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Introduction

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Marketing has traditionally prided itself on being the discipline in management that is most alert and responsive to the business environment and its changing demands. A review of marketing's early evolution gives ample justification for this pride. For example, marketing originally defined itself around the task of selling what the business produced, a focus that reflected the rapid industrialization, growth and prosperity of post-World War II economies. It was the right definition for its time. Later the focus on demand promotion changed to the 'marketing concept' to reflect the many changes that were taking place in the marketplace. Customers were becoming more sophisticated and demanding; competition, on the other hand, was getting more severe as growth in many markets slowed down and the fight for market share intensified. The marketing concept that promoted the idea of focusing the business organization towards identifying and satisfying customer needs was the discipline's response to the new business realities and a more exacting marketplace. And it was the right response for its time.

The adaptive early history of marketing notwithstanding, the truth is that the discipline's record of keeping up with more recent developments in the market environment has been disappointing. One could persuasively argue that the fast changes in the marketplace have outpaced marketing's ability to adapt and respond. Take the example of bundled services. For a growing number of sectors and companies, the distinction between products and services has disappeared. The customer-value proposition is an integrated offer of both tangible products and intangible services. Companies such as Otis or Schindler, for example, not only sell new elevators but also maintain, service and modernize the old ones in their installed base. Likewise, computer companies like IBM and HP sell hardware but also an increasing volume of bundled services, including business consulting. In both cases the customer offer is an integrated package in which the depth and breadth of the service component are increasingly the sources of differentiation and profitability.

Despite the emergence of add-on and integrated services, however, the traditional core ideas in marketing, including the ever-present marketing mix (Product, Price, Place and Promotion), continue to be tangible product-centred – a relic of a distant past. The discipline has had difficulty integrating the bundled product–service strategies into its core concepts. Consequently the marketing of services (as stand-alone 'products') has developed as a separate branch and a niche discipline for some academics and book publishers. But for a growing population of practitioners, the complexity of profitably marketing integrated products *and* services remains an issue for which the discipline does not offer much help.

To understand the shortfalls of traditional marketing in today's demanding markets, we must begin with a review of the changes that have fundamentally transformed the marketing environments for many firms – the changes have outpaced the discipline's historical ability to adapt. The present chapter highlights some of the more relevant and pervasive changes in the structure of markets and their behaviour. These changes have also inspired innovations that have bypassed the traditional boundaries of the discipline – innovations that are the subjects of future chapters. The list of highlighted changes is not meant to be exhaustive, but a useful backdrop for the rest of the book. This introduction also offers a quick overview of the next seven chapters, each devoted to an in-depth treatment of a topic and related innovative management practices. Given the diversity of topics and their coverage, the reader is advised to begin with the current overview before delving into the chapters.

Forces of change

Market change is a constant source of problems for some firms and opportunities for others. The particular changes that are highlighted in the following paragraphs have for the most part brought new managerial issues to the surface and, in doing so, have challenged our traditional ways of thinking about marketing. If marketing is to remain a central and relevant discipline in business, it must find ways of addressing these deep and intertwined shifts in the environment. Only then can it guide managers in their never-ending search for effective practices.

- **Commoditization** An unrelenting change in technology, in addition to well-informed customers and fast-moving competition, has made sure that many once unique products or services have rapidly lost their intrinsic differentiation value and become 'commoditized'. Take the example of PalmOne, the original makers of palm-sized personal digital assistants (PDAs). The company that spends close to 10% of its turnover on new product development, and enjoys one of the strongest brands in the business, still finds itself suffering from the effects of commoditization – i.e. declining customer franchise due to the emergence of rivals with similar or enhanced offerings, and the resulting pressure on prices and margins. Competition from Hamstring (later acquired by the company), HP, Dell, Toshiba, Sony and a number of others has had a devastating impact on the pioneer of PDAs. Since 2001, the company's turnover has declined by 45% (to $872 million in 2003) and its net income has sunk from a profit of $57.5 million in 2000 to a loss of $64 million in 2003, dragging share prices down from the split adjusted level of nearly $1600 in 2000 to around $22 in mid-2004.[1]

  PalmOne is not alone in feeling the effects of commoditization. Managers in a growing numbers of industries as diverse as IT, pharmaceuticals, branded consumer products and banking services, just to name a few sectors, complain of the ever-shortened lifecycles of their product or service offerings and the resulting negative impact on profitability. How to pre-empt or slow down the commoditization process remains the single most crucial issue for many marketers. Marketing innovation (as opposed to product innovation) can form the centrepiece of such strategies, but it also remains an area to which traditional marketing has paid scant attention. Innovations in segmentation and target marketing, in pricing, distribution, communication and services are all areas where management practices have bypassed the discipline in countering commoditization.

