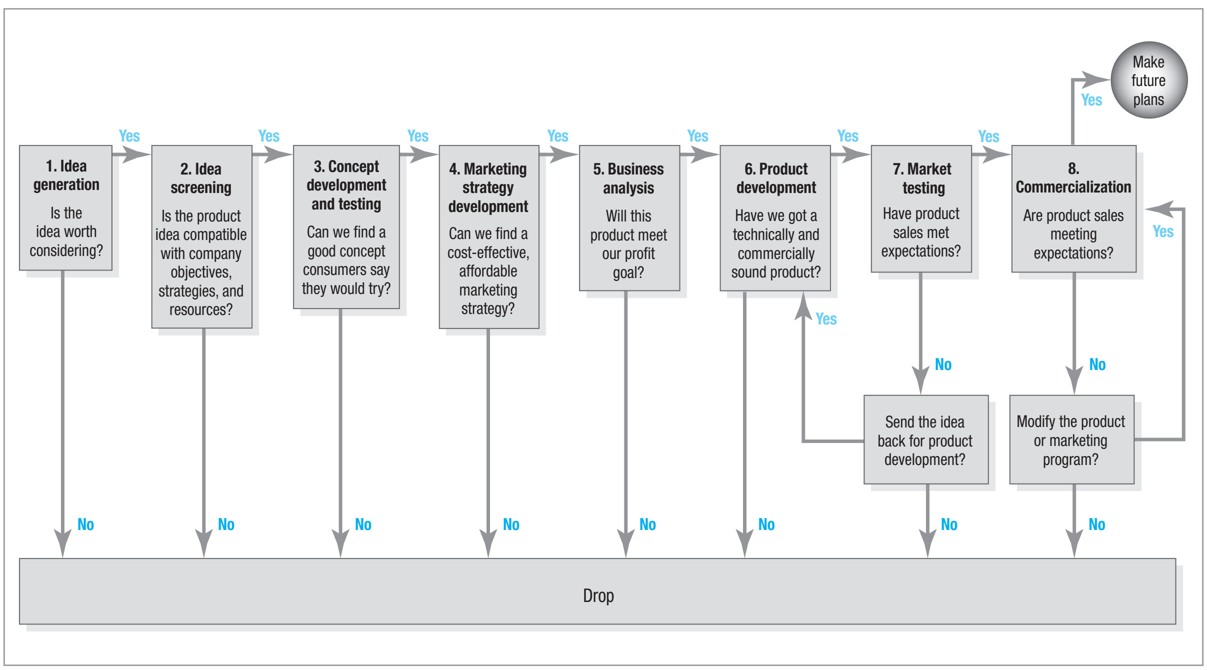
New products continue to fail at rates estimated as high as 50 percent or even 95 percent in the United States and 90 percent in Europe.[23] The reasons are many: ignored or misinterpreted market research; overestimates of market size; high development costs; poor design or ineffectual performance; incorrect positioning, advertising, or price; insufficient distribution support; competitors who fight back hard; and inadequate ROI or payback.

New Product Development

The stages in new product development are shown in Figure 9.2 and discussed next.

Idea Generation The new-product development process starts with the search for ideas. Some marketing experts believe we find the greatest opportunities and highest leverage for new

FIGURE 9.2 The New-Product Development Decision Process



products by uncovering the best possible set of unmet customer needs or technological innovation.[24] Ideas can come from interacting with customers, employees, scientists, and other groups; from using creativity techniques; and from studying competitors. Through Internet-based **crowdsourcing,** paid or unpaid outsiders can offer needed expertise or a different perspective on a new-product project that might otherwise be overlooked. The traditional company-centric approach to product innovation is giving way to a world in which companies cocreate products with consumers. Besides producing new and better ideas, cocreation can help customers feel closer to the company and create favorable word of mouth.[25]

Idea Screening The purpose of screening is to drop poor ideas as early as possible because product-development costs rise substantially at each successive development stage. Most companies require new-product ideas to be described on a standard form for a committee's review. The description states the product idea, the target market, and the competition and estimates market size, product price, development time and costs, manufacturing costs, and rate of return. The executive committee then reviews each idea against a set of criteria. Does the product meet a need? Would it offer superior value? Can it be distinctively advertised or promoted? Does the company have the necessary know-how and capital? Will the new product deliver the expected sales volume, sales growth, and profit? The committee estimates whether the probability of success is high enough to warrant continued development.

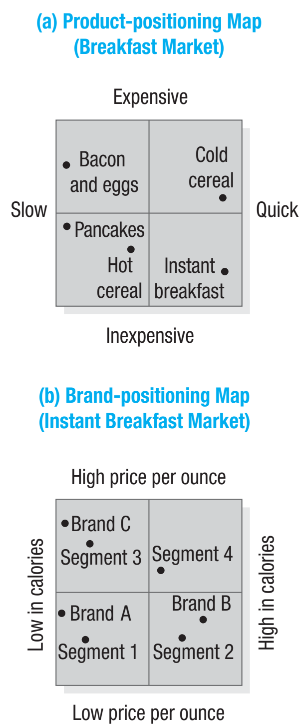
Concept Development and Testing A *product idea* is a possible product the company might offer to the market. A *product concept* is an elaborated version of the idea expressed in consumer terms. A product idea can be turned into several concepts by asking: Who will use this product? What primary benefit should this product provide? When will people consume or use it? By answering these questions, a company can form several concepts, select the most promising, and create a *product-positioning map* for it. Figure 9.3(a) shows the positioning of a product concept, a low-cost instant breakfast drink, based on the two dimensions of cost and preparation time and compared with other breakfast foods. These contrasts can be useful in communicating and promoting a concept to the market.

Figure 9.3 (b) is a *brand-positioning map*, a perceptual map showing the current positions of three existing brands of instant breakfast drinks (Brands A–C) as seen by consumers in four segments, whose preferences are clustered around the points on the map. The brand-positioning map helps the company decide how much to charge and how calorific to make its drink. As shown on this map, the new brand would be distinctive in the medium-price, medium-calorie market or in the high-price, high-calorie market. There is also a segment of consumers (4) clustered fairly near the medium-price, medium-calorie market, suggesting this may offer the greatest opportunity.

Concept testing means presenting the product concept to target consumers, physically or symbolically, and getting their reactions. The more the tested concepts resemble the final product or experience, the more dependable concept testing is. In the past, creating physical prototypes was costly and time consuming, but today firms can use *rapid prototyping* to design products on a computer and then produce rough models to show potential consumers for their reactions. Companies are also using *virtual reality* to test product concepts. Consumer reactions indicate whether the concept has a broad and strong consumer appeal, what products it competes against, and which consumers are the best targets. The need-gap levels and purchase-intention levels can be checked against norms for the product category to determine whether the concept appears to be a winner, a long shot, or a loser.

Marketing Strategy Development Following a successful concept test, the firm develops a preliminary three-part strategy for introducing the new product. The first part describes the target market's size, structure, and behavior; the planned brand positioning; and the sales, market share,

FIGURE 9.3 Product and Brand Positioning



and profit goals sought in the first few years. The second part outlines the planned price, distribution strategy, and marketing budget for the first year. The third part describes the long-run sales and profit goals and marketing-mix strategy over time. This strategy lays a foundation for the business analysis.

