

# 4

CHAPTER

# Collecting and Analyzing Marketing Information

## Introduction

In this chapter, we begin the process of developing a marketing plan by examining key issues in collecting and structuring marketing information to assist in the formulation of marketing strategies. Managers in all organizations, large and small, devote a major portion of their time and energy to developing plans and making decisions. As shown in Beyond the Pages 4.1, continuous tracking of the buying preferences of target consumers over time is critical. However, the ability to do so requires access to and analysis of data to generate usable information in a timely manner. Staying abreast of trends in the marketing environment is but one of several tasks performed by marketing managers. However, it is perhaps the most important task because practically all planning and decision making depends on how well this analysis is conducted.

One of the most widely used approaches to the collection and analysis of marketing information is situation analysis. The purpose of situation analysis is to describe current and future issues and key trends as they affect three key environments: the internal environment, the customer environment, and the external environment. As shown in Exhibit 4.1, many issues need to be considered in a situation analysis. When viewed together, the data collected during the situation analysis give the organization a big picture of the issues and trends that affect its ability to deliver value to stakeholders. These efforts drive the development of the organization's competitive advantages and strategic focus as discussed in the next chapter.

In this chapter, we examine several issues related to conducting a situation analysis, the components of a situation analysis, and the collection of marketing data and information to facilitate strategic marketing planning. Although situation analysis has traditionally been one of the most difficult aspects of market planning, recent advances in technology have made the collection of market data and information much easier and more efficient. A wealth of valuable data and information are free for the asking. This chapter examines the different types of marketing data and

*Beyond the Pages 4.1***A FRESH LOOK AT BABY BOOMERS<sup>1</sup>**

Baby boomers—the 77 million people born between 1946 and 1964—have long been the holy grail of marketers aimed at growing their business. The simple raw numbers have always made boomers a powerful force and a favored target of marketers for decades. However, 2006 was a milestone year for boomers and the marketers that pursue them. As the oldest boomers turn 60, over half of all baby boomers are now over the age of 50. These numbers are significant because 50 is the typical age at which marketers give up on consumers. Tradition says that by the age of 50, a consumer has developed deeply entrenched buying preferences and brand loyalty that no amount of marketing can undo. Today's marketers, however, are finding that tradition is wrong.

Marketers are rediscovering baby boomers for a number of reasons. One reason is the incredible buying potential. Thanks to better health and longer life expectancies, most boomers plan to continue working well into their 60s in order to fatten their retirement savings. Today, boomers account for over \$1 trillion in spending power every year. A second reason is that today's consumers who are 50 years and older are much more active than their parents. Unlike previous generations, boomers are much more likely to change careers, have more children, go back to school, remarry, pursue new hobbies, and inherit more money from their parents. Consequently, marketers are finding that boomers' brand preferences and shopping habits are not as entrenched as once thought. Finally, marketers cannot give up on boomers due to the relatively smaller number of Generation X consumers—only 50 million strong—who are following behind them. In the years ahead, businesses must continue to reach out to boomers until the

74 million Generation Y consumers (teens and 20-somethings) reach their peak earning potential.

Reaching out to boomers has become a challenge for many marketers because they have to throw out their stereotypical ideas about consumers who are 50 years and older. The Gap, for example, tried to reach out to boomers using advertising featuring well-known boomer celebrities. That strategy backfired, however, because The Gap's clothes do not suit boomers' tastes. To solve the problem, the company launched a new chain called Forth & Towne, which sells career wear and casual clothing. Other marketers have found success simply by catering to boomers' ideals and needs. For example, Dove saw its sales increase 3.4 percent after it dropped attractive models from its advertising in favor of ordinary, 40-something women. Cover Girl adopted a similar strategy by launching its first line of makeup targeted at older women. The Home Depot is adding renovation services to its mix in addition to its assortment of products for do-it-yourselfers. And even Honda was surprised when it learned that 40 percent of its minivan buyers were older customers who needed to haul grandchildren rather than their own children. As a result, Honda introduced a luxury version of its popular Odyssey minivan to cater to the needs of older consumers.

In addition to discarding traditional ideas about older consumers, experts also agree that marketers must not assume that the 50+ market is of one mind. Researchers at Duke University have discovered that boomers are the most diverse of all current generations. Consequently, marketers must segment this market carefully to ensure that their marketing resonates with the correct boomer segment.

information needed for planning, as well as many sources where such data may be obtained.

## Conducting a Situation Analysis

Before we move forward in our discussion, it is important to keep in mind four important issues regarding situation analysis. We hope our advice helps you overcome potential problems throughout the situation analysis.

**EXHIBIT 4.1****ISSUES TO BE CONSIDERED IN A SITUATION ANALYSIS***The Internal Environment*

Review of current objectives, strategy, and performance  
 Availability of resources  
 Organizational culture and structure

*The Customer Environment*

Who are our current and potential customers?  
 What do customers do with our products?  
 Where do customers purchase our products?  
 When do customers purchase our products?  
 Why (and how) do customers select our products?  
 Why do potential customers not purchase our products?

*The External Environment*

Competition  
 Economic growth and stability  
 Political trends  
 Legal and regulatory issues  
 Technological advancements  
 Sociocultural trends

**Analysis Alone Is Not a Solution**

Although it is true that a comprehensive situation analysis can lead to better planning and decision making, analysis itself is not enough. Put another way, situation analysis is a necessary but insufficient prerequisite for effective strategic planning. The analysis must be combined with intuition and judgment to make the results of the analysis useful for planning purposes. Situation analysis should not replace the manager in the decision-making process. Its purpose is to empower the manager with information for more effective decision making.

A thorough situation analysis empowers the marketing manager because it encourages both analysis and synthesis of information. From this perspective, situation analysis involves taking things apart: whether it's a customer segment (to study the heavy users), a product (to understand the relationship between its features and customers' needs), or competitors (to weigh their strengths and weaknesses against your own). The purpose of taking things apart is to understand why people, products, or organizations perform the way they do. After this dissection is complete, the manager can then synthesize the information to gain a big-picture view of the complex decisions to be made.

**Data Are Not the Same as Information**

Throughout the planning process, managers regularly face the question "How much data and information do I need?" The answer sounds simple, but in practice

it is not. Today, there is no shortage of data. In fact, it is virtually impossible to know everything about a specific topic. Thankfully, the cost of collecting and storing vast amounts of data has dropped dramatically over the past decade. Computer-based marketing information systems are commonplace. Online data sources allow managers to retrieve data in a matter of seconds. The growth of wireless technology now gives managers access to vital data while in the field. The bottom line is that managers are more likely to be overwhelmed with data rather than face a shortage.

Although the vast amount of available data is an issue to be resolved, the real challenge is that good, useful information is not the same as data. Data are easy to collect and store, but good information is not. In simple terms, *data* are a collection of numbers or facts that have the potential to provide information. Data, however, do not become informative until a person or process transforms or combines them with other data in a manner that makes them useful to decision makers. For example, the fact that your firm's sales are up 20 percent is not informative until you compare it with the industry's growth rate of 40 percent. It is also important to remember that information is only as good as the data from which it comes. As the saying goes, "Garbage in, garbage out." It is a good idea to be curious about, perhaps even suspicious of, the quality of data used for planning and decision making.

### The Benefits of Analysis Must Outweigh the Costs

Situation analysis is valuable only to the extent that it improves the quality of the resulting marketing plan. For example, data that cost \$4,000 to acquire but improve the quality of the decision by only \$3,999 should not be part of the analysis process. Although the costs of acquiring data are easy to determine, the benefits of improved decisions are quite difficult to estimate. Managers must constantly ask such questions as, "Where do I have knowledge gaps?"; "How can these gaps be filled?"; "What are the costs of filling these gaps?"; and "How much improvement in decision making will be gained by acquiring this information?" By asking these questions, managers can find a balance between jumping to conclusions and "paralysis by analysis," or constantly postponing a decision due to a perceived lack of information. Perpetually analyzing data without making any decisions is usually not worth the additional costs in terms of time or financial resources.

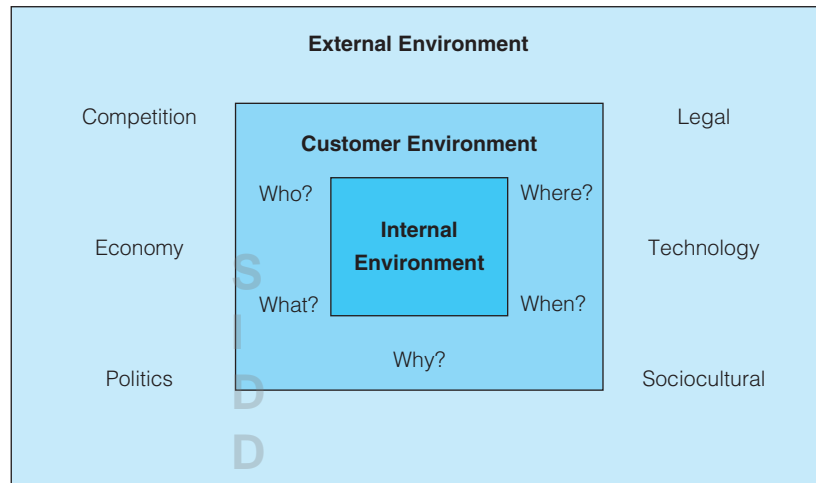
### Conducting a Situation Analysis Is a Challenging Exercise

Situation analysis is one of the most difficult tasks in developing a marketing plan. Managers have the responsibility of assessing the quality, adequacy, and timeliness of the data and information used for analysis and synthesis. The dynamic nature of internal and external environments often creates breakdowns in the effort to develop effective information flows. This dynamism can be especially troubling when the firm attempts to collect and analyze data in international markets.

It is important that any effort at situation analysis be well organized, systematic, and supported by sufficient resources (for example, people, equipment, information,

EXHIBIT 4.2

### THE INTERCONNECTEDNESS OF THE INTERNAL, CUSTOMER, AND EXTERNAL ENVIRONMENTS



and budget). However, the most important aspect of the analysis is that it should be an ongoing effort. The analysis should not only take place in the days and weeks immediately preceding the formation of strategies and plans, but the collection, creation, analysis, and dissemination of pertinent marketing data and information must also be ingrained in the organization's culture. This is not an easy task, but if the organization is going to be successful, it must have the ability to assess its current situation in real time. This type of live data is especially important when tracking customers and competitors.

A final challenge is the task of tracking all three environments (internal, customer, and external) simultaneously. Although the rapid pace of change in today's economy is one cause of this difficulty, the interconnectedness of all three environments creates challenges as well. As shown in Exhibit 4.2, the internal, customer, and external environments do not exist independently. Changes in one portion of the external environment can cause subsequent shifts in the customer environment or the internal environment. For example, due to a patent infringement lawsuit, it appeared that Research in Motion would have to shut down the system behind its incredibly popular BlackBerry wireless handheld device. This single challenge from its legal environment not only threatened the BlackBerry's existence but also affected competitors' stances toward the market. Although Research in Motion eventually settled the suit, it is likely to face additional legal hurdles in the future.<sup>2</sup>

As we turn our attention to the three major components of the situation analysis, keep in mind that data and information about these environments will come from both internal and external sources. Even information about the firm's internal environment can be collected via external sources such as third-party analysis and ratings, financial commentaries, or customer opinion ratings. Finally, it is important to

remember that the type of data and information source is not as important as having ready access to a wide variety of sources.

## The Internal Environment

The first aspect of a situation analysis involves the critical evaluation of the firm's internal environment with respect to its objectives, strategy, performance, allocation of resources, structural characteristics, and political climate. Exhibit 4.3 provides a framework for analyzing the internal environment.

### EXHIBIT 4.3

#### A FRAMEWORK FOR ANALYZING THE INTERNAL ENVIRONMENT

##### *Review of Current Marketing Objectives, Strategy, and Performance*

1. What are the current marketing goals and objectives?
2. Are the marketing goals and objectives consistent with the corporate or business-unit mission, goals, and objectives? Are they consistent with recent changes in the customer or external environments? Why or why not?
3. How are current marketing strategies performing with respect to anticipated outcomes (for example, sales volume, market share, profitability, communication, brand awareness, customer preference, customer satisfaction)?
4. How does current performance compare with other organizations in the industry? Is the performance of the industry as a whole improving or declining? Why?
5. If performance is declining, what are the most likely causes? Are marketing objectives inconsistent? Is the strategy flawed? Was the strategy poorly implemented?
6. If performance is improving, what actions can be taken to ensure that performance continues to improve? Is the improvement in performance due to a better-than-anticipated environment or superior planning and implementation?

##### *Review of Current and Anticipated Organizational Resources*

1. What is the state of current organizational resources (for example, financial, human, experience, relationships with key suppliers or customers)?
2. Are these resources likely to change for the better or worse in the near future? How?
3. If the changes are for the better, how can these added resources be used to meet customer needs better than competitors?
4. If the changes are for the worse, what can be done to compensate for these new resource constraints?

##### *Review of Current and Anticipated Cultural and Structural Issues*

1. What are the positive and negative aspects of the current and anticipated organizational culture?
2. What issues related to internal politics or management struggles might affect the organization's marketing activities?
3. What is the overall position and importance of the marketing function as seen by other functional areas? Are key executive positions expected to change in the future?
4. How will the overall market- or customer-orientation of the organization (or lack thereof) affect marketing activities?
5. Does the organization emphasize a long- or short-term planning horizon? How will this emphasis affect marketing activities?
6. Currently, are there positive or negative issues with respect to motivating employees, especially those in frontline positions (for example, sales and customer service)?

## Review of Current Objectives, Strategy, and Performance

First, the marketing manager must assess the firm's current marketing objectives, strategy, and performance. A periodic assessment of marketing objectives is necessary to ensure that they remain consistent with the firm's mission and the changing customer and external environments. It may also be necessary to reassess the firm's marketing goals if the objectives prove to be out-of-date or ineffective. This analysis serves as an important input to later stages of the marketing planning process.

The marketing manager should also evaluate the performance of the current marketing strategy with respect to sales volume, market share, profitability, and other relevant measures. This analysis can take place at many levels: by brand, product line, market, business unit, division, and so on. It is also important to analyze the marketing strategy relative to overall industry performance. Poor or declining performance may be the result of (1) holding on to marketing goals or objectives inconsistent with the current realities of the customer or external environments, (2) a flawed marketing strategy, (3) poor implementation, or (4) changes in the customer or external environments beyond the control of the firm. The causes for poor or declining performance must be pinpointed before marketing strategies can be developed to correct the situation.

For example, in the mid-1990s Pepsi was locked in a seemingly endless market-share battle with Coca-Cola. By all accounts, the battle was not going well for Pepsi: Its profits trailed Coca-Cola's by 47 percent while its market value was less than half of its chief rival.<sup>3</sup> But losing out to Coca-Cola in the cola wars was just the kick that Pepsi needed to regroup. Forced to look outside of the soft-drink industry for new growth opportunities, Pepsi moved aggressively into noncarbonated and sports beverages, food, and snacks. Today, Pepsi's Aquafina bottled water and Gatorade are dominant over Coke's Dasani bottled water and PowerAde in their respective markets. In addition, Pepsi's Frito-Lay division commands over 60 percent of the U.S. snack-food market. Since 2000 Pepsi's profits have climbed more than 100 percent.

## Availability of Resources

Second, the marketing manager must review the current and anticipated levels of organizational resources that can be used for marketing purposes. This review includes an analysis of financial, human, and experience resources, as well as any resources the firm might hold in key relationships with supply chain partners, strategic alliance partners, or customer groups. An important element of this analysis is to gauge whether the availability or level of these resources is likely to change in the near future. Additional resources might be used to create competitive advantages in meeting customer needs. If the marketing manager expects resource levels to decline, he or she must find ways to compensate when establishing marketing goals, objectives, and strategies for the next planning period.

In bad economic times, financial shortfalls get most of the attention. However, many experts predict that a shortage of skilled labor will be a major problem in the U.S. over the next few years. The problem is not the raw number of workers but the skill set that each one brings to the job. After years of increasing technological innovation,

workers must now possess the right set of skills to work with technology. Likewise, workers of today must possess knowledge-related skills such as abstract reasoning, problem solving, and communication. Firms in many industries—most notably services—have turned to moving jobs offshore to other countries where highly educated, English-speaking employees will work for less pay than their U.S. counterparts. Of all white-collar jobs that have been sent offshore, a full 90 percent are now located in India. An interesting irony is that the same technology that demands increased skills from employees allows these jobs to be sent offshore to other countries.<sup>4</sup>

## Organizational Culture and Structure

Finally, the marketing manager should review current and anticipated cultural and structural issues that could affect marketing activities. One of the most important issues in this review involves the internal culture of the firm. In some organizations, marketing does not hold a prominent position in the political hierarchy. This situation can create challenges for the marketing manager in acquiring resources and gaining approval of the marketing plan. The internal culture also includes any anticipated changes in key executive positions within the firm. The marketing manager, for example, could have difficulty in dealing with a new production manager who fails to see the benefits of marketing. Other structural issues to be considered include the overall customer orientation of the firm (or lack thereof), issues related to employee motivation and commitment to the organization (particularly among unionized employees), and the relative emphasis on long- versus short-term planning. Top managers who concern themselves only with short-term profits are unlikely to see the importance of a marketing plan that attempts to create long-term customer relationships.

For most firms, culture and structure are relatively stable issues that do not change dramatically from one year to the next. In fact, changing or reorienting an organization's culture is a difficult and time-consuming process. In some cases, however, the culture and structure can change swiftly, causing political and power struggles within the organization. Consider the effects when two organizations combine their separate cultures and structures during a merger. For example, the merger of Chrysler Corporation and Daimler Benz AG in a deal of so-called equals resulted in culture conflicts, with the German component of the merged firm taking over most management positions. Management issues continued under former CEO Juergen Schrempp to the point that DaimlerChrysler lost sight of the importance of the Mercedes brand. After several years of declining quality, lower sales, and declining profits for Mercedes, new CEO Dieter Zetsche overhauled the management structure at DaimlerChrysler to reinstate the Mercedes division to its dominant position as the core business of the company.<sup>5</sup>

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## The Customer Environment

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In the second part of a situation analysis, the marketing manager must examine the current and future situation with respect to customers in the firm's target markets. During this analysis, information should be collected that identifies (1) the firm's

current and potential customers, (2) the prevailing needs of current and potential customers, (3) the basic features of the firm's and competitors' products perceived by customers as meeting their needs, and (4) anticipated changes in customers' needs.

In assessing the firm's target markets, the marketing manager must attempt to understand all relevant buyer behavior and product usage characteristics. One method that the manager can use to collect this information is the 5W Model: Who, What, Where, When, and Why. We have adapted and applied this model to customer analysis, as shown in Exhibit 4.4. Organizations that are truly market or customer oriented should know their customers well enough that they have easy access to the types of information that answer these questions. If not, the organization may need to conduct primary marketing research to fully understand its target markets.

### Who Are Our Current and Potential Customers?

Answering the "who" question requires an examination of the relevant characteristics that define target markets. This includes demographic characteristics (gender, age, income, and so on), geographic characteristics (where customers live, density of the target market, and so on), and psychographic characteristics (attitudes, opinions, interests, and so on). Depending on the types of products sold by the firm, purchase influencers or users, rather than actual purchasers, may be important as well. For example, in consumer markets it is well known that the influence of children is critical for purchases such as cars, homes, meals, toys, and vacations. In business markets, the analysis typically focuses on the buying center. Is the buying decision made by an individual or by a committee? Who has the greatest influence on the purchase decision?

The analysis must also assess the viability of potential customers or markets that may be acquired in the future. This involves looking ahead to situations that may increase the firm's ability to gain new customers. For example, firms around the world are particularly excited about the further opening of the Chinese market and its 1.4 billion potential consumers. Many firms, including Procter & Gamble, Wal-Mart, Starbucks, and Pepsi have established a presence in China that they hope to leverage for future growth opportunities. German-based Adidas went so far as to spend roughly \$100 million to become the official footwear sponsor of the 2008 Beijing Olympics.<sup>6</sup>

### What Do Customers Do with Our Products?

The "what" question entails an assessment of how customers consume and dispose of the firm's products. Here the marketing manager might be interested in identifying the rate of product consumption (sometimes called the usage rate), differences between heavy and light users of products, whether customers use complementary products during consumption, and what customers do with the firm's products after consumption. In business markets, customers typically use the firm's products in the creation of their own products. As a result, business customers tend to pay very close attention to product specifications and quality.

In some cases, marketers cannot fully understand how customers use their products without looking at the complementary products that go with them. In

**EXHIBIT 4.4****THE EXPANDED 5W MODEL FOR CUSTOMER ANALYSIS***Who Are Our Current and Potential Customers?*

1. What are the demographic, geographic, and psychographic characteristics of our customers?
2. Who actually purchases our products?
3. Do these purchasers differ from the users of our products?
4. Who are the major influencers of the purchase decision?
5. Who is financially responsible for making the purchase?

*What Do Customers Do with Our Products?*

1. In what quantities and in what combinations are our products purchased?
2. How do heavy users of our products differ from light users?
3. Do purchasers use complementary products during the consumption of our products? If so, what is the nature of the demand for these products, and how does it affect the demand for our products?
4. What do our customers do with our products after consumption?
5. Are our customers recycling our products or packaging?

*Where Do Customers Purchase Our Products?*

1. From what types of vendors are our products purchased?
2. Does e-commerce have an effect on the purchase of our products?
3. Are our customers increasing their purchasing from nonstore outlets?

*When Do Customers Purchase Our Products?*

1. Are the purchase and consumption of our products seasonal?
2. To what extent do promotional events affect the purchase and consumption of our products?
3. Do the purchase and consumption of our products vary based on changes in physical/social surroundings, time perceptions, or the purchase task?