- **Consolidation** A real force for change in many markets is the growing concentration of sales and profits among a handful of major customers. A good example is the global automobile manufacturing industry, in which suppliers find themselves relying on a shrinking number of OEM (original equipment manufacturer) customers, a process that is accelerated by mergers, acquisitions and alliances among previously independent automakers. Other sectors facing similar consolidation in their customer base include health care and pharmaceuticals, shipping and transportation, paper, fast-moving consumer goods (FMCGs) and retail distribution, to name a few.

  The steady and highly visible process of consolidation in distribution has led to the emergence of powerful retail chains and buying groups (a collection of smaller chains and independents joining forces together). Sony, the global leader in consumer electronics, sells a growing share of its worldwide production through fewer and fewer mega retailers. As of a few years ago the company sold more than 40% of its volume in Europe through no more than ten retail chains and buying groups. That percentage has kept rising steadily, bringing increasing pressure on manufacturer prices and margins.

  The central issue for marketers facing consolidation among their customers is to find ways of acquiring and retaining their ever-larger accounts, and of doing so profitably. The recent focus on key account processes and customer relationship management (CRM) systems is a reflection of changing times where gaining or losing a single customer could have a major impact on profitability. The focus also reflects a major shift in perspectives, from transactional mass marketing, the discipline's traditional preoccupation, to customer- and account-specific relationship marketing. The discipline's need for new models and tools for managing important and long-lasting customer relationships cannot be overstated.

- **Power shift** A direct consequence of the trend towards consolidation among customers is a general shift of bargaining power away from vendors to their buyers. Perhaps nowhere is this trend more in evidence than in retailing, where the ever-larger chains and buying groups have gained the upper hand *vis-à-vis* their suppliers, including producers of many branded products. Wal-Mart, the world's largest retailer with sales of nearly $260 billion, uses its enormous buying power to drive down prices paid to its suppliers and, in addition, to dictate its strict policies on quality, logistics and vendor services. That power has allowed the retailer to enter and prosper in product categories not normally associated with mass discounting. To illustrate, Wal-Mart became the largest seller of DVD players in the US market thanks to its aggressively low prices (with some models selling for as little as $39), made possible by its huge purchasing power. A latecomer to DVD retailing, Wal-Mart stole shares from specialist chains like Circuit City and Best Buy with prices they could not profitably match.

  The growth of private labels has been a factor in boosting retailers' power *vis-à-vis* their branded-goods suppliers. In some markets the penetration of lower priced private labels in food and other grocery categories is as high as 40%, if not more. Another factor contributing to the shift in power is the retailers' increasing access to relevant and timely information on consumer shopping behaviour. The advent of bar codes and intelligent cash-register systems has allowed retailers to know a great deal about consumers, and they are using that knowledge to their advantage in dealing with their less-informed suppliers.

Outside consumer retailing, a shift in bargaining power downstream, to customers and, in turn, to their customers, has taken place across a wide spectrum of industries, including computer parts and electronics, auto parts and components, packaging material and systems, speciality chemicals and professional services, to name a few. The complex set of issues arising out of marketing to powerful customers has not been adequately dealt with in traditional marketing literature. Innovations like the 'Intel inside' brand campaign that bypass the immediate industrial customers to promote the company's ingredient products to final end users are examples of how companies might effectively use downstream marketing tactics to rebalance their bargaining power *vis-à-vis* their large and powerful buyers. Such innovative practices aside, the discipline is far from ready to tackle the compelling issues surrounding the power shift.

- **Margin erosion** The combined effects of commoditization, consolidation in customer base and shift in bargaining power have had a predictably negative impact on producer margins. Levi's, the iconic brand for jeans, is a recent victim of margin erosion. Faced with multitudes of rivals marketing low-priced denims, the company has launched a new line of discount jeans selling through mass distributors like Wal-Mart and Target. Called Levi Strauss Signature, the line sells at prices nearly 50% below those of the company's traditional jeans, and offers margins that are significantly below those of its core line. The entry into low-margin discount jeans was a strategy that the struggling Levi's had for a long time tried to avoid. But its hand was forced by the seemingly unstoppable loss of market share to its lower priced competitors, including private labels. And it remains far from clear if the low-priced line can catapult the company back to profitability.

