IIB Business Support Americas

White Paper Series

Marketing for Small Business

By: Robert Vinson,

Accredited Executive Associate
The Institute for Independent Business

October, 2005

Table of Contents

Introduction 4
What is Marketing? 5
The Marketing Mix – the four P's 5
Product 6
Price 6
Place 6
Promotion 6
Market Identification 7
Market Demand 7
Discovering Market Demand 8
Focus Groups 8
Product Trials 8
Surveys 8
The Government 8
Schools and Universities 9
Industry Associations 9
Large Financial Institutions 9
Local Business Associations 9
Market Share 9
Market Targeting 10
Geography 10
Demographics 10
Life-style (Psychographics) 10
Competitive Analysis 10
Value Proposition 11
Brands and Branding 12
Brand Equity 12
Brand Development 13
Pricing 13
The Economist's View of Pricing 14
How to Price 14
Cost plus 14
Competitive matching 14
Pricing Actions and Profitability 15
Distribution 16
Product Development 17
Products 17
Competitive Advantage 18
Life Cycles 19
The Marketing Process 20
Envision the Future 21

Identify Capabilities 22
Target Markets 23
Develop/Refine Products 23
Promote and Sell 23
Measure and Assess 23
Conclusion 24

Marketing for Small Businesses

Commissioned by IIB-Business Support Americas ***October, 2005***

Submitted By: Robert Vinson
Accredited Associate of The Institute for Independent Business

Introduction

It's part of entrepreneurial lore: the engineer who designs the better mousetrap, starts a company to produce it, and has the world beating a path to his door. Unfortunately, the story ends there. It doesn't go on to say that over time the mice got smarter, or the engineer's competitors got smarter, or the U.S. Congress banned all animal trapping, or the Pied Piper came through and swept away all the mice and with them, the engineer's market.

Or, let's look at a real world example. Thomas Edison created the business of electricity distribution when he constructed the first electricity distribution system in a small part of downtown Manhattan. Unfortunately, Edison's system used direct current. George Westinghouse had a better idea. He implemented alternating current, safer and more reliable, and eventually took the market away from Edison. Today there is a multi-national Westinghouse company. Consolidated Gas bought and merged Edison's electric company.

Business analysts anecdotally assert that new businesses, once established, begin to fail at a rate that leaves less than 5% in existence within a few years. A more rigorous study of business failure in 2002 concluded that, among employer firms (firms having employees), the data from 1989 through 1998 showed that 66% were still in operation two years after establishment, 49.6% four years after, and only 39.5% six years following their opening.[1]

Having established a product and a business, entrepreneurs often fail to turn their attention away from their cherished innovation and toward the the tasks of sales and especially of marketing. This lack of market orientation, I believe, has two main causes. First, our engineer, by his training and avocation, is predisposed to think in terms of products, not markets. And, second, most entrepreneurs are almost totally ignorant of even the basic concepts of markets and marketing.

Most small business managers I have talked to have great difficulty separating product and company. More specifically, they totally fail to imagine their company in a different product market.

Secondarily, even those small businesses that are aware of their markets, because of their very smallness, lack the resources to recover from major decision errors and tend to be extremely reluctant to take the large risks of industry and product line changes. Part of this lack of small business focus on marketing comes from the dream that many entrepreneurs have of being in a given business with a given product. Many don't want to have a business, they want to be in business in a certain manner and if that is not possible, then they'd rather go back to their nine to five. Those people we can only wish

good fortune. However, for the rest of us, who want to establish and maintain a viable company over an extended period, marketing is key.

What is Marketing?

Unfortunately, small business owners as a group are ignorant of the difference between marketing and sales. In fact, most use the terms interchangeably. However, there is a great difference. Sales is the art and science of finding people that will buy what you're offering. Marketing is the art and science of formulating an offer that a significant group of people will buy.

Theodore Levitt put it quite succinctly when he said: "Selling focuses on the needs of the seller, marketing on the needs of the buyer."[2]

In fact, salespeople and marketers often are at odds on the relative positions of their individual disciplines. Salespeople consider marketing to be a servant of sales, the task of which is to establish a compelling product image. On the other hand, marketers consider sales to be an adjunct of their own discipline, a part of marketing communications.

In his note "Introduction to Marketing"[3], Benson Shapiro poses the example of a watch manufacturer who must answer the following questions:

> "1. To which consumers should I sell my watches?
> "2. What product or products should I offer?
> "3. How much should I charge for each watch?
> "4. Should I sell direct to consumers or through stores, and if through stores, what type of stores?
> "5. How should I communicate to the consumers to whom I wish to sell?"

These are the questions that inform every marketing plan and comprise the basis of the discipline of marketing. In order they translate roughly to the following marketing sub-disciplines:

1. Market identification and analysis
2. Product development
3. Pricing
4. Distribution and channel management
5. Branding, sales, and advertising

You'll notice that, of these five questions, one addresses the market (forces external to the company) and the remaining four address decisions internal to the company (products, pricing, distribution, and communications). The answers to the general forms of these questions comprise the nucleus of any marketing plan, whether for multi-national corporations or corner coffee shops; whether the plan is a multi-volume tome or a sketch in the owners head.

The Marketing Mix – the four P's

Most marketers term the decisions arising from the answers to questions two through five, those decisions that are internal to the company, the company's "marketing mix".

In the 80's E.J. McCarthy[4] introduced "The Four P's", a mnemonic device to help us remember the components of the marketing mix:

- Product
- Price
- Place
- Promotion

Product

The term "product" in this paper means the offering of the company to consumers and may include a single form or a whole line varied by feature and function.
In any case the term "product" refers to that bundle of values delivered to the customer through his/her use of the company's offering. This includes tangibles, the physical aspects, product form, feature, and function but also includes the overall experience of the customer in his use of the product: level of satisfaction, perception of quality, expectation of future use, expectation of future satisfaction and so on.
Often a small business will have only one product or one product line that it offers to customers.

Price

We're all aware that the price of a product is a primary determiner of the level of sales of that product. Common sense tells us that, between two fungible products, the lower-priced will sell the most. However, what most business managers don't take into account is that the lower-priced product often is not the one that produces the best financial result for the company. Product pricing is a complex and important factor in the marketing mix. We will consider it most closely later on in this paper.

Place

The mnemonic "Place" invokes consideration of product distribution. How do we get our product to the customer (or to the potential customer)? This covers everything from the farmer, who grows the vegetables, transports them in his pickup to a farmers' market, and sells them directly to the consumer on the weekend; to the multinational such as Dell that manufactures and sources in multiple locations, manages a massive supply chain, sells directly through the internet, agents, wholesalers, and distributors. There's been much discussion especially over the last five years of the world-wide web as a marketing "place". We'll take a brief look at that later.