*Why (and How) Do Customers Select Our Products?*

1. What are the basic features provided by our products and our competitors' products? How do our products compare to those of competitors?
2. What are the customer needs fulfilled by our products and our competitors' products? How well do our products meet these needs? How well do our competitors' products meet these needs?
3. Are the needs of our customers expected to change in the future? If so, how?
4. What methods of payment do our customers use when making a purchase? Is the availability of credit or financing an issue with our customers?
5. Are our customers prone to developing close long-term relationships with us and our competitors, or do they buy in a transactional fashion (primarily based on price)?
6. How can we develop, maintain, or enhance the relationships we have with our customers?

*Why Do Potential Customers Not Purchase Our Products?*

1. What are the basic needs of noncustomers that our products do not meet?
2. What are the features, benefits, or advantages of competing products that cause noncustomers to choose them over our products?
3. Are there issues related to distribution, promotion, or pricing that prevent noncustomers from purchasing our products?
4. What is the potential for converting noncustomers into customers of our products?

Source: Adapted from Donald R. Lehmann and Russell S. Winer, *Analysis for Marketing Planning*, 6th ed. (Boston: McGraw-Hill/Irwin, 2005).

these cases of *derived demand*—where the demand for one product depends on (is derived from) the demand of another product—the marketer must also examine the consumption and usage of the complementary product. For example, tire manufacturers concern themselves with the demand for automobiles, and makers of computer accessories closely watch the demand for desktop and laptop computers. By following the demand for and consumption of complementary products, marketers are in a much better position to understand how customers use their own products.



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Before customers and marketers became more concerned about the natural environment, many firms looked only at how their customers used products. Today, marketers have become increasingly interested in how customers dispose of products, such as whether customers recycle the product or its packaging. Another postconsumption issue deals with the need for reverse channels of distribution to handle product repairs. Car manufacturers, for example, must maintain an elaborate network of certified repair facilities (typically through dealers) to handle maintenance and repairs under warranty.

Sometimes recycling and repair issues come into conflict. The relatively low cost of today's home electronics leads many customers to buy new televisions, radios, computers, or cell phones rather than have old ones repaired. This causes a problem: What do consumers do with e-waste, or broken and obsolete electronic devices? Though e-waste makes up only 1 percent of our country's garbage volume, state governments and local communities have struggled for years with the roughly five million tons of e-waste that enters landfills each year. The problem has also created environmental concerns with respect to the lead, cadmium, mercury, and other hazardous materials contained in e-waste. Many states have responded to these concerns by implementing bans on the dumping of e-waste in landfills and incinerators or by creating recycling programs specifically aimed at e-waste. As a result of these initiatives, schools, churches, and charities have been inundated with donations of obsolete electronics.<sup>7</sup>

### Where Do Customers Purchase Our Products?

The “where” question is associated mainly with distribution and customer convenience. Until recently, most firms looked solely at traditional channels of distribution such as brokers, wholesalers, and retailers. Thus, the marketing manager would have concerns about the intensity of the distribution effort and the types of retailers that the firm's customers patronized. Today, however, many other forms of distribution are available. The fastest growing form of distribution today is nonstore retailing—which includes vending machines; direct marketing through catalogs, home sales, or infomercials; and

electronic merchandising through the Internet, interactive television, and video kiosks.<sup>8</sup> Business markets have also begun to capitalize on the lower costs of procurement via the Internet. Likewise, many manufacturers have bypassed traditional distribution channels in favor of selling through their own outlet stores or websites. Disney, for example, has begun selling many of its movies via online download for use on computers and portable devices.<sup>9</sup> The move allows Disney to close the time gap between DVD release and cable on-demand availability by several months.

### **When Do Customers Purchase Our Products?**

The “when” question refers to any situational influences that may cause customer purchasing activity to vary over time. This includes broad issues such as the seasonality of the firm’s products and the variability in purchasing activity caused by promotional events or budgetary constraints. Everyone knows that consumer-purchasing activity increases just after payday. In business markets, budgetary constraints and the timing of a firm’s fiscal year often dictate the “when” question. For example, many schools and universities buy large quantities of supplies just before the end of their fiscal years.

The “when” question also includes more subtle influences that can affect purchasing behavior such as physical and social surroundings, time perceptions, and the purchase task. For example, a consumer may purchase a domestic brand of beer for regular home consumption but purchase an import or microbrew when visiting a bar (physical surroundings), going out with friends (social surroundings), or throwing a party. Customers can also vary their purchasing behavior based on the time of day or how much time they have to search for alternatives. Variation by purchase task depends on what the customer intends to accomplish with the purchase. For example, a customer may purchase Brand A for her own use, brand B for her children, and brand C for her coworker as a gift.

### **Why (and How) Do Customers Select Our Products?**

The “why” question involves identifying the basic need-satisfying benefits provided by the firm’s products. The potential benefits provided by the features of competing products should also be analyzed. This question is important because customers may purchase the firm’s products to fulfill needs that the firm never considered. For example, most people think of vinegar as an ingredient in salad dressings. However, vinegar boasts many other uses, including cleaning floors, loosening rusted screws or nuts, tenderizing meat, and softening hard paint brushes.<sup>10</sup> The answer to the “why” question can also aid in identifying unsatisfied or undersatisfied customer needs. During the analysis, it is also important to identify potential changes in customers’ current and future needs. Customers may purchase the firm’s products for a reason that may be trumped by newly launched competitive products in the future.

The “how” part of this question refers to the means of payment that customers use when making a purchase. Although most people use cash (which also includes checks and debit cards) for most transactions, the availability of credit makes it possible for

customers to take possession of high-priced products like cars and homes. The same is true in business markets where credit is essential to the exchange of goods and services in both domestic and international transactions. Recently, a very old form of payment has reemerged in business markets—barter. Barter involves the exchange of goods and services for other goods or services; no money changes hands. Barter arrangements are very good for small businesses short on cash. According to the International Reciprocal Trade Association, over \$8.4 billion of international trade in goods and services is conducted on a noncash basis—a number that represents 15 percent of the global economy. Barter has grown at the rate of roughly eight percent each year, thanks in part to the advent of barter networks on the Internet.<sup>11</sup>

### Why Do Potential Customers Not Purchase Our Products?

An important part of customer analysis is the realization that many potential customers choose not to purchase the firm's products. Although there are many potential reasons why customers might not purchase a firm's products, some reasons include the following:

- Noncustomers have a basic need that the firm's product does not fulfill.
- Noncustomers perceive that they have better or lower-priced alternatives such as competing substitute products.
- Competing products actually have better features or benefits than the firm's product.
- The firm's product does not match noncustomers' budgets or lifestyles.
- Noncustomers have high switching costs.
- Noncustomers do not know that the firm's product exists.
- Noncustomers have misconceptions about the firm's product (weak or poor image).
- Poor distribution makes the firm's product difficult to find.

Once the manager identifies the reasons for nonpurchase; he or she should make a realistic assessment of the potential for converting noncustomers into customers. Although conversion is not always possible, in many cases converting noncustomers is as simple as taking a different approach. For example, Australian-based Casella Wines was able to convert noncustomers into wine drinkers by fundamentally changing their approach to the wine industry. Through its [yellow tail] brand, Casella converted nonwine drinkers by positioning itself as being easy to drink, easy to understand, easy to buy, and fun. [yellow tail] ignored long-held wine attributes such as prestige and complexity to make wine more approachable to the masses. The end result is that [yellow tail] is now the number-one imported wine in the United States.<sup>12</sup>

Once the marketing manager has analyzed the firm's current and potential customers, the information can be used to identify and select specific target markets for

the revised marketing strategy. The firm should target those customer segments where it can create and maintain a sustainable advantage over its competition.

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## The External Environment

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The final and broadest issue in a situation analysis is an assessment of the external environment, which includes all the external factors—competitive, economic, political, legal/regulatory, technological, and sociocultural—that can exert considerable direct and indirect pressures on both domestic and international marketing activities. Exhibit 4.5 provides a framework for analyzing factors in the external environment. As this framework suggests, the issues involved in examining the external environment can be divided into separate categories (that is, competitive, economic, political, and so on). However, some environmental issues can fall into multiple categories.

One such example is the explosive growth in direct-to-consumer (DTC) advertising in the pharmaceutical industry. In 2005 the industry spent roughly \$3 billion on DTC advertising through “ask your doctor” style ads aimed at encouraging consumers to request drugs by name from their physicians. This promotional strategy has been praised and criticized on a number of fronts. Some argue that DTC advertising plays an important role in educating the population about both disease and available treatments. Critics—including the U.S. Congress—argue that DTC advertising encourages consumers to self-diagnose and is often misleading about a drug’s benefits and side effects. In response to these criticisms, the pharmaceutical industry developed a set of guiding principles for DTC advertising. However, most expect Congress to eventually pass legislation curtailing or barring the practice.<sup>13</sup>

Issues in the external environment can often be complex. For example, a 1997 strike by UPS employees not only put UPS employees out of work but also led to economic slowdowns in UPS hub cities. The strike also became a political issue for President Bill Clinton because he was continually pressured to invoke the Taft–Hartley Act to force striking UPS employees back to work. Although the effects of the UPS strike were short lived, some changes have a lasting impact. The tragic events of September 11, 2001 led to many changes in the competitive, economic, political, legal, technological, and sociocultural environments that will be felt for decades to come. Thankfully, complex situations like these occur infrequently. As we examine each element of the external marketing environment, keep in mind that issues arising in one aspect of the environment are usually reflected in other elements as well.

### Competition

In most industries, customers have choices and preferences in terms of the goods and services that they can purchase. Thus, when a firm defines the target markets it will serve, it simultaneously selects a set of competing firms. The current and future actions of these competitors must be constantly monitored and, hopefully, even anticipated. One major problem in analyzing competition is the question of identification. That is, how does the manager answer the question “Who are our current and

**EXHIBIT 4.5****A FRAMEWORK FOR ANALYZING THE EXTERNAL ENVIRONMENT***Competition*

1. Who are our major brand, product, generic, and total budget competitors? What are their characteristics in terms of size, growth, profitability, strategies, and target markets?
2. What are our competitors' key strengths and weaknesses?
3. What are our competitors' key capabilities and vulnerabilities with respect to their marketing program (for example, products, distribution, promotion, and pricing)?
4. What response can we expect from our competitors if environmental conditions change or if we change our marketing strategy?
5. How is our set of competitors likely to change in the future? Who are our new competitors likely to be?

*Economic Growth and Stability*

1. What are the general economic conditions of the country, region, state, and local area in which our firm operates?
2. What are the economic conditions of our industry? Is our industry growing? Why or why not?
3. Overall, are customers optimistic or pessimistic about the economy? Why?
4. What are the buying power and spending patterns of customers in our industry? Are our industry's customers buying less or more of our products? Why?

*Political Trends*

1. Have recent elections changed the political landscape within our domestic or international markets? If so, how?
2. What type of industry regulations do elected officials favor?
3. What are we doing currently to maintain good relations with elected officials? Have these activities been effective? Why or why not?

*Legal and Regulatory Issues*

1. What proposed changes in international, federal, state, or local laws and regulations have the potential to affect our marketing activities?
2. Do recent court decisions suggest that we should modify our marketing activities?
3. Do the recent rulings of federal, state, local and self-regulatory agencies suggest that we should modify our marketing activities?
4. What effect will changes in global trade agreements or laws have on our international marketing opportunities?

*Technological Advancements*

1. What impact has changing technology had on our customers?
2. What technological changes will affect the way that we operate or manufacture our products?
3. What technological changes will affect the way that we conduct marketing activities such as distribution or promotion?
4. Are there any current technologies that we do not use to their fullest potential in making our marketing activities more effective and efficient?
5. Do any technological advances threaten to make our products obsolete? Does new technology have the potential to satisfy previously unmet or unknown customer needs?

*Sociocultural Trends*

1. How are society's demographics and values changing? What effect will these changes have on our customers, products, pricing, distribution, promotion, and our employees?
2. What challenges or opportunities have changes in the diversity of our customers and employees created?
3. What is the general attitude of society about our industry, company, and products? Could we take actions to improve these attitudes?
4. What social or ethical issues should we be addressing?

EXHIBIT 4.6

## MAJOR TYPES OF COMPETITION

Product Category (Need Fulfilled)	Brand Competitors	Product Competitors	Generic Competitors	Total Budget Competitors
Sport utility vehicles (transportation)	Ford Escape Toyota RAV4 Honda CR-V	Trucks Passenger cars Minivans	Rental cars Motorcycles Bicycles	Vacation Debt reduction Home remodeling
Soft drinks (refreshment)	Coca-Cola Classic Pepsi Cola Dr. Pepper	Tea Orange juice Bottled water	Tap water	Candy Gum Potato chips
Movies (entertainment)	<i>Harry Potter</i> <i>The Matrix</i> <i>Star Wars</i>	Cable TV Pay-Per-View Video rentals	Athletic events Arcades Concerts	Shopping Reading Fishing
Colleges (education)	New Mexico Florida State LSU	Trade school Community college Online programs	Books CD-ROMs Apprenticeships	New cars Vacations Investments

future competitors?” To arrive at an answer, the manager must look beyond the obvious examples of competition. Most firms face four basic types of competition:

1. *Brand competitors*, which market products with similar features and benefits to the same customers at similar prices
2. *Product competitors*, which compete in the same product class but with products that are different in features, benefits, and price
3. *Generic competitors*, which market very different products that solve the same problem or satisfy the same basic customer need
4. *Total budget competitors*, which compete for the limited financial resources of the same customers

Exhibit 4.6 presents examples of each type of competition for selected product markets. In the fast-growing, small-SUV segment of the automobile industry, for example, the Ford Escape, Toyota RAV4, Honda CR-V, and Subaru Forester are brand competitors. However, each faces competition from other types of automobile products such as midsize SUVs, trucks, minivans, and passenger cars. Some of this product competition comes from within each company’s own product portfolio (for example, Ford’s Explorer SUV, Taurus car, Freestar minivan, and F-150 truck). Small SUVs also face generic competition from Honda motorcycles, Schwinn bicycles, Hertz rental cars, and public transportation—all of which offer products that satisfy the same basic customer need for transportation. Finally, customers have many alternative uses for their money rather than purchasing a small SUV: They can take a vacation, install a pool in the backyard, buy a boat, start an investment fund, or pay off debt.

All four types of competition are important, but brand competitors rightfully receive the greatest attention because customers see different brands as direct substitutes for each other. For this reason, strategies aimed at getting customers to switch

brands are a major focus in any effort to beat brand competitors. For example, Gatorade, far and away the dominant sports drink, has taken steps to convince soft-drink consumers to switch to noncarbonated beverages. The company has introduced many new flavors including Frost, Fierce, Xtremo, and All-Stars; Gatorade has also developed a low-calorie fitness water called Propel. These additions, along with the introduction of new bottles, multipacks, and refreshed labeling, has placed Gatorade squarely alongside other drink choices in supermarkets and convenience stores. Gatorade's popularity was also behind its recent partnership with Comcast to develop programming for a new on-demand service called Exercise<sup>tv</sup>. Gatorade's bold moves into the mainstream have made the brand a formidable product competitor among branded competition in the soft-drink market.<sup>14</sup>

Competitive analysis has received greater attention recently for several reasons: more intense competition from sophisticated competitors, increased competition from foreign firms, shorter product life cycles, and dynamic environments, particularly in the area of technological innovation. A growing number of companies have adopted formalized methods of identifying competitors, tracking their activities, and assessing their strengths and weaknesses—a process referred to as competitive intelligence. *Competitive intelligence* involves the legal and ethical observation, tracking, and analysis of the total range of competitive activity including competitors' capabilities and vulnerabilities with respect to sources of supply, technology, marketing, financial strength, manufacturing capacities and qualities, and target markets. It also attempts to predict and anticipate competitive actions and reactions in the marketplace.<sup>15</sup> Competitive analysis should progress through the following stages:

1. **Identification** Identify all current and potential brand, product, generic, and total budget competitors.
2. **Characteristics** Focus on key competitors by assessing the size, growth, profitability, objectives, strategies, and target markets of each one.
3. **Assessment** Assess each key competitor's strengths and weaknesses, including the major capabilities and vulnerabilities that each possesses within its functional areas (marketing, research and development, production, human resources, and so on).
4. **Capabilities** Focus the analysis on each key competitor's marketing capabilities in terms of its products, distribution, promotion, and pricing.
5. **Response** Estimate each key competitor's most likely strategies and responses under different environmental situations as well as its reactions to the firm's own marketing efforts.

Many sources are available for gathering information on current or potential competitors. Company annual reports are useful for determining a firm's current performance and future direction. An examination of a competitor's mission statement can also provide information, particularly with respect to how the company defines itself. A thorough scan of a competitor's website can also uncover information—such

as product specifications and prices—that can greatly improve the competitive analysis. Other, clever ways to collect competitive information include data-mining techniques, patent tracking to reveal technological breakthroughs, creating psychological profiles of competitor's key executives, searching consumer review and blog websites, and attending trade shows and conferences.<sup>16</sup> Other valuable information sources include business periodicals and trade publications that provide newsworthy tidbits about companies. There are also numerous commercial databases, such as ABI/INFORM, InfoTrac, EBSCO, Hoover's, and Moody's, which provide a wealth of information on companies and their marketing activities. The information contained in these databases can be purchased in print form, on CD-ROM, or through an online connection with a data provider such as a school or public library.

### **Economic Growth and Stability**

If there is one truism about any economy, it is that it will inevitably change. Therefore, current and expected conditions in the economy can have a profound impact on marketing strategy. A thorough examination of economic factors requires marketing managers to gauge and anticipate the general economic conditions of the nation, region, state, and local area in which they operate. These general economic conditions include inflation, employment and income levels, interest rates, taxes, trade restrictions, tariffs, and the current and future stages of the business cycle (prosperity, stagnation, recession, depression, and recovery). After a downward trend in inflation since 1990's 5+ percent rate, evidence suggests that inflation may be on the rise again. Since 2002 annual inflation has increased from just above one percent to roughly 3.5 percent today.<sup>17</sup>

Equally important economic factors include consumers' overall impressions of the economy and their ability and willingness to spend. Consumer confidence (or lack thereof) can greatly affect what the firm can or cannot do in the marketplace. In times of low confidence, consumers may not be willing to pay higher prices for premium products, even if they have the ability to do so. In other cases, consumers may not have the ability to spend, regardless of the state of the economy. Another important factor is the current and anticipated spending patterns of consumers in the firm's target market. If consumers buy less (or more) of the firm's products, there could be important economic reasons for the change.

One of the most important economic realities in the United States over the last 50 years has been a steady shift away from a tangibles-dominant economy (goods, equipment, and manufacturing) to one dominated by intangibles such as services and information. In fact, virtually everyone is aware that the U.S. economy is a knowledge-based economy. However, our methods of measuring and reporting on the economy have not kept pace with this change. Our methods are very good at capturing manufacturing output, capital expenditures, and investments in other tangible assets; but they cannot capture investments in intangibles such as innovation, employee training, brand equity, or product design. Consequently, the true nature of our economy is underreported by virtually all current statistics such as the revered gross domestic product (GDP). Innovation, creativity, and human assets—the main drivers behind

the success of most U.S. businesses—are not counted as a part of yearly GDP statistics. One of the major challenges moving forward is finding ways of capturing these intangibles in our regular reporting and economic analyses.<sup>18</sup>

## Political Trends

Although the importance will vary from firm to firm, most organizations should track political trends and attempt to maintain good relations with elected officials. Organizations that do business with government entities, such as defense contractors, must be especially attuned to political trends. Elected officials who have negative attitudes toward a firm or its industry are more likely to create or enforce regulations unfavorable for the firm. For example, the antitobacco trend in the United States has been in full swing since the late 1990s. Today, many states and local communities have passed laws to prevent smoking in public places. One of the most hotly contested political issues in 2006 was the status of illegal immigrants crossing the U.S. border, especially from Mexico. This single issue had potential ramifications for the U.S. economy (employment, health care, and trade), society (language and culture), and political relations with other nations. As these examples show, political discussions can have serious, lasting consequences for an industry or firm.

Many organizations view political factors as beyond their control and do little more than adjust the firm's strategies to accommodate changes in those factors. Other firms, however, take a more proactive stance by seeking to influence elected officials. For example, some organizations publicly protest legislative actions, while others seek influence more discreetly by routing funds to political parties or lobbying groups. Whatever the approach, managers should always stay in touch with the political landscape.

## Legal and Regulatory Issues

As you might suspect, legal and regulatory issues have close ties to events in the political environment. Numerous laws and regulations have the potential to influence marketing decisions and activities. The simple existence of these laws and regulations causes many firms to accept this influence as a predetermined aspect of market planning. For example, most firms comply with procompetitive legislation rather than face the penalties of noncompliance. In reality, most laws and regulations are fairly vague (for instance, the Americans with Disabilities Act), which often forces firms to test the limits of certain laws by operating in a legally questionable manner. The vagueness of laws is particularly troubling for e-commerce firms who face a number of ambiguous legal issues involving copyright, liability, taxation, and legal jurisdiction.



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For reasons such as these, the marketing manager should carefully examine recent court decisions to better understand the law or regulation in question. New court interpretations can point to future changes in existing laws and regulations. The marketing manager should also examine the recent rulings of federal, state, local and self-regulatory trade agencies to determine their effects on marketing activities.

