Course: Economics of Industry

Lecture 2: Marketing Strategy

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Agenda

- **Introduction**
- Approaches for Managing Sustainable Competitive Advantage
  - Evolution of Sustainable Competitive Advantage in Marketing
  - Customer Equity Perspective
  - Customer Experiments
- Framework for Managing Competitive Advantage
  - Inputs to the Sustainable Competitive Advantage Framework
  - Outputs of the Sustainable Competitive Advantage Framework
  - Process for Managing Sustainable Competitive Advantage
- Takeaways
- Case

All Competitors React

- The persistent efforts by all firms in the market to copy and innovate, such that all competitors react, constitutes a third challenge that managers confront
- Thus, when managers develop their marketing strategies, they need to consider customers heterogeneity and dynamism, but also anticipate competitors' reactions, now and in the future, to be able to build barriers that hold up against sustained competitive assaults, termed **sustainable competitive advantages (SCA)**
- Typically a firm must establish the sustainable position with a targeted customer group before they can build an SCA around that position
- Of the four First Principles of marketing, managing SCA may be the most difficult to execute

Building SCAs is Key Since "All Competitors React"

"The art of war teaches us to rely not on the likelihood of the enemy's not coming, but on our own readiness to receive him; not on the chance of his not attacking, but rather on the fact that we have made our position unassailable."

Sun Tzu

Example: Tesco (UK)

- UK grocery giant, world's third largest retailer
- Expanded to other markets, including US, but failed to build an SCA that worked in those markets
- Introduced large stores with massive assortments, but many US consumers prefer to visit several stores that offer smaller (but deeper) assortments
- Overestimated consumers' preferences for local brands
- Exited the US in 2013

Sustainable Competitive Advantages (SCA)

- A firm has an SCA when it is able to generate more customer value than competitive firms in its industry for the same set of products and service categories and when these other firms are unable to duplicate its effective strategy
- A **good SCA meets three criteria**:

1. Customers care about what this SCA offers
2. The firm does it better than competitors, which generates a relative advantage
3. The SCA must be hard to duplicate or substitute, even with significant resources

- Thus, being first to market with a new idea is not sufficient to create a barrier to competitors, especially if deep-pocketed market leaders recognize the threat of an innovative new entrant and devote their resources to protect their sales to existing customers
- To make an SCA hard to copy, firms often turn to key market-based sources of SCAs

Marketing-Based Sources of Sustainable Competitive Advantage

- There are three market-based sources of sustainable competitive advantage
  - **Brands** – is most effective in large consumer markets
    - More effective for consumer goods
    - Advertising, PR, sponsors
  - **Offerings** – effective because new and innovative products and services have the potential to disrupt virtually any market segment
    - R&D
    - New products and services
    - New technologies
  - **Relationships** – most effective in business-to-business, service, and complex offering settings
    - More effective for B2B goods, services, intangibles, and complex or risky offerings
    - Salespeople, any boundary spanner, online relationships
- These three sources of sustainable competitive advantage—brands, offerings, and relationships (BOR)—are additive and often work synergistically to give a firm a strong relative position in the marketplace

Example: Starbucks (US)

- Starbucks has a high-quality **brand** (valued at $5.4 billion) that customers feel emotionally attached to
- Distinctive **offering** of unique coffee-based drinks and store environments
- Customers develop **relationships** with the employees in their local stores, who remember their drink orders or recognize them by name
- These sources of SCAs, generated from effective BOR strategies, work together to increase customers' loyalty, and competitors find it very hard to overcome these barriers.
- Starbucks continues to innovate its offerings (e.g., Teavana tea products) and technology-based services (e.g., mobile payment) to maintain its SCA in this category

Example: Maruti (India)

- Maruti (now Maruti-Suzuki) led India's domestic automobile market for nearly 30 years, largely because of laws that limited the entry of foreign firms
- With a liberalized market, new players such as Volkswagen and Ford have increased the competitive pressure on Maruti, which thus far has proven unable to reinvent itself to serve India's younger, more affluent middle class

MARUTI

Market-based Sources of SCAs

Source	Barriers to Duplication	Where it is Most Effective	Examples
Brands	Brand images reside in consumers' minds, which makes them difficult to duplicate; facilitates habitual buying through awareness and provides identity benefits to customers	Large consumer markets (soft drinks, beer, fashion, automobiles)	BMW, Anheuser-Busch
Offerings	Cost benefits, performance advantages, access to distribution channels	Most markets, technology-based businesses (software, electronics)	Apple iPhone, Bose, Tesla
Relationships	Leads to trust, commitment, and interpersonal reciprocal bonds that are hard to build or duplicate	Business-to-business markets, services, complex products (test equipment, haircut, financial services)	Edward Jones, Granger