Promotion

How do we make our potential customers aware of our products? This P gets us into the various types of market communications and especially advertising and selling. A common generalization is that marketing communications generate and guide consumers purchasing urges. As we shall see later, that is only somewhat the case.

Market Identification

For many entrepreneurs, this is where the trouble starts. Instead of beginning with market analysis and planning product to meet demand, they start with the product(s) and go looking for the market(s). This often works in the short term because the entrepreneur may have an intuitive grasp of existing market segments for his particular product. Many successful businesses have emerged based on this approach and, frankly, for small businesses with limited in resources to dedicate to market analysis, this can be an effective start-up tactic. Most small businesses, whether start-up or not cannot afford the time and resources to completely investigate their target market.

However, entrepreneurs usually need to polish and refine their understanding of the single-product market they serve to be able to anticipate its dynamics or even to identify current movements.

Especially there are two aspects of the market that are important – the characteristics of products being demanded, and the quantity of products being demanded.

Market Demand

The wants and needs of consumers drive market demand. Each of us is a unique individual with unique wants and needs, which, incidentally, evolve continually as each of us progresses through time and life. Consequently, it is almost impossible to ascertain the demands of any particular individual. Market analysis instead is based on broad categories of demand accumulated across significant groups of consumers. We posit that the constituents of this group have certain wants and needs in common which, because of the size of the group, change only very slowly over time. These are the wants and needs that we take as the basis to formulate our value proposition for this particular "market". The demand for product that evolves from these common wants and needs we call "market demand".

However, there is a basic conundrum in the concept of market demand. While marketers are busy trying to identify and quantify it, they also are busy trying to create and influence it, especially through sales and advertising. This gives marketers a somewhat schizophrenic view of the market, as a force both malleable and immutable – as both master and servant.

The primary objective of marketing is to identify and meet this "market demand" by devising and presenting products that, when employed, deliver value that satisfies it. However, discovering market demand is a time and resource-consuming exercise. The questions of its characteristics and its quantity determine the potential for success of a small business' market offerings. There must be sufficient demand for the product to produce sales that will sustain the firm (see Market Share below).

At the time of business start-up, many entrepreneurs have, or believe that they have, a rough idea of demand in a particular market just through their prior experience. As time goes on though, and markets change, most small businesses do their market demand research by consulting their friends and neighbors, *post facto* by soliciting feedback from customers, and through anecdotal evidence from others familiar with the industry: trade journals, trade associations, competitors, and business owners and managers in associated industries.

There are many services that offer "market studies" estimating current and future market characteristics and demand levels for various products and for broad industries. While some of the best (and most expensive) may be quite methodologically sound most studies are done on a national or international level while most small businesses operate in local or regional markets.

Discovering Market Demand

The final truth is that most consumers know what they want only after they've seen it. We've devised some very clever methods to try to wrest from consumers a description of their wants and needs – to help identify market characteristics and measures.

Focus Groups

In this approach to market research the marketer assembles a group of consumers from his target market, facilitates a discussion of their wants and needs regarding the proposed product, and may introduce blind trials of the product against its competitors.

Product Trials

The company releases an early version of the product in a very restricted market, measures the consumer reaction, makes changes to the product if warranted, and may make several trials before either releasing the product generally or abandoning it. A well-know example of this is the Broadway producer who opens his show in Buffalo, New York, to get audience feed-back and to work with cast and writers fine-tuning the show before trying to move on to New York City where things are much more expensive and difficult and where a failed run will doom the production.

Surveys

By mail, email, or telephone the marketer contacts potential customers to get their responses to questions he has formulated which are intended to ferret out their likely reaction to a proposed product.

There are other methods based on trend analyses and predicting group behavior. All suffer from high cost in resources and time, and the relative inability of most consumers to succinctly and accurately describe their desires. Also, results tend to be strongly influenced by the choice of participants and of questions asked. So much so that some believe that you can get whatever result you wish merely by clever selection of participants and queries.

For most small business, such direct market research probably is not practical.

There are other, indirect sources of market demand data available to the small businessman. These include:

The Government

The U.S. Bureau of the Census, the Department of Commerce, Federal Reserve Banks (especially for regional data), Department of Labor

Schools and Universities

Many provide data on the regional economy through their economics or business departments.

Industry Associations

Many industry associations do market research and market analysis regarding their industry.

Large Financial Institutions

Some of the larger banks, brokerages, and insurance providers publish research on specific industries.

Local Business Associations

In many large cities business associations or even large businesses publish economic and market information. This is more specific to the local nature of the small businessman's market, but also is rather sparse in industry coverage and variable in quality.
Two *caveats* regarding these sources; the research tends to be rather broad in geographical scope and not well focused on particular market segments, and, the object of the research may diverge significantly from the needs of marketers and may require some clever data manipulation before it can be applied.

Market Share

Product and business analysts make much of what they term "market share" in their evaluations of various products and companies. Market share is the dollar percentage of total product or industry sales that a single product or company captures in a given time. Simply, we calculate market share by dividing a company's annual sales or its annual sales of a single product by the total sales of all companies in a given market, either for the product (in the case of product market share) or for the whole industry (to calculate the firm's market share).
For a small business, market share, as a measure of results, is less important than other measures such as total sales and revenue, cash flow, production costs, and so on. However, it is important in one respect. Any business, especially a single-product business, must achieve a certain minimum market share to survive.
A small business must always produce compensation for its principals equal to their opportunity cost, what each could earn by going to another opportunity. Additionally, the company, to survive, must produce enough to repay its creditors in a timely manner. This implies two things about the company's target market:

1. The market must be large enough in terms of primary demand to provide this minimum revenue.
2. Assuming that the primary demand is sufficient, the company must capture a large enough share of the market to meet this minimum.

Market Targeting

Even the largest of producers can't satisfy all market demand. It is much more efficient to define a "target market", a segment of the whole market as the intended customers for a given product and as the recipients of our market communications regarding that product. Many small businesses, especially those dealing in relatively low-price items, or in service delivery, tend to restrict their markets geographically to control the cost of product delivery. For low-cost physical products, the cost of shipping tends to overwhelm any value delivered to the customer. Services, generally, must be produced in the location where they are consumed, and the cost of moving the service production facility any great distance can, again, overwhelm realized value. (Franchising, especially by service providers, can counteract this by establishing a low or no-cost production facility in an otherwise unserved geographical territory.)
There are several ways to segment potential buyers into market segments and businesses can, and probably should, use more than one method simultaneously to arrive at a reasonable target market.

Geography

This is an automatic for most small businesses as I mentioned above. In the first place, small businesses must constrain their target market to those areas where they can effectively deliver their products. In the second, the larger the geographic market, the greater the market communications costs. The use of the internet has somewhat mitigated the second reason, but managers still need to consider it in the cases of other media. Also, some products simply don't work in some geographical areas – snow blowers in Miami for instance. The result is that most small businesses address solely local or regional markets.