One of the most profound legislative shifts in recent times occurred with President George Bush's signing of the Sarbanes–Oxley Act on July 30, 2002. Sarbanes–Oxley was essentially the federal government's response to a string of corporate scandals—most notably Enron, Tyco, and WorldCom. The law introduced very stringent rules for financial practice and corporate governance designed to protect investors by increasing the accuracy and reliability of corporate disclosures of financial information. An interesting result of Sarbanes–Oxley is the intense media and public attention that it garnered. The accuracy of corporate disclosures is now such a closely watched issue that organizations are forced into compliance both legally and practically. It is estimated that compliance with the law—in the form of new information and reporting systems—has cost U.S. businesses more than \$30 billion.<sup>19</sup>

Organizations that engage in international business should also be mindful of legal issues surrounding the trade agreements among nations. The implementation of the North American Free Trade Agreement (NAFTA), for example, created an open market of roughly 374 million consumers. Since NAFTA went into effect, many U.S. firms have begun or expanded operations in Canada and Mexico. Conversely, national governments sometimes use trade agreements to limit the distribution of certain products into member countries. Recurring disagreements between the United States, Canada, and Argentina and the European Union over genetically modified foods, for example, prompted the United States to file a complaint with the World Trade Organization in 2003. The European Union had banned all genetically modified food and crops since 1998. The complaint argued that the ban lacked scientific support and amounted to an unfair trade barrier. The WTO ruled against the European Union in 2006, opening the way for genetically modified foods to enter the European Union. Despite the ruling, market access for producers of genetically modified foods may not be enough: Over 54 percent of European consumers believe that these foods are unsafe for consumption.<sup>20</sup>

## Technological Advancements

When most people think about technology, they tend to think about new high-tech products such as wireless telephones, broadband Internet access, medical breakthroughs, or interactive television. However, technology actually refers to the way that we accomplish specific tasks or the processes that we use to create the “things” we consider as new. Of all the new technologies created in the past 30 years, none has had a greater impact on marketing than advances in computer and information technology. These technologies have changed the way that consumers and employees live and the way that marketers operate in fulfilling their needs. In some cases, changes in technology can be so profound that they make a firm's products obsolete, such as with vinyl long-playing (LP) records, typewriters, cassette tapes, and pagers.

Many changes in technology assume a frontstage presence in creating new marketing opportunities. By *frontstage technology*, we mean those advances that are most noticeable to customers. For example, products such as wireless telephones, DVDs, microwave ovens, and genetic engineering have spawned entirely new industries aimed at fulfilling previously unrecognized customer needs. Many frontstage technologies, such as smart phones and GPS satellite navigation systems, aim to increase customer convenience. Likewise, companies continue to push toward even more substantial changes in the ways that marketers reach customers through the use of interactive marketing via computers and digital television.

These and other technological changes can also assume a backstage presence when their advantages are not necessarily apparent to customers. Advances in backstage technology can affect marketing activities by making them more efficient and effective. For example, advances in computer technology have made warehouse storage and inventory control more efficient and less expensive. Similar changes in communication technology have made field sales representatives more efficient and effective in their dealings with managers and customers.

In some cases, technology can have both a frontstage and a backstage presence. One of the most promising breakthroughs is radio-frequency identification (RFID), which involves the use of tiny radio-enabled chips that can be attached to a product or its packaging. The radio signals emitted or reflected from the chip can be used to track inventory levels, detect product spoilage, or prevent theft. They can also be used for the instantaneous checkout of an entire shopping cart of items. RFID is also used in other applications such as patient tracking in hospitals, real-time data analysis in Indy racecars, and EZ-Pass systems on the nation's toll roads. Many retailers and packaged goods manufacturers fund research to develop RFID, which is expected to replace bar-code technology by 2016.<sup>21</sup>

## Sociocultural Trends

Sociocultural factors are those social and cultural influences that cause changes in attitudes, beliefs, norms, customs, and lifestyles. These forces profoundly affect the way that people live and help determine what, where, how, and when customers buy a firm's products. The list of potentially important sociocultural trends is far too long to examine each one here. Exhibit 4.7 lists examples of some of these trends. Two of the more important trends, however, are changes in demographics and customer values.

Many changes are taking place in the demographic makeup of the U.S. population. For example, most of us know that the population as a whole has grown older as a result of advances in medicine and healthier lifestyles. Research suggests that the number of Americans age 65 years and older will increase 147 percent between 2000 and 2050, from 12.4 to 21 percent of the population.<sup>22</sup> Experts project that by 2050, the worldwide population of older people will be larger than the population of children ages 0–14 for the first time in human history. As a result, marketers of health care, recreation, tourism, and retirement housing can expect large increases in demand over the next several decades. Other important changes include a decline in the teenage population, an increasing number of singles and single-parent households,

## EXHIBIT 4.7

## TRENDS IN THE SOCIOCULTURAL ENVIRONMENT

*Demographic Trends*

- Aging of the American population
- Decline in the teen population (as a percentage of the total population)
- Population growth in Sun Belt states
- Increasing number of single-member/individual households
- Increasing participation of women in the workforce
- Increasing number of single-parent families
- Increasing population diversity, especially in the number of Hispanic Americans
- Increasing immigration (legal and illegal)
- Increasing number of wealthy Americans

*Lifestyle Trends*

- Clothing has become more casual, especially at work
- Clothing has become more revealing, especially for women
- Growing participation in body modification (for example, tattoos and piercings)
- Americans have less time for leisure activities
- Vacationing at home is more common
- Less shopping in malls, more shopping from home
- Continuing focus on health, nutrition, and exercise
- Increasing importance of leisure time versus work time
- Time spent watching television and reading newspapers has declined
- Time spent using computers and talking on cell phones has increased
- Growing popularity of fuel-efficient hybrid vehicles
- Growing ubiquity of digital music and portable music players

*Value Trends*

- Shorter attention spans and less tolerance for waiting
- Less focus on "me-oriented" values
- More value-oriented consumption (good quality, good price)
- Importance of maintaining close, personal relationships with others
- Increasing importance of family and children
- Increasing concerns about the natural environment
- Greater focus on ethics and social responsibility
- Increased interest in giving back to the community
- Less tolerance of smoking in public places
- More tolerance of individual lifestyle choices
- Growing disconnect with government

and still greater participation of women in the workforce. The increase in the number of two-income and single-parent families has, for example, led to a massive increase in demand and retail shelf space for convenient frozen entrees and meals. Our growing focus on health and nutrition has led many of the marketers of these meals to offer lower-calorie and lower-carbohydrate content in their products.

One of the other most important demographic changes taking place is the increasing diversity of the U.S. population. The number of legal immigrants coming to the United States has risen steadily since 1975. Between 2006 and 2050, minority population growth will account for a full 90 percent of the growth of the total U.S. population. This trend is especially true among the Hispanic population, which will

grow by 188 percent. By 2050 almost one-quarter of the U.S. population will be of Hispanic decent.<sup>23</sup> These changes in diversity will create both threats and opportunities for most organizations. A diverse population means a diverse customer base. Firms must alter their marketing practices, including the way they recruit and select employees, to match these changing customer segments. For example, women of color, ignored by cosmetics companies for a long time, used to have a very difficult time finding makeup in shades appropriate for their skin tones. Now, virtually all cosmetics companies offer product lines designed specifically for these previously unserved markets. Furthermore, discount retailer Kmart has moved toward a multicultural customer base, especially Hispanics, in the heavily populated urban areas where its stores are located. Over 40 percent of Kmart's sales come from this customer group.<sup>24</sup>

Changes in our cultural values—the guiding principles of everyday life—can also create opportunities and challenges for marketers. Values influence our views of how to live, the decisions we make, the jobs we do, and the brands we buy. In a major study of American values, researchers found that the three most important values regardless of age, gender, race, income, or region are (1) having close relationships with other people, (2) being secure and stable, and (3) having fun. In fact, despite what we often see depicted on television and in advertising, few Americans actually concern themselves with “me-oriented” values like power, influence, or developing themselves personally.<sup>25</sup> Astute marketers can use this information to reflect our prevailing values in the products they design and the advertising they create.

As you can see, the external environment encompasses a wide array of important factors that must be analyzed carefully before developing the marketing plan. These issues are so important that most firms have specialists on staff to track emerging trends and develop strategies for dealing with external concerns. These specialists are typically housed in corporate affairs departments as outlined in Beyond the Pages 4.2. Although the external environment is the largest of the three environments that we have discussed, it is not necessarily the most important. Depending on the firm, its industry, and the timing, the internal and/or customer environments can be much more important in developing marketing strategy. The important issue is that all three environments must be analyzed prior to developing a marketing strategy and marketing plan. Good analysis requires the collection of relevant data and information, our next topic in this chapter.

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## Collecting Marketing Data and Information

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To perform a complete situation analysis, the marketing manager must invest time and money to collect data and information pertinent to the development of the marketing plan. This effort will always involve the collection of secondary data, which must be compiled inside or outside the organization for some purpose other than the current analysis. However, if the required data or information is unavailable, primary data may have to be collected through marketing research. Accessing secondary data sources is usually preferable as a first option because these sources can be obtained more quickly and at less cost than collecting primary data. In this section, we examine the different sources of environmental data and challenges in collecting this data.

*Beyond the Pages 4.2***A CORPORATE AFFAIRS PRIMER<sup>26</sup>**

What is corporate affairs? In its broadest sense, *corporate affairs* is a collection of strategic activities aimed at marketing an organization, its issues, and its ideals to potential stakeholders (consumers, general public, shareholders, media, government, and so on). One way to think about corporate affairs is that it includes all of the organization's marketing activities not directed at the end users of its products. The activities that define corporate affairs vary; however, most organizations maintain departments that engage in the following strategic activities:

- *Corporate communication* includes activities aimed at telling the organization's story and promoting goodwill among a variety of stakeholders. It includes such activities as public relations, employee relations, corporate image advertising, public affairs, and media relations.
- *Government relations* are activities aimed at educating and influencing elected officials, government officials, and regulatory agencies with respect to key issues that are pertinent to the firm. The most visible form of government relations is lobbying.
- *Investor relations* are activities designed to promote investment in the organization through the sale of financial instruments such as stocks and bonds. It includes such activities as developing the annual report, planning shareholders' meetings, and other customer service activities directed at corporate shareholders.
- *Corporate philanthropy* includes activities aimed at serving the needs of the community at

large (either domestically or globally) through product or cash donations, volunteerism, or support of humanitarian initiatives.

- *Policy analysis* involves activities designed to influence the national or international dialogue with respect to public or economic policy in an industry-related area. It includes research and analysis designed to provide needed information for making policy decisions.

Perhaps the best way to understand corporate affairs is to see what organizations themselves have to say about it. Here are a few examples:

*Microsoft*

Public policy influences everyone's daily life. Good public policy requires that everyone's voice be heard. Often found at the intersection where government, corporate, community and private interests meet, decisions must be reached on myriad issues: What's the role of government in ensuring Internet safety for children? How can Microsoft and other business leaders help to address the growing threat of identity theft? What do elected officials and community leaders need to understand about the impact of the digital divide on people's lives?

Microsoft's Global Corporate Affairs group, which includes professionals focused on government relations and public policy advocacy, industry outreach, regulatory counsel, and compliance advice and community engagement programs, is our public voice on important issues.

*(continued)*

## Secondary Information Sources

There are four basic sources of secondary data and information: internal, government, periodicals/books, and commercial. Most of these sources are available in both print and electronic formats. Let's look at the major strengths and weaknesses of these sources.

**Internal Sources** The firm's own records are the best source of data on current objectives, strategy, performance, and available resources. Internal sources may also be a good source of data on customer needs, attitudes, and buying behavior. Internal data also has the advantage of being relevant and believable because the organization itself has responsibility for its collection and organization.

Government, industry and regulatory affairs employees are corporate ambassadors to every level of government—local, state, national and international. They contribute knowledgeable insights required for sound public policy decision-making, cultivate mutually beneficial relationships and advocate on technology-related policy issues.

Our community engagement professionals manage nearly \$500 million in corporate community investments in thousands of inter-governmental and nonprofit organizations around the world. This group also oversees employee engagement programs that encourage Microsoft's workforce to give generously of their time and money to improve the lives of others.

#### *Philip Morris International*

In Corporate Affairs, we work with governments and other stakeholders to secure comprehensive regulation of all aspects of the tobacco business so that there are clear rules established and enforced for all tobacco companies.

We seek to understand what our stakeholders expect from us, and to respond to those expectations where our products are sold.

We communicate with our consumers and others about our products, the health risks of smoking, and our efforts to pursue solutions to important issues such as the harm caused by smoking, and how to tackle the complex issue of youth smoking.

#### *Pfizer*

Corporate Affairs' seasoned professionals employ their skills and knowledge in the fields of government relations; media relations;

communications; corporate advertising; public affairs; philanthropy; and economic, science, and healthcare policy to help create the social and political conditions essential for Pfizer to sustain its industry leadership.

#### *BlueScope Steel (Australia)*

BlueScope Steel Corporate Affairs manages BlueScope Steel's corporate relationships with a number of key external stakeholders including media, governments, industry bodies, and other steelmakers. Corporate Affairs produces regular media releases and announcements, and is responsible for managing the production of corporate reports, including the Annual Report and the Community, Safety & Environment Report.

Corporate Affairs is also responsible for the management of communications with the company's 17,000-plus employees around the globe, including production of the company-wide employee newspaper, Steel Connections.

BlueScope Steel maintains a sophisticated electronic communications system, including regular 'Stop Press' email announcements and an extensive corporate intranet site, in addition to the company's external Internet sites.

Given the complexity of the external environment in today's economy, strategic planning regarding corporate affairs is every bit as important as developing sound strategy for reaching the organization's customers. No organization exists in isolation. Consequently, all organizations must actively manage their relationships with potential stakeholders to ensure continued success.

One of the biggest problems with internal data is that they are often not in a readily accessible form for planning purposes. Boxes of printed company records that sit in a warehouse are hardly useful for marketing planning. To overcome this problem, many organizations maintain corporate intranets or virtual private networks (VPNs) that make data easily accessible and interactive. These systems enable employees to access internal data, such as customer profiles and product inventory, and to share details of their activities and projects with other company employees across the hall or the world. Intranets and VPNs provide an opportunity for company-wide marketing intelligence that permits coordination and integration of efforts to achieve a true market orientation.

**Government Sources** If it exists, the U.S. government has collected data about it. The sheer volume of available information on the economy, population, and business activities is the major strength of most government data sources. Government sources also have the added advantages of easy accessibility and low cost—most are even free. The major drawback to government data is timeliness. Although many government sources have annual updates, some are done much less frequently (for example, the census every decade). As a result, some government sources may be out-of-date and not particularly useful for market planning purposes.

Still, the objectivity and low cost of government sources make them an attractive answer to the data needs of many organizations. Some of the best government sources available on the Internet include the following:

- Federal Trade Commission (<http://www.ftc.gov>) provides reports, speeches, and other facts about competitive, antitrust, and consumer protection issues.
- *FedWorld* (<http://www.fedworld.gov>) offers links to various federal government sources of industry and market statistics.
- Edgar Database (<http://www.sec.gov/edgarhp.htm>) provides comprehensive financial data (10K reports) on public corporations in the United States.
- U.S. Small Business Administration (<http://www.sba.gov>) offers numerous resources for small businesses, including industry reports, maps, market analyses (national, regional, or local), library resources, and checklists.

**Book and Periodical Sources** The articles and research reports available in books and periodicals provide a gamut of information about many organizations, industries, and nations. Forget any notion about books and periodicals appearing only in print. Today, many good sources exist only in electronic format. Timeliness is a major strength of these sources because most are about current environmental trends and business practices. Some sources, such as academic journals, provide detailed results of research studies that may be pertinent to the manager's planning efforts. Others, such as trade publications, focus on specific industries and the issues that characterize them.

Many of these sources are freely available on the Internet. Most, however, require paid subscriptions. Some of the better examples include the following:

- Subscription services such as *Moody's* (<http://www.moody.com>), *Hoover's* (<http://www.hoovers.com>), *Standard and Poor's* (<http://www.standardandpoors.com/>), and *Dismal Scientist* (<http://www.dismal.com>) offer in-depth analyses and current statistics about major industries and corporations.
- Major trade associations (such as the American Marketing Association <http://www.marketingpower.com/> and Sales and Marketing Executives <http://www.smei.org>) and trade publications (such as *Adweek* <http://www.adweek.com> and *Chain Store Age* <http://www.chainstoreage.com>) offer a wide range of news and information to their membership and readers.

- Academic journals, such as the *Harvard Business Review* (<http://www.hbr.org>) and the *Sloan Management Review* (<http://sloanreview.mit.edu/smr>), are good sources of cutting-edge thinking on business and marketing.
- General business publications, such as the *Wall Street Journal* (<http://www.wsj.com>), *Fortune* (<http://www.fortune.com>), and *BusinessWeek* (<http://www.businessweek.com>), offer a wealth of information on a wide variety of industries and companies.

The two biggest drawbacks to book and periodical sources are information overload and relevance to the specific problem at hand. That is, despite the sheer volume of information that is available, finding data or information that pertains to the manager's specific and unique situation can feel like looking for that proverbial needle in a haystack.

**Commercial Sources** Commercial sources are almost always relevant to a specific issue because they deal with the actual behaviors of customers in the marketplace. Firms such as Nielsen monitor a variety of behaviors from food purchases in grocery stores to media usage characteristics. Commercial sources generally charge a fee for their services. However, their data and information are invaluable to many companies. Some commercial sources provide limited information on their websites:

- A. C. Nielsen Company (<http://www.acnielsen.com>) and Information Resources, Inc. (<http://www.infores.com>) supply data and reports on point-of-purchase sales.
- Mediamark Research, Inc. (<http://www.mediamark.com/>) and Arbitron (<http://www.arbitron.com>) specialize in multimedia audience research by providing a wealth of customer demographic, lifestyle, and product usage data to major media and advertising companies.
- The Audit Bureau of Circulations (<http://www.accessabc.com>) provides independent, third-party audits of print circulation, readership and website activity.
- Surveys.com (<http://www.surveys.com>) uses an online consumer panel to provide information to businesses about the products and services they provide.

The most obvious drawback to these and other commercial sources is cost. Although this is not a problem for large organizations, small companies often cannot afford the expense. However, many commercial sources provide limited, free access to some data and information. Additionally, companies often find “off-the-shelf” studies less costly than conducting primary research.

## Primary Data Collection

The situation analysis should always begin with an examination of secondary data sources due to their availability and low cost. Each secondary data source has its

advantages and disadvantages, so the best approach is one that blends data and information from a variety of sources. However, if the needed secondary data are not available, out of date, inaccurate, unreliable, or irrelevant to the specific problem at hand, an organization may have little choice but to collect primary data through marketing research. Primary marketing research has the major advantages of being relevant to the specific problem, as well as trustworthy due to the control that the manager has over data collection. However, primary research is extremely expensive and time consuming. There are four major types of primary data collection:

- *Direct observation*, where the researcher records the overt behaviors of customers, competitors, or suppliers in natural settings. Historically, researchers have used direct observation to study the shopping and buying behaviors of customers. However, behavior can be observed today through the use of technology such as bar-code scanners and RFID tags. The main advantage of observation research is that it accurately describes behavior without influencing the target under observation. However, the results of observation research are often overly descriptive and subject to a great deal of bias and researcher interpretation.
- *Focus groups*, where the researcher moderates a panel discussion among a gathering of six to ten people who openly discuss a specific subject. Focus group research is an excellent means of obtaining in-depth information about a particular issue. Its flexibility also allows it to be used in a variety of settings and with different types of panel members (that is, customers, suppliers, and employees). Focus groups are also very useful in designing a large-scale survey to ensure that questions have the appropriate wording. The main disadvantage is that focus groups require a highly skilled moderator to help limit the potential for moderator bias.
- *Surveys*, where the researcher asks respondents to answer a series of questions on a particular topic. Surveys can be administered using the paper-and-pencil method, either in person or through the mail; or they can be administered interactively via telephone, e-mail, or the Internet. Although surveys are a very useful and time-efficient way to collect primary data, it has become increasingly difficult to convince people to participate. Potential respondents have become skeptical of survey methods due to overly long questionnaires and the unethical practices of many researchers. These concerns are one of the reasons behind the creation of the national Do Not Call Registry for telemarketers.<sup>27</sup>
- *Experiments*, where the researcher selects matched subjects and exposes them to different treatments while controlling for extraneous variables. Because experiments are well suited to testing for cause-and-effect relationships, researchers use them often in test-marketing programs. Marketers can experiment with different combinations of marketing-mix variables to determine which combination has the strongest effect on sales or profitability. The major obstacles to effective experimentation in marketing are the expense and the difficulty of controlling for all extraneous variables in the test.

As with secondary data, often the best approach to primary data collection is to use a combination of data sources. Focus groups and direct observation can be used to gain a more complete understanding of a particular issue or marketing phenomenon. Surveys can then be used to further test for certain tendencies or effects before launching into a full-scale test-marketing program. At this point, the process comes full circle because observation and focus groups can be used to explore the outcomes of the test-marketing program.

## Overcoming Problems in Data Collection

Despite the best intentions, problems usually arise in collecting data and information. One of the most common problems is an incomplete or inaccurate assessment of the situation that the gathering of data should address. After expending a great degree of effort in collecting data, the manager may be unsure of the usefulness or relevance of what has been collected. In some cases, the manager might even suffer from severe information overload. To prevent these problems from occurring, the marketing problem must be accurately and specifically defined before the collection of any data. Top managers who do not adequately explain their needs and expectations to marketing researchers often cause the problem.

Another common difficulty is the expense of collecting environmental data. Although there are always costs associated with data collection (even if the data are free), the process need not be prohibitively expensive. The key is to find alternative data collection methods or sources. For example, an excellent way for some businesses to collect data is to engage the cooperation of a local college or university. Many professors seek out marketing projects for their students as a part of course requirements. Likewise, to help overcome data collection costs, many researchers have turned to the Internet as a means of collecting both quantitative and qualitative data on customer opinions and behaviors.

A third issue is the time it takes to collect data and information. Although this is certainly true with respect to primary data collection, the collection of secondary data can be easy and fast. Online data sources are accessible. Even if the manager has no idea where to begin the search, the powerful search engines and indexes available on the Internet make it easy to find data. Online data sources have become so good at data retrieval that the real problem involves the time needed to sort through all of the available information to find something that is truly relevant.