In Class Exercise on SCA

- Take a few minutes to describe 3 purchases
- Bought for brand _____
  - Top two reasons why _____ _____
  - What would it take for you to cl _____
- Bought for offering _____
  - Top two reasons why _____ & _____
  - What would it take for you to change _____

Competitive Reaction: A Fundamental Assumption of Marketing Strategy

- Competitors can displace firms in many different ways, including:
  1. Technical innovations that provide competitors with a platform to launch a disruptive offering
  2. Exploiting changes in customers' desires due to cultural, environmental, or other factors
  3. Individual entrepreneurship that constantly seeks a better way to solve a problem
  4. "Me-too" copycats that improve the efficiency or effectiveness of an existing execution
- Thus, managers need to anticipate competitors' reactions, now and in the future, by building barriers or **sustainable competitive advantages** that can withstand competitive assaults

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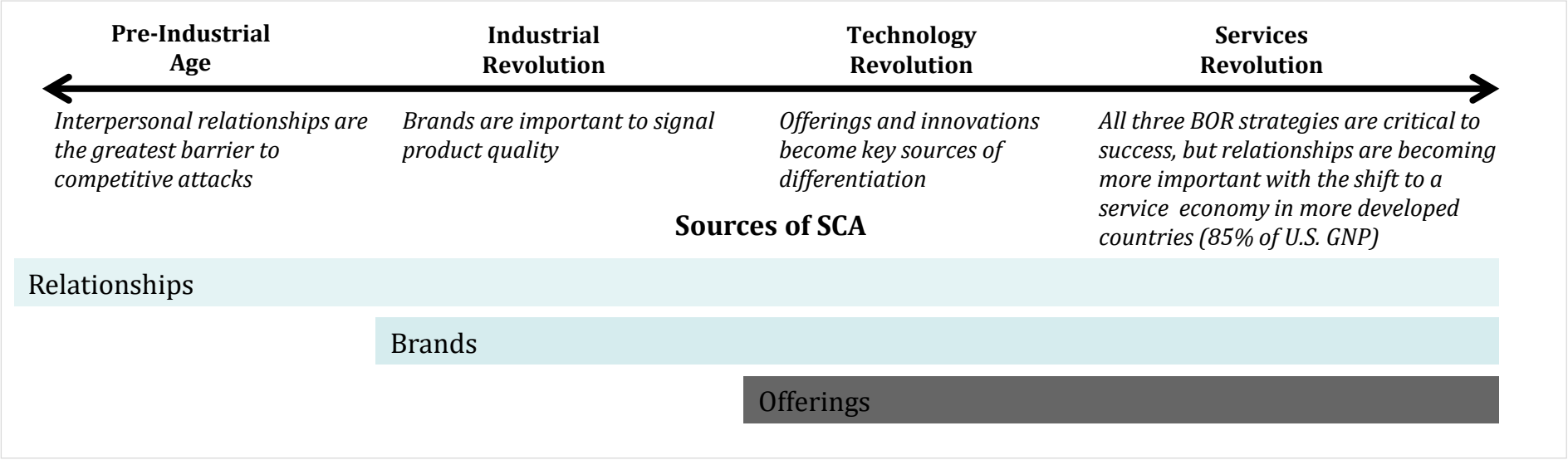
Evolution of Approaches for Managing Sustainable Competitive Advantage in Marketing



Factors Affecting the Sources of SCAs

- Producer is both the marketer and the retailer.
- Sales are to geographically proximate customers.
- Examples: Shoe cobblers, farmers, and tailors all relied on direct relationships with customers; traders on the silk route relied on relational trust with other traders to exchange goods.

- Mass production provides economies of scale.
- More geographically dispersed customers.
- Emergence of middlemen.
- Large supply creates the need for aggressive sales promotions.
- Examples: Original brands built on strong family names such as Ferrari, J.C. Penney, and Gillette to signal quality and differentiate themselves from competitors.

- Shift from tangible to digital and knowledge products.
- Fast technological change and turbulence.
- Examples: Apple and Google who both focus on technological innovation and have surpassed Coca-Cola as the most valuable brands.

- Disintermediation removes the middleman between producer and consumer.
- Economy shift from a focus on products to services.
- Examples: IBM shifted to selling business solutions rather than equipment; financial service firms such as HSBC and Wells Fargo continue to grow.