Demographics

Demographic groups are those that share personal characteristics such as age ranges, political affiliations, social networks, gender, cultural heritage, family characteristics, occupation, and so on. Some Value Propositions make little sense when made to some demographic groups. It would be futile to tout the benefits of sea urchin row, a much-esteemed delicacy in Japan, to beef-eating mid-western Americans.

Life-style (Psychographics)

Segmenting by life-style is subtly different from demographic segmentation. Life-style consideration might separate outdoorsmen from couch potatoes, or snow-skiers from those of us who would rather sit on the beach.
Geographic and demographic characteristics of large consumer groups tend to be fairly readily available. Psychographic characteristics are much less so and usually are rather difficult to analyze and/or predict with any certainty.

Competitive Analysis

It is at this point in market analysis that marketers usually bring in competitive analysis, the examination of various markets for competitors and, when found, the discovery of their strengths, weaknesses, products, and likely future actions. The intent, in the case of

large companies and start-ups, is to help identify attractive industries for the purpose of entry.[5]

In the case of startup small businesses I consider this the expenditure of great time and effort to acquire competitive information of small benefit. Obviously it would be great to be in an industry and to produce products with little competitive pressure. However, most small businesses have limited latitude in their choice of industry and products, being primarily constrained by the skills, knowledge, and experience of their owners and managers.

A second purpose of competitive analysis is to identify product substitutes and alternatives and to compare them, form, feature, function, and benefits to one's own products. Most small business managers do this on a regular basis almost intuitively. It's relatively easy to keep track of competitors and their products in the typically limited market in which most small businesses operate. My experience has been that many of a small company's product improvements have come from observing the competition. Unfortunately, most small business managers that are aware of product competition usually view it with the eyes of the salesman, i.e. it's our product against their product; rather than with the viewpoint of the marketer: it's our company against their company. Their reaction tends to be that of the salesman also, pricing action, which we will discuss below. In many cases, the more effective response to competition would be product development, also discussed below.

Value Proposition

The "value proposition" is exactly what it sounds like – a proposal from the seller to the buyer to part with his money (the price of the product) in exchange for the described benefits offered him through use of the product. Theodore Levitt[6] is reported to have told his MBA marketing class: "People don't want ¼ inch drill bits, they want ¼ inch holes." This comment holds the essence of the concept of the value proposition. We talked above about identifying characteristics of products demanded by the market. However, very rarely are there products that directly satisfy consumer wants and needs. More commonly, products provide the means to satisfy wants and needs. It is this promised satisfaction, balanced against price and other costs, that constitutes a product's Value Proposition.

There obviously was market demand for listen anywhere music. The product that satisfied it was the Sony Walkman (and now the iPod – which is an acronym for ***i***nternet ***P***rogram ***o***n ***d***emand interestingly enough). Those who buy iPods, however, don't want this contraption of circuit boards, plastic cases, and wiring; instead they want music in their ears wherever they go. The Value Proposition from Apple, then, is: "If you pay us a certain amount of money, you can have the music you want wherever you go."

Notice two things – first, the Value Proposition is one made from the seller to the buyer; and, second, it describes the benefits the seller claims the buyer will get from exchanging his money for the use of the product."

It's important to recognize, however, that there could be a completely different set of benefits realized from product use by the buyer is realizing and for which he is willing to pay than those promised by the seller. As opposed to the Value Proposition (benefitst the

seller promises in exchange for the price) the customer may also (or instead) realize unpromised benefits (call these "value in use" benefits).

An example is the odyssey of Arm & Hammer's lowly box of baking soda. Originally a common and relatively cheap baking ingredient, it has become the deodorizer and abrasive cleaner of choice in multiple applications ranging from industrial to household. We now can find it in toothpaste, refrigerators, chemical spill remediation, acid burn treatments, and even being flushed down household toilets. Users discovered the multiple benefits of soda while Arm & Hammer was still selling to the baking industry. Fortunately for Arm & Hammer, their marketing team was able to spot these "values in use" and incorporate them into various Value Propositions across multiple markets, thus vastly improving Arm & Hammer's bottom line.

Brands and Branding

A brand is a short-hand device for consumers. In some sense, it can be viewed as the "reputation" of the product or organization to which it refers. Think of famous brands: Nike, Coca-Cola, Air Jordan, Diet Coke, March of Dimes, and The Red Cross. Each brings to mind a set of perceptions that, for each of us, define the product or organization.

"Brands allow the consumer to shop with confidence, and they provide a route map through a bewildering variety of choices. The customer does not have to be an expert on the complexities of mobile telecommunications to choose between one service supplier and another. The brand name, the tariff and the method of payment are all that is required to make an informed choice. And as tariffs and methods of payment are largely the same among competing companies, it is the brand and consumers' appreciation of its underlying appeals – that will ultimately drive the purchase decision."[7]

However, perception generated by advertising is only a part, and for small businesses, usually a small part, of the brand's impression on the consumer. A larger part comes from the product's performance history. The history of the product in use forms a reputation for the brand that often outweighs all the efforts of the advertiser and salesperson. If the value in use of a product diverges from or is contrary to the value proposition put forth by the producer, consumers will usually follow the popular conception. Thus massive public relations efforts sometimes go for naught or even cause negative reaction in the market when they are seen to present values not found in the products in use.

Examples of this can be found every day at the movie theatres near you. Regardless of the untiring efforts of Hollywood publicists, consumers make their purchasing decisions for films shown in theatres based primarily on the recommendations of their friends or of movie critics.

Brand Equity

The thing that brand managers seek to establish is a positive set of impressions that attach to the brand and the product in the minds of the consumers. Marketers commonly call the set of values evoked to the consumer by the brand the brand's "equity". In economic terms, this is the premium that the consumer will pay to acquire a product of a particular brand. Automobile shoppers expect to pay more for a Cadillac than for a Volkswagen, a fact that has distressed Volkswagen marketers for some time now. Notice that this equity

may be negative. Brands can become liabilities if the public attaches enough negative perceptions to them. The "New Coke" comes to mind. Also, the Ford Pinto with its (deserved or not) reputation for fiery crashes.

Brand Development

Given limited resources, small businesses usually cannot afford the investment necessary to establish more than one brand, or to establish that brand in greater than a local or regional market; at least not through the usual market communications methods, sales and advertising in particular.

As an example, several years ago one of my clients was a company that manufactured, marketed, and sold the large metal electrical transmission towers that support main transmission lines from power generator such as hydro-electric dams and power stations. These poles were their only product and the governmental, quasi-governmental, and large private power generation and management organizations were their only customers. Even though their market was national, it was relatively small in number of potential customers. They had a substantial market share because of the reputation for high quality of their products. Their brand, established primarily through the performance of their product in use, had significant brand equity. It was known and valued throughout their relatively small (in number of consumers) market segment.