Finally, it can be challenging to find a way to organize the vast amount of data and information collected during the situation analysis. Clearly defining the marketing problem and blending different data sources are among the first steps toward finding all the pieces to the puzzle. A critical next step is to convert the data and information into a form that will facilitate strategy development. Although a variety of tools can be used to analyze and organize environmental data and information, one of the most effective tools is SWOT analysis. As we will see in the next chapter, SWOT analysis—which involves classifying data and information into strengths, weaknesses,

opportunities, and threats—can be used to organize data and information and used as a catalyst for strategy formulation.

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## Lessons from Chapter 4

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Collecting and analyzing marketing information through a situation analysis

- is perhaps the most important task of the marketing manager because practically all decision making and planning depends on how well he or she conducts the analysis.
- should be an ongoing effort that is well organized, systematic, and supported by sufficient resources.
- involves analysis and synthesis to understand why people, products, and organizations perform the way they do.
- is not intended to replace the marketing manager in the decision-making process but to empower him or her with information for decision making.
- recognizes that data and information are not the same. Data are not useful until converted into information.
- forces managers to ask continually, “How much data and information do I need?”
- is valuable only to the extent that it improves the quality of the resulting decisions. Marketing managers must avoid “paralysis by analysis.”
- should provide as complete a picture as possible about the organization’s current and future situation with respect to the internal, customer, and external environments.

Analysis of the internal environment

- includes an assessment of the firm’s current goals, objectives, performance, and how well the current marketing strategy is working.
- includes a review of the current and anticipated levels of organizational resources.
- must include a review of current and anticipated cultural and structural issues that could affect marketing activities.

Analysis of the customer environment

- examines the firm’s current customers in its target markets, as well as potential customers that currently do not purchase the firm’s product offering.
- can be conducted by using the expanded 5W model:

Who are our current and potential customers?  
What do customers do with our products?

Where do customers purchase our products?  
When do customers purchase our products?  
Why (and how) do customers select our products?  
Why do potential customers not purchase our products?

#### Analysis of the external environment

- examines the competitive, economic, political, legal and regulatory, technological, and sociocultural factors in the firm's external environment.
- includes an examination of the four basic types of competitors faced by all businesses: brand competitors, product competitors, generic competitors, and total budget competitors.
- is often handled by a team of specialists within an organization's corporate affairs department.

#### Marketing data and information

- can be collected from a wide array of internal, government, periodical, book, and commercial sources, as well as through primary marketing research.
- are often collected through four different types of primary research: direct observation, focus groups, surveys, and experiments.
- must be blended from many different sources to be the most useful for planning purposes.

#### Problems that can occur during data collection include

- an incomplete or inaccurate definition of the marketing problem.
- ambiguity about the usefulness or relevance of the collected data.
- severe information overload.
- the expense and time associated with data collection.
- finding ways to organize the vast amount of collected data and information.

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### Questions for Discussion

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1. Of the three major environments in a situation analysis (internal, customer, and external), which do you think is the most important in a general sense? Why? What are some situations that would make one environment more important than the others?
2. Understanding the motivations of a firm's noncustomers is often just as important as understanding its customers. Look again at the reasons why an individual would not purchase a firm's products. How can a firm reach out to noncustomers and successfully convert them into customers?

3. Do you think that the Internet has made it easier or more difficult to collect marketing data and information? Why? How might the major data collection issues of today compare to the issues that occurred in the pre-Internet era?

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## Exercises

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1. Choose a specific product that you use on a daily basis (such as food items, toiletries, or your car) and apply the 5W model in Exhibit 4.4 to yourself:
  - a. Who are you (demographics, psychographics, and so on)?
  - b. What do you do with the product (consumption, storage, disposal, and so on)?
  - c. Where do you purchase the product? Why?
  - d. When do you purchase the product? Why?
  - e. Why and how do you select the product?
  - f. Why do you not purchase competing products?

Assume that your responses are similar to millions of other consumers. Given this profile, how would you approach the marketing strategy for this particular product?

2. Consider the last purchase you made (maybe it was lunch or a soft drink). List all of the brand, product, generic, and total budget competitors for that product. In a general sense, what would it take for you to switch to another type of competitor? Are there situations that would encourage you to switch to a generic competitor? When would total budget competitors become more relevant to your decision making?
3. Review the sociocultural trends in Exhibit 4.7. What other trends could be added to the list? What trends are specific to your generation that do not universally apply to all Americans?

# 5 CHAPTER

# Developing Competitive Advantage and Strategic Focus

## Introduction

Situation analysis, as discussed in Chapter 4, can generate a great deal of data and information for marketing planning. But information in and of itself provides little direction to managers in preparing a marketing plan. If the analysis does not structure the information in a meaningful way that clarifies both present and anticipated situations, the manager cannot see how the pieces fit together. This synthesis of information is critical in developing competitive advantages and the strategic focus of the marketing plan. As illustrated in Beyond the Pages 5.1, this synthesis often comes from enhanced innovation, a stronger focus on customer needs, and tighter integration within the firm. Understanding the connectedness of the external environment is vital to enhanced innovation across a number of industries.

How should the marketing manager organize and use the information collected during the situation analysis? One widely used tool is SWOT analysis (strengths, weaknesses, opportunities, and threats). A SWOT analysis encompasses both the internal and external environments of the firm. Internally, the framework addresses a firm's strengths and weaknesses on key dimensions such as financial performance and resources, human resources, production facilities and capacity, market share, customer perceptions, product quality, product availability, and organizational communication. The assessment of the external environment organizes information on the market (customers and competition), economic conditions, social trends, technology, and government regulations.

As shown in Exhibit 5.1, many consider SWOT analysis to be one of the most effective tools in the analysis of marketing data and information. SWOT analysis is a simple, straightforward framework that provides direction and serves as a catalyst for the development of viable marketing plans. It fulfills this role by structuring the assessment of the fit between what a firm can and cannot do (strengths and weaknesses), and the environmental conditions working for and against the firm (opportunities and threats). When performed correctly, a SWOT analysis not only organizes data and information but also can be especially useful in uncovering competitive

## Beyond the Pages 5.1

INNOVATION: THE KEY TO SUCCESS?<sup>1</sup>

Innovation is the buzzword of business in the twenty-first century. Of course, innovation has always been important, especially with respect to developing new products. What has changed, however, is the focus of innovation in most companies. The twentieth-century model of innovation was about quality control, cost cutting, and operational efficiency. Today, innovation is more about reinventing business processes, collaborating and integrating within the firm, and creating entirely new markets to meet untapped customer needs. Increasing globalization, the growth of the Internet, and more demanding customers are forcing marketers to find innovative ways of conducting business.

An important lesson that many companies have learned is that innovation is not always about technology or offering the latest gee-whiz product. Differences in innovation style are apparent in *BusinessWeek's* second annual list of the World's Most Innovative Companies. The top-ten companies on the list include both cultural icons and manufacturing giants:

Rank	Company	1995–2005 Stock Returns (%)
1	Apple	24.6
2	Google	n/a
3	3M	11.2
4	Toyota	11.8
5	Microsoft	18.5
6	General Electric	13.4
7	Procter & Gamble	12.6
8	Nokia	34.6
9	Starbucks	27.6
10	IBM	14.4
Median of 100 Most Innovative Companies		14.3
Median of S&P 1,200 Global Stock Index		11.1

Several types of innovation are presented in this list. For example, in launching the iPod, Apple combined innovations in product design (the iPod), branding (the white color), strategic alliances (agreements with music companies), and business

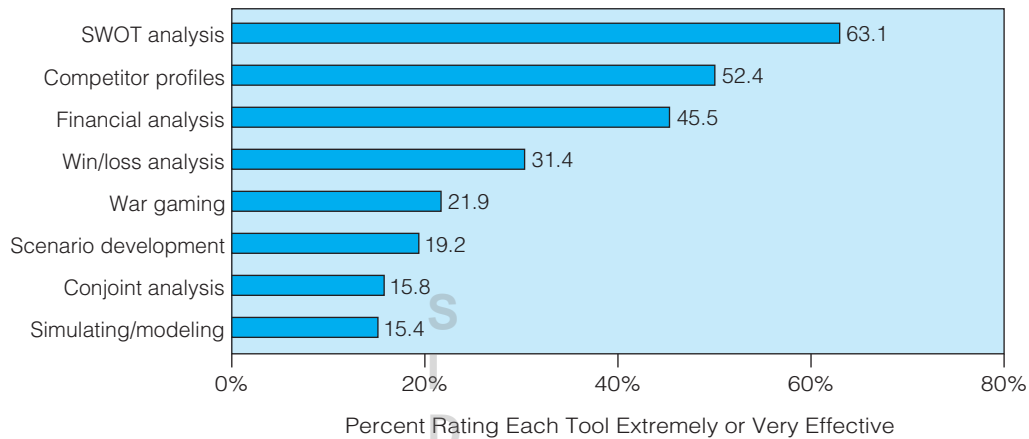
model (selling songs via iTunes for 99¢ each) to create a cultural phenomenon. Innovation at Starbucks has nothing to do with technology. Instead, the company innovated by seeing itself as more than a coffee company. Toyota makes the top ten due to relentless manufacturing expertise, tight integration within the firm, and advancements in hybrid technology with its Prius.

One thing that all innovative companies have in common is a laserlike focus on customer needs. Innovative companies find new ways of learning from customers in addition to traditional methods. For example, many companies closely watch blogs and online communities to learn what customers are thinking. Focusing on customers may not sound innovative, but increasing competition and shorter product cycles are forcing marketers to shift away from the price- and efficiency-driven approaches of the past. To escape from commodity hell, marketers must find innovation in unfamiliar places. For example, BMW (number sixteen on the list) finds innovation in product design by relocating hundreds of employees from across the globe to a central design studio. Starbucks finds innovation outside of coffee by offering music and movies to its customers. An interesting side effect of innovation is that it often creates a new set of competitors for the firm. For example, Apple competes with Starbucks in music and is soon to compete with Nokia in cell phones. Another example is the chewing gum industry. Wrigley has launched Airwaves Active (a wellness gum that contains vitamins and other ingredients that boost the immune system) and Orbit White (a teeth-whitening gum). Likewise, GumRunners has licensed the Jolt brand to launch a caffeinated gum to capitalize on the increasing popularity of energy drinks.

As reflected in the table, innovation is obviously good for the bottom line. Through increased growth, better collaboration, and a broader product mix, the most innovative companies can pull their products out of commodity status and increase their profit margins. It is clear that innovation has become a key driver of competitive advantage and success in today's market.

EXHIBIT 5.1

## EFFECTIVENESS OF ANALYSIS TOOLS



Source: Timothy Powell and Cynthia Allgaier, "Enhancing Sales and Marketing Effectiveness Through Competitive Intelligence," *Competitive Intelligence Review* 9 (October–December 1998): 29–41. Copyright © 1998 by John Wiley & Sons. Reprinted by permission of John Wiley & Sons, Inc.

advantages that can be leveraged in the firm's marketing strategy. These competitive advantages help establish the strategic focus and direction of the firm's marketing plan.

As a planning tool, SWOT analysis has many benefits, as outlined in Exhibit 5.2. In fact, SWOT analysis is so useful and logical that many underestimate its value in planning. However, this simplicity often leads to unfocused and poorly conducted analyses.<sup>2</sup> The most common criticisms leveled against SWOT analysis are that (1) it allows firms to create lists without serious consideration of the issues and (2) it often becomes a sterile academic exercise of classifying data and information. It is important to remember that SWOT analysis by itself is not inherently productive or unproductive. Rather, the way that one uses SWOT analysis will determine whether it yields benefits for the firm.

## Making SWOT Analysis Productive

Whether a firm receives the full benefits of SWOT analysis depends on the way that the manager uses the framework. If done correctly and smartly, SWOT analysis can be a viable mechanism for the development of the marketing plan. If done haphazardly or incorrectly, it can be a great waste of time and other valuable resources. To help ensure that the former, not the latter, takes place, we offer the following directives to make SWOT analysis more productive and useful. Exhibit 5.3 outlines these directives.

## EXHIBIT 5.2

## MAJOR BENEFITS OF SWOT ANALYSIS

*Simplicity*

SWOT analysis requires no extensive training or technical skills to be used successfully. The analyst needs only a comprehensive understanding of the nature of the company and the industry in which it competes.

*Lower Costs*

Because specialized training and skills are not necessary, the use of SWOT analysis can actually reduce the costs associated with strategic planning. As firms begin to recognize this benefit of SWOT analysis, many opt to downsize or eliminate their strategic planning departments.

*Flexibility*

SWOT analysis can enhance the quality of an organization's strategic planning even without extensive marketing information systems. However, when comprehensive systems are present, they can be structured to feed information directly into the SWOT framework. The presence of a comprehensive information system can make repeated SWOT analyses run more smoothly and efficiently.

*Integration and Synthesis*

SWOT analysis gives the analyst the ability to integrate and synthesize diverse information, both of a quantitative and qualitative nature. It organizes information that is widely known, as well as information that has only recently been acquired or discovered. SWOT analysis can also deal with a wide diversity of information sources. In fact, SWOT analysis helps transform information diversity from a weakness of the planning process into one of its major strengths.

*Collaboration*

SWOT analysis fosters collaboration and open information exchange between different functional areas. By learning what their counterparts do, what they know, what they think, and how they feel, the marketing analyst can solve problems, fill voids in the analysis, and eliminate potential disagreements before the finalization of the marketing plan.

**Stay Focused**

Marketing planners often make the mistake of conducting one generic SWOT analysis for the entire organization or business unit. Such an approach produces stale, meaningless generalizations that come from the tops of managers' heads or from press release files. Although this type of effort may make managers feel good and provide a quick sense of accomplishment, it does little to add to the creativity and vision of the planning process.

When we say SWOT analysis, we really mean SWOT *analyses*. In most firms, there should be a series of analyses, each focusing on a specific product–market combination. For example, a single SWOT analysis for the Chevrolet division of General Motors would not be focused enough to be meaningful. Instead, separate analyses for each product category (passenger cars, trucks, minivans) or brand (Corvette, Impala, Avalanche, Tahoe, Uplander) in the division would be more appropriate. Such a focus enables the marketing manager to look at the specific mix of competitors, customers, and external factors that are present in a given market. Chevrolet's Tahoe, for example, competes in the crowded SUV market in which the auto industry releases new models at a staggering pace. Consequently, market planning for the Tahoe should differ substantially from market planning for Chevrolet's Corvette or Uplander minivan. If

**EXHIBIT 5.3****DIRECTIVES FOR A PRODUCTIVE SWOT ANALYSIS***Stay Focused*

A single, broad analysis leads to meaningless generalizations. Separate analyses for each product–market combination are recommended.

*Search Extensively for Competitors*

Although major brand competitors are the most important, the analyst must not overlook product, generic, and total budget competitors. Potential future competitors must also be considered.

*Collaborate with Other Functional Areas*

SWOT analysis promotes the sharing of information and perspective across departments. This cross-pollination of ideas allows for more creative and innovative solutions to marketing problems.

*Examine Issues from the Customers' Perspective*

Customers' beliefs about the firm, its products, and marketing activities are important considerations in SWOT analysis. The views of employees and other key stakeholders must also be considered.

*Look for Causes, Not Characteristics*

Rather than simply list characteristics of the firm's internal and external environments, the analyst must also explore the resources possessed by the firm and/or its competitors that are the true causes for the firm's strengths, weaknesses, opportunities, and threats.

*Separate Internal Issues from External Issues*

If an issue would exist even if the firm did not exist, the issue should be classified as external. Marketing options, strategies, or tactics are not the same as opportunities in SWOT analysis.

needed, separate product–market analyses can be combined to examine the issues relevant for the entire strategic business unit, and business-unit analyses can be combined to create a complete SWOT analysis for the entire organization. The only time a single SWOT analysis would be appropriate is when an organization has only one product–market combination.

**Search Extensively for Competitors**

Information on competitors and their activities is an important aspect of a well-focused SWOT analysis. The key is not to overlook any competitor, whether a current rival or one on the horizon. As we discussed in Chapter 4, the firm will focus most of its efforts on brand competition. During the SWOT analysis, however, the firm must watch for any current or potential direct substitutes for its products. Product, generic, and total budget competitors are important as well. Looking for all four types of competition is crucial because many firms and managers never look past brand competitors. Although it is important for the SWOT analysis to be focused, it must not be myopic.

Even industry giants can lose sight of their potential competitors by focusing exclusively on brand competition. Kodak, for example, had always taken steps to maintain its market dominance over rivals Fuji, Konica, and Polaroid in the film industry. However, the advent of digital photography added Sony, Nikon, and Canon to Kodak's set

of competing firms. And, as digital cameras become better integrated into wireless phones, Kodak will have to add Motorola, LG, Samsung, and Nokia to its competitive set. A similar trend has occurred in financial services as deregulation has allowed brokers, banks, and insurance firms to compete in each other's traditional markets. State Farm, for example, now offers mortgage loans, credit cards, mutual funds, and traditional banking services alongside its well-known insurance products. This shift has forced firms such as Charles Schwab and Citigroup to look at insurance companies in a different light.

### **Collaborate with Other Functional Areas**

One of the major benefits of SWOT analysis is that it generates information and perspective that can be shared across a variety of functional areas in the firm. The SWOT process should be a powerful stimulus for communication outside normal channels. The final outcome of a properly conducted SWOT analysis should be a fusion of information from many areas. Managers in sales, advertising, production, research and development, finance, customer service, inventory control, quality control, and other areas should learn what other managers see as the firm's strengths, weaknesses, opportunities, and threats. This allows the marketing manager to come to terms with multiple perspectives before actually creating the marketing plan.

While combining the SWOT analyses from individual areas, the marketing manager can identify opportunities for joint projects and cross selling of the firm's products. In a large firm, the first time a SWOT takes place may be the initial point at which managers from some areas have ever formally communicated with each other. Such cross-pollination can generate a very conducive environment for creativity and innovation. Moreover, research has shown that the success of introducing a new product, especially a radically new product, is extremely dependent on the ability of different functional areas to collaborate and integrate their differing perspectives. For example, every time that BMW develops a new car, they relocate 200 to 300 engineering, design, production, marketing, and finance employees from their worldwide locations to the company's research and innovation center. For up to three years, these employees work alongside BMW's research and development team in a manner that speeds communication and car development.<sup>3</sup>

### **Examine Issues from the Customers' Perspective**

In the initial stages of SWOT analysis, it is important to identify issues exhaustively. However, all issues are not equally important with respect to developing competitive advantages and strategic focus for the marketing plan. As the analysis progresses, the marketing manager should identify the most critical issues by looking at each one through the eyes of the firm's customers. To do this, the manager must constantly ask questions such as the following:

- What do customers (and noncustomers) believe about us as a company?
- What do customers (and noncustomers) think of our product quality, customer service, price and overall value, convenience, and promotional messages in comparison to our competitors?

- Which of our weaknesses translate into a decreased ability to serve customers (and decreased ability to convert noncustomers)?
- How do trends in the external environment affect customers (and noncustomers)?
- What is the relative importance of these issues; not as we see them, but as customers see them?

Marketing planners must also gauge the perceptions of each customer segment that the firm attempts to target. For example, older banking customers, due to their reluctance to use ATMs and online banking services, may have vastly different perceptions of a bank's convenience than younger customers. Each customer segment's perceptions of external issues, such as the economy or the environment, are also important. It matters little, for example, that managers think the economic outlook is positive if customers have curbed their spending because they think the economy is weak.

Examining issues from the customers' perspective also includes the firm's internal customers: its employees. The fact that management perceives the firm as offering competitive compensation and benefits is unimportant. The real issue is what the employees think. Employees are also a valuable source of information on strengths, weaknesses, opportunities, and threats that management may have never considered. Some employees, especially frontline employees, are closer to the customer and can offer a different perspective on what customers think and believe. For example, research indicates that employees are a valuable source of information regarding the effectiveness of a firm's advertising.<sup>4</sup> Other key stakeholders, such as investors, the general public, and government officials, should also be considered. The key is to examine every issue from the most relevant perspective. Exhibit 5.4 illustrates how taking the customers' perspective can help managers interpret the clichés they might develop and then break them down into meaningful customer-oriented strengths and weaknesses.

Taking the customers' perspective is a cornerstone of a well-done SWOT analysis. Managers have a natural tendency to see issues the way that they think they are (for example, "We offer a high-quality product"). SWOT analysis forces managers to change their perceptions to the way that customers and other important groups see things (for example, "The product offers weak value given its price and features as compared against the strongest brand competitor"). The contrast between these two perspectives often leads to the identification of a gap between management's version of reality and customers' perceptions. As the planning process moves ahead, managers must reduce or eliminate this gap and determine whether their views of the firm are realistic.

## Look for Causes, Not Characteristics

Although taking the customers' perspective is important, it often provides just enough information to get into serious trouble. That is, it provides a level of detail that is often very descriptive, but not very constructive. The problem lies in listing strengths, weaknesses, opportunities, and threats as simple descriptions or characteristics of the firm's internal and external environments without going deeper to consider the causes

## EXHIBIT 5.4

## BREAKING DOWN MANAGERIAL CLICHÉS INTO CUSTOMER-ORIENTED STRENGTHS AND WEAKNESSES

Cliché	Potential Strengths	Potential Weaknesses
"We are an established firm."	Stable after-sales service Experienced Trustworthy	Old-fashioned Inflexible Weak innovation
"We are a large supplier."	Comprehensive product line Technical expertise Longevity Strong reputation	Bureaucratic Focused only on large accounts Impersonal Weak customer service
"We have a comprehensive product line."	Wide variety and availability One-stop supplier Convenient Customized solutions	Shallow assortment Cannot offer hard-to-find products Limited in-depth product expertise
"We are the industry standard."	Wide product adoption High status and image Good marketing leverage Extensive third-party support	Vulnerable to technological changes Limited view of competition Higher prices (weaker value)

Source: Adapted from Nigel Piercy, *Market-Led Strategic Change* (Oxford, UK: Butterworth-Heinemann, 1992), 261.

for these characteristics. Although the customers' perspective is valuable, customers do not see behind the scenes to understand the reasons for a firm's characteristics. More often than not, the causes for each issue in a SWOT analysis can be found in the resources possessed by the firm and/or its competitors.