Evolution of Sustainable Competitive Advantage in Marketing

- Pre-Industrial Age – interpersonal relationships were the greatest barrier to competitive attacks
- Industrial Revolution – brands are important to signal product quality
- Technology Revolution – offerings and innovations become key sources of differentiation
- Services Revolution – all three BOR strategies are critical to success, but relationships are becoming more important with the shift to a service economy in more developed countries
  - Some researchers argue that developed counties are undergoing the next SCA revolution, due to the wider shift to a service economy
- Despite the shifting emphases on the different sources of SCA, all three sources (brands, offerings, and relationships) build on one another and often combine synergistically to determine a firm's overall SCA

Customer Equity Perspective

- **Customer equity** for a firm refers to “the total of the discounted lifetime values of all its customers”
- When a firm advertises to build strong brands, makes R&D investments to develop innovative products, or spends to hire and train salespeople who can enter into relationships with clients, it should increase that firm’s brand, offering, and relational equities
- Together these three BOR equities constitute the firm’s customer equity and often is the best barrier (SCA) to competitive assault, sometimes termed a **BOR Equity Stack**

“Customer Equity” a Different Measure of a Firm’s Most Important Assets

- **Premise:** Customers are considered a financial asset, which should be measured, managed, and maximized
  - Treat customers just like other assets even though accountants typically don’t treat “customers” as an asset
  - Customer equity is not captured on a balance sheet: spending on building equity (e.g., brands, R&D, relationships) is treated as an expense
- **Why bother with customer-centric accounting:**
  1. Primary driver of many firms’ sales and profits
  2. Brand, offering, and relational equities are a primary sc s SCA
  3. Captures long-term impact of marketing actions (Coke’s brand equity reaches past one year)

BOR Equity Stack

- Three equities combine in an additive customer or BOR equity stack

1. Relationship equity
2. Brand equity
3. Offering equity

- At the individual level, customer equity is analogous to the customer's lifetime value (CLV)
- Then when each customer's equity is added together, it generates the firm's overall customer equity
- In this sense, the customer equity perspective is well suited to using a CLV analysis approach, because each market-based equity can be assessed as an addition to the customer's discounted cash flow over time
- Thus, BOR equities are similar to tangible assets: They generate a return on assets (ROA), can be built through investments, and depreciate over time if not maintained

Offering Equity (Beer)

- Offering equity represents the core benefits relative to costs of an offering stripped of any benefits from brands or relationships
  - Price and performance only
  - Represents a large portion of total equity for commodity products (e.g., EDLP strategies)
  - Does Wal-Mart have much brand or relationship equity?
- Less important for:
  - Services or high involvement products
  - Products that provide meaning or status
  - Maturing markets/industries

Brand Equity (Beer name/label/image)

- **Brand equity** is a set of brand assets and liabilities linked to a brand, its name, and symbol, that add to or subtract from the value provided by a firm's offering
  - Knowledge of the brand differentially affects behavior
  - Brand equity **"lies in the minds of the customer"**

- Key for consumer goods, status based offerings, and as consumption is more visible

- Since brand building can be hard to target, brand equity is better for offerings with large homogenous user group

- Hard to quickly adapt or change brand equity

Relationship Equity (people serving beer and other customers)

- **Relationship equity** is a set of relational assets and liabilities linked to boundary spanning employees and the social network associated with the offering or experience that add to or subtract from the value provided by a firm's offering

- Relationships affect behavior
  - Relational-based decision making is ingrained in our psyche (20 to 30% of brain)
  - Many psychological processes are engaged in relational or pseudo-relational contexts

- Key for B2B, services, and complex selling cycles

- Can target and adapt more easily than brands

Using Experiments to Determine Customer Equity

- Strong test of causality since:
  - Random assignment of customers
  - Control of conditions or treatments
  - Comparison to control groups overtime
- Use to test “findings” from other method
- Simple process
  1. Randomly divide customers into groups (2 to 3)
  2. Do nothing to one group (control group)
  3. Do your test (conditions/treatments) to other group(s), but nothing else (ideally customers and employees involved don’t know the difference; “double blind”)
  4. After period of time test the difference in outcomes across groups and see if it varied significantly

DAT 4.1 Marketing Experiments

Description

Marketing experiments test how customers might respond to marketing decisions, while ruling out confounds that otherwise would be present when comparing a treatment to a control group.