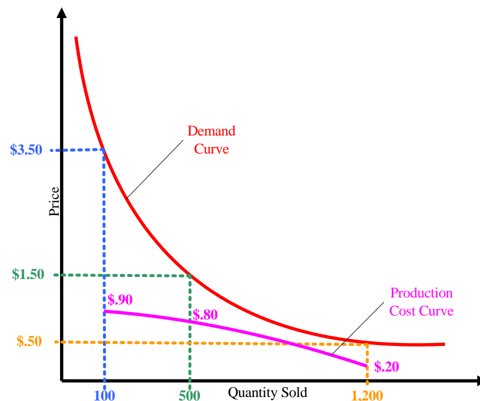
If you are a small business many times the brand is you. It is what you offer to you customers. It is your product, your reputation, your value, it is your business wrapped up in a package. The business owner has a large part in establishing the product or company brand because, in many cases, especially where the product is a service delivered by the owner, the way that the owner presents himself and the way that he delivers, in great part, shapes the perception of value by the customer. Even if the product is something apart from the owner, the owner's reputation, apparent knowledge and skill, ability to interact positively with the customer, provide value. I'm sure that a part of the value perceived by the agencies buying my client's pole structures stemmed from his "schmoozing" with agency executive and procurement officers.

Pricing

Unfortunately, pricing is a total mystery to most small business owners. A common method of pricing a product is to try to stay even with or even slightly lower than the competition.

Most business owners realize the relationship between price and sales volume, and therefore, tend to under-price to gain market share at the expense of their profitability. In many cases, small businesses go for long periods without price adjustments because they are afraid that they will lose customers with price increases, or lose profit with price decreases. A new client of mine came to me with the concern that her revenues had been steadily declining for several years. Finally she admitted to me that her company had not adjusted pricing in at least 5 years, despite known increases in raw material prices, wages and salaries, insurance costs, taxes, interest, and just about any other business cost you can imagine. I told her that, surprisingly enough, most small companies price below their profit maximization point and that the customers they might lose due to increased prices often are found to be those that are least profitable.

The Economist's View of Pricing



Economist many years ago came up with a model of the relationship between the price of a product and the amount sold – it's called the "demand curve" (in red above). Notice that, as you would expect, the cheaper a product is the more units we can sell. In our example, at a price of fifty cents we sell 1,200 units, at $1.50 we sell 500, and at $3.50 we sell only 100 units. So, you say, let's corner the market and sell at fifty cents. With the stated demand, that price gives us revenue of $600 as opposed to total revenue of $750 if we price at $1.50 and only $350 at the price of $3.50. Obviously we want to price at $1.50 and get the most revenue. However, because of the fixed capacity in our production facility, it costs us twenty cents a unit to produce 1,200 units, eighty cents a unit to produce 500 units, and ninety cents a unit to produce just 100 units (the Production Cost Curve in fuchsia). So the profit earned at each level would be $360 at 1,200 unit sales, $350 at 500 unit sales, and $260 if we sold only 100 units.
Further, suppose your competitor has a different cost of production and he prices at forty-eight cents. If you match his price and sell half the market at that price (say 625 units out of 1,250) your profit would decline to $175 (assuming your production costs remained unchanged). Throw in economic cycles, changes in product demand, changes in production methods, technology advances, etc. Pricing is a complicated task.

How to Price

Consequently, most small businesses price using one of two methods:

Cost plus

Take what you think is your unit cost of production and add on what you want for margin on each unit.

Competitive matching

Go see what your competitor is charging and charge the same or slightly less. The trouble with the first is that price has absolutely nothing to do with cost of production. Price has to do with value realized by the consumer. The higher the value of your product to him, the more he will be willing to pay for it. You may be significantly under or over-pricing and leaving a lot of revenue on the table.

Regarding the second pricing method, if you have unique benefits and price with your competitors, you will not realize the premium due you from your advantage. If you have equivalent benefits but lower production costs and price with your competitors, you fail to take advantage of your lower cost structure to capture market share. If you have equivalent benefits and pricing, you need to do some serious product development and/or target market adjustment.

The range of prices available to a small business is from the lowest price that will still cover the fully burdened cost of product production to the highest price that will not lose the business such market share as to threaten its survival. Within that range we can attempt to determine consumer price reaction for a particular product in two ways:

1. Ask consumers what they would be willing to pay (pricing surveys);
2. Experiment with pricing and observe the results.

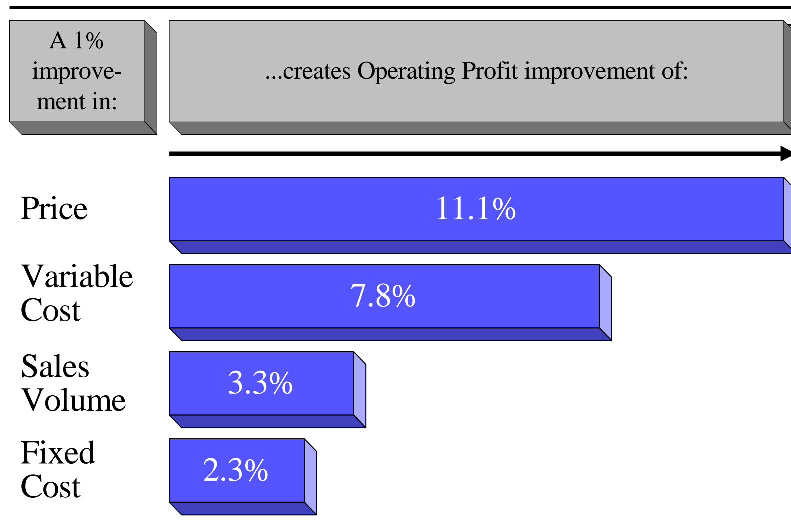
The first is the least risky, and the most unreliable. People often don't act as they say they would in a hypothetical situation. The second is more risky, especially for small businesses that may not be able to recover from loss of market due to bad pricing decisions. However, a small business may be able to substantially reduce the risk of the second by experimenting within limited market portions carefully selected to mimic the behavior of the larger segments of which they are a part.

Also, it is possible to estimate consumer price reactions by collecting actual prices throughout the market and fitting a straight line through the points that they represent. This is called a "price-response" curve and, when constructed correctly, can indicate customer reaction to price actions under current static conditions.

The ultimate objective of price-setting is to price a product just under the highest price that a customer is willing to pay for it. This is called "value pricing" and yields the maximum in revenue. From our demand curve, above, we can see that various customers are willing to pay from approximately $5.00 to fifty cents for our product. Unfortunately, unless there is no communication of pricing information among our customers, we have to offer one standard price.