Business Analysis Here the firm evaluates the proposed product's business attractiveness. Management needs to prepare sales, cost, and profit projections to determine whether they satisfy company objectives. If they do, the concept can move to the development stage. As new information comes in, the business analysis will undergo revision and expansion. Sales-estimation methods depend on whether the product is purchased once (such as an engagement ring), infrequently, or often.

For one-time products, sales rise at the beginning, peak, and approach zero as the number of potential buyers becomes exhausted; if new buyers keep entering the market, the curve will not drop to zero. Infrequently purchased products such as automobiles exhibit replacement cycles dictated by physical wear or obsolescence associated with changing styles, features, and performance. Therefore, sales forecasts must estimate first-time sales and replacement sales separately. With frequently purchased products, such as consumer and industrial nondurables, the number of first-time buyers initially increases and then decreases as fewer buyers are left (assuming a fixed population). Repeat purchases occur soon, providing the product satisfies some buyers. The sales curve eventually falls to a plateau of steady repeat-purchase volume; by this time, the product is no longer a new product.

Product Development Up to now, the product has existed only as a description, drawing, or prototype. The next step represents a jump in investment that dwarfs the costs incurred so far. The company will determine whether the product idea can translate into a technically and commercially feasible product.

The job of translating target customer requirements into a working prototype is helped by a set of methods known as *quality function deployment* (QFD). The methodology takes the list of desired *customer attributes* (CAs) generated by market research and turns them into a list of *engineering attributes* (EAs) that engineers can use. For example, customers of a proposed truck may want a certain acceleration rate (CA). Engineers can turn this into the required horsepower and other engineering equivalents (EAs). QFD improves communication between marketers, engineers, and manufacturing people.[26]

The R&D department develops a prototype that embodies the key attributes in the product-concept statement, performs safely under normal use and conditions, and can be produced within budgeted manufacturing costs, speeded by virtual reality technology and the Internet. Prototypes must be put through rigorous functional and customer tests before they enter the marketplace. *Alpha testing* tests the product within the firm to see how it performs in different applications. After refining the prototype, the company moves to *beta testing* with customers, bringing consumers into a laboratory or giving them samples to use at home.

Market Testing After management is satisfied with functional and psychological performance, the product is ready to be branded with a name, logo, and packaging and go into a market test. Not all companies undertake market testing. The amount of testing is influenced by the investment cost and risk on the one hand and time pressure and research cost on the other. High-investment–high-risk products, whose chance of failure is high, must be market tested; the cost will be an insignificant percentage of total project cost. Consumer-products tests seek to estimate four variables: *trial*, *first repeat*, *adoption*, and *purchase frequency.* Table 9.3 shows four methods of consumer-goods testing, from the least costly to the most costly.

Expensive industrial goods and new technologies will normally undergo alpha and beta testing. During beta testing, the company's technical people observe how customers use the product,

TABLE 9.3 Methods of Market Testing Consumer Goods

Method	Description
Sales-wave research	Consumers who initially try the product at no cost are reoffered it, or a competitor's product, at slightly reduced prices. The offer may be made as many as five times (sales waves), while the company notes how many customers select it again and their reported level of satisfaction.
Simulated test marketing	Thirty to 40 qualified shoppers are asked about brand familiarity and preferences in a specific product category and attend a brief screening of advertising. Consumers receive a small amount of money and are invited into a store to shop. The company notes how many consumers buy the new brand and competing brands and asks consumers why they bought or did not buy. Those who did not buy the new brand are given a free sample and are reinterviewed later to determine attitudes, usage, satisfaction, and repurchase intention.
Controlled test marketing	A research firm delivers the product to a panel of participating stores and controls shelf position, pricing, and number of facings, displays, and point-of-purchase promotions. The company can evaluate sales, the impact of local advertising and promotions, and customers' impressions of the product.
Test markets	The company chooses a few representative cities, implements a full marketing communications campaign, and sells the trade on carrying the product. Marketers must decide how many test cities to use, how long the test will last, and what data will be collected. At the conclusion, they must decide what action to take. Many companies today skip test marketing and rely on faster and more economical testing methods.

a practice that often exposes unanticipated problems of safety and servicing and alerts the company to customer training and servicing requirements. At trade shows the company can observe how much interest buyers show in the new product, how they react to features and terms, and how many express purchase intentions or place orders. In distributor and dealer display rooms, products may stand next to the manufacturer's other products and possibly competitors' products, yielding preference and pricing information in the product's normal selling atmosphere. However, customers who come in might not represent the target market, or they might want to place early orders that cannot be filled.

Commercialization Commercialization is the costliest stage in the process because the firm will need to contract for manufacture, or it may build or rent a full-scale manufacturing facility. Most new-product campaigns also require a sequenced mix of market communication tools to build awareness and ultimately preference, choice, and loyalty.[27] Market timing is critical.

If a firm learns that a competitor is readying a new product, one choice is *first entry* (for "first mover advantages" of locking up key distributors and customers and gaining leadership). However, this can backfire if the product has not been thoroughly debugged. A second choice is *parallel entry* (timing its entry to coincide with the competitor's entry to gain both products more attention). A third choice is *late entry* (delaying its launch until after the competitor has borne the cost of educating the market). This might reveal flaws the late entrant can avoid and also show the size of the market.

Most companies will develop a planned market rollout over time. In choosing rollout markets, the major criteria are market potential, the company's local reputation, the cost of filling the pipeline, the cost of communication media, the influence of the area on other areas, and competitive penetration. With the Internet connecting far-flung parts of the globe, competition is more likely to cross national borders. Companies are increasingly rolling out new products simultaneously across the globe.

The Consumer-Adoption Process

Adoption is an individual's decision to become a regular user of a product and is followed by the *consumer-loyalty process*. New-product marketers typically aim at early adopters and use the theory of innovation diffusion and consumer adoption to identify them.

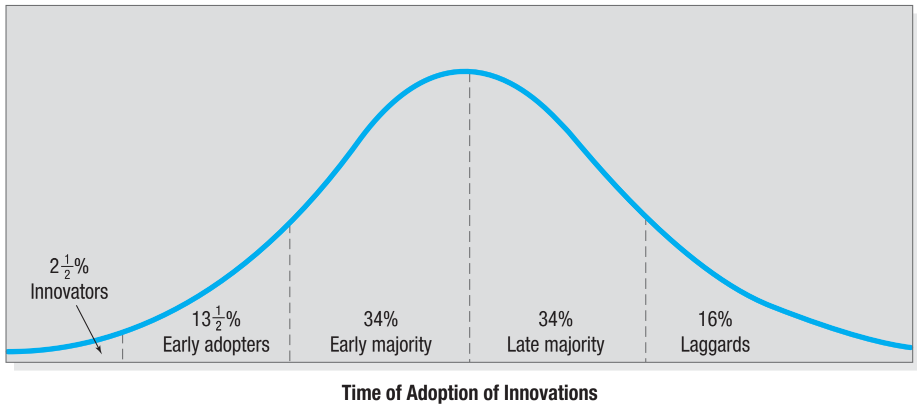
Stages in the Adoption Process

An **innovation** is any good, service, or idea that someone *perceives* as new, no matter how long its history. Everett Rogers defines the **innovation diffusion process** as "the spread of a new idea from its source of invention or creation to its ultimate users or adopters."[28] The *consumer-adoption process* is the mental steps through which an individual passes from first hearing about an innovation to final adoption.[29] These five steps are: (1) *awareness* (consumer becomes aware of the innovation but lacks information about it), (2) *interest* (consumer is stimulated to seek information about the innovation), (3) *evaluation* (consumer considers whether to try the innovation), (4) *trial* (consumer tries the innovation to estimate its value), and (5) *adoption* (consumer decides to make full and regular use of the innovation).