When to Use

- To determine if there is a direct causal relationship between a specific BOR (brand/offering/relational) investment and customer or firm outcomes.
- To choose among a set of BOR investment strategies and tactics, according to their financial impacts (e.g., lift in sales).

How it Works

An experiment seeks to establish a causal relationship between an independent variable (BOR investment) and an outcome. Causality implies (1) the independent variable and outcome variable co-vary together (e.g., 10% off the price on a website and greater online sales), (2) the independent variable precedes the outcome variable in time (e.g., online sales are measured after the price promotion begins), and (3) alternative explanations for the measured effect can be ruled out.

To ensure causality, the marketing experiment needs to be designed well. First, a good treatment group needs to be in place. A treatment reflects the precise statement of the causal BOR relationship to be tested (e.g., how much an increase in the commission paid to a salesperson increases sales by this salesperson); a treatment group is the group of subjects (i.e., salespeople) who receive this treatment. Second, we need a comparison group, in which the causal factor stays constant (e.g., commissions to another group of salespeople stay the same). Third, the treatment and control groups absolutely must be similar in all other respects (e.g., size, demographic makeup, selling motivation, experience). To achieve this criterion, most experiments use random assignments to the treatment and control conditions. With a random assignment, in a probabilistic sense, the chances of subjects receiving the treatment are equal across the different groups. Then, in the following equation,

Example

The floral delivery company DFG business was in the midst of its quarterly marketing budget meeting. Noting the company spent $250,000 in annual advertising, one manager questioned whether it was warranted, or if DFG was overspending. In the ensuing internal discussion, some managers insisted that that local television advertising was crucial to creating brand equity and generating revenues; others believed the company was heavily overspending.

To resolve the predicament, DFG decided to use a controlled experiment. First, to ensure causality, it defined the treatment as a 10% increase in local television spots in the next quarter in 50 selected regional markets (treatment territories). As a control group, it used 50 territories in which the amount of local television spending remained the same. In addition, DFG gathered brand awareness, brand recall, and sales figures in the quarter preceding (T0) and the quarter during (T1) the treatment, then calculated the differences between T0 and T1, across the treatment and control territories (i.e., before-after design). To ensure validity, DFG statistically controlled for the demographic (income, education, age distribution, race distribution, gender distribution) and economic (buying power, retail penetration, Internet penetration) makeup of both the control and treatment territories. For the brand awareness measure, its equation was:

Example: Find Best Internet "Ad"

- You want to get people to buy supplemental items when buying online plane tickets
  - You have existing ad
  - Your boss wants to use a
  - Take 5 minutes and desi test to make the decision
- Discuss:
  - Sample source and size
  - Research design
  - Analysis of data

Results of Experiment (Using Excel)

	Ad-now sales	Ad-swimsuit sales		
	$771	$345		
	$447	$1,280		
	$772	$441		
	$333	$967		
	$71	$992		
	$452	$234		
	$771	$761		
	$340	$449		
	$883	$1,671		
	$911	$567		
	$716	$290		
	$392	$1,712		
	$345	$28		
	$149	$564		
	$717	$386		
	$278	$912		
	$456	$937		
	$397	$0		
	$12	$706		
	$285	$394		
	$828	$1,616		
	$856	$512		
	$570	$1,450		
	$895	$564		
	$456	$1,090	**Difference in two groups**	
Mean	**$524**	**$755**	$231	average
Median	**$456**	**$567**	$111	midpoint
Std Dev	**$265**	**$486**	$221	"+/- 1 std dev captures 68% of sample, +/- 2 s 95%"
Ttest		**4.69%**		probability difference is due to chance

"=Ttest(range 1, range 2, use 2 tail, use 2 equal variance)"

- Randomly assign customers
- Analysis
  - Mean
  - Median
  - Std. dev.
  - Difference in groups
  - T-test to determine if difference in

Natural Experiments (Data Mining)

- Not as a strong test of causality, but usually choice

- Use natural variation or shock to business
- Example:
  - Competitor entered three markets and your sales force has responded differently (matched price, held price, gave free shipping). Use differences in effect on sales to see what is best strategy
  - But, what if territories are not the same (size, brand strength, types of products sold)?
  - You can do the same test while “controlling” for these other variables (comparing means or regression)
  - Strategies may work better for some customers than others (segment and test)