Pricing Actions and Profitability

Something that most small business owners fail to understand is the powerful effect of pricing action. Taking the company economics of 2,463 companies from the Standard & Poor's Compustat aggregate, two consultants from McKinsey & Co. determined that, volume remaining equal, positive pricing action contributed far more to the bottom line than cost or sales volume improvement.[8]



Notice that a one percent increase in price lead to an increase in Operating Profit of eleven percent while a one percent increase in sales volume yielded only a three percent increase in profit. Unfortunately, the same ratio holds in reverse. A reduction in price has a significant lowering effect on profit. That is why discounting is so insidious. Giving a discount in most small businesses is an easy and satisfying way to convince yourself that you are giving good customer service, but the small business rarely stops to calculate its effect on the bottom line.

Distribution

Once we have identified our market(s) and our product(s), the next question is how do we get our products in front of consumers and, ultimately, to our customers? For physical goods this usually involves wholesaling and retailing. Although there are more and more manufacturers dealing direct on the internet. The great advantage of internet retailing is that it eliminates the overhead of wholesalers and distributors. On the other hand, the great disadvantage is that it eliminates from the distribution channel specialists in retail and customer management, the wholesalers and distributors. Wholesalers and distributors, in general, buy goods from manufacturers and resell those goods to retailers, managing the logistics of distribution and the retailer relationships so that the manufacturer can concentrate on his production. Wholesalers and distributors also maintain inventories which act as capacity buffers allowing on-time delivery to customers without creating production peaks and valleys. They also increase sales for the manufacturer by maintaining these product reserves. In some cases, retailers may take over the distribution function and purchase directly from the manufacturer.

> Sidebar 2 Use Costs
>
> The common use of wholesalers, distributors, and retailers stems in large part from attempts to overcome costs to the consumer known as “use costs”. These are costs of consumption of a product in addition to the price of the product. For instance, to use an electric razor you must research the available products (research costs) to find the model you want (decision costs), find a retailer selling that model (search costs), buy ancillary products such as razor oil and cleaning brushes (related costs), take it home (transportation costs), and learn a new way of shaving (learning costs). These, and similar costs factor in to consumer decisions. Usually, price and benefit being equal, the consumer will pick the product with the lower use costs associated.

Retailers are specialists in managing the relationship with end users of products. Think of grocery stores. The advantage of using wholesalers, distributors, and retailers is that they provide proximity and timeliness in delivering products to customers (see Sidebar 2).

Wholesalers and distributors (and retailers) offer products from a broad range of manufacturers to meet the product requirement mix of a certain market (again, think grocery stores). Agents and manufacturers representatives, on the other hand, usually offer products from one or a few manufacturers, usually in one ore a few related products lines. Also, they rarely take possession of the products, unlike wholesalers and distributors.

A third channel category, one that is popular with service providers especially (since most services must be produced where they are consumed), is the franchise (think McDonald's). The advantage of the franchise is that you can place and control an outlet in a geographical market without the cost of owning the outlet. Franchisers usually pay a fee to the franchising company which entitles them to use its brand, sell its products, participate in broad-based marketing, get assistance in management, operations, and marketing, and sometimes get financial help.

Product Development

I said earlier that a long-term successful business follows the market; in other words, is market-oriented. Such an orientation implies that the business analyzes market demand and adjusts its offerings according to the dynamics. This further implies that the business changes its offerings to meet changes in demand. This process of changing product to meet demand is called "product development".

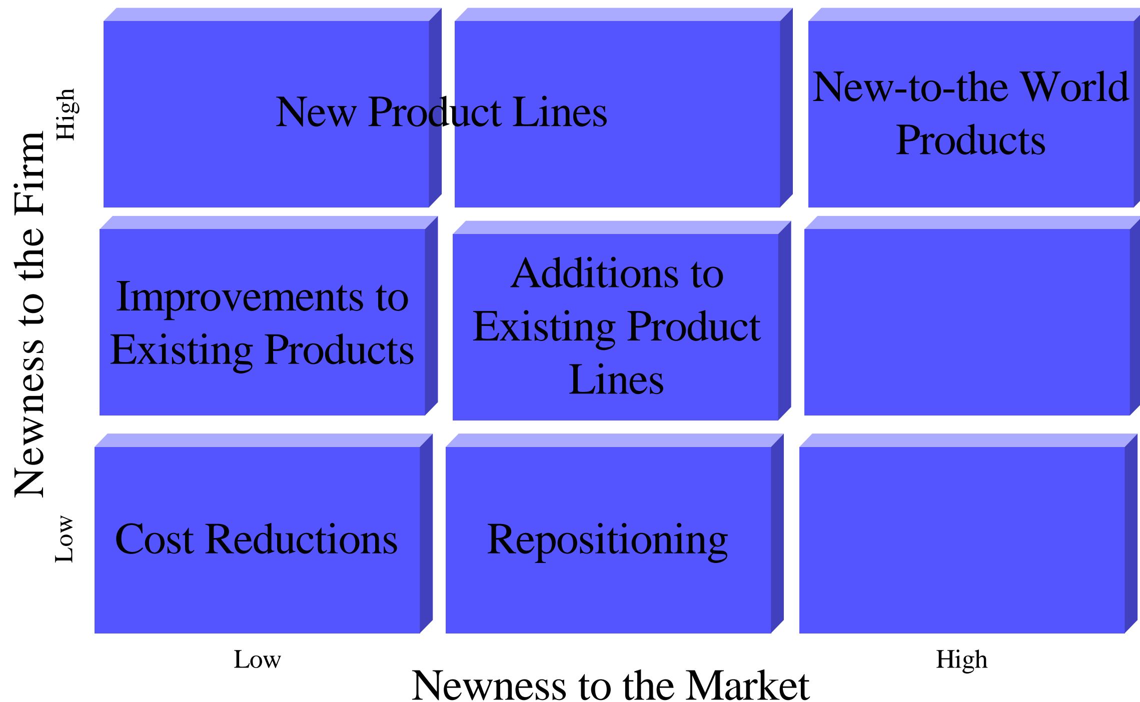
Products

Contrary to the popular image (our engineer/entrepreneur from above) not all small businesses enter the market with a revolutionary new product. Most, I believe from my experience, come into the market with the perception that they possess some competitive advantage such as the ability to lower costs and/or increase quality of existing products or services, or at minimum, with a new twist on an existing product.

In the 1980's the consulting firm Booz, Allen, Hamilton came up with a categorization of new product introductions based on the newness of the introduced product to the market and on the newness of the product to the firm. They identified six categories ranging from "new to the world" (products completely new to the market and to the firm) to "cost reductions" (changes in the consumption costs of existing products).