From a resource-based viewpoint, every organization can be considered as a unique bundle of tangible and intangible resources. Major types of these resources include the following:<sup>5</sup>

- **Financial Resources** Cash, access to financial markets, physical facilities, equipment, raw materials, systems and configurations
- **Intellectual Resources** Expertise, discoveries, creativity, innovation
- **Legal Resources** Patents, trademarks, contracts
- **Human Resources** Employee expertise and skills, leadership
- **Organizational Resources** Culture, customs, shared values, vision, routines, working relationships, processes and systems
- **Informational Resources** Customer intelligence, competitive intelligence, marketing information systems
- **Relational Resources** Strategic alliances, relations with customers, vendors, and other stakeholders, bargaining power, switching costs
- **Reputational Resources** Brand names, symbols, image

The availability or lack of these resources are the causes for the firm's strengths and weaknesses in meeting customers' needs and determine which external conditions represent opportunities and threats. For example, Wal-Mart's strength in low-cost distribution and logistics comes from its combined resources in terms of distribution, information, and communication infrastructure; committed employees; and strong relationships with vendors. Likewise, 3M's strength in product innovation is the result of combined financial, intellectual, legal, organizational, and informational resources. These resources not only give Wal-Mart and 3M strengths or advantages in serving customers but also create imposing threats for their competitors.

### Separate Internal Issues from External Issues

For the results of a SWOT analysis to be truly beneficial, we have seen that the analyst must go beyond simple descriptions of internal and external characteristics to explore the resources that are the foundation for these characteristics. It is equally important, however, for the analyst to maintain a separation between internal issues and external issues. Internal issues are the firm's strengths and weaknesses, whereas external issues refer to opportunities and threats in the firm's external environments. The key test to differentiate a strength or weakness from an opportunity or threat is to ask, "Would this issue exist if the firm did not exist?" If the answer is yes, the issue should be classified as external.

At first glance, the distinction between internal and external issues seems simplistic and immaterial. However, the failure to understand the difference between internal and external issues is one of the major reasons for a poorly conducted SWOT analysis. This happens because managers tend to get ahead of themselves and list their marketing options or strategies as opportunities. However, options and strategies are not the same as opportunities in the SWOT framework. Opportunities (and threats) exist independently of the firm and are associated with characteristics or situations present in the economic, customer, competitive, sociocultural, technological, political, or legal environments in which the firm resides. A manager's options, strategies, or tactics should be based on what the firm intends to do about its opportunities and threats relative to its own strengths and weaknesses. The development of strategic options occurs at a later point within the marketing plan framework.

In summary, a SWOT analysis should be directed by Socrates' advice: "Know thyself." This knowledge should be realistic, based on how customers (external and internal) and other key stakeholders see the company, and viewed in terms of the firm's resources. If managers find it difficult to make an honest and realistic assessment of these issues, they should recognize the need to bring in outside experts or consultants to oversee the process.

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## SWOT-Driven Strategic Planning

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As we discussed in Chapter 4, the collection of marketing information via a situation analysis identifies the key factors that should be tracked by the firm and organizes them within a system that will monitor and distribute information on these factors on an ongoing basis. This process feeds into and helps define the boundaries of a SWOT

## EXHIBIT 5.5

## POTENTIAL ISSUES TO CONSIDER IN A SWOT ANALYSIS

*Potential Internal Strengths*

Abundant financial resources  
 Well-known brand name  
 Number 1 ranking in the industry  
 Economies of scale  
 Proprietary technology  
 Patented processes  
 Lower costs (raw materials or processes)  
 Respected company/product/brand image  
 Superior management talent  
 Better marketing skills  
 Superior product quality  
 Alliances with other firms  
 Good distribution skills  
 Committed employees

*Potential Internal Weaknesses*

Lack of strategic direction  
 Limited financial resources  
 Weak spending on research and development  
 Very narrow product line  
 Limited distribution  
 Higher costs (raw materials or processes)  
 Out-of-date products or technology  
 Internal operating problems  
 Internal political problems  
 Weak market image  
 Poor marketing skills  
 Alliances with weak firms  
 Limited management skills  
 Undertrained employees

*Potential External Opportunities*

Rapid market growth  
 Complacent rival firms  
 Changing customer needs/tastes  
 Opening of foreign markets  
 Mishap of a rival firm  
 New product discoveries  
 Economic boom  
 Government deregulation  
 New technology  
 Demographic shifts  
 Other firms seeking alliances  
 High brand switching  
 Sales decline for a substitute product  
 Changing distribution methods

*Potential External Threats*

Entry of foreign competitors  
 Introduction of new substitute products  
 Product life cycle in decline  
 Changing customer needs/tastes  
 Declining consumer confidence  
 Rival firms adopting new strategies  
 Increased government regulation  
 Economic downturn  
 Change in Federal Reserve policy  
 New technology  
 Demographic shifts  
 Foreign trade barriers  
 Poor performance of ally firm  
 International political turmoil  
 Weakening currency exchange rates

analysis that will be used as a catalyst for the development of the firm's marketing plan. The role of SWOT analysis then is to help the marketing manager make the transition from a broad understanding of the marketing environment to the development of a strategic focus for the firm's marketing efforts. The potential issues that can be considered in a SWOT analysis are numerous and will vary depending on the particular firm or industry being examined. To aid your search for relevant issues, we have provided a list of potential strengths, weaknesses, opportunities, and threats in Exhibit 5.5. This list is not exhaustive, and these items illustrate only a handful of potential issues that may arise in a SWOT analysis.

**Strengths and Weaknesses**

Relative to market needs and competitors' characteristics, the marketing manager must begin to think in terms of what the firm can do well and where it may have

deficiencies. Strengths and weaknesses exist either because of resources possessed (or not possessed) by the firm or in the nature of the relationships between the firm and its customers, its employees, or outside organizations (for example, supply chain partners, suppliers, lending institutions, and government agencies). Given that SWOT analysis must be customer focused to gain maximum benefit, strengths are meaningful only when they serve to satisfy a customer need. When this is the case, that strength becomes a capability.<sup>6</sup> The marketing manager can then develop marketing strategies that leverage these capabilities in the form of strategic competitive advantages. At the same time, the manager can develop strategies to overcome the firm's weaknesses or find ways to minimize the negative effects of these weaknesses.

A great example of strengths and weaknesses in action occurs in the U.S. airline industry. As a whole, the industry was in trouble even before September 11, 2001. Big carriers—such as American, Delta, Northwest, and US Airways—have strengths in terms of sheer size, passenger volume, and marketing muscle. However, they suffer from a number of weaknesses related to internal efficiency, labor relations, and business models that cannot compensate for changes in customer preferences. These weaknesses are especially dramatic when compared to low-cost airlines such as Southwest, AirTran, and JetBlue. Initially, these carriers offered low-cost service in routes ignored by the big carriers. Their strengths in terms of internal efficiency, flexible operations, and lower-cost equipment gave low-cost carriers a major advantage with respect to cost economies. The differences in operating expenses per available seat mile (an industry benchmark) are eye opening: JetBlue (6.9¢), Southwest (7.7¢), AirTran (9.3¢), and ATA (10.7¢) versus American (12¢), Delta (14¢), US Airways (16.1¢), and Northwest (16.2¢). The ability of low-cost carriers to operate more efficiently and at reduced costs has changed the way customers look at air travel. Today, most customers see air travel as a commodity product, with price being the only real distinguishing feature among competing brands. As a result, many analysts predict that the internal operating weaknesses of the major air carriers will cause one or two carriers to cease operations within five years.<sup>7</sup>

## Opportunities and Threats

In leveraging strengths to create capabilities and competitive advantages, the marketing manager must be mindful of trends and situations in the external environment. Stressing internal strengths while ignoring external issues can lead to an organization that, although efficient, cannot adapt when external changes either enhance or impede the firm's ability to serve the needs of its customers. Opportunities and threats exist outside the firm, independently of internal strengths, weaknesses, or marketing options. Opportunities and threats typically occur within the



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competitive, customer, economic, political/legal, technological, and/or sociocultural environments. After identifying opportunities and threats, the manager can develop strategies to take advantage of opportunities and minimize or overcome the firm's threats.

Market opportunities can come from many sources. For example, when founder Howard Schultz first envisioned the idea of Starbucks in 1983, he never dreamed that his idea would create an entire industry. Schultz was on a trip to Milan, Italy when he first conceived of a chain of American coffee bars. At that time, there was essentially no competition in coffee because most consumers considered it a commodity. He knew that the demand for coffee was high because it is only second to water in terms of consumption around the world. However, the U.S. coffee market was largely found on grocery store shelves and in restaurants. In fact, only 200 coffeehouses existed in the United States when Starbucks began its expansion. This clear lack of competition gave Schultz the impetus to take Starbucks from its humble Seattle, Washington, beginnings to the rest of the world. Today, there are over 11,000 Starbucks coffeehouses around the world—71 percent of them in the United States. Coffee is now a cultural phenomenon because there are over 14,000 coffeehouses in the United States today, most being mom-and-pop businesses that piggyback on Starbucks' success. Starbucks, customers eagerly spend \$3 for a cup of coffee, but they get more than a mere drink. Starbucks is a place to meet friends, talk business, listen to music, or just relax. Starbucks' popularity has spread to grocery store shelves where the brand is now a major threat to traditional in-store competitors. It is clear that Schultz's idea has forever changed the worldwide coffee market.<sup>8</sup>

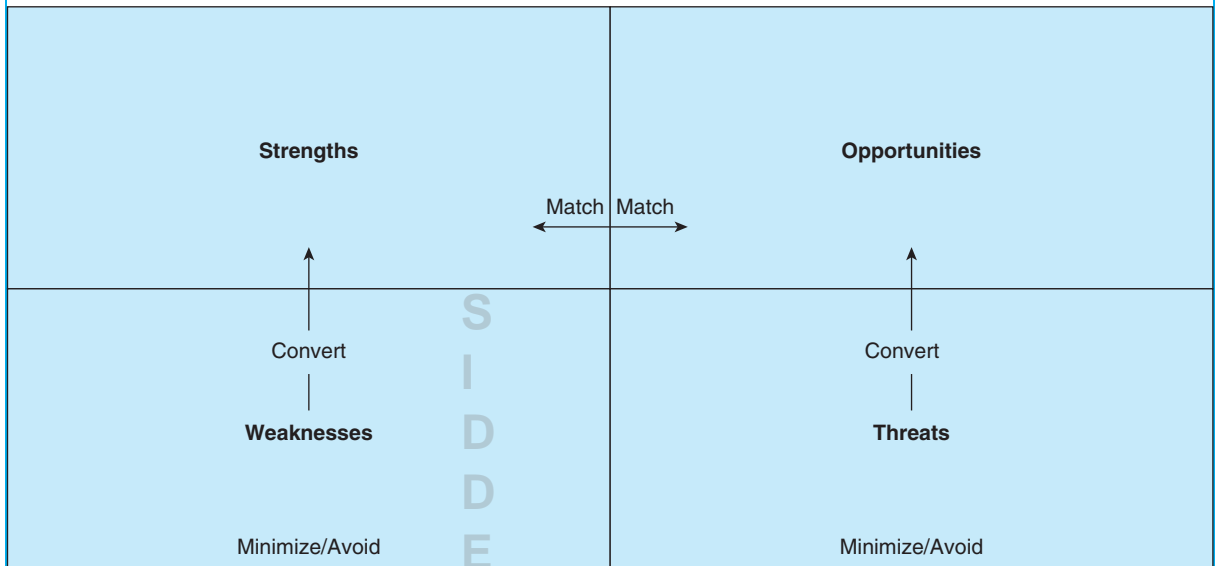
### The SWOT Matrix

As we consider how a firm can use its strengths, weaknesses, opportunities, and threats to drive the development of its marketing plan, remember that SWOT analysis is designed to synthesize a wide array of information and aid the transition to the firm's strategic focus. To address these issues properly, the marketing manager should appraise every strength, weakness, opportunity, and threat to determine their total impact on the firm's marketing efforts. To utilize SWOT analysis successfully, the marketing manager must be cognizant of four issues:<sup>9</sup>

1. The assessment of strengths and weaknesses must look beyond the firm's resources and product offering(s) to examine processes that are key to meeting customers' needs. This often entails offering "solutions" to customers' problems, rather than specific products.
2. The achievement of the firm's goals and objectives depends on its ability to create capabilities by matching its strengths with market opportunities. Capabilities become competitive advantages if they provide better value to customers than competing offerings.
3. Firms can often convert weaknesses into strengths or even capabilities by investing strategically in key areas (for example, customer support, research and development,

EXHIBIT 5.6

## THE SWOT MATRIX



Source: Adapted from Nigel Piercy, *Market-Led Strategic Change* (Oxford, UK: Butterworth-Heinemann, 1992), 260.

supply chain efficiency, and employee training). Likewise, threats can often be converted into opportunities if the right resources are available.

4. Weaknesses that cannot be converted into strengths become the firm's limitations. Limitations that are obvious and meaningful to customers or other stakeholders must be minimized through effective strategic choices.

One useful method of conducting this assessment is to visualize the analysis via a SWOT matrix. Exhibit 5.6 provides an example of this four-cell array that can be used to visually evaluate each element of a SWOT analysis. At this point, the manager must evaluate the issues within each cell of the matrix in terms of their magnitude and importance. As we have stated before, this evaluation should ideally be based on customers' perceptions. If customers' perceptions cannot be gathered, managers should base the ratings on the input of employees, business partners, or their own intuition and expertise.

It is not mandatory that the SWOT matrix be assessed quantitatively, but it can be informative to do so. Exhibit 5.7 illustrates how this assessment might be conducted using information from the marketing plan example in Appendix B. The first step is to quantify the magnitude of each element within the matrix. *Magnitude* refers to how strongly each element affects the firm. A simple method is to use a scale of 1 (low magnitude), 2 (medium magnitude), or 3 (high magnitude) for each strength and opportunity and –1 (low magnitude), –2 (medium magnitude), or –3 (high magnitude) for each weakness and threat. The second step is to rate the importance of each element using a scale of 1 (weak importance), 2 (average importance), or 3

**EXHIBIT 5.7****QUANTITATIVE ASSESSMENT OF THE SWOT MATRIX**

This analysis was conducted for the marketing plan example that appears in Appendix B. The ratings in each cell have their basis in a thorough analysis of the company and the industry.

<b>Strengths</b>	<b>M</b>	<b>I</b>	<b>R</b>	<b>Opportunities</b>	<b>M</b>	<b>I</b>	<b>R</b>
BOPREX approved to treat arthritis, migraine headache, and general pain	3	3	9	FDA has approved the transition of prescription NSAIDs into OTC market	3	3	9
Patent exclusivity for three years	3	3	9	Consumers will try new products as they become available	3	3	9
New product entry	3	2	6	NSAIDs can be used as general pain reliever and fever reducer	3	3	9
Prescription-strength pain relief available OTC	3	2	6	Potential market channels not currently exploited	3	3	9
Effective migraine treatment	3	2	6	Competing prescription pain relievers have been pulled from the market	3	2	6
Talented and motivated workforce	2	2	4	Weak product differentiation among OTC competitors	3	2	6
Lower cost of raw materials	3	1	3	U.S. population is increasingly seeking convenience of online shopping	2	3	6
Wide range of products	1	2	2	Increase in aging population	2	2	4
<b>Weaknesses</b>	<b>M</b>	<b>I</b>	<b>R</b>	<b>Threats</b>	<b>M</b>	<b>I</b>	<b>R</b>
Limited marketing budget	-3	3	-9	Competition from both prescription pain relievers and OTC pain relievers	-3	3	-9
Market position (number 6 in market)	-3	3	-9	Extremely crowded OTC market	-3	3	-9
Weak product differentiation	-3	3	-9	Consumer loyalty with existing competitors	-3	2	-6
Current brand name (new to market)	-3	2	-6	Negative publicity regarding NSAIDs	-2	3	-6
Mid-sized company	-2	2	-4	Declining physician recommendation of NSAIDs	-1	3	-3
BOPREX associated with gastrointestinal side effects	-1	3	-3	OTC NSAIDs not indicated for long-term use	-1	2	-2
Variability in offshore suppliers	-1	2	-2	Regulations on drug advertisements could intensify	-1	2	-2

M = magnitude of the element, I = importance of the element, R = total rating of the element.

Magnitude scale ranges from  $\pm 1$  (low magnitude) to  $\pm 3$  (high magnitude).

Importance scale ranges from 1 (low importance) to 3 (high importance).

(major importance) for all elements in the matrix. The final step is to multiply the magnitude ratings by the importance ratings to create a total rating for each element. Remember that the magnitude and importance ratings should be heavily influenced by customer perceptions, not just the perceptions of the manager.

Those elements with the highest total ratings (positive or negative) should have the greatest influence in developing the marketing strategy. A sizable strength in an important area must certainly be emphasized in order to convert it into a capability or competitive advantage. On the other hand, a fairly small and insignificant opportunity should not play a central role in the planning process. The magnitude and importance of opportunities and threats will vary depending on the particular product or market. For example, a dramatic increase in new housing starts would be very important for the lumber, mortgage, or real estate industries but inconsequential for

industries involving semiconductors or telecommunications. In this example, the magnitude of the opportunity would be the same for all industries; however, the importance ratings would differ across industries.

## Developing and Leveraging Competitive Advantages

After the magnitude and importance of each element in the SWOT matrix have been assessed, the manager should focus on identifying competitive advantages by matching strengths to opportunities. The key strengths most likely to be converted into capabilities will be those that have a compatibility with important and sizable opportunities. Remember that capabilities that allow a firm to serve customers' needs better than the competition give it a competitive advantage. As outlined in Exhibit 5.8, competitive advantages can arise from many internal or external sources.

EXHIBIT 5.8

### COMMON SOURCES OF COMPETITIVE ADVANTAGE

#### Relational Advantages

- Brand-loyal customers
- High customer-switching costs
- Long-term relationships with supply chain partners
- Strategic alliance agreements
- Comarketing or cobranding agreements
- Tight coordination and integration with supply chain partners
- Strong bargaining power

#### Legal Advantages

- Patents and trademarks
- Strong and beneficial contracts
- Tax advantages
- Zoning laws
- Global trade restrictions
- Government subsidies

#### Organizational Advantages

- Abundant financial resources
- Modern plant and equipment
- Effective competitor and customer intelligence systems
- Culture, vision, and shared goals
- Strong organizational goodwill

#### Human Resource Advantages

- Superior management talent
- Strong organizational culture
- Access to skilled labor
- Committed employees
- World-class employee training

#### Product Advantages

- Brand equity and brand name
- Exclusive products
- Superior quality or features
- Production expertise
- Guarantees and warranties
- Outstanding customer service
- Research and development
- Superior product image

#### Pricing Advantages

- Lower production costs
- Economies of scale
- Large-volume buying
- Low-cost distribution
- Bargaining power with vendors

#### Promotion Advantages

- Company image
- Large promotion budget
- Superior sales force
- Creativity
- Extensive marketing expertise

#### Distribution Advantages

- Efficient distribution system
- Real-time inventory control
- Extensive supply chain integration
- Superior information systems
- Exclusive distribution outlets
- Convenient locations
- Strong e-commerce capabilities

When we refer to *competitive advantages*, we usually speak in terms of real differences between competing firms. After all, competitive advantages stem from real strengths possessed by the firm or in real weaknesses possessed by rival firms. However, competitive advantages can also be based more on perception than reality. For example, Apple's iPod dominates the market for portable MP3 players despite the fact that it is not technically the best player on the market. In fact, competing products from Toshiba, iRiver, and Creative typically match or beat the iPod in terms of features and expert reviews. Customers who are unaware of better players (or those who simply don't care) buy the iPod because of its slick image, integration with iTunes, and the availability of third-party accessories.<sup>10</sup>

Effectively managing customer's perceptions has been a challenge for marketers for generations. The problem lies in developing and maintaining capabilities and competitive advantages that customers can easily understand and that solve their specific needs. Capabilities or competitive advantages that do not translate into specific benefits for customers are of little use to a firm. In recent years, many successful firms have developed capabilities and competitive advantages based on one of three basic strategies: operational excellence, product leadership, and customer intimacy:

- **Operational Excellence** Firms employing a strategy of operational excellence focus on efficiency of operations and processes. These firms operate at lower costs than their competitors, allowing them to deliver goods and services to their customers at lower prices or a better value. Low-cost airlines, like Southwest Airlines, are a prime example of operational excellence in action. Southwest's no-frills service—no meals or advanced seating—and use of nearly identical Boeing 737 aircraft keep operating costs quite low compared with other air carriers. Other firms that employ operational excellence include Dell and Wal-Mart.<sup>11</sup>
- **Product Leadership** Firms that focus on product leadership excel at technology and product development. As a result, these firms offer customers the most advanced, highest-quality goods and services in the industry. For example, Microsoft, which dominates the market for personal computer operating systems and office productivity suites, continues to upgrade and stretch the technology underlying its software while creating complementary products that solve customers' needs. Pfizer, Intel, and 3M are other examples of companies that pursue a product leadership strategy.
- **Customer Intimacy** Working to know your customers and understand their needs better than the competition is the hallmark of customer intimacy. These firms attempt to develop long-term relationships with customers by seeking their input on how to make the firm's goods and services better or how to solve specific customer problems. Nordstrom, for example, organizes its store layout by fashion and lifestyle rather than by merchandise categories. The company offers high-quality products with impeccable customer service. In fact, Nordstrom is consistently ranked tops in customer service among all retail chains.<sup>12</sup> Other firms that pursue customer intimacy include Amazon, DHL, and Saturn.