Factors Influencing the Adoption Process

Rogers defines a person's level of innovativeness as "the degree to which an individual is relatively earlier in adopting new ideas than the other members of his social system." As Figure 9.4 shows, innovators are the first to adopt something new. After a slow start, an increasing number

FIGURE 9.4 Adopter Categorization on the Basis of Relative Time of Adoption of Innovations



Source: Tungsten, http://en.wikipedia.ord/wiki/Everett_Rogers. Based on E. Rogers, *Diffusion of Innovations* (London: Free Press, 1962).

of people adopt the innovation, the number reaches a peak, and then it diminishes as fewer non-adopters remain. The five adopter groups (innovators, early adopters, early majority, late majority, and laggards) differ in their value orientations and their motives for adopting or resisting the new product.[30]

Personal influence, the effect one person has on another's attitude or purchase probability, has greater significance in some situations and for some individuals than others, and it is more important in evaluation than in the other stages. It has more power over late than early adopters and in risky situations.

Five characteristics influence an innovation's rate of adoption. The first is *relative advantage*, the degree to which the innovation appears superior to existing products. The second is *compatibility,* the degree to which the innovation matches consumers' values and experiences. The third is *complexity,* the degree to which the innovation is difficult to understand or use. The fourth is *divisibility,* the degree to which the innovation can be tried on a limited basis. The fifth is *communicability,* the degree to which the benefits of use are observable or describable to others. Other characteristics that influence the rate of adoption are cost, risk and uncertainty, scientific credibility, and social approval.

Finally, adoption is associated with variables in the organization's environment (community progressiveness, community income), the organization itself (size, profits, pressure to change), and the administrators (education level, age, sophistication). Other forces come into play in trying to get a product adopted into organizations that are mostly government-funded, such as public schools. A controversial or innovative product can be squelched by negative public opinion.

Product Life-Cycle Marketing Strategies

A company's positioning and differentiation strategy must change as its product, market, and competitors change over the *product life cycle* (PLC). To say a product has a life cycle is to assert four things: (1) products have a limited life, (2) product sales pass through distinct stages, each posing different marketing challenges and opportunities, (3) profits rise and fall at different stages, and (4) products require different marketing, financial, manufacturing, purchasing, and human resource strategies in each stage.

Product Life Cycles

Most product life cycles are portrayed as bell-shaped curves (see Figure 9.5), typically divided into four stages: introduction, growth, maturity, and decline. In *introduction,* sales grow slowly as the product is introduced; profits are nonexistent because of the heavy introductory expenses. *Growth* is a period of rapid market acceptance and substantial profit improvement. In *maturity,* sales growth slows because the product has achieved acceptance by most potential buyers, and profits stabilize or decline because of increased competition. In *decline*, sales drift downward and profits erode.

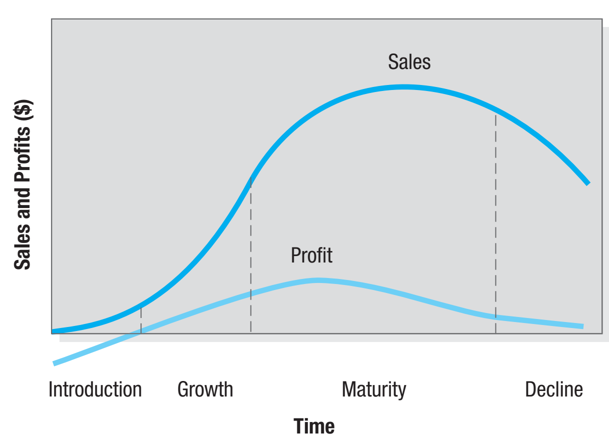
Marketing Strategies: Introduction Stage and the Pioneer Advantage

Because it takes time to roll out a new product, work out technical problems, fill dealer pipelines, and gain consumer acceptance, sales growth tends to be slow in the introduction stage. Profits are negative or low, and promotional expenditures are at their highest ratio to sales because of the need to (1) inform potential consumers, (2) induce product trial, and (3) secure distribution.[31]

To be the first to introduce a product can be rewarding, but risky and expensive. Steven Schnaars studied 28 industries in which imitators surpassed the innovators and found several weaknesses among the failing pioneers.[32] These included new products that were too crude, improperly positioned, or launched before strong demand existed; exhaustive product-development costs; a lack of resources to compete against larger entrants; and managerial incompetence or unhealthy complacency. Successful imitators thrived by offering lower prices, continuously improving the product, or using brute market power to overtake the pioneer.

Gerald Tellis and Peter Golder have identified five factors underpinning long-term market leadership: vision of a mass market, persistence, relentless innovation, financial commitment, and asset leverage.[33] One study found Internet companies that realized benefits from moving fast (1) were first movers in large markets, (2) erected barriers of entry against competitors, and (3) directly controlled critical elements necessary for starting a company.[34]

FIGURE 9.5 Sales and Profit Life Cycles



Marketing Strategies: Growth Stage

The growth stage is marked by a rapid climb in sales. Early adopters like the product, and additional consumers start buying it. New competitors enter, introducing new features and expanding distribution, and prices stabilize or fall slightly, depending on how fast demand increases. Companies maintain marketing expenditures or raise them slightly to meet competition, but sales rise much faster than marketing expenditures. Profits increase as marketing costs are spread over a larger volume, and unit manufacturing costs fall faster than price declines. Firms must watch for a change to a decelerating rate of growth in order to prepare new strategies.

To sustain rapid market share growth now, the firm must improve product quality, add new features, and improve styling; add new models and flanker products to protect the main product; enter new segments; increase distribution coverage and enter new channels; shift from awareness and trial communications to preference and loyalty communications; and cut price to attract price-conscious buyers. By spending money on product improvement, promotion, and distribution, the firm can capture a dominant position, trading off maximum current profit for high market share and the hope of greater profits in the next stage.

Marketing Strategies: Maturity Stage

At some point, the rate of sales growth slows. Most products are in this stage of the life cycle, which normally lasts longer than the preceding ones. Three ways to change the course for a brand in the maturity stage are market, product, and marketing program modifications. A firm might try to expand the market by increasing the number of users (converting nonusers, entering new segments, or attracting rivals' customers) and increasing usage rates among users (getting current customers to use the product on more occasions, use more on each occasion, or use the product in new ways). The firm can also try to stimulate sales by improving quality, features, or style. Finally, it might try to stimulate sales by modifying non-product elements—price, distribution, and communications in particular.

Marketing Strategies: Decline Stage

Sales decline for a number of reasons, including technological advances, shifts in consumer tastes, and increased foreign competition. All can lead to overcapacity, increased price cutting, and profit erosion. As sales and profits decline, some firms withdraw. Those remaining may reduce the number of products they offer, exiting smaller segments and weaker trade channels, cutting marketing budgets, and reducing prices further. Unless strong reasons for retention exist, carrying a weak product is often very costly.