It's useful for small business owners to think of products in this light for two reasons – first, such conception effectively separates products from firm and places them in their correct perspective as market offerings designed to help the firm achieve its strategic goals. Second, this categorization points out that, far from there being just products and other products, there are variations on existing products, additions to existing product lines, repositioning of products in the markets, and changes in the value structure of existing product (here represented by the "Cost Reductions" box) and that the firm's products should not be immutable and unchanging.

A recent commentary suggested that a start-up business should have at least eight separate income streams to enhance its chances of survival. If we regard each product as a source of income, that means that the small business should have eight different market offerings. One way to achieve this is to develop our single product into multiple products by variations in form, feature, and function. Also, as in our Arm & Hammer example, above, we can use essentially the same product to deliver different Value Propositions to different markets.



Notice also that the x axis above might just as validly be labeled "Degree of change in the product value proposition" and the y axis "Degree of change in the product form". Marketers typically think of each individual product as being one variation in a whole line of related products, the "product line". The commonality usually is in production processes, product forms, and technologies used. Think of the General Motors automobile. The basic form of all GM autos is very much the same. However, on this basic "product platform" GM has built several product lines: Cadillac, Buick, Chevrolet, Oldsmobile, and Pontiac. Further, each of these product lines has several variations, for Chevrolet alone there are the Cavalier, the Cobalt, the Monte Carlo, the Corvette, the Aveo, the Malibu, and the Impala. Each product is targeted at a different market.

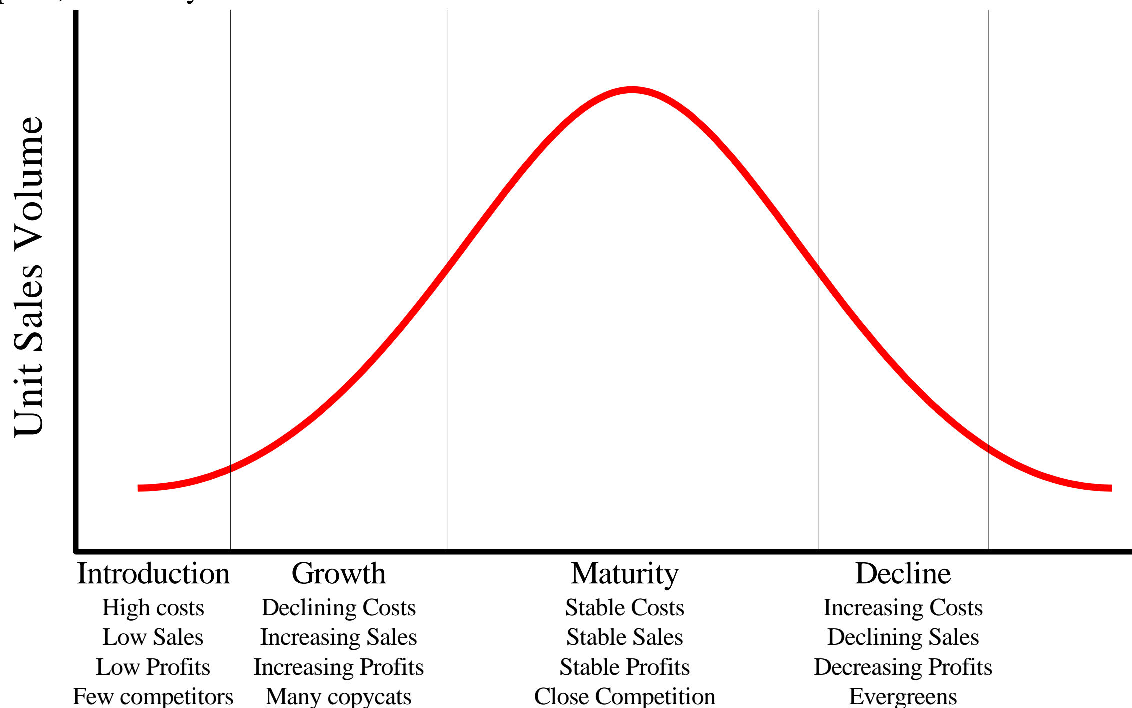
Competitive Advantage

As before, most entrepreneurs start a company, not with a new product, but with a feeling of competitive advantage regarding a certain product or service. Whether such an advantage exists in any given case, the concept of competitive advantage is key in product planning. A company has an advantage over its competitors when it can deliver superior value to its customers through higher quality, uniqueness, or lower consumption cost. According to Michael Porter: "Value is what buyers are willing to pay, and superior value stems from offering lower prices than competitors for equivalent benefits or

providing unique benefits that more than offset a higher price."[9] In the small business environment, where one product or product line is the whole of the company's offering, achievement of competitive advantage rests in the superiority of the product in the company's target market. If a small business cannot have some competitive advantage in a product it is producing, one must question whether it should continue to produce that product.

Life Cycles

Both products and industries have shown themselves in the past to have definite life spans and, during those spans, common characteristic phases. Small business people can be sure that, even if nothing else changes in their market, products will emerge, build, peak, and decay across time.