Nokia is another example of a company that has seen its margins erode as it tries to combat the growing competition in its sector. The company's enviable global market share and operating margins in handsets have come under pressure thanks to the entry of new players like Samsung and LG Electronics on the one hand and the revival of old competitors like Motorola on the other. To regain losses in market share (down 10% from a high of 40%), the company has had to slash by more than 20% its average selling prices. The net effect on operating margins has been dramatic: a reduction from 23% return on sales just a few years ago, down to a projected 16%. The news of a shortfall in profitability has had a devastating effect on the company's market capitalization, with stock prices dropping by nearly 40% in the course of a few months.

The cases of Levi's and Nokia, two truly global brands, are by no means exceptional. An OECD survey of major international companies shows that the trend of margin erosion is a pervasive one. The survey illustrates a clear degradation of operating margins among the 147 Fortune Global 500 firms for which data was available. For the period under consideration, the survey shows, the average domestic operating margins for these firms declined from nearly 10% in 1990 to just about 7% in 2001. For non-domestic margins the decline was even larger, from 10% to close to 5% over the same period.[2]

The growing issue of margin erosion has coincided with the general pressure on management to increase profitability and shareholder value. Over the last decade managers have turned their focus towards cost cutting under different banners such as 're-engineering', 'streamlining the business', or 'reducing complexity'. Whatever the euphemism used, the reality is that today's marketers are under pressure to 'make the numbers', which often means cutting back on both short-term marketing expenses and long-term investments. For many top managers eager to deliver on tight financial targets, it is easier to cut back on advertising than on IT budgets, or to downsize and even eliminate the marketing department than to do the same with procurement and supply-chain planning. Business priorities are shifting and marketing has to learn to go about its mission in leaner times.

The inherent risk in margin erosion is that it can lead to a myopic view of marketing that would further accentuate the profitability problem. More specifically, many value-adding strategies meant to improve a producer's ability to charge higher prices and improve margins require investments that might be considered excessive or even dispensable under a cost-rationalization regime. Investments to improve customer-service capability, modernize the product portfolio, strengthen the brand or upgrade skills for key-account personnel all require commitment of financial resources that could only be justified over the longer run. In their absence, the firm falls victim to its own short-term priorities that could simply accelerate commoditization and put even greater pressure on margins and profits.

Traditional marketing practices offer little in the way of combating margin erosion or doing more with less. As top-of-mind issues for today's corporate managers, measuring and increasing the productivity of marketing expenditures are not adequately addressed by the discipline. The reputation of marketers as free spenders continues to be more than just a caricature. It rings true in many companies.

- **Value focus** The tough market changes highlighted above are compelling companies to re-examine their past strategies and embark on new directions that aim to offer customers novel and differentiated values – values that combat commoditization and the accompanying margin erosion. While the other forces are all external to the firm, the renewed focus on value creation is an internal push for change. Such efforts take place under different banners, but almost all incorporate at least two ingredients: a drive towards a customer-oriented organization; and a greater focus on value innovation. The first ingredient is centred on making the entire organization more knowledgeable about the customers it serves and enabling it to be more responsive to their unmet needs. The second is about finding innovative ways of fulfilling those needs profitably. Both ingredients are essential for a customer-focused strategic renewal.

  For Nestlé, the world's largest food company, value focus has meant a renewed emphasis on innovation as a pillar of the company's growth strategy. The brand managers are being exhorted to seek consumer insights that lead to innovative products and marketing practices. In this light, the firm makes a distinction between 'renovation' and 'innovation', with the first aiming to keep pace with changing consumer expectations, and the second striving to leapfrog ahead of the consumer with novel product ideas. A new and improved formulation of Nescafé, the company's global brand of instant coffee, is an example of the former; the launch of Nespresso, a highly successful roast and ground coffee-making system incorporating hardware and services, is an example of the latter. The drive towards renovation and innovation is led from the CEO's office and is being felt all across the company's global organization.

The push towards new customer values can take the strategy beyond a company's core, and often commoditized, markets. The Swedish company SKF, the world's largest producer of ball bearings, has stretched beyond its core by turning its know-how in rotation technology into innovative products and services for its customers in the manufacturing sector. The services division presents plant managers with a pallet of modular packages including preventive maintenance, technical service, training and even management assistance, all aiming to enhance factory productivity. These value-added services, offered with performance guarantees, have made the division the most profitable in SKF, with returns several times above those of the core business of ball bearings.

Similarly, IBM's spectacular turnaround in the mid-1990s was built on a move towards new value-adding services that took the company beyond its core of mainframe computers. The old IBM-centred and hardware-focused philosophy had to be transformed through a customer-centred strategy that combined products, including those produced by competitors, with services into innovative solutions for business problems. Examples of IBM solutions range from helping retailers to increase revenues from each customer visit with smart shopping carts that help shoppers to navigate comfortably through crowded aisles, to running a global company's accounting and finance department, and business consulting services on e-commerce strategies. While hardware sales have declined, revenues from the highly profitable and fast-growing business services have risen to $43 billion.