A company in an unattractive industry that possesses competitive strength should consider shrinking selectively. A strong competitor in an attractive industry should consider strengthening its investment. Companies that successfully restage or rejuvenate a mature product often do so by adding value to it. Two other options are harvesting and divesting. *Harvesting* calls for gradually reducing a product or business's costs while trying to maintain sales. When a company decides to *divest* a product with strong distribution and residual goodwill, it can probably sell it to another firm. If the company can't find any buyers, it must decide whether to liquidate the brand quickly or slowly.

Critique of the Product Life-Cycle Concept

Table 9.4 summarizes the characteristics, marketing objectives, and marketing strategies in each stage in the product life cycle. The PLC concept helps marketers interpret product and market dynamics, conduct planning and control, and do forecasting. However, critics say that life-cycle

TABLE 9.4 Summary of Product Life-Cycle Characteristics, Objectives, and Strategies

	Introduction	Growth	Maturity	Decline
Characteristics				
Sales	Low sales	Rapidly rising sales	Peak sales	Declining sales
Costs	High cost per customer	Average cost per customer	Low cost per customer	Low cost per customer
Profits	Negative	Rising profits	High profits	Declining profits
Customers	Innovators	Early adopters	Middle majority	Laggards
Competitors	Few	Growing number	Stable number beginning to decline	Declining number
Marketing Objectives				
	Create product awareness and trial	Maximize market share	Maximize profit while defending market share	Reduce expenditure and milk the brand
Strategies				
Product	Offer a basic product	Offer product extensions, service, warranty	Diversify brands and items	Phase out weak products
Price	Charge cost-plus	Price to penetrate market	Price to match or best competitors'	Cut price
Distribution	Build selective distribution	Build intensive distribution	Build more intensive distribution	Go selective: phase out unprofitable outlets
Communications	Build product awareness and trial among early adopters and dealers	Build awareness and interest in the mass market	Stress brand differences and benefits and encourage brand switching	Reduce to minimal level needed to retain hard-core loyals

Sources: Chester R. Wasson, *Dynamic Competitive Strategy and Product Life Cycles* (Austin, TX: Austin Press, 1978); John A. Weber, "Planning Corporate Growth with Inverted Product Life Cycles," *Long Range Planning* (October 1976), pp. 12–29; Peter Doyle, "The Realities of the Product Life Cycle," *Quarterly Review of Marketing* (Summer 1976).

patterns are too variable to be generalized and that marketers can seldom tell what stage their product is in. A product that appears mature may actually be at a plateau prior to another upsurge. Critics also say that the PLC pattern is the self-fulfilling result of marketing strategies and that skillful marketing can in fact lead to continued growth.[35] Firms also need to visualize a *market's* evolutionary path as it is affected by new needs, competitors, technology, channels, and other developments and change product and brand positioning to keep pace.[36]

Executive Summary

A product is anything that can be offered to a market to satisfy a want or need. The marketer needs to think through the five levels of the product: the core benefit, the basic product, the expected product, the augmented product, and the potential product. Marketers classify products on the basis of durability, tangibility, and use (consumer or industrial). Products may be differentiated by form, features, performance quality, conformance quality, durability, reliability, repairability, style, customization, and design. Service differentiators include ordering ease, delivery, installation, customer training, customer consulting, and maintenance and repair.

A product mix can be classified according to width, length, depth, and consistency, four dimensions for developing the marketing strategy and deciding which product lines to grow, maintain, harvest, and divest. Physical products must be packaged and labeled, may have well-designed packages, and may come with warranties and guarantees. The new-product development process consists of: idea generation, screening, concept development and testing, marketing strategy development, business analysis, product development, market testing, and commercialization. The adoption process—by which customers learn about new products, try them, and adopt or reject them—is influenced by multiple factors. Each product life-cycle stage (introduction, growth, maturity, and decline) calls for different marketing strategies.

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Chapter 10

Designing and Managing Services

In this chapter, we will address the following questions:

Marketing Management at USAA

USAA Insurance sells auto and other insurance products to current and former members of the military and their families. The company has increased its share of each customer's business by launching a consumer bank, issuing credit cards, opening a discount brokerage, and offering no-load mutual funds. Its legendary service quality has led to the highest customer satisfaction in the industry, resulting in high customer loyalty and significant cross-selling opportunities. It trains its call center reps to answer investment queries as well as insurance-related calls, increasing productivity and reducing the need to transfer customers between agents. A technological leader, USAA was the first bank to allow iPhone deposits for its military customers and to conduct face-to-face video chats with soldiers in the field. Whether a customer is using a tablet, smartphone, or computer or visiting one of its financial centers—located mostly near military bases—USAA is committed to meeting needs by providing exemplary service.[1]

As companies find it harder to differentiate their physical products, they turn to service differentiation, whether that means on-time delivery, better and faster response to inquiries, or quicker resolution of complaints. Because it is critical to understand the special nature of services and what that means to marketers, in this chapter we analyze services and how to market them most effectively.

The Nature of Services

The *government sector,* with its courts, hospitals, military services, police and fire departments, postal service, regulatory agencies, and schools, is in the service business. The *private nonprofit sector*—museums, charities, churches, colleges, and hospitals—is in the service business. A good part of the *business sector,* with its airlines, banks, hotels, insurance companies, law firms, medical practices, and real estate firms, is in the service business. Many workers in the *manufacturing sector,* such as accountants and legal staff, are really service providers, making up a "service factory" providing services to the "goods factory." And those in the *retail sector,* such as cashiers, salespeople, and customer service representatives, are also providing a service.

A **service** is any act or performance one party can offer to another that is essentially intangible and does not result in the ownership of anything. Its production may or may not be tied to a physical product. Increasingly, manufacturers, distributors, and retailers are providing value-added services, or simply excellent customer service, to differentiate themselves. Many pure service firms are now using the Internet to reach customers; some operate purely online.

Categories of Service Mix

The service component can be a minor or a major part of the total offering. We distinguish five categories of offerings:

1. ***A pure tangible good*** such as soap, toothpaste, or salt with no accompanying services.
2. ***A tangible good with accompanying services***, like a car, computer, or cell phone, with a warranty or customer service contract. Typically, the more technologically advanced the product, the greater the need for high-quality supporting services.
3. ***A hybrid*** offering, like a restaurant meal, of equal parts goods and services.
4. ***A major service with accompanying minor goods and services***, like air travel with supporting goods such as snacks and drinks.
5. ***A pure service,*** primarily an intangible service, such as babysitting, psychotherapy, or massage.