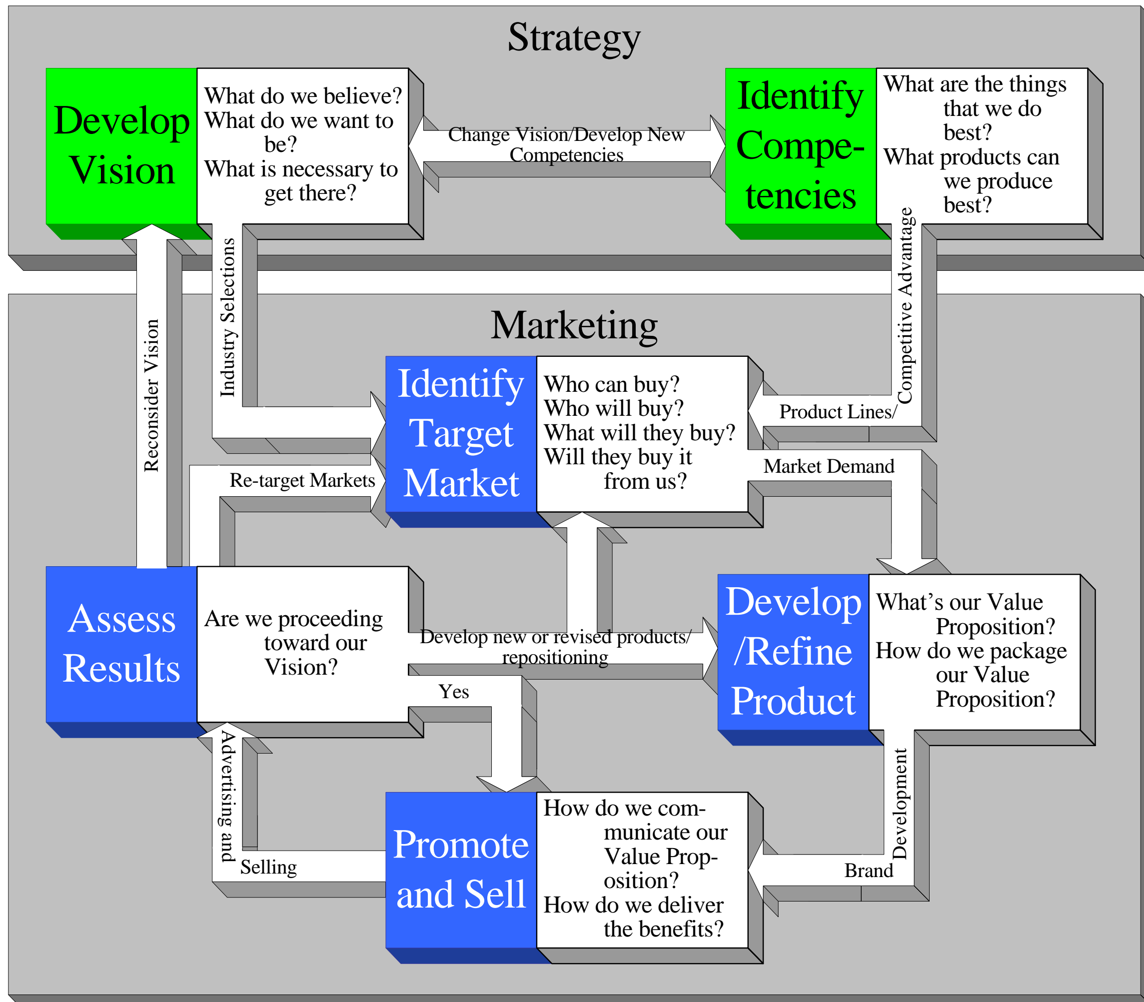
Introduction	Growth	Maturity	Decline
High costs	Declining Costs	Stable Costs	Increasing Costs
Low Sales	Increasing Sales	Stable Sales	Declining Sales
Low Profits	Increasing Profits	Stable Profits	Decreasing Profits
Few competitors	Many copycats	Close Competition	Evergreens

The typical product life cycle shown above is in the form of a normal curve with the "new to the market" product introduction point at the left. At the time of introduction, production costs are usually relatively high, sales are low, profits are low, and there are few competitors. As the product starts to gain in the market, other firms start to product "copycat products". Sales increase as do profits primarily due to declining production costs. At maturity costs, sales, and profits are level and many higher cost producers begin to drop out of the market due to increased competitiveness. Finally, newer products supplant our original product, firms drop the product, production costs begin to increase again lowering profits, and firms start to "evergreen" the product, changing value propositions, repositioning, extending lines, etc.

The overall life cycle of a given product line can be quite long depending on how effective firms are at changing it to meet changes in market wants and needs. Our baking soda has been around a long, long time.

The Life Cycle concept is a powerful argument for continuous product development by a small business.

The Marketing Process



In marketing planning, as in all planning, it is not the plan that is valuable, but the process of planning, identifying and validating the ultimate intent, understanding the current situation, mapping out the waypoints from here to there, arranging the tasks and resources for the journey. The intellectual process, once accomplished, should continue to occupy the thoughts of the planner, contributing course adjustments, guiding task accomplishment, pointing to necessary resource acquisitions, and so on.

"In preparing for battle I have always found that plans are useless, but planning is indispensable."[10]

In form and function there is little difference between a marketing plan for a small business and one for a multi-national. The difference primarily is in scope resulting from the need for the plans of the larger to span multiple products, markets, and organizations. The resource limitations of a small business usually result in its marketing plan addressing a market constrained geographically, demographically, in number of products offered, or some mix of the three.

Marketing planning for a small business usually revolves around one product or one product-line rather than a portfolio of existing and potential products as in larger companies. The first step in marketing planning is to have and to utilize an overall vision of the company's direction.

As that great business thinker Yogi Berra is reputed to have said: "You got to watch out if you don't know where you're going because you might not get there."[11]

Concurrently we consider the internal abilities of the company. What are the things that the company is capable of? What things do we do well? What consumer benefits might we produce and market effectively and efficiently? These two initial steps actually fit into the realm of strategic planning. But they are necessary precursors to market planning.

Next, we should analyze the current and expected markets searching for those groups that most closely present wants and needs that match those values that we can deliver and who have the means and desire to acquire these benefits from us.

Once we have identified a market, we develop and refine our value proposition for that market. Based on our value proposition we then develop market communications, advertising and promotions, and channels, distributors, agents, etc. that can present and make available our value proposition.

The final, most crucial and often overlooked, step is continual assessment of our progress toward our strategic vision and making course corrections as necessary.

Envision the Future

In a 1990 article John Luther, then head of business-development consulting at MCA emphasized the importance of having an overall vision for the company: "We're not talking about product strategy, but about business vision: this is what I want my company to stand for in this world."[12]

Most small businesses get caught up in the task of survival and either fail to enunciate a vision, or lose track of it in the daily hubbub.

After a six-year study of successful companies, James Collins and Jerry Porras concluded that: "Companies that enjoy enduring success have core values and a core purpose that remain fixed while their business strategies and practices endlessly adapt to a changing world."[13] They found that effective articulation of a company's vision seemed to consist of:

- ❖ A core ideology – Consists of core values, "…values having intrinsic value and importance to those inside the corporation"[14] and core purpose, the organization's reason for being.
- ❖ An envisioned future – Consists of long-term goals and a vivid description of desired outcomes.

The authors give the following example for Sony Corporation in the 1950's:

Core values	Core purpose	Long term Goals	Vivid Description
❖ Elevation of the Japanese culture and national status	To experience the joy of advancing and applying technology for the	Become the company most known for changing the worldwide poor-	We will create products that become pervasive around the world.…

❖ Being a pioneer – not following others; doing the impossible ❖ Encouraging individual ability and creativity	benefit of the public	quality image of Japanese products	We will be the first Japanese company to go into the U.S. market and distribute directly.… We will succeed with innovations that U.S. companies have failed at – such as the transistor radio.… Fifty years from now, our brand name will be as well known as any in the world…and will signify innovation and quality that rival the most innovative companies anywhere.… "Made in Japan" will mean something fine, not something shoddy.

Successful envisioning usually will provide some influence on the company's selection of industry. Notice that Sony's vision pointed them toward high-tech industries world-wide and which demanded strong investment in innovation and quality. In the '50's and 60's consumer electronics was such an industry.

Identify Capabilities

The concept of core capabilities for a company is fairly straight forward for a small start-up. These capabilities usually are identical to those of the founders. If an electrical engineer and a former chief financial officer partner to start a two-man business, the company's capabilities probably will fall into electronic design and electronic goods production and into financial management. Its strongest position then might be to be a financially well-managed innovator and producer of electronic goods. It definitely would not be to be an efficiently run and skillfully marketed grocery chain.