Customer Equity Perspective Offers Many Benefits But It Is Hard to Do

- Customer equity perspective involves building and maintaining a parallel "customer-centric accounting process," outside the firm's normal financial accounting process
- There are three main arguments for using customer equity accounting and a BOR equity stack
  1. BOR equities are often the primary source of a firm's SCA
  2. To make optimal decisions, a firm needs a framework that measures, tracks, and reports customer equities
  3. Effective customer equity systems represent a SCA in their own right
- Suboptimal marketing decisions happen in firms every day, at many different management levels, and especially during economic downturns

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Framework for Managing Sustainable Competitive Advantage

- The organizing framework for managing sustainable competitive advantages (SCA) integrates the preceding approaches and analyses
- Three key inputs:
  1. Positioning statements
  2. AER strategies
  3. Future trends
- Two outputs:
  1. SCAs
  2. BOR strategies

Marketing Principle #3: All Competitors React ➔ Managing Sustainable Competitive Advantage

Inputs (MP#1 & MP#2)

Positioning Statements
- Target (external customers)
- AER (internal personas)

AER Strategies
- What strategies work best for each persona/AER stage

Future Trends
- Technology trends
- Regulatory trends
- Socioeconomic trends

Managing Sustainable Competitive Advantage

Approaches & Processes
SCA
Brand, offering, relationship equity stack
AER strategy and BOR equity grids
Brand and relationship mgt.
Innovation processes

Analyses
Field experiments
Conjoint analysis
Multivariate regression
Choice models

Outputs (SCA, BOR)

SCAs
- Existing SCAs, why you win now
- Future SCAs, how you will win in future

BOR Strategies
- Brand strategies
- Offering/innovation strategies
- Relationship marketing strategies

Inputs to the Sustainable Competitive Advantage Framework

- Positioning statements – answers three key questions:
  - **Who** customers are
  - **What** set of needs the product or service fulfills
  - **Why** this product/service is the best option to satisfy customer needs (relative to competition)
- AER strategies – provide key guidance into how a firm should invest to acquire and keep customers
- Future trends – long-term technology, regulatory, and socioeconomic trends, which clearly can disrupt any organization's SCAs

Example: Brussels Airlines (Belgium)

- Brussels Airlines, Belgium's national carrier, emphasizes the importance of adapting its marketing model with the changing technological trends
- "We have all got to digitally transform to provide the tools to our guests that can help them get through the whole air travel experience. We need to allow them to book online and do everything they need to do from their mobile devices." -Si

Outputs of the Sustainable Competitive Advantage Framework

- Descriptions of the firm's SCA now and in the future – needs to clearly address the three conditions for SCA:
  1. Customers care about it
  2. The firm does it better than competitors
  3. It is hard to duplicate or substitute
- Detailed BOR strategies – aggregate and reorganize each targeted customer segment and persona according to its needs; the most effective strategies across time (accounting for customer dynamics) are in the brand, offering, and relationship categories
- Both these outputs (SCA and BOR strategies) represent aggregations of insights gained from more fine-grained analyses, combined and reorganized to support effective macro-level decision making

Process for Managing Sustainable Competitive Advantage

- **Step 1: AER Strategy Grid** – each box in this grid describes the most effective strategy for a unique persona at a single point in time
- **Step 2: Key Trends** – managers should account for key environmental trends (e.g., long-term technology or regulatory changes) so that investments in BOR strategies lead to SCA, now and later
- **Step 3: BOR Equity Grid** – completed to describe three key pieces of information for the BOR strategies
  - Marketing objectives
  - Relative advantages
  - Sources of sustainability

Natural Sequence for Using Brands, Offerings, and Relationships to Build an SCA

1. A firm should make brand decisions, which are influenced by the firm's overall positioning objectives from MP#1 and MP#2 and largely determine how the firm will be positioned in the overall marketplace and in existing customers' minds
2. The firm can then focus on its offering decisions; product and service innovation and R&D efforts need to support both brand strategies and the firms positioning objectives
3. Relationship strategies normally are determined last, because they involved the delivery and experiential aspect because in this case, boundary spanners are critical to the customer experience and the firm's overall value proposition

Strategy and BOR Equity Grids

AER Strategy Grid			
	Acquisition Strategy	**Expansion Strategy**	**Retention Strategy**
Persona #1	Most effective acquisition strategies for Persona 1	Most effective expansion strategies for Persona 1	Most effective retention strategies for Persona 1
Persona #2	Most effective acquisition strategies for Persona 2	Most effective expansion strategies for Persona 2	Most effective retention strategies for Persona 2
Persona #3	Most effective acquisition strategies for Persona 3	Most effective expansion strategies for Persona 3	Most effective retention strategies for Persona 3