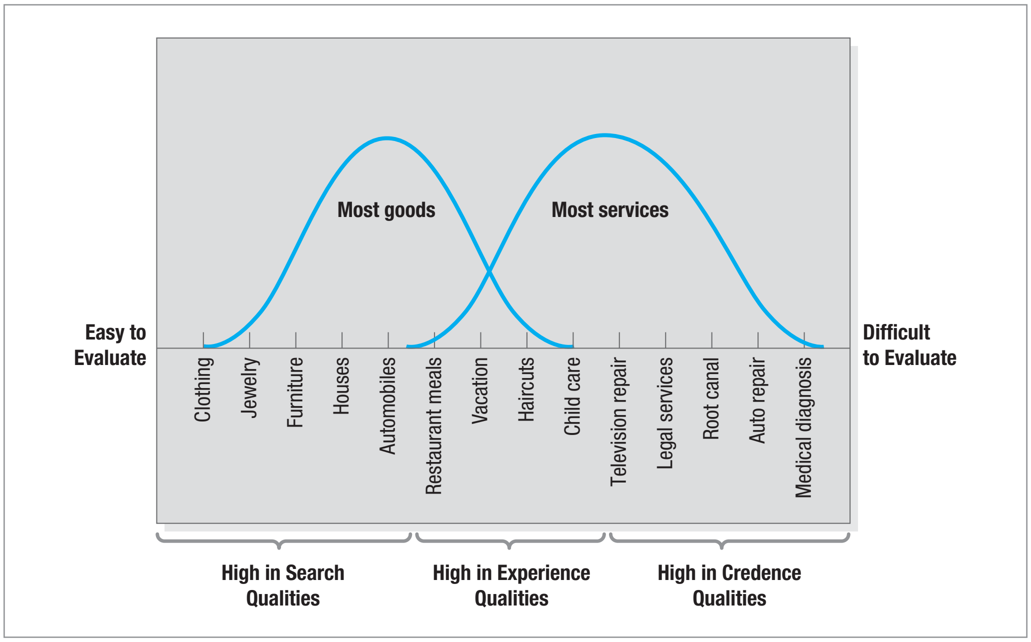
Customers typically cannot judge the technical quality of some services even after they have received them, as shown in Figure 10.1.[2] At the left are goods high in *search qualities*—that is, characteristics the buyer can evaluate before purchase. In the middle are goods and services high in *experience qualities*—characteristics the buyer can evaluate after purchase. At the right are goods and services high in *credence qualities*—characteristics the buyer normally finds hard to evaluate even after consumption.[3]

Because services are generally high in experience and credence qualities, there is more risk in their purchase, with several consequences. First, service consumers generally rely on word of mouth rather than advertising. Second, they rely heavily on price, provider, and physical cues to judge quality. Third, they are highly loyal to service providers who satisfy them. Fourth, because switching costs are high, consumer inertia can make it challenging to entice business away from a competitor.

Distinctive Characteristics of Services

Four distinctive service characteristics greatly affect the design of marketing programs: *intangibility, inseparability, variability,* and *perishability*.

FIGURE 10.1 Continuum of Evaluation for Different Types of Products



Source: Valarie A. Zeithaml, "How Consumer Evaluation Processes Differ between Goods and Services," James H. Donnelly and William R. George, eds., *Marketing of Services* (Chicago: American Marketing Association, 1981). Reprinted with permission of the American Marketing Association.

Intangibility Unlike physical products, services cannot be seen, tasted, felt, heard, or smelled before they are bought. A person getting cosmetic surgery cannot see the results before the purchase, for instance. To reduce uncertainty, buyers will look for evidence of quality by drawing inferences from the place, people, equipment, communication material, symbols, and price. Therefore, the service provider's task is to "manage the evidence," to "tangibilize the intangible."[4] Service companies can try to demonstrate their service quality through *physical evidence* and *presentation.*[5] Table 10.1 measures brand experiences in general along sensory, affective, behavioral, and intellectual dimensions; applications to services are clear.

Inseparability Whereas physical goods are manufactured, then inventoried, then distributed, and later consumed, services are typically produced and consumed simultaneously. Because the client is also often present, provider–client interaction is a special feature of services marketing. Several strategies exist for getting around the limitations of inseparability. When clients have strong provider preferences, the provider can raise its price to ration its limited time. The service provider can also work with larger groups, work faster, or train more providers and build up client confidence.

Variability Because the quality of services depends on who provides them, when and where, and to whom, services are highly variable. Service buyers are aware of potential variability and often talk to others or go online to collect information before selecting a specific service provider. To reassure customers, some firms offer *service guarantees* that may reduce consumer perceptions of risk.[6] Three steps to increase quality control of services are to (1) invest in good hiring and training procedures, (2) standardize the service-performance process, and (3) monitor

TABLE 10.1 Dimensions of Brand Experience

Sensory

- This brand makes a strong impression on my visual sense or other senses.
- I find this brand interesting in a sensory way.
- This brand does not appeal to my senses.

Affective

- This brand induces feelings and sentiments.
- I do not have strong emotions for this brand.
- This brand is an emotional brand.

Behavioral

- I engage in physical actions and behaviors when I use this brand.
- This brand results in bodily experiences.
- This brand is not action-oriented.

Intellectual

- I engage in a lot of thinking when I encounter this brand.
- This brand does not make me think.
- This brand stimulates my curiosity and problem solving.

Source: Joško Brakus, Bernd H. Schmitt, and Lia Zarantonello, "Brand Experience: What Is It? How Is It Measured? Does It Affect Loyalty?," *Journal of Marketing* 73 (May 2009), pp. 52–68. Reprinted with permission from the *Journal of Marketing*, published by the American Marketing Association.

customer satisfaction. Service firms can also design marketing communication and information programs so consumers learn more about the brand than what their subjective experience alone tells them.

Perishability Services cannot be stored, so their perishability can be a problem when demand fluctuates. To accommodate rush-hour demand, public transportation companies must own more equipment than if demand was even throughout the day. Demand or yield management is critical—the right services must be available to the right customers at the right places at the right times and right prices to maximize profitability.

Several strategies can produce a better match between service demand and supply.[7] On the demand (customer) side, these include differential pricing to shift some demand to off-peak periods (such as pricing matinee movies lower), cultivating nonpeak demand (the way McDonald's promotes breakfast), offering complementary services as alternatives (the way banks offer ATMs), and using reservation systems to manage demand (airlines do this). On the supply side, strategies include adding part-time employees to serve peak demand, having employees perform only essential tasks during peak periods, increasing consumer participation (shoppers bag their own groceries), sharing services (hospitals can share medical-equipment purchases), and having facilities for future expansion.

The New Services Realities

Although service firms once lagged behind manufacturers in their use of marketing, service firms are now some of the most skilled marketers. However, because U.S. consumers generally have high expectations about service delivery, they often feel their needs are not being adequately met. A 2013 Forrester study asked consumers to rate 154 companies on how well they met their needs and how easy and enjoyable they were to do business with. Almost two-thirds of the companies were rated only "OK," "poor," or "very poor." Retail and hotel companies were rated the highest on average, and Internet, health service, and television service providers were rated the worst.[8] This is just one indicator of the shifting relationship between customers and service providers.

A Shifting Customer Relationship

Savvy services marketers are recognizing the new services realities, such as the importance of the newly empowered customer, customer coproduction, and the need to engage employees as well as customers.