> Without a doubt, the changes implied by value focus are no less than a rediscovery of the spirit of the marketing concept, a working philosophy that was almost forgotten during the heyday of corporate re-engineering. But while customer-value creation is on the top management agenda, in most companies the marketing people are not driving it. Contributing to this fact is the misconception that marketing is all about short-term action, while value innovation is a strategic responsibility best assigned to new business development, strategic planners or even R&D. The result: business strategies that are elegant but fail to take into account customer needs, and new products and services that are innovative but lack consumer appeal. Sidelining marketing has not been in the best interests of business.
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> The marketing discipline has only itself to blame for the current state of affairs. The field has failed to rise above its traditional preoccupation with tactics; it has failed to address the big picture – the issues surrounding the business strategy, the organization and its culture, and the transformations required to link a company's priorities with those of its customers. The discipline that invented the all-important marketing concept is excluded from participating in its implementation.

Figure 1.1 depicts the five forces highlighted above and their interrelationship. The two forces of commoditization and consolidation are the primary drivers; they provide the engine behind power shift, margin erosion and the push for value focus.

As mentioned, the preceding list of market forces is not meant to be exhaustive of all changes that have challenged traditional marketing. Marketing's slowness to adapt can also be seen elsewhere. Where the traditional ideas in marketing have been of little use, the practice has bypassed

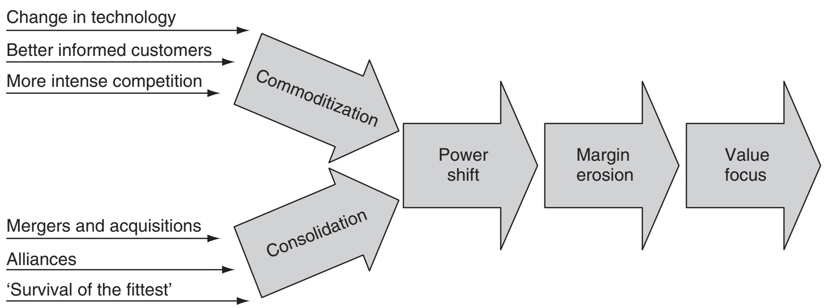

Figure 1.1 Forces of change in the marketing environment

the discipline. Through trial and error, innovative management action has filled the gap.

The book's coverage

This book is about fresh ideas that go beyond the traditional boundaries of marketing, ideas that are for the most part inspired by the recent innovations in practice. Our work does not claim to address all the gaps in the discipline, nor suggest a 'new and improved' marketing mix for the twenty-first century. Those noble and much-needed contributions are far beyond the scope of this book. Rather, the authors have selected a number of areas where modern marketers have devised innovative ways of addressing the emerging issues in their businesses and, in doing so, have contributed to the practice of marketing. The discipline can learn much from these practices.

What follows is an overview of each of the next seven chapters with a summary of the core ideas presented under each heading. Chapter 2 begins the sequence with value chain marketing, a topic that examines opportunities for marketing downstream to the customer's customer. The following three chapters view novel value creation and differentiation through aligning with major customers, the effective marketing of services and two-way (internal and external) branding. Chapter 6 offers a robust conceptual tool for analysing market opportunities and devising profitable marketing strategies. Profitability is also a concern of Chapter 7, which delves into the emerging practices of price discrimination – a by-product of the growth of database marketing. The last chapter addresses the issue of organizational structure and how it can help or hinder customer-value creation and responsiveness.

A short abstract of each chapter follows.

- **Chapter 2: Value Chain Marketing**
  Much of traditional marketing theory and practice is focused on a firm's immediate customers. Typically, they are defined as the 'next in line' institutions who are the direct users of a company's products or services. Many vendors have found that this narrow view, focusing on the nearest set of buyers, is insufficient for sustained competitive advantage. Instead, companies have learned to look down the entire value chain to understand the behaviour of the customer's customers, sometimes several steps beyond the immediate buyers. We have named this process of identifying, understanding and at times even influencing the downstream customers *value chain marketing*. Chapter 2 covers this concept and explains how it can best be employed to strengthen a firm's marketing operations.

- **Chapter 3: Countering Commoditization: Value-added Strategies and Aligning with Customers**
  Commoditization of products and services has forced many industrial vendors to look beyond their core businesses for growth and profitability. Attempts to overcome commoditization have led to novel value-added strategies that range from customization to system development and solutions innovation. In addition, a growing number of firms are engaging their major customers in what could best be described as 'collaborative marketing': attempting to align their own operations and/or strategies towards serving a