AER stages account for customer dynamics

Personas account for customer heterogeneity

Environmental Trends
Technology trends
Regulatory trends
Socioeconomic trends

BOR Equity Grid			
	Marketing Objectives	**Relative Advantages**	**Sources of Sustainability**
Brand Strategy (Chapter 5)	Brand marketing objectives	Relative advantages of the firm's brand vs. competitors' brands	Brand's sources of sustainability
Offering Strategy (Chapter 6)	Offering and innovation objectives	Relative advantages of the firm's offering vs. competitors' offerings	Offering's sources of sustainability
Relationship Strategy (Chapter 7)	Relationship marketing objectives	Relative advantages of the firm's relationships vs. competitors' relationships	Relationship marketing's sources of sustainability

Analysis of Customer Heterogeneity and Dynamics

AER Strategy Grid			
	Acquisition Strategy	**Expansion Strategy**	**Retention Strategy**
Persona #1	Most effective acquisition strategies for Persona 1	Most effective expansion strategies for Persona 1	Most effective retention strategies for Persona 1
Persona #2	Most effective acquisition strategies for Persona 2	Most effective expansion strategies for Persona 2	Most effective retention strategies for Persona 2
Persona #3	Most effective acquisition strategies for Persona 3	Most effective expansion strategies for Persona 3	Most effective retention strategies for Persona 3

- Output of MP#2 is a microanalysis of customer heterogeneity and dynamics in the firm's customer portfolio
- The insights from MP#2 then can be inserted into the AER strategy grid to reveal high-impact strategies
- Each box in this grid describes the most effective strategy for a unique persona at a single point in time

Perspective of Market-Based Sources of SCA

BOR Equity Grid			
	Marketing Objectives	**Relative Advantages**	**Sources of Sustainability**
Brand Strategy (Chapter 5)	Brand marketing objectives	Relative advantages of the firm's brand vs. competitors' brands	Brand's sources of sustainability
Offering Strategy (Chapter 6)	Offering and innovation objectives	Relative advantages of the firm's offering vs. competitors' offerings	Offering's sources of sustainability
Relationship Strategy (Chapter 7)	Relationship marketing objectives	Relative advantages of the firm's relationships vs. competitors' relationships	Relationship marketing's sources of sustainability

- Brand, Offering, and Relationship (BOR) Equity Grid represents last step in the process

- BOR equity grid offers a high-level summary of what the firm is trying to achieve with each BOR strategy
- Using the inputs from the AER strategy grid and key environmental trends, the BOR equity grid can be completed to describe three key pieces of information for the BOR strategies:
  - Marketing objectives
  - Relative advantages over competition
  - Maintaining the SCA over time

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Takeaways

- All competitors react. Firms must address competitive attacks by building and maintaining sustainable competitive advantages (SCA).
- Customers generate sales and profits; firms must protect them from constant attacks by competitors. Although SCA are critical, firms must first establish their differentiated position with a targeted customer group before building SCA around this position.
- All SCA must meet three conditions: (1) customers must care about what it offers, (2) the firm must do it better than competitors, and (3) it must be hard to duplicate.
- In marketing domains, the primary sources of SCA are brands, offerings (innovative products or services), and relationships (BOR). The strongest SCA use all three strategies in combination to reinforce the differentiated and targeted appeal of a firm to customers.

Takeaways

- Experiments can reveal the causality of BOR investments, by randomly assigning customers to multiple groups with different BOR investment levels/designs, including both treatment and control groups, to minimize potential confounds.
- Competitors have many ways to undermine a firm's SCA, including technical innovations, exploiting customers' changed desires, finding better solutions to a problem, and introducing "me-too" offerings with greater efficiency.
- A customer equity perspective implies that customers should be considered assets, managed and tracked that way, to improve firm performance. Investments in brands, offerings, and relationships represent important sources of customer equity.
- There are three inputs to the SCA framework: the output of MP#1 about what customers want and how the firm should position itself, the output of MP#2 about the most effective AER strategies as customers change, and long-term environmental trends.

Takeaways

- The two outputs of the SCA framework are: a description of a firm's SCA now and in the future and a description of the BOR strategies needed to achieve it.
- The three-step process for managing SCA includes an AER Strategy Grid, an analysis of key environmental trends, and a BOR Equity Grid.
- Technology, regulatory, and socioeconomic trends constantly change; a firm's competitors constantly try to find new ways to satisfy customers' needs and desires. These changes all have the potential to disrupt any firm's market position.

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