Customer Empowerment Customers are becoming more sophisticated about buying product-support services and are pressing for "unbundled services" so they can select the elements they want. They increasingly dislike having to deal with a multitude of service providers handling different types of products or equipment. Most importantly, the Internet has empowered customers by letting them send their comments around the world with a mouse click. A person who has a good customer experience is more likely to talk about it, but someone who has a bad experience will talk to more people.[9] When a customer complains, most companies are responsive because solving a customer's problem quickly and easily goes a long way toward winning long-term loyal customers.[10]

Customer Coproduction The reality is that customers do not merely purchase and use a service; they play an active role in its delivery. Their words and actions affect the quality of their service experiences and those of others as well as the productivity of frontline employees.[11] This coproduction can put stress on employees, however, and reduce their satisfaction, especially if they differ from customers culturally or in other ways.[12] Moreover, one study estimated that one-third of all service problems are caused by the customer.[13]

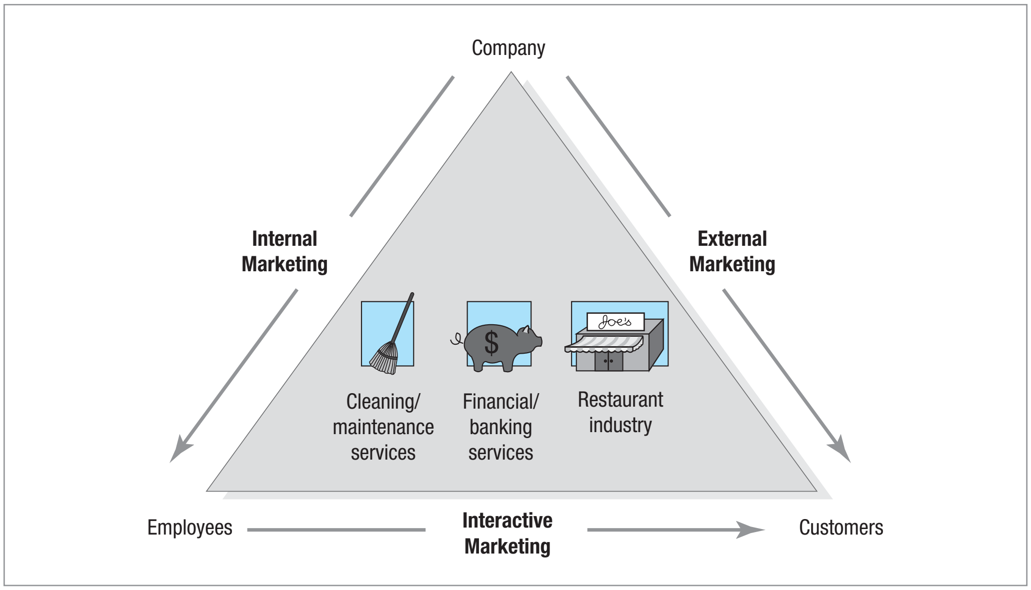
Preventing service failures is crucial because recovery is always challenging. One of the biggest problems is attribution—customers often feel the firm is at fault or, even if not, that it is still responsible for righting any wrongs. Unfortunately, although many firms have well-designed and executed procedures to deal with their own failures, they find managing *customer* failures—when a service problem arises from a customer's mistake or lack of understanding—much more difficult. Solutions include: redesigning processes and customer roles to simplify service encounters; using technology to aid customers and employees; enhancing customer role clarity, motivation, and ability; and encouraging customers to help each other.[14]

Satisfying Employees as Well as Customers Excellent service companies know that positive employee attitudes will strengthen customer loyalty.[15] Instilling a strong customer orientation in employees can also increase their job satisfaction and commitment, especially if they have high customer contact. Employees thrive in customer-contact positions when they have an internal drive to (1) pamper customers, (2) accurately read their needs, (3) develop a personal relationship with them, and (4) deliver high-quality service to solve customers' problems.[16] Given the importance of positive employee attitudes to customer satisfaction, service companies must attract the best employees they can find, marketing a career rather than just a job. They must design a sound training program, provide support and rewards for good performance, and reinforce customer-centered attitudes. Finally, they must audit employee job satisfaction regularly.

Achieving Excellence in Services Marketing

The increased importance of the service industry and the new realities have sharpened the focus on what it takes to excel in the marketing of services.[17] In the service sector, excellence

FIGURE 10.2 Three Types of Marketing in Service Industries



must cover broad areas of marketing: external, internal, and interactive (see Figure 10.2).[18] *External marketing* describes the normal work of preparing, pricing, distributing, and promoting the service to customers. *Internal marketing* describes training and motivating employees to serve customers well. The most important contribution the marketing department can make is to be "exceptionally clever in getting everyone else in the organization to practice marketing."[19]

Interactive marketing describes the employees' skill in serving the client. Clients judge service not only by its *technical quality* (Was the surgery successful?), but also by its *functional quality* (Did the surgeon show concern and inspire confidence?).[20] In interactive marketing, teamwork is often key. Delegating authority to frontline employees can allow for greater service flexibility and adaptability because it promotes better problem solving, closer employee cooperation, and more efficient knowledge transfer.[21]

Companies must avoid pushing technological efficiency so hard, however, that they reduce perceived quality.[22] Some methods lead to too much standardization, but service providers must deliver "high touch" as well as "high tech."[23] Amazon has some of the most innovative technology in online retailing, but it also keeps customers extremely satisfied when a problem arises even if they don't actually talk to an Amazon employee.[24]

Well-managed service companies that achieve marketing excellence have in common a strategic concept, a history of top-management commitment to quality, high standards, profit tiers, and systems for monitoring service performance and resolving customer complaints.

Strategic Concept Top service companies are "customer obsessed." They have a clear sense of their target customers and their needs and have developed a distinctive strategy for satisfying them.

Top-Management Commitment Companies such as USAA and Marriott have a thorough commitment to service quality. Their managers look monthly not only at financial performance but also at service performance. USAA, Allstate, Dunkin' Brands, and Oracle have high-level senior executives with titles such as Chief Customer Officer, Chief Client Officer, or Chief Experience Officer, giving these executives the power to improve customer service across every customer interaction.[25]

High Standards The best service providers set high quality standards. Standards must be set *appropriately* high. A 98 percent accuracy standard may sound good, but it would result in 400,000 incorrectly filled prescriptions daily, 3 million lost pieces of mail each day, and no phone, Internet, or electricity for eight days per year.

Profit Tiers Firms have decided to coddle big spenders to retain their patronage as long as possible. Customers in high-profit tiers get special discounts, promotional offers, and lots of special service; those in lower-profit tiers who barely pay their way may get more fees, stripped-down service, and voice messages to process their inquiries. Companies that provide differentiated levels of service must be careful about claiming superior service, however—customers who receive lesser treatment will bad-mouth the company and injure its reputation. Delivering services that maximize both customer satisfaction and company profitability can be challenging.

Monitoring Systems Top firms audit service performance, both their own and competitors', on a regular basis. They collect *voice of the customer (VOC) measurements* to probe customer satisfiers and dissatisfiers and use comparison shopping, mystery or ghost shopping, customer surveys, suggestion and complaint forms, service-audit teams, and customers' letters.

Satisfying Customer Complaints On average, 40 percent of customers who suffer through a bad service experience stop doing business with the company.[26] Companies that encourage disappointed customers to complain—and also empower employees to remedy the situation on the spot—have been shown to achieve higher revenues and greater profits than companies without a systematic approach for addressing service failures.[27] Customers evaluate complaint incidents in terms of the outcomes they receive, the procedures used to arrive at those outcomes, and the nature of interpersonal treatment during the process.[28] Companies also are increasing the quality of their call centers and their customer service representatives (see "Marketing Insight: Improving Company Call Centers").