**EXHIBIT 5.9****CORE COMPETENCIES NECESSARY FOR COMPETITIVE  
ADVANTAGE STRATEGIES***Operational Excellence Strategy*

Notable firms using operational excellence: Wal-Mart, Southwest Airlines, and Dell

Core competencies:

- Low-cost operations
- Totally dependable product supply
- Expedient customer service
- Effective demand management

Common attributes:

- Deliver compelling value through the use of low prices, standardized product offerings, and convenient buying processes
- Target a broad, heterogeneous market of price-sensitive buyers
- Invest to achieve scale economies and efficiency-driven systems that translate into lower prices for buyers
- Develop information systems geared toward capturing and distributing information on inventories, shipments, customer transactions, and costs in real time
- Maintain a system to avoid waste and highly reward efficiency improvement

*Product Leadership*

Notable firms using product leadership: Microsoft, Intel, and 3M

Core competencies:

- Basic research/rapid research interpretation
- Applied research geared toward product development
- Rapid exploitation of market opportunities
- Excellent marketing skills

Common attributes:

- Focus their marketing plans on the rapid introduction of high-quality, technologically sophisticated products in order to create customer loyalty
- Constantly scan the environment in search of new opportunities, often making their own products obsolete through continuous innovation

*(continued)*

To be successful, firms should be able to execute all three strategies. However, the most successful firms choose one area at which to excel and then actively manage customer perceptions so that customers believe that the firm does indeed excel in that area. To implement any one of these strategies effectively, a firm must possess certain core competencies as outlined in Exhibit . Firms that boast such competencies are more likely to create a competitive advantage than those that do not. However, before a competitive advantage can be translated into specific customer benefits, the firm's target markets must recognize that its competencies give it an advantage over the competition. Exhibit includes a list of attributes that customers might use to describe a company that possesses each particular competitive advantage. The core

- Target narrow, homogeneous market segments
- Maintain organizational cultures characterized by decentralization, adaptability, entrepreneurship, creativity, and the expectation of learning from failure
- Have an attitude of “How can we make this work?” rather than “Why can’t we make this work?”

### Customer Intimacy

Notable firms using customer intimacy: Nordstrom, Saturn, and Amazon

Core competencies:

- Exceptional skills in discovering customer needs
- Problem-solving proficiency
- Flexible product/solution customization
- A customer-relationship management mind-set
- A wide presence of collaborative (win-win) negotiation skills

Common attributes:

- See customer loyalty as their greatest asset as they focus their efforts on developing and maintaining an intimate knowledge of customer requirements
- Consistently exceed customer expectations by offering high-quality products and solutions without an apology for charging higher prices
- Decentralize most decision-making authority to the customer-contact level
- Regularly form strategic alliances with other companies to address customers’ needs in a comprehensive fashion
- Assess all relationships with customers or alliance partners on a long-term, even lifetime, basis

Source: Adapted from Michael Treacy and Fred Wiersema, *The Discipline of Market Leaders* (Reading, MA: Addison-Wesley, 1995).

competencies are internal (strength) issues, and specific attributes refer to activities that customers will notice as they interact with the firm.

## Establishing a Strategic Focus

At the conclusion of the SWOT analysis, the marketing manager must turn his or her attention toward establishing the strategic focus of the firm’s marketing program. By *strategic focus*, we mean the overall concept or model that guides the firm as it weaves various marketing elements together into a coherent strategy. A firm’s strategic focus is typically tied to its competitive advantages. However, depending on the situation, the strategic focus can shift to compensate for the firm’s weaknesses or to defend against its vulnerabilities. A firm’s strategic focus can change over time to reflect the dynamic nature of the internal and external environments. The direction taken depends on how the firm’s strengths and weaknesses match up with its external opportunities and threats. Using the results of the SWOT analysis as a guide, a firm might consider four major directions for its strategic efforts:<sup>13</sup>

- **Aggressive: Many Internal Strengths/Many External Opportunities** Firms in this enviable position can take an aggressive stance toward their marketing strategies.

Expansion and growth, with new products and new markets, are the keys to an aggressive approach. These firms are often so dominant that they can actually reshape the industry or the competitive landscape to fit their agenda. Good examples of aggressive companies include Google, Apple, Starbucks, Microsoft, and Procter & Gamble.

- **Diversification: Many Internal Strengths/Many External Threats** Firms in this position have a great deal to offer, but external factors weaken their ability to pursue aggressive strategies. To help offset these threats, firms can use marketing strategy to diversify their portfolio of products, markets, or even business units. A perfect example of this strategy in action is the Altria Group, whose divisions include Philip Morris USA, Philip Morris International, a majority ownership in Kraft Foods, and partial ownership of SABMiller (the world's second largest brewer). Altria's international tobacco and Kraft assets, along with many of the world's most recognizable brands, are its major strengths. Unfortunately, the firm faces innumerable threats from low-cost competitors, taxes, and litigation. Until litigation against the company settles down, Altria plans to remain a diversified concern.<sup>14</sup>
- **Turnaround: Many Internal Weaknesses/Many External Opportunities** Firms often pursue turnaround strategies because they find themselves in the situation—often temporary—of having too many internal problems to consider strategies that will take advantage of external opportunities. In these cases, firms typically have to put their own house back in order before looking beyond their current products or markets. For example, Vodaphone was once on a quest for global domination in the wireless phone market. The company invested heavily in infrastructure in an effort to offer purely wireless high-speed data and voice services. However, Vodaphone ran into difficulties in integrating its services around the world. And, the market for voice, data, and television began to converge to a point where a wireless-only company like Vodaphone could not compete effectively. To begin its turnaround, Vodaphone began investing in fixed landline infrastructure and created a division to begin offering converged services on both fixed-line and wireless platforms.<sup>15</sup>
- **Defensive: Many Internal Weaknesses/Many External Threats** Firms take a defensive posture when they become overwhelmed by internal and external problems simultaneously. For example, pharmaceutical giant Merck started reeling in 2004 when it was announced that patients taking the company's pain reliever Vioxx were at an increased risk of heart attacks. Merck withdrew Vioxx from the market, which marked the beginning of a string of potentially damaging litigation against the firm. Further, over the next several years Merck faced the loss of patent protection for many of its most popular drugs including Zocor, Fosamax, and Singulair. These losses are further exacerbated by the fact that Merck's research and development pipeline is very thin. Industry analysts believed that the uncertainty over the Vioxx lawsuits and Merck's weakened product portfolio would hang over the company for 5 to 10 years.<sup>16</sup>

Although these four stances are common, other combinations of strengths, weaknesses, opportunities, and threats are possible. For example, a firm may have few

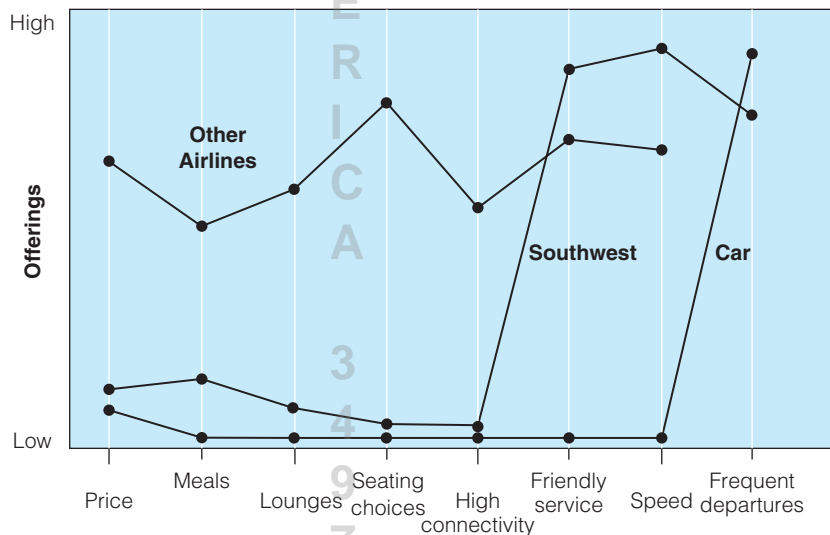
internal strengths but many external opportunities. In this situation, the firm cannot take advantage of opportunities because it does not possess the needed resources to create capabilities or competitive advantages. To resolve this problem, the firm might focus all its efforts toward small-niche markets, or it might consider establishing alliances with firms that possess the necessary resources. It is also possible that a firm will possess many internal strengths but few external opportunities. In this situation, the firm might pursue a strategy of diversification by entering new markets or acquiring other companies. This strategy is dangerous, however, unless these new pursuits are consistent with the mission of the firm. Business history is replete with stories of firms that explored new opportunities that were outside their core mission and values. Sears' expansion into real estate, financial services, and credit cards in the 1980s should remind us all that stepping beyond core strengths is often a bad idea.

Establishing a solid strategic focus is important at this stage of the planning process because it lays the groundwork for the development of marketing goals and objectives that follow. Unfortunately, many firms struggle with finding a focus that translates into a strategy that offers customers a compelling reason for purchasing the firm's products. Firms can use any number of tools and techniques for identifying a compelling strategic focus. We believe that one of the most useful tools is the strategy canvas, which was developed by W. Chan Kim and Renee Mauborgne in their book *Blue Ocean Strategy*.<sup>17</sup>

In essence, a *strategy canvas* is a tool for visualizing a firm's strategy relative to other firms in a given industry. As an example, consider the strategy canvas for Southwest Airlines depicted in Exhibit 5.10.<sup>18</sup> The horizontal axis of a strategy canvas

EXHIBIT 5.10

## STRATEGY CANVAS FOR SOUTHWEST AIRLINES



Source: W. Chan Kim and Renee Mauborgne, *Blue Ocean Strategy* (Boston Harvard Business School Press, 2005), 38.

identifies the key factors that the industry competes on with the products that are offered to customers. In the case of the airline industry, these factors include price, meals, seating choices, and service, among others. The vertical axis indicates the offering level that firms offer to buyers across these factors. The central portion of the strategy canvas is the value curve, or the graphic representation of the firm's relative performance across its industry's factors. The key to using the strategy canvas (and the key to developing a compelling strategic focus) lies in identifying a value curve that stands apart from the competition.

As illustrated in Exhibit 5.10, Southwest's strategic focus is based on downplaying the traditional competitive factors used in the airline industry (price, meals, and so on), stressing other factors (service and speed), and creating a new factor upon which to base its competitive advantage (frequent departures). In doing this, Southwest offers a compelling alternative to customers who dislike making the trade-offs between air travel and car travel. Southwest's strategic focus, then, is offering fast, friendly, and frequent air travel at prices that appeal to customers who would have customarily opted to travel by car. As we have seen earlier in this chapter, Southwest can support this focus through its competitive advantages based on operational excellence. It should be no surprise that Southwest has been successful and profitable for over 30 years.<sup>19</sup>

To use the strategy canvas successfully, the marketing manager must identify a value curve with two major characteristics.<sup>20</sup> First, the value curve should clearly depict the firm's strategic focus. As shown in Exhibit 5.10, Southwest Airlines' focus on service, speed, and frequent departures is clear. All other competitive factors are downplayed in Southwest's strategy. Second, the value curve should be distinctively different from competitors. Again, this is the case for Southwest because its combination of competitive factors clearly separates the firm from the competition. More information on the Blue Ocean approach to developing a strategic focus can be found in Beyond the Pages 5.2.

The combination of the SWOT matrix and the strategy canvas offers a useful and powerful means of visualizing the firm's competitive advantage and strategic focus. Clearly articulating the firm's focus is crucial as the marketing manager moves ahead in developing the marketing plan. In the next phase of the planning process, the manager must identify the firm's marketing goals and objectives in order to connect the strategic focus to the outcomes that are desired and expected. These goals and objectives will also be crucial at the latter stages of planning as the manager identifies standards that will be used to assess the performance of the marketing strategy. In the next section, we look at the development of marketing goals and objectives in more detail.

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## Developing Marketing Goals and Objectives

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After identifying a strategic focus, the marketing manager may have some ideas about potential marketing activities that can be used to leverage the firm's competitive advantages relative to the opportunities available in the market. At this stage, however, there are likely to be many different goals and objectives that coincide with the anticipated strategic direction. Because most firms have limited resources, it is

## Beyond the Pages 5.2

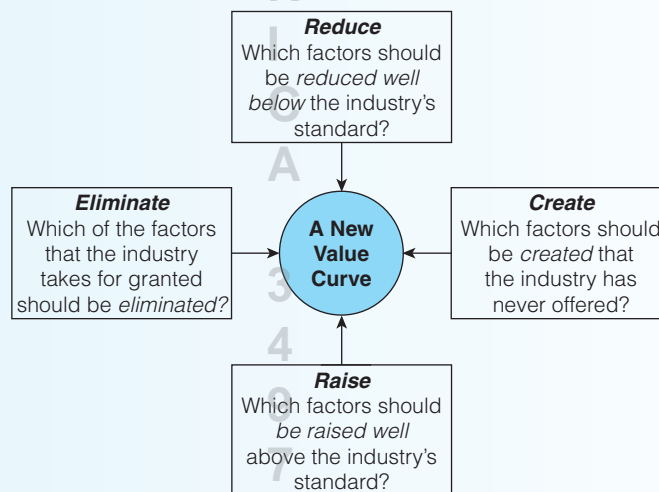
A CLOSER LOOK AT BLUE OCEAN STRATEGY<sup>21</sup>

In addition to the strategy canvas discussed in the chapter, Kim and Mauborgne developed a companion tool called the four-actions framework. Whereas the strategy canvas graphically depicts the firm's strategic focus relative to competitors and the factors that define competition within an industry, the four-actions framework is a tool for discovering how to shift the strategy canvas and reorient the firm's strategic focus. As shown in the diagram, the four-actions framework is designed to challenge traditional assumptions about strategy by asking four questions about the firm's way of doing business.

As an example of how the four-actions framework can be used, Kim and Mauborgne drew on the experiences of Casella Wine's successful launch of [yellow tail]. First, Casella *eliminated* traditional competitive factors such as impenetrable wine terminology, aging qualities, and heavy marketing expenditures. Casella reasoned that these factors made wine inaccessible to the mass of buyers who were unfamiliar with wine culture. Second, Casella *reduced* the importance of other factors such as wine complexity, range of wine selections, and prestige. At launch, for example, Casella introduced only two wines: chardonnay and shiraz. They also used a nontraditional label featuring an orange and yellow kangaroo on a black background to reduce the prestige or "snob appeal" common in most wines. Third, Casella *raised* the importance of

competitive factors such as store involvement. Casella involved store employees by giving them Australian clothing to wear at work. This created a laid-back approach to wine that made the employees eager to recommend [yellow tail] to their customers. Finally, Casella *created* easy to drink, easy to buy, and fun as new competitive factors. [yellow tail] has a soft fruity taste that makes it more approachable. Casella also put red and white wines in the same-shaped bottle—an industry first. This simple change greatly reduces manufacturing costs and makes point-of-sale displays simpler and more eye catching.

In addition to Casella, the Blue Ocean approach is used successfully by Southwest Airlines, Cirque du Soleil, and Curves (a chain of women-only fitness centers), among others. Kim and Mauborgne argue that successfully reorienting a firm's strategic focus requires the firm to give up long-held assumptions about how business should be conducted. They caution firms to avoid benchmarking and extensive customer research because these approaches tend to create a typical "more for less" mentality that guides the strategic focus of most firms. Instead, the Blue Ocean approach requires firms to fundamentally alter their strategic logic. Therein lies the challenge of Blue Ocean thinking: It is very, very difficult for most businesses to change. Consequently, true Blue Ocean approaches tend to be a rare occurrence.



THE FOUR-ACTIONS FRAMEWORK

typically difficult to accomplish everything in a single planning cycle. At this point, the manager must prioritize the firm's strategic intentions and develop specific goals and objectives for the marketing plan.

We reiterate that marketing goals and objectives must be consistent with the overall mission and vision of the firm. Once the firm has a mission statement that clearly delineates what it is, what it stands for, and what it does for others, the marketing manager can then begin to express what he or she hopes to achieve in the firm's marketing program. These statements of desired accomplishments are goals and objectives. Some use the terms *goals* and *objectives* interchangeably. However, failure to understand the key differences between them can severely limit the effectiveness of the marketing plan. *Goals* are general desired accomplishments, whereas *objectives* provide specific, quantitative benchmarks that can be used to gauge progress toward the achievement of the marketing goals.

## Developing Marketing Goals

As statements of broad, desired accomplishments, goals are expressed in general terms and do not contain specific information about where the organization presently stands or where it hopes to be in the future. Electronics retailer Circuit City, for example, has a goal of having lower prices than the competition. This goal is not specific, however, because it does not specify a benchmark that defines what a lower price is. To achieve this goal, Circuit City offers a price guarantee that matches then beats competitors' prices by 10 percent.<sup>22</sup> Goals like these are important because they indicate the direction in which the firm attempts to move, as well as the set of priorities it will use in evaluating alternatives and making decisions.

It is also important that all functional areas of the organization be considered in the goal-setting process. In developing goals for the marketing plan, it is important to keep in mind that marketing goals should be attainable, consistent, comprehensive, and involve some degree of intangibility. Failure to consider these issues will result in goals that are less effective and perhaps even dysfunctional. Let's look more closely at these characteristics.

**Attainability** Setting realistic goals is important because the key parties involved in reaching them must see each goal as reasonable. Determining whether a goal is realistic requires an assessment of both the internal and external environments. For example, it would not be unrealistic for a firm in second place in market share, trailing the leading brand by just two percent, to set a goal of becoming the industry leader. Other things being equal, such a goal could help motivate employees toward becoming "number one." In contrast, a firm in sixth place, trailing the fifth place firm by five percent and the leader by 30 percent, could set the same goal—but it



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would not be realistic. Unrealistic goals can be demotivational because they show employees that management is out of touch. Because one of the primary benefits of having goals is to motivate employees toward better performance, setting unrealistic goals can cause major problems.

**Consistency** In addition to being realistic, management must work to set goals that are consistent with one another. Enhancing market share and working to have the highest profit margins in the industry are both reasonable goals by themselves, but together they are inconsistent. Goals to increase both sales and market share would be consistent, as would goals to enhance customer service and customer satisfaction. However, setting goals to reduce inventory levels and increase customer service are usually incompatible. Goals across and within functional areas should also mesh together. This is a major concern in large organizations, and it highlights the need for a great deal of information sharing during the goal-formulation process.

**Comprehensiveness** The goal-setting process should also be comprehensive. This means that each functional area should be able to develop its own goals that relate to the organization's goals. For example, if goals are set only in terms of advancing the technology associated with a firm's products, members of the marketing department may wonder what role they will play in this accomplishment. The goal should be stated so that both marketing and research and development can work together to help advance the organizational goal of offering the most technologically advanced products. Marketing will need to work on the demand side of this effort (measuring customer needs and staying attuned to trends in the external environment), while research and development will focus on the supply side (conducting basic and applied research, as well as staying abreast of all major technological innovations). Goals should help clarify the roles of all parties in the organization. Functional areas that do not match any of the organization's goals should question their need for future resources and their ability to acquire them.

**Intangibility** Finally, goals should involve some degree of intangibility. Some planners have been known to confuse strategies, and even tactics, with goals. A goal is not some action that the firm can take; rather, it is an outcome that the organization hopes to accomplish. Actions such as hiring 100 new salespeople or doubling the advertising budget are not goals because any firm with adequate resources can accomplish both tasks. However, having "the best-trained sales force in the industry" or "the most creative and effective advertising campaign in the industry" are suitable goals. Note the intangibility associated with the use of terms such as *best-trained*, *most creative*, and *most effective*. These terms are motivational because they promote comparisons with rival firms. They also continually push for excellence because their open-ended nature always leaves room for improvement.

## Developing Marketing Objectives

Objectives provide specific and quantitative benchmarks that can be used to gauge progress toward the achievement of the marketing goals. In some cases, a particular

goal may require several objectives for its progress to be adequately monitored, usually across multiple business functions. For example, a goal of “creating a high-quality image for the firm” cannot be accomplished by better inventory control if accounts receivable makes mistakes and customer complaints about the firm’s salespeople are on the rise. Similarly, the marketing department alone could not have accomplished The Home Depot’s phenomenal growth in stores—up 20 percent in the past two years.<sup>23</sup> Such an endeavor requires a carefully coordinated effort across many departments.

Goals without objectives are essentially meaningless because progress is impossible to measure. A typical marketing objective might be that “the sales division will decrease unfilled customer orders from three percent to two percent between January and June of this fiscal year.” Note that this objective contains a high degree of specificity. It is this specificity that sets goals and objectives apart. Objectives involve measurable, quantitative outcomes, with specifically assigned responsibility for their accomplishment and a definite time period for their attainment. Let’s look at the specific characteristics of marketing objectives.

**Attainability** As with goals, marketing objectives should be realistic given the internal and external environments identified during the situation and SWOT analyses. A good objective is one that is attainable with a reasonable amount of effort. Easily attainable objectives will not motivate employees to achieve higher levels of performance. Likewise, good objectives do not come from false assumptions that everything will go as planned or that every employee will give 110 percent effort. In some cases, competitors will establish objectives that include taking customers and sales away from the firm. Setting objectives that assume inanimate or inept competitors, when history has proven otherwise, creates objectives that quickly lose their value as employees recognize them as being unreasonable.

**Continuity** The need for realism brings up a second consideration, that of continuity. Marketing objectives can be either continuous or discontinuous. A firm uses continuous objectives when its current objectives are similar to objectives set in the previous planning period. For example, an objective “to increase market share from 20 to 22 percent in the next fiscal year” could be carried forward in a similar fashion to the next period: “to increase market share from 22 to 24 percent in the next fiscal year.” This would be a continuous objective because the factor in question and the magnitude of change are similar, or even identical, from period to period.

An important caveat about continuous objectives: Objectives that are identical or only slightly modified from period to period often do not need new strategies, increased effort, or better implementation to be achieved. Marketing objectives should lead employees to perform at higher levels than would otherwise have been the case. Employees naturally tend to be objective oriented. Once they meet the objective, the level of creativity and effort tends to fall off. There are certainly circumstances where continuous objectives are appropriate, but they should not be set simply as a matter of habit.