For a larger company, the identification of core capabilities becomes a little more complicated. First, larger companies may have the resources to develop or acquire new capabilities through training, hiring, acquisition, or new process design.

Second, the existing capabilities are a sum of those of the company's workers interacting with the company's resources and established business processes. The larger the company, the more complex competency identification can become.

Target Markets

The idea of targeting markets is to discover, not create, a group of consumers that require the values that we can produce. The basic measure of this group is whether they have the means and desire to acquire the benefits that we can produce given our capabilities. Market research begins and ends with the measurement of the qualitative and quantitative characteristics of this group. Qualitative – will they buy the benefits that we produce? Quantitative – are there enough of them to make our business viable?

Market research is not a one-time effort. The small business needs to continue to assess the characteristics of its target markets. Markets change, sometimes suddenly and drastically. Make sure, in addition, that market measurement includes those who are now your customers. First, they are the best source of information regarding whether your Value Proposition is meeting the market wants and demands. Second, in most cases, you want them to continue to buy your products. If their wants and needs change then your Value Proposition must change for you to retain them.

Develop/Refine Products

At this point we have identified a bundle of benefits, a set of values, that a target market will buy from us. The question in product development is: "What sort of package can we make and deliver that will encapsulate and deliver those benefits when accepted by the customer". At this point we probably already have a general idea of the basics of the product lines and need to refine and fine tune the individual products. In some cases trial and error may be the most effective way to do this.

Promote and Sell

Now that we have products, how do we let the potential customer know about our Value Proposition (what is our advertising and promotion strategy)? Also, how do we arrange the delivery of our products, retail stores, agents, direct shipment, on-site services, off-site services, etc.? The key here is to make it cheap enough, not only in money but also in time and effort, for the customer to find, acquire, and use our products that we don't price ourselves out of the market through excessive use costs.

Measure and Assess

The final arbiter of the success of your marketing is your bottom line. If you are following your vision, but the market is not coming along, there is something amiss somewhere in your marketing efforts. Consult your ongoing market research. Have wants and needs changed? Consider if you can satisfy changed consumer values by changes to your existing product, or by extending your product lines. Can you identify new wants and needs that your existing products can satisfy in your current target market? You may need to develop completely new products based on your current capabilities. Perhaps you need to target a completely new set of potential customers in terms of geography, demographics, or psychographics.

In the extreme, you may need to go back to your strategic vision. Given what you know, is your vision achievable with your current capabilities? If not, change your vision; develop new capabilities, or both.

Conclusion

I've attempted to introduce the essential concepts in marketing and to tailor the view of the marketing process to the view of the small business person. Obviously, there is much, much more to this subject and, in many cases, the small business owner or manager would do well to seek out the assistance of someone versed in the subject to help him or her in navigating the dynamics of his market.

There are some subjects, such as marketing communications, that are so complex and inexact that a reasonable treatment would generate another paper of this length or greater. Other subjects, such as distribution management, have so much material as to be a subject on their own. Also, readers will notice that I have left out the subject of sales. Sales not only is its own sufficient topic, it has become a major edifice with seminars, classes, how-to books, analyses, professorships, researchers, and the rest. Sales has been well (and sometimes poorly) written and spoken about almost to its death.

In his latest writing, Peter Drucker comments on the work of the CEO: "The CEO is the link between the organization, which is the inside, where there are only costs, and the outside, where all the results are."[15] The small business owner/manager is the CEO of the small business. It is his primary job to constantly monitor results from outside and make adjustments on the inside. To do this effectively, the small business person must have information from both outside and from inside.

The small business owner must constantly consider external market events, but must also be aware of his firm's capabilities to react and to progress. He must constantly maintain both internal and external audits and must constantly anticipate the future.

That means that the business must constantly and accurately collect and analyze data from the market: wants and needs, competitive products, individual product sales, product line sales, technology changes, firm-level competition, regulatory and legislative changes, market growth and dynamics. Second, the business must constantly and accurately collect and analyze data from inside: production costs, personnel development, management development, organizational dynamics, product development, process operations, financial positioning. Unfortunately, many small businesses don't invest enough in their information systems (here I am not talking necessarily only about computer technology). Without good information, the owner is unable to perform his primary job.

I hope this paper will give small business owners some epiphanies and some insight into the subject of marketing and will allow them not to stand helpless in the face of market dynamics. And I hope that, utilizing some of the concepts herein, small business owners and managers can escape the unfortunate fate of so many of their peers.

---

[1] Headd, Brian, "Redefining Business Success: Distinguishing Between Closure and Failure", (Washington D.C., Office of Advocacy, Small Business Administration, 2002).

[2] Levitt, Theodore, "Marketing Myopia", (Boston, MA: Harvard Business Review, September-October, 1975).

[3] Shapiro, Benson, "Introduction to Marketing", (Boston, MA: Publishing Division, Harvard Business School, ,1984)

[4] E Jerome McCarthy with Andrew A. Brogowicz, *Basic Marketing: A Managerial Approach*, 7th Edition, (Homewood, Ill.: Richard D. Irwin, 1981)

[5] For those who wish to engage in competitive analysis at an industry level, see Porter, Michael, *Competitive Strategy: Techniques for Analyzing Industries and Competitors*, (New York, The Free Press, 1980).

[6] Levitt, Theodore, Professor of Business Administration Emeritus, Harvard Business School.

[7] Blacklett, Tom, "What is a Brand", contained in *Brands and Branding,*, Rita Clifton; John Simmons; and Sameena Ahmad, Eds., (London, Bloomberg Press, February, 2004)

[8] Marn, Michael and Robert Rosiello, "Managing Price, Gaining Profit", *Harvard Business Review*, September-October, 1992, (Boston, Harvard Business School, 1992).

[9] Porter, Michael, *Competitive Advantage: Creating and Sustaining Superior Performance*, (New York, The Free Press, 1985).

[10] Eisenhower, Dwight D, (1890–1969), U.S. general, Republican politician, president. Quoted by Richard Nixon in "Krushchev, Six Crises" (1962).

[11] Berra, Yogi, Hall of Fame baseball player and noted malapropist.

[12] Richman, Tom, "How to Grow a Product-based Business", interview with Jim McManus CEO of MCA, Inc. Magazine, April, 1990.

[13] Collins, James C. and Jerry L. Porras, "Building Your Company's Vision", *Harvard Business Review*, September-October, 1996, (Boston, Harvard Business School Publishing, 1996).

[14] *Op cit*.

[15] Drucker, Peter, "On the CEO's Work", *the Flame*, Spring, 2005, (Claremont, CA, Claremont Graduate University, 2005).