Differentiating Services

Marketing excellence requires service marketers to continually differentiate their brands so they are not seen as a commodity. What the customer expects is called the *primary service package*. The provider can also add *secondary service features* to the package. In the hotel industry, various chains have introduced such secondary service features as merchandise for sale, free breakfast buffets, and loyalty programs.

Innovation is as vital in services as in any industry.[29] And it can have big payoffs. When Ticketmaster introduced interactive seat maps that allowed customers to pick their own seats instead of being given one by a "best seat available" function, the conversion rate from potential to actual buyers increased by 25 percent to 30 percent. Persuading a ticket buyer to add an "I'm going …" message to Facebook adds an extra $5 in ticket sales on average; adding reviews of a show on the site doubles the conversion rate.[30]

marketing insight — Improving Company Call Centers

Many firms have learned the hard way that empowered customers will not put up with poor service. After Sprint and Nextel merged, they ran their call centers as cost centers rather than as a means to enhance customer loyalty. Employee rewards were for keeping customer calls short, and when management started to monitor even bathroom trips, morale sank. With customer churn spinning out of control, Sprint Nextel appointed its first chief service officer and started rewarding operators for solving problems on a customer's first call.

Some firms, such as AT&T, JPMorgan Chase, and Expedia, have call centers in the Philippines rather than India because Filipinos speak lightly accented English and are more steeped in U.S. culture. Others are getting smarter about the calls they send to off-shore call centers, *homeshoring* by directing complex calls to highly trained domestic service reps. Some firms are using Big Data to match individual customers with the call center agent best suited to meet their needs. Using something like the methods of online dating sites, advanced analytics technology mines customer transaction and demographic information and examines call center agents' average call handling time and sales efficiency to identify optimal matches in real time.

Sources: Claudia Jasmand, Vera Blazevic, and Ko de Ruyter, "Generating Sales while Providing Service: A Study of Customer Service Representatives' Ambidextrous Behavior," *Journal of Marketing* 76 (January 2012), pp. 20–37; Kimmy Wa Chan and Echo Wen Wan, "How Can Stressed Employees Deliver Better Customer Service?," *Journal of Marketing* 76 (January 2012), pp. 119–37; Joseph Walker, "Meet the New Boss: Big Data," *Wall Street Journal*, September 20, 2012; Vikas Bajaj, "A New Capital of Call Centers," *New York Times*, November 25, 2011; Michael Shroeck, "Why the Customer Call Center Isn't Dead," *Forbes*, March 15, 2011; Michael Sanserino and Cari Tuna, "Companies Strive Harder to Please Customers," *Wall Street Journal*, July 27, 2009, p. B4; Spencer E. Ante, "Sprint's Wake-Up Call," *BusinessWeek*, March 3, 2008, pp. 54–57; Jena McGregor, "Customer Service Champs," *BusinessWeek*, March 5, 2007.

Managing Service Quality

The service quality of a firm is tested at each service encounter. One study identified more than 800 critical behaviors that cause customers to switch services; see the eight categories of those behaviors in Table 10.2.[31] A more recent study honed in on the service dimensions customers would most like companies to measure. Knowledgeable frontline workers and the ability to achieve one-call-and-done rose to the top.[32] Two important considerations in service quality are managing customer expectations and incorporating self-service technologies.

Managing Customer Expectations

Customers form service expectations from many sources, such as past experiences, word of mouth, and advertising. In general, they compare *perceived* service and *expected* service. If the perceived service falls below the expected service, customers are disappointed. Successful companies add benefits to their offering that not only satisfy customers but surprise and delight them by exceeding expectations.[33] The service-quality model in Figure 10.3 on page 168 highlights five gaps that can prevent successful service delivery:[34]

1. ***Gap between consumer expectation and management perception***—Management does not always correctly perceive what customers want. Hospital administrators may think patients want better food, but patients may be more concerned with nurse responsiveness.

TABLE 10.2 Factors Leading to Customer Switching Behavior

Pricing
- High price
- Price increases
- Unfair pricing
- Deceptive pricing

Inconvenience
- Location/hours
- Wait for appointment
- Wait for service

Core Service Failure
- Service mistakes
- Billing errors
- Service catastrophe

Service Encounter Failures
- Uncaring
- Impolite
- Unresponsive
- Unknowledgeable

Response to Service Failure
- Negative response
- No response
- Reluctant response

Competition
- Found better service

Ethical Problems
- Cheat
- Hard sell
- Unsafe
- Conflict of interest

Involuntary Switching
- Customer moved
- Provider closed

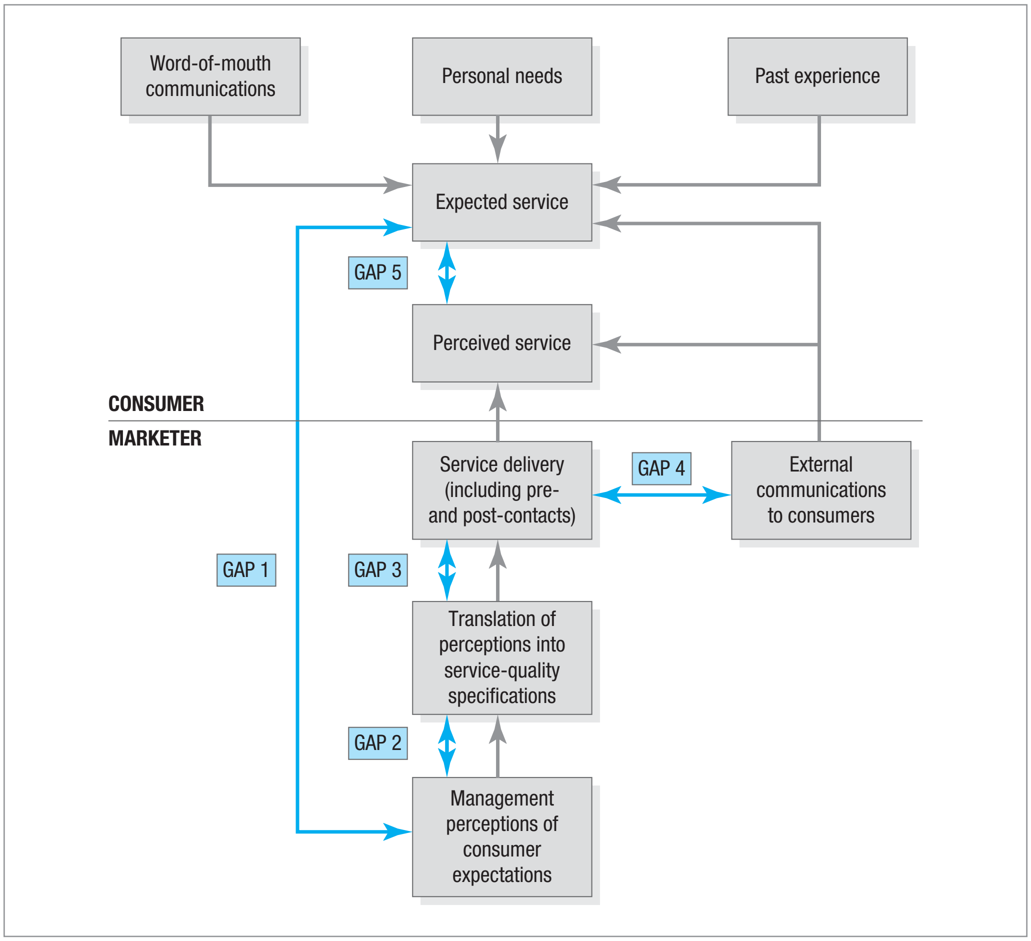
Source: Susan M. Keaveney, "Customer Switching Behavior in Service Industries: An Exploratory Study," *Journal of Marketing* (April 1995): 71–82. Reprinted with permission from the *Journal of Marketing*, published by the American Marketing Association.