Discontinuous objectives significantly elevate the level of performance on a given outcome factor or bring new factors into the set of objectives. If sales growth has been

averaging 10 percent and the SWOT analysis suggests that this is an easily obtainable level, an example of a discontinuous objective might be “to increase sales 18 percent during the next fiscal year.” This would require new strategies to sell additional products to existing customers, to expand the customer base, or at the very least to develop new tactics and/or enhance the implementation of existing strategies. Discontinuous objectives require more analysis and linkage to strategic planning than continuous objectives.

Developing discontinuous objectives is one of the major benefits a company can gain from applying for the Malcolm Baldrige National Quality Award. Exhibit 5.11 identifies the performance criteria for the Baldrige Award. To demonstrate proficiency in these areas, a firm must first establish benchmarks, which typically are the quantitative

**EXHIBIT 5.11** 2006 BALDRIGE AWARD CRITERIA FOR PERFORMANCE EXCELLENCE

Categories and Items		Point Values
1	<b>Leadership</b>	120
	1.1 Senior Leadership	70
	1.2 Governance and Social Responsibilities	50
2	<b>Strategic Planning</b>	85
	2.1 Strategy Development	40
	2.2 Strategy Deployment	45
3	<b>Customer and Market Focus</b>	85
	3.1 Customer and Market Knowledge	40
	3.2 Customer Relationships and Satisfaction	45
4	<b>Measurement, Analysis, and Knowledge Management</b>	90
	4.1 Measurement, Analysis, and Review of Organizational Performance	45
	4.2 Information and Knowledge Management	45
5	<b>Human Resource Focus</b>	85
	5.1 Work Systems	35
	5.2 Employee Learning and Motivation	25
	5.3 Employee Well-Being and Satisfaction	25
6	<b>Process Management</b>	85
	6.1 Value Creation Processes	45
	6.2 Support Processes and Operational Planning	40
7	<b>Results</b>	450
	7.1 Product and Service Outcomes	100
	7.2 Customer-Focused Outcomes	70
	7.3 Financial and Market Outcomes	70
	7.4 Human Resource Outcomes	70
	7.5 Organizational Effectiveness Outcomes	70
	7.6 Leadership and Social Responsibility Outcomes	70
<b>Total Points</b>		<b>1,000</b>

Source: “2006 Criteria for Performance Excellence,” *Malcolm Baldrige National Quality Award Program* (Gaithersburg, MD: National Institute of Standards and Technology, Technology Administration, U.S. Department of Commerce, 2006), 14.

performance levels of the leaders in an industry. The firm then develops objectives that center on improving performance in each area. Many companies feel that simply applying for the Baldrige Award has positive effects on performance, if for no other reason than the process forces the company to set challenging discontinuous objectives. This is also true for organizations that use the Baldrige guidelines as a planning aid.

**Time Frame** Another key consideration in setting objectives is the time frame for their achievement. Although companies often establish marketing plans on an annual basis, marketing objectives may differ from this period in their time frame. Sales volume, market share, customer service, and gross margin objectives may be set for terms less than, equal to, or greater than one year. The time frame should be appropriate and allow for accomplishment with reasonable levels of effort. To set a target of doubling sales for a well-established company within six months would likely be unreasonable. On the other hand, objectives having an excessively long time frame may be attained without any increased effort or creativity. The combination of managerial expertise and experience, along with the information acquired during the situation and SWOT analyses, should lead to the establishment of an appropriate time frame.

For objectives with longer time frames, it is important to remind employees of the objective on a regular basis and to provide feedback on progress toward its achievement. For example, employees at Federal Express' (FedEx) terminal in Memphis, Tennessee, can see a real-time accuracy gauge that displays the company's current performance in terms of getting packages to their rightful destinations. FedEx also uses a nightly countdown clock to remind employees of the speed needed to turn-around packages and load them on outbound cargo planes. Whether a weekly announcement, a monthly newsletter, or a real-time gauge on the wall that charts progress toward the objective, feedback is a critical part of the objective-setting process, particularly for longer-term objectives.

**Assignment of Responsibility** One final aspect of objectives that sets them apart from goals is that the marketing manager must identify the person, team, or unit responsible for achieving each objective. By explicitly assigning responsibility, the firm can limit the problems of stealing credit and avoiding responsibility. A bank might give the marketing department the responsibility of achieving an objective of "having 40 percent of its customers list the bank as their primary financial institution within one year." If by the end of the year, 42 percent of all customers list the bank as their primary financial institution, the marketing department gets credit for this outcome. If the figure is only 38 percent, the marketing department must provide an explanation.

## Moving Beyond Goals and Objectives

Marketing goals and objectives identify the desired ends, both general and specific, that the organization hopes to achieve during the planning period. However, companies do not fulfill properly set goals and objectives automatically or through wishing and hoping. They set into motion a chain of decisions and serve as a catalyst for the

subsequent stages in the planning process. Organizational goals and objectives must lead to the establishment of consistent goals and objectives for each functional area of the firm. Having recognized the desired ends, each area, including marketing, must next determine the means that will lead to these targeted results.

As we move forward, we focus our attention on the means issue as we address marketing strategy development. Although a firm might consider the steps of the market planning process sequentially, in reality the firm must move back and forth between steps. If marketing strategies that have the potential to achieve the marketing goals and objectives cannot be developed, the goals and objectives may not be reasonable and need to be reevaluated before the development of the marketing strategy. Given that the marketing plan must be a working document, the cycling among planning steps never truly ends.

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## Lessons from Chapter 5

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### SWOT analysis

- is considered to be one of the most useful tools in analyzing marketing data and information.
- links a company's ongoing situation analysis to the development of the marketing plan.
- structures the information from the situation analysis into four categories: strengths, weaknesses, opportunities, and threats.
- uses the structured information to uncover competitive advantages and guide the selection of the strategic focus for the firm's marketing strategy.

To make SWOT analysis as productive as possible, the marketing manager should

- stay focused by using a series of SWOT analyses, each focusing on a specific product–market combination.
- search extensively for competitors, whether they are present competitors or ones in the future.
- collaborate with other functional areas by sharing information and perspectives.
- examine issues from the customers' perspective by asking such questions as “What do customers (and noncustomers) believe about us as a company?” and “Which of our weaknesses translate into a decreased ability to serve customers (and a decreased ability to convert noncustomers)?” This includes examining the issues from the perspective of the firm's internal customers, its employees.
- look for causes, not characteristics, by considering the firm's resources that are the true causes for the firm's strengths, weaknesses, opportunities, and threats.

- separate internal issues from external issues using this key test to differentiate: “Would this issue exist if the firm did not exist?” If the answer is yes, the issue should be classified as external.

#### Strengths and weaknesses

- exist because of resources possessed (or not possessed) by the firm, or they exist due to the nature of key relationships between the firm and its customers, its employees, or outside organizations.
- must be leveraged into capabilities (in the case of strengths) or overcome (in the case of weaknesses).
- are meaningful only when they assist or hinder the firm in satisfying customer needs.

#### Opportunities and threats

- are not potential marketing actions. Rather, they involve issues or situations that occur in the firm’s external environments.
- should not be ignored as the firm gets caught up in developing strengths and capabilities for fear of creating an efficient but ineffective organization.
- may stem from changes in the competitive, customer, economic, political/legal, technological, and/or sociocultural environments.

#### The SWOT matrix

- allows the marketing manager to visualize the analysis.
- should serve as a catalyst to facilitate and guide the creation of marketing strategies that will produce desired results.
- allows the manager to see how strengths and opportunities might be connected to create capabilities that are key to meeting customer needs.
- involves assessing the magnitude and importance of each strength, weakness, opportunity, and threat.

#### Competitive advantage

- stems from the firm’s capabilities in relation to those held by the competition.
- can be based on both internal and external factors.
- is based on both reality and customer perceptions.
- is often based on the basic strategies of operational excellence, product leadership, and/or customer intimacy.

#### Establishing a strategic focus

- is based on developing an overall concept or model that guides the firm as it weaves various marketing elements together into a coherent strategy.

- is typically tied to the firm's competitive advantages.
- involves using the results of the SWOT analysis as the firm considers four major directions for its strategic efforts: aggressiveness, diversification, turnaround, or defensiveness.
- can help ensure that the firm does not step beyond its core strengths to consider opportunities that are outside its capabilities.
- can be visualized through the use of a strategy canvas where the goal is to develop a value curve that is distinct from the competition.
- is often done by downplaying traditional industry competitive factors in favor of new approaches.
- is an important stage of the planning process because it lays the groundwork for the development of marketing goals and objectives and connects the outcomes of the SWOT analysis to the remainder of the marketing plan.

#### Marketing goals

- are broad, desired accomplishments that are stated in general terms.
- indicate the direction the firm attempts to move in, as well as the set of priorities it will use in evaluating alternatives and making decisions.
- should be attainable, realistic, internally consistent, and comprehensive and help clarify the roles of all parties in the organization.
- should involve some degree of intangibility.

#### Marketing objectives

- provide specific and quantitative benchmarks that can be used to gauge progress toward the achievement of the marketing goals.
- should be attainable with a reasonable degree of effort.
- may be either continuous or discontinuous, depending on the degree to which they depart from present objectives.
- should specify the time frame for their completion.
- should be assigned to specific areas, departments, or individuals who have the responsibility to accomplish them.

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### Questions for Discussion

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1. Strengths, weaknesses, opportunities, and threats: Which is the most important? Why? How might your response change if you were the CEO of a corporation? What if you were a customer of the firm? An employee? A supplier?

2. Support or contradict this statement: “Given the realities of today’s economy and the rapid changes occurring in business technology, all competitive advantages are short lived. There is no such thing as a *sustainable* competitive advantage that lasts over the long term.” Defend your position.
3. Is it possible for an organization to be successful despite having a value curve that is not distinct from the competition? In other words, can an organization be successful by selling a me-too product (a product that offers no compelling differences when compared to the competition)? Explain.

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## Exercises

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1. Perform a SWOT analysis using yourself as the product. Be candid about your resources and the strengths and weaknesses you possess. Based on the opportunities and threats you see in the environment, where do you stand in terms of your ability to attend graduate school, get a job, begin a career, or change careers?
2. Choose two companies from the same industry: one that is successful and one that is struggling. For each company, list every strength and weakness that you believe it possesses (both the company and its products). Compare your answers with those of your colleagues. What could these companies learn from your analysis?
3. Using the same companies from Exercise 2, draw a strategy canvas that depicts the value curve of both firms, as well as the “average” firm in the industry (that is, draw three value curves). What does the successful firm offer that the struggling firm does not offer? What might a firm do to break away from the industry’s traditional competitive factors?

# Napster

## The Cat Fights On

### The History of Napster

**S**hawn Fanning—a 17-year-old Northeastern University freshman who left college to develop a technology to trade music over the Internet—launched Napster on June 1, 1999. Napster allowed computer users to share high-quality digital copies (MP3s) of music recordings via the Internet using its proprietary MusicShare software. Napster didn't actually store the recordings on its own computers but instead provided an index of all the songs available on the computers of members who were logged onto the service. Napster functioned as a sort of clearinghouse where members could search by artist or song title and identify MP3s of interest so that they could be downloaded from another member's hard drive. Napster became one of the most popular sites on the Internet, claiming some 15 million users in little more than a year. Indeed, so many college students were downloading songs from Napster that many universities were forced to block the site from their systems in order to regain bandwidth.

From the beginning, Napster's service was as controversial as it was popular. Barely a year after its launch, Napster was sued by the Recording Industry Association of America (RIAA), which represents major recording companies such as Universal Music, BMG, Sony Music, Warner Music Group, and EMI. The RIAA claimed that Napster's service violated copyright laws by allowing users to swap music recordings for free. The RIAA also sought an injunction to stop the downloading of copyrighted songs, as well as damages for lost revenue. The RIAA argued that song swapping via Napster and similar firms had cost the music industry more than \$300 million in lost sales. A few months after the RIAA lawsuit was filed, Metallica, a heavy metal band, and rap star Dr. Dre filed separate lawsuits accusing Napster of copyright infringement and racketeering. Lars Ulrich, Metallica's drummer, told a Senate committee that Napster users are basically stealing from the band every time they download one of its songs.

On July 26, 2000, U.S. District Judge Marilyn Patel granted the RIAA's request for an injunction and ordered Napster to stop making copyrighted recordings available

Michael D. Hartline, Florida State University, prepared this case for classroom discussion rather than to illustrate effective or ineffective handling of an administrative, legal, or ethical situation. Research support for the marketing plan that appears in this case was provided by Brian Cooper, Treva Gorman, Margaret Jarvis, Matt Lake, Matt Long, Danny O'Connor, Rebecca Payne, Kaleem Sultan, and Viktoria Szilagyi (Florida State University MBA Class of 2005 and 2007). The marketing plan portion of this case is intended for classroom discussion rather than to illustrate effective or ineffective marketing planning.

for download, which would have effectively shut down the service by pulling the plug on its most popular feature. However, on July 28, 2000, just nine hours before Napster would have shut down, the Ninth Circuit Court of Appeals stayed that order, granting Napster a last-minute reprieve until the lawsuits could be tried in court.

In its battle with the RIAA, Napster turned to three past rulings on copyright infringement to support its defense: Sony Betamax, the 1992 Audio Home Recording Act, and the 1998 Digital Millennium Copyright Act. In the Sony Betamax case, the Motion Picture Association of America (MPAA) filed suit against Sony out of fears that its new video recording technology would unlock the door for widespread film production. Although a lower court found Sony guilty of copyright infringement, the U.S. Supreme Court overturned the decision, stating that a new technology must be “merely capable of substantial non-infringing uses in order to be protected by law.” Because Napster’s MP3 technology had legitimate uses, Napster argued that it should have the same protections as Sony.

Napster also sought to apply the 1992 Audio Home Recording Act (AHRA), which permits people to copy music for personal use. The law, enacted in response to the development of digital audiotape recorders, was passed before the Internet revolution. Napster supporters contended that the law applies to music downloads because the music being copied is for personal use, not redistribution for profit. Many others, however, including the U.S. Department of Justice, disagreed because this act was based on digital audiotapes, not web-distributed music files. The 1998 Digital Millennium Copyright Act (DMCA) granted immunity to Internet service providers for the actions of their customers. Napster attorneys argued that the company had broad protection from copyright claims because it functions like a search engine rather than having direct involvement with music swapping. However, according to the legal community, “Napster does not take the legal steps required of search engines in dealing with copyright violations.”

Despite its claims, Napster was found guilty of direct infringement of the RIAA’s musical recordings, and the ruling was upheld on appeal on February 12, 2001. The District Court of Appeals refuted all of Napster’s defense tactics and ordered the company to stop allowing its millions of users to download and share copyrighted material without properly compensating the owners of the material. The court determined the Audio Home Recording Act was irrelevant because it did not address the downloading of MP3 files or digital audio recording devices. The court also rejected Napster’s reliance on the Digital Millennium Copyright Act, stating simply that it does not include contributory infringers.

In response to the ruling, Hank Barry, CEO of Napster and Shawn Fanning, Napster’s founder, released statements to the public. They claimed that they remained committed to finding an industry-supported solution to the controversy, such as a membership-based service. They also acknowledged negotiations with Bertelsmann AG to expand and improve Napster with the goal of prohibiting pirated music transfers and counting the number of song downloads in order to properly reimburse their artists.

A few days later, Napster offered \$1 billion to the recording industry to settle the lawsuit. Under the proposal, \$150 million would be paid annually for the first five years

to Sony, Warner, BMG, EMI, and Universal, with \$50 million allotted annually for independent labels. However, record industry executives refused to accept Napster's proposal, saying they were not willing to settle for anything less than shutting down Napster. The service was not shut down at that point, however, because doing so could have violated the rights of artists who had given Napster permission to trade their music. But, the company was required to block all songs on a list of 5,000 provided by the RIAA.

In late September 2001, Napster agreed to pay \$26 million for past distribution of unauthorized music and made a proposal that would let songwriters and musicians distribute their music on Napster for a fee. This agreement would have covered as many as 700,000 songs, but Napster still needed an agreement before the company could legally distribute the music.

However, with failed attempts to reach a suitable compromise with the recording industry and litigation expenses mounting, the company filed for Chapter 11 reorganization in June 2002 as a last grasp effort to try and reach a deal with Bertelsmann AG, Napster's strategic partner.

The final "nail in the coffin" for Napster came on September 3, 2002, when a Delaware bankruptcy judge blocked the sale of the company to Bertelsmann, ruling that negotiations with the German media company had not been made at arm's length and in good faith. Bertelsmann had agreed to pay creditors \$8 million for Napster's assets. According to the bankruptcy petition, the company had assets of \$7.9 million and debts of \$101 million as of April 30, 2002. Shortly after the judge's ruling, Napster laid off nearly its entire staff of 42 people and proceeded to convert its Chapter 11 reorganization into a Chapter 7 liquidation. At the time, this seemed like the ultimate end of Napster as most thought the company was closing its doors forever.

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## The Emergence of the Online Music Market

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Napster's problems were not so much about Napster as they were about the inability of the recording industry to adapt to changing technology and shifting consumer preferences. Each of the major music labels had been dabbling in online distribution, but Napster had beaten them all to the punch and had done it with striking efficiency. Research conducted on the effects of online music distribution had revealed some interesting findings:

- A study by Jupiter Research concluded that people who downloaded music from the Internet were 15 percent more likely to buy music through regular channels.
- Another survey by the Digital Media Association and Yankelovich Partners showed that of the respondents who had downloaded music from an online source, 66 percent said listening to a song online had prompted them to later buy a CD featuring that song.
- A survey by the Wharton School of Business concluded that 70 percent of Napster members reported using the service to sample music before buying it.

- Many music-store owners actually saw an increase in sales during the Napster controversy. As one owner stated, “Our sales are up 19% over last year because of all the publicity . . . you can’t open a newspaper or magazine and not see a Napster headline. We’ve never got so much free advertising. Music is exciting again.”
- Some studies indicated that college students were not the thieves that everyone thought—a full 27 percent had never used Napster or similar services.
- Contrary to popular belief, college students were not the only fans of online music sites. In fact, Media Metrix found that adults over 50 years old comprised 17% of the visitors to music sites—a number that had increased 92 percent in one year.

On both sides of the controversy, it was clear that online music distribution was here to stay. It was only a matter of time until a compromise could be reached among the recording studios, the artists, and Napster-like music providers. Some thorny issues remained, however. First, even pay-for-download services are not immune to piracy. As a result, the recording industry wanted to develop technology that would prevent downloaders from swapping files on their own even after making a legitimate purchase. To protect the artists, the industry also wanted to limit the number of times that a song could be downloaded and copied. Suggestions included using the MD5 hash—a digital fingerprint—or software that monitors sound patterns to detect illegal copies. A second issue was the development of a revenue model. Should MP3 files be available individually, as one file in a complete album, or both? Should pricing be based on a per-download basis or on an unlimited basis for a monthly subscription fee?

In late 2002, Roxio, a company that was widely known for its CD-burning software, purchased Napster’s name and assets. Shortly after, Roxio announced its intentions to relaunch Napster as a fee-based service in late 2003. In the meantime, other content providers were rapidly getting their houses in order. One of the first was AOL, who in February 2003 launched MusicNet offering twenty music streams and twenty downloads for \$3.95 per month. By far the most newsworthy foray into online music was Apple’s launch of iTunes in April 2003:

*Apple today announced the launch of its iTunes Music Store, a new online store that lets customers quickly find, purchase and download the music they want for 99 cents per song, without subscription fees. The iTunes Music Store, which is integrated with iTunes 4 (also released today), offers “groundbreaking” personal use rights, including burning songs onto an unlimited number of CDs for personal use, listening to songs on an unlimited number of iPods, playing songs on up to three Macs, and using songs in any application on the Mac, including iPhoto, iMovie and iDVD. The iTunes Music Store features over 200,000 songs from music companies including BMG, EMI, Sony Music Entertainment, Universal and Warner.*

Apple’s launch of iTunes hailed the beginning of the online music frenzy that followed. The following music services launched in mid- to late 2003:

- Rhapsody ([www.listen.com](http://www.listen.com)), a division of Real Networks, whose RealPlayer is ubiquitous on millions of PCs. Rhapsody now offers over one million songs for download.
- MusicMatch ([www.musicmatch.com](http://www.musicmatch.com)), which was later acquired by Yahoo!, now offers over 900,000 songs for download.
- BuyMusic.com ([www.buymusic.com](http://www.buymusic.com)), a subsidiary of Buy.com, now offers over one million songs, some as low as 79¢ per download.
- Apple's release of iTunes for Windows. Since 2003, the iTunes Music Store has been upgraded several times and now offers over three million songs, as well as videos and podcasts for download.

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## The Launch of Napster 2.0

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After much fanfare and excitement, Roxio revived Napster as Napster 2.0 on October 29, 2003. Later in 2004, Roxio sold its consumer software division and changed its corporate name to Napster. This cemented a single identity for the company, allowing it to focus on the task of gaining users in the face of daunting competition. Since its relaunch, Napster has successfully navigated the pay-for-play market though it pales in comparison to the success of Apple's iTunes and its extremely popular iPod. Although estimates are sketchy, Apple holds roughly 70 to 80 percent of the online music market. Second-place Rhapsody controls 10 to 15 percent of the market, and Napster is third with roughly 5 to 10 percent. The remaining portion of the market is divided among several different companies.

Napster's strategy has been focused more on a subscription-based revenue model rather than the download-to-own model favored by Apple. The company's Napster-to-Go service—its primary offering—allows users to download as much music as they want from Napster's library of over two million songs for a flat \$14.95 per month fee. Napster also offers Free Napster, which allows any computer user to listen to all two million songs up to three times each before they are required to buy the song for 99¢ or subscribe to Napster to Go. Urge.com (a joint effort between MTV and Microsoft), Rhapsody, and Yahoo! Music offer similar services. Napster has also worked hard to establish corporate partnerships with BellSouth, Ericsson, and XM Satellite Radio as a way to enter untapped markets.

In October 2006, Napster launched Napster Japan in partnership with Tower Records Japan. The service features 1.9 million songs, 10 percent of which are comprised of music by Japanese artists. The service launched 14 months after Apple scored a resounding success with its launch of iTunes Japan. However, Napster has also partnered with NTT DoCoMo, Japan's largest and most popular mobile phone company, to create handsets that can download and play songs from Napster. This partnership is significant because a full 90 percent of music downloads in Japan occur through wireless phones. Napster hopes that its "all-you-can-eat" subscription model and its partnership with NTT DoCoMo will push it past Apple in Japan.

Napster has also sent signals that it is interested in being acquired by another firm. The first signs of this began in mid-2006 when Napster started partnership conversations with Google. More recently, Napster has hired UBS Investment Bank to help it with a possible sale. Companies rumored to be interested in acquiring Napster include Creative (makers of a line of popular MP3 players), Amazon.com, Samsung, and Motorola.

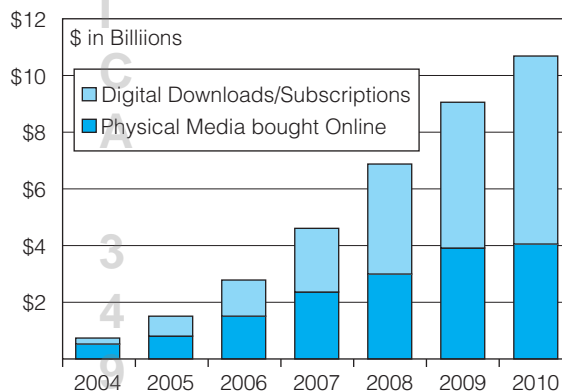
## A Shift in Music Distribution

Since the launch of Napster 2.0, the growth in the online music market has been remarkable and is expected to explode over the next several years. Revenue from downloaded music topped revenue from physical media (for example, CDs) for the first time in 2007. Worldwide, online music sales are expected to grow from \$1.5 billion to roughly \$11 billion by 2010 (Case Exhibit 1.1). A full 20 percent of all Americans own at least one portable music player. Among teens, however, ownership tops 54 percent.

Despite the phenomenal potential of the online music market, two major statistics are troubling for Napster. First, half of all music downloaders use CDs (from their own collections or from a friend) as the primary source of content for their MP3 players. These users simply move their current music collection onto a portable player rather than acquire a new collection from online sources (Case Exhibit 1.2). Further, only 25 percent fill their portable players with songs downloaded over the Internet. Even more alarming for Napster: A full 67 percent of portable-player owners prefer to download music on a per-song basis rather than use a subscription-based service.

CASE EXHIBIT 1.1

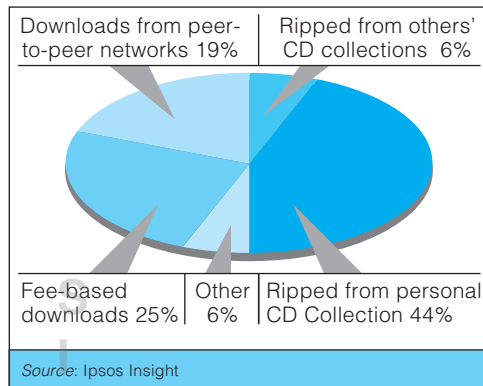
### WORLDWIDE ONLINE MUSIC MARKET REVENUE



Source: "As Consumers Continue to Take Legal Route, Online Music Market to Experience Healthy Growth."  
In-Stat press release, March 15, 2006 (<http://www.instat.com/press.asp?ID=1612&sku=IN0602972CM>).

## CASE EXHIBIT 1.2

## MUSIC BREAKDOWN OF MP3 PLAYERS



"Songs ripped from CDs are the most popular type of music content on downloaders' portable MP3 players. Fee-based downloads account for 25 percent."

Source: Candace Lombardi, "What's on Your iPod?" CNET News, June 30, 2006 ([http://news.com.com/Whats+on+your+iPod/2100-1027\\_3-6090042.html](http://news.com.com/Whats+on+your+iPod/2100-1027_3-6090042.html)).

A sizable number still acquire music via illegal peer-to-peer networks—the very sector pioneered by Napster.

## Your Challenge

Although no one knows what the future will hold for Napster or other online music providers, the ability to purchase music free of physical media is here to stay. Your task is to develop a marketing plan for Napster that leverages its advantages in an effort to increase users and revenue within the online music industry. To assist you in this effort, the first half of a potential marketing plan for Napster is provided in the following sections. Your assignment is to update the Napster case, add to and refine the marketing plan sections that exist here, and develop the remaining portions of the marketing plan. You will have to develop goals and objectives for Napster, develop a marketing strategy, and discuss how your strategy will be implemented, evaluated, and controlled. This marketing plan follows the marketing planning worksheets in Appendix A. Use these worksheets to complete the remaining portions of the marketing plan.

## Marketing Plan for Napster

### Executive Summary

This marketing plan is designed to expand Napster's customer base and revenue stream and make Napster the market leader in the online music industry. This plan discusses the goals and objectives that can be implemented to reach our ultimate goal

of being the best in the industry. We have developed a marketing strategy that will increase Napster's value to consumers. Napster has the potential to become the best and most popular online music provider in the industry.

## Situation Analysis

**Analysis of the Internal Environment** Our goal is to bring Napster back to where it once was in the online music industry. Napster should be the destination of choice for music lovers to purchase all types of music at a competitive price. This goal is consistent with Napster's mission to provide "great music experiences more accessible to all music fans." Our current objectives focus on broadening our reach among current and potential customers, primarily focusing on increasing subscriptions to Napster to Go. Through Napster.com and other tie-ins including Napster on Campus, we strive to increase awareness of all that Napster can offer to the music lover.

Currently, Napster is third in the industry with respect to overall market share. Though we compete with Apple, its iTunes Store focuses solely on the download-to-own sector of the industry. Though we offer downloads, Napster focuses on the subscription-based model. Our service is compatible with a number of popular MP3 players and other portable music devices. However, we are somewhat at a disadvantage to Apple in that we do not control our own companion playing device.

**Analysis of the Customer Environment** With so many ways to access the Internet, it is difficult to define our customer base. Further, because music spans so many generations, pinpointing the demographics and lifestyles of our customers is a challenging task. However, the typical music downloader does possess certain defining demographic characteristics, as shown in Case Exhibit 1.3. Our service can be accessed anywhere in the world, any time of day. Given the worldwide interest in music, our customers come from all walks of life. Without parameters such as mandatory membership length, anyone with access to the Internet is a possible customer.

Napster also has the potential to convert illegal peer-to-peer users into paying customers. Recent research indicates that the use of peer-to-peer networks is declining: Roughly 41 percent of music downloaders admit to pulling music from peer-to-peer networks; down from 58 percent two years ago.

Our customers choose Napster because of convenience and a wide selection of music titles. Many customers choose Napster because they do not like Apple and its insistence on tying its music library to the iPod. We allow customers to choose from a wide selection of seventy-five different MP3 players and smart phones. However, there are several reasons that potential customers do not purchase our services. One reason is competition. Many music downloaders still prefer peer-to-peer networks rather than pay-for-play services. Others love the style and chic of the iPod, so they are loyal users of the iTunes Store. A second reason is the lack of a broadband Internet connection. Broadband is now available in over 50 percent of U.S. households. However, music lovers who are stuck with their dial-up accounts are hesitant to use our services due to the time involved in downloading music. These users are more likely to fill their portable players with music from their own CD collection. A third reason is cost.

## CASE EXHIBIT 1.3

DEMOGRAPHIC CHARACTERISTICS OF MUSIC  
DOWNLOADERS

	March 2003 (%)	March 2005 (%)
<b>All Adults</b>	29	22
Men	32	25
Women	26	19
<b>Age Cohorts</b>		
18–29	52	40
30–49	27	18
50+	12	13

The percentage of each group of Internet users who download music:

Source: Pew Internet and American Life Project Surveys, March 2003 and March 2005. Margin of error is  $\pm 3\%$ .

Although our price of \$14.95 for Napster to Go is competitive, it is more expensive than Yahoo! Music Unlimited. However, their \$11.99 per month fee only gets users access to a library of one million songs. Napster's music library is twice as large.

### Analysis of the External Environment

**Competition** Our major competitors in the pay-for-play market include iTunes, Urge, Yahoo! Music Unlimited, AOL's Music Now, and Rhapsody (Case Exhibit 1.4). These services are all brand competitors because they offer the same basic service offered by Napster. Our product competitors consist of the many peer-to-peer file-sharing services, such as Limewire and BitTorrent, which offer free downloads of pirated music. Other competitors include the thousands of offline and online music record stores that offer CDs and other merchandise. However, given the movement in the industry toward online downloading of music, these competitors may soon become less worrisome.

We consider our biggest competitors to be iTunes and Urge. The iTunes library of three million songs is easily the largest in the industry. Plus, the popularity of the iPod gives Apple a distinct advantage. The iTunes software application is easy to use, works for both Macintosh and Windows operating systems, and boasts fewer

## CASE EXHIBIT 1.4

## MAJOR COMPETITORS IN THE ONLINE MUSIC MARKET

Music Service	Monthly Cost for PC Access Only (\$)	Monthly Cost for "To Go" Service (\$)	Price per Song Download (\$)	Price per Album (\$)	Songs Available (\$)
Napster	9.95	14.95	0.99	9.95	2 million
iTunes	—	—	0.99	9.99	3 million
Urge	9.95	14.95	0.99	9.99	2 million
AOL Music Now	9.95	14.95	0.99	10.00	2 million
Rhapsody	9.99	14.95	0.89	9.00	2 million
Yahoo! Music Unlimited	6.99	11.99	0.79	9.99	1 million

restrictions than other competitors. The services offered by Urge are very similar to our own. We consider Urge to be a major competitor because MTV and Microsoft back it. MTV adds a unique brand identity, while Microsoft adds the ability to create the ultimate software and hardware integration with the Urge service.

**Economic Growth and Stability** The United States is considered to have the largest music market in the world. According to statistical measures, 40 percent of all annual global sales and almost 33 percent of all unit sales are made in the United States. Per-capita spending on music in the United States averages roughly \$50 per year. According to the RIAA, more than \$10.5 billion in CDs were sold in the United States in 2005, an 8.1 percent decline. However, during the same time period, U.S. sales of downloaded music singles topped \$363 million, an increase of 163 percent. U.S. sales of downloaded albums exceeded \$135 million, an increase of 199 percent. Worldwide, sales of downloaded music totaled \$790 million, an increase of more than 350 percent.

Though online sales pale in comparison to CD sales, all the growth is in online music. The RIAA predicts that traditional U.S. music sales (mostly CDs) will continue to fall five to eight percent per year. The main reason for the decline is the low value added by traditional physical media. Although consumers value CDs because they provide “long-term” entertainment, when asked by a survey conducted by the RIAA, many stated that CDs cost too much. According to the RIAA’s research, a significant number of consumers do not fully understand the variables that play a role in the overall pricing of a CD. Consumers counter that they resent paying \$13 to \$18 for a CD to get only one or two popular songs. This is precisely why downloading music appeals to so many.

**Political, Legal, and Regulatory Issues** The RIAA is an organization that represents the U.S. recording industry. The mission of the trade group is to facilitate a business and legal environment that ensures and encourages its members’ creativity and sound financial existence. Its members include well-known national record companies. The responsibilities of the RIAA members include the creation, manufacturing, and distribution of approximately 90 percent of all recordings made and marketed in the United States.

The RIAA is also in charge of protecting intellectual-property rights worldwide, ensuring the First Amendment Rights of performers, engaging in consumer and technical research, and overseeing and enforcing state as well as federal rules and regulations regarding music industry policies. The RIAA also certifies several sales awards, such as the Gold<sup>®</sup>, Platinum<sup>®</sup>, Multi-Platinum<sup>®</sup>, Diamond<sup>®</sup> and Los Premios De Oro y Platino<sup>™</sup>.

In addition to regulation by the RIAA, the music industry is affected by a number of laws and regulations, including the following:

- **U.S. Copyright Law** The U.S. Copyright Law protects owners of copyright from the illegal reproduction, adaptation, performance, display, and/or distribution of copyrighted material. Depending on the nature of the offense, whether it is criminal or civil, penalties may differ.
- **The Federal Anti-Bootleg Statute** This statute was established to disallow illegal recording, manufacturing, distribution, or trafficking in audio or visual

recordings of artists' performances. Offenders may be penalized for fines up to \$250,000 and up to five years in prison.

- **Fair Use Doctrine** The Fair Use Doctrine is a federal law that controls the use of copyrighted material. The "fair use" of a copyrighted work includes instances when it is used as a comment, teaching material, or criticism.
- **The Sonny Bono Copyright Term Extension Act** The Sonny Bono Copyright Term Extension Act extended the U.S. copyright term from the artist's life and 50 years, to the artist's life and 70 years. This act was enacted to protect U.S. artists' work abroad.
- **The Audio Home Recording Act of 1992 (AHRA)** The AHRA was enacted to protect consumers against lawsuits for copyright infringement. According to this act, it is legal to record music for personal use/entertainment. Commercial use of copied material is prohibited under this act. This act also facilitates easier access to advanced digital audio-recording technologies and ensures royalties for artists and music related organizations. Recording devices, such as CD and cassette players, are covered under the AHRA with the conditions that the manufacturer of the covered device registers with the Copyright Office, pays a royalty on each device sold, and adds the serial copyright management technology to each device.
- **The Digital Performance Right in Sound Recordings Act of 1995 (DPRA)** DPRA was the first to protect public performance rights in sound recordings. Sound-recording copyright holders have the discretion "to perform the copyrighted work publicly by means of a digital audio transmission." This enables the record companies who hold the sound-recording rights to collect a royalty on digital "performances" of the sound recording.
- **The Digital Millennium Copyright Act (DMCA)** The DMCA was established as a result of the 1996 World Intellectual Property Organization's Diplomatic conference in Geneva. The act was passed in 1998 to strengthen copyright protections. The DMCA prohibits the manufacturing and distribution of devices that are used to "challenge" technology used to protect copyrighted materials. The DMCA also streamlined the activities and responsibilities of Internet service providers attempting to decrease the number of online copyright cases.
- **No Electronic Theft Law (NET Act)** The NET Act was enacted in December 1997 as an effort to lessen computer-based piracy by implementing criminal penalties for copyright infringement. Copyright violations may result in criminal prosecution even though there may not be a profit gain from the illegal activity. Fines can be as high as \$250,000 along with up to three years in prison. The NET Act also altered the definition of "commercial advantage or private financial gain" by adding the need of a receipt of any copyrighted material.
- **Piracy Deterrence and Education Act of 2003** The Piracy Deterrence and Education Act of 2003 was enacted in order for the Federal Bureau of Investigation

(FBI) to develop methods to deter copyright violation and for the Department of Justice to obtain authority to educate the public about copyright violations and its consequences.

- **Author, Consumer, and Computer Owner Protection and Security Act** This act proposed \$15 million to the Department of Justice to enhance the enforcement of copyright laws both domestically and internationally. The act also covers copyright violation penalties of up to five years in prison.

**Technological Advancements** In 1999 Shawn Fanning combined three key functions to create new technology. He combined a search engine, which was dedicated to finding MP3 files; file-sharing technology, which gave users the ability to trade without a centralized server; and Internet Relay Chat, which created a peer-to-peer file-sharing network. This technological advancement revolutionized the way that consumers listened to music. Consumers no longer needed to go to a music store to purchase a CD, a record, or a cassette tape to listen to their favorite songs. Consumers could opt to download just the song they liked instead of being forced to purchase the entire CD. The fact that a consumer could download a song and play it immediately added to the attractiveness of the original Napster service.

Despite the obvious threat to the music industry represented in this technology, the ability to download music online also creates a number of benefits for traditional record companies. First, companies no longer have to manufacture as many CDs to sell in music stores. Second, distribution costs are lowered tremendously because distribution through a physical store is no longer needed. Third, music download sites can use tracking technology to better understand their customers' music preferences. These data, combined with demographic information, can be valuable in promoting artists and record sales.

Though technological trends are often difficult to predict, the next "big thing" in digital music distribution is likely to be wireless or satellite technology. Makers of wireless devices are working on technology that will allow music to be downloaded to smart phones, PDAs, and other handheld devices. In fact, Microsoft has launched an "iPod Killer" called Zune that will allow users to purchase music via integrated wireless access. This will probably be the next step in the evolution of portable music devices because it will allow users to purchase music without the need to be tethered to a computer. In the future, music will likely be available on demand via wireless players and satellite-based systems for both home and car.

**Sociocultural Trends** Customers flock to online music services due to their ease of use and convenience. Customers value our services because they purchase only the songs that they want instead of wasting money on an entire CD. Our service provides customers with a convenient way to purchase the music they love. In today's culture, people spend less time in front of the television and more time in front of a computer. Our service is poised to take advantage of this trend and the growing opportunity in online music.

Of course, our business must be operated with ethical and social responsibilities in mind. Today's parents are concerned with what their children do on the Internet.

There is a growing concern for more parental controls on children's Internet browsing capabilities. In addition to these concerns, the late 1980s and early 1990s brought about parental advisory warnings for CDs. It is our responsibility to include these controls in our software to prevent children from coming into contact with explicit songs that are not age appropriate.

## SWOT Analysis

Case Exhibit 1.5 summarizes the SWOT (strengths, weaknesses, opportunities, and threats) analysis for Napster. Each point is briefly discussed in the following sections.

### Napster's Strengths

- **Strong Brand Name and Reputation** Napster pioneered the concept of downloading and sharing music over the Internet. Napster's parent company, Roxio, officially changed its name to Napster to capitalize on this strong reputation. As an industry leader, Napster is one of the first names associated with digital music.
- **Large Music Library** Napster's agreements with all major recording labels gives them access to a very large library of digital music.
- **Partnerships with Other Industry Leaders** Napster's partnership with Samsung (one of the world's most innovative companies) has led to the creation of several innovative MP3 players carrying the Napster brand. Napster also has a partnership with XM radio that takes advantage of the growing satellite-radio market. Napster also maintains partnerships with Best Buy and several leading universities throughout the United States. Napster's partnership with Tower Records Japan and NTT DoCoMo gives it a significant advantage in the Japanese music market.
- **Convenient and Easy to Use** Napster offers its entire music library via an innovative format that does not require downloading any bulky software packages.

#### CASE EXHIBIT 1.5

#### THE SWOT MATRIX

##### Strengths

- Strong brand name and reputation
- Large music library
- Partnerships with other industry leaders
- Convenient and easy to use

##### Weaknesses

- Limited avenues for differentiation
- Lack of compatibility
- Pricing structure

##### Opportunities

- Young and rapidly growing market
- Decline in illegal file sharing
- Emerging technologies

##### Threats

- Powerful competition
- Potential for disintermediation
- Emerging technologies

Napster allows consumers to listen to music directly through its website for free by registering an email address.

### *Napster's Weaknesses*

- **Limited Avenues for Differentiation** Increasing our customer base is difficult because our service is essentially the same as other competitors. We offer a large, but not the largest, online music library. Our services are competitively priced but are not the least expensive in the industry. Therefore, standing out in such a highly competitive market is difficult.
- **Lack of Compatibility** Napster is not compatible with all MP3 players, especially the market-leading iPod. Potential customers who already own an incompatible player will not be inclined to purchase our services.
- **Pricing Structure** Because Napster pioneered free file sharing, many customers are not interested in a pay-for-play service. For these users, a number of free peer-to-peer suppliers are still in existence. Further, other competitors—like iTunes, Urge, and Yahoo!—are backed by powerful firms with very efficient cost structures. Consequently, Napster has a limited ability to cut prices should a price war ensue.

### *Napster's Opportunities*

- **Young and Rapidly Growing Market** Music lovers obviously have a preference for downloading music from the Internet. The explosive growth in the digital music market attests to this fact. Our service will give these customers a vehicle for fulfilling their needs and preferences.
- **Decline in Illegal File Sharing** The declining use of peer-to-peer networks, along with the continued efforts of the RIAA, indicates that customers need a source whereby music can be obtained legally. Users of peer-to-peer networks are becoming more concerned about the legality of downloading music for free. Consequently, these individuals are potential customers for our service.
- **Emerging Technologies** A number of emerging and improving technologies will allow music lovers to access music more conveniently in the future. Wireless and satellite technologies hold the most promise in the short term. The continued integration of handheld devices like phones, PDAs, and MP3 players will continue unabated in the future.

### *Napster's Threats*

- **Powerful Competition** In addition to the continuing popularity of peer-to-peer networks, Napster faces very stiff competition from very powerful firms. The sheer dominance of Apple's iTunes and iPod prevents Napster from making significant gains in the industry. Also, other large firms (for example, Wal-Mart, Google, and Amazon) are making progress toward their online music services. Finally, a large number of music lovers consider themselves to be audiophiles who prefer the highest-quality recordings possible. These consumers will always prefer CDs until

technology evolves to a point where online music no longer has to be compressed to facilitate online distribution.

- **Potential for Disintermediation** One reason for the early rift between Napster and recording labels was that Napster beat them to the online market. The major record labels still depend on intermediaries such as Napster and iTunes to electronically distribute their music. As these firms wean their revenues off of the traditional CD-based business model, they have the potential to electronically distribute their own music. When this happens, Napster and other music services will lose out because they do not control the content that customers seek.
- **Emerging Technologies** As new technology allows customers to access music via their phones or other wireless/satellite-based devices, these customers will no longer be tied to a computer or even the Internet. Wireless phone providers, such as Verizon and Cingular, already allow their customers to purchase music over their networks. As these trends continue, the potential exists for Napster to be marginalized as a means for obtaining digital music.

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