2. ***Gap between management perception and service-quality specification***—Management might correctly perceive customers' wants but not set a performance standard. Hospital administrators may tell the nurses to give "fast" service without specifying speed in minutes.
3. ***Gap between service-quality specifications and service delivery***—Employees might be poorly trained or incapable of or unwilling to meet the standard; they may be held to conflicting standards, such as taking time to listen to customers and serving them fast.
4. ***Gap between service delivery and external communications***—Consumer expectations are affected by statements made by company representatives and ads. If a hospital brochure shows a beautiful room but the patient finds it cheap and tacky-looking, external communications have distorted the customer's expectations.
5. ***Gap between perceived service and expected service***—The consumer may misperceive the service quality. The physician may keep visiting the patient to show care, but the patient may interpret this as an indication that something is really wrong.

Based on this service-quality model, researchers identified five determinants of service quality. In descending order of importance, they are reliability, responsiveness, assurance, empathy, and tangibles.[35] The researchers also note there is a *zone of tolerance,* or a range in which a service dimension would be deemed satisfactory, anchored by the minimum level consumers are willing to accept and the level they believe can and should be delivered.

Much work has validated the role of expectations in consumers' interpretations and evaluations of the service encounter and in the relationship they adopt with a firm over time.[36] Consumers are often forward-looking with respect to their decision to keep or drop a service relationship in terms of their likely behavior and interactions with a firm. Any marketing activity that affects current or expected future usage can help to solidify a service relationship.

FIGURE 10.3 Service-Quality Model



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Incorporating Self-Service Technologies

Consumers value convenience in services,[37] and many person-to-person service interactions are being replaced by self-service technologies (SSTs) intended to provide that convenience. To traditional vending machines we can add automated teller machines (ATMs), self-pumping at gas stations, self-checkout at hotels, and a variety of activities on the Internet, such as ticket purchasing. Not all SSTs improve service quality, but they can make service transactions more accurate, convenient, and faster. Obviously, they can also reduce costs. One technology firm, Comverse, estimates the cost to answer a query through a call center at $7, but online at only 10 cents.[38]

Successfully integrating technology into the workforce thus requires a comprehensive reengineering of the front office to identify what people do best, what machines do best, and how to deploy them separately and together.[39] Customers must have a clear sense of their roles in the process.

Managing Product-Support Services

Manufacturers of equipment—small appliances, office machines, tractors, mainframes, airplanes—all must provide *product-support services,* now a battleground for competitive advantage. Some equipment companies, such as Caterpillar Tractor and John Deere, make a significant percentage of their profits from these services.[40] In the global marketplace, companies that make a good product but provide poor local service support are seriously disadvantaged.

Identifying and Satisfying Customer Needs

Traditionally, customers have had three specific worries about product service.[41] First, they worry about reliability and *failure frequency.* A farmer may tolerate a combine that will break down once a year, but not one that goes down two or three times a year. Second, they worry about *downtime.* The longer the downtime, the higher the cost, which is why the customer counts on the seller's *service dependability*—the ability to fix the machine quickly or at least provide a loaner. The third issue is *out-of-pocket costs.* How much does the customer have to spend on regular maintenance and repair costs?

A buyer takes all these factors into consideration and tries to estimate the **life-cycle cost**, which is the product's purchase cost plus the discounted cost of maintenance and repair less the discounted salvage value. To provide the best support, a manufacturer must identify the services customers value most and their relative importance. For expensive equipment, manufacturers offer *facilitating services* such as installation, staff training, maintenance and repair services, and financing. They may also add *value-augmenting services* that extend beyond the product's functioning and performance.

A manufacturer can offer, and charge for, product-support services in different ways. One chemical company provides a standard offering plus a basic level of services. If the business customer wants additional services, it can pay extra or increase its annual purchases to a higher level. Many companies offer *service contracts* (also called *extended warranties*), agreeing to provide maintenance and repair services for a specified period at a specified contract price.

Product companies must understand their strategic intent and competitive advantage in developing services. Are service units supposed to support and protect existing product businesses or grow as an independent platform? Are the sources of competitive advantage based on economies of scale (size) or economies of skill (smarts)?[42]

Postsale Service Strategy

The quality of customer service departments varies greatly. At one extreme are those that simply transfer customer calls to the appropriate person for action with little follow-up. At the other extreme are departments eager to receive customer requests, suggestions, and even complaints and handle them expeditiously. Some firms even proactively contact customers to provide service after the sale is complete.[43]

Manufacturers usually start by running their own parts-and-service departments. They want to stay close to the equipment and know its problems. They also find it expensive and time consuming to train others and discover they can make good money from parts and service if they are the only supplier and can charge a premium price. In fact, many equipment manufacturers price their equipment low and compensate by charging high prices for parts and service.

Over time, manufacturers switch more maintenance and repair service to authorized distributors and dealers. These intermediaries are closer to customers, operate in more locations, and can offer quicker service. Still later, independent service firms emerge and offer a lower price or faster service. A significant percentage of auto-service work is now done outside franchised automobile dealerships by independent garages and chains such as Midas Muffler and Sears. Independent service organizations handle mainframes, telecommunications equipment, and a variety of other equipment lines.

Customer-service choices are increasing rapidly, however, and equipment manufacturers increasingly must figure out how to make money on their equipment, independent of service contracts. Some new-car warranties now cover 100,000 miles before customers have to pay for servicing. The increase in disposable or never-fail equipment makes customers less inclined to pay 2 percent to 10 percent of the purchase price every year for service. Some business customers may find it cheaper to have their own service people on-site.

Executive Summary

A service is any act or performance that one party can offer to another that is essentially intangible and does not result in the ownership of anything. It may or may not be tied to a physical product. Five categories of offerings are: (1) pure tangible good, (2) tangible good with accompanying services, (3) hybrid offering of equal parts goods and services, (4) major service with accompanying minor goods and services, and (5) pure service. Services are intangible, inseparable, variable, and perishable. Marketers must find ways to give tangibility to intangibles, to increase service providers' productivity, to increase and standardize the service quality, and to match the supply of services with market demand.

Marketing of services faces new realities due to customer empowerment, customer coproduction, and the need to satisfy employees as well as customers. Achieving excellence in service marketing calls for external marketing, internal marketing, and interactive marketing. Top service companies adopt a strategic concept, have top-management commitment to quality, commit to high standards, establish profit tiers, and monitor service performance and customer complaints. They also differentiate their brands through primary and secondary service features and continual innovation. Superior service delivery requires managing customer expectations and incorporating self-service technologies. Manufacturers of tangible products should identify and satisfy customer needs for service and provide postpurchase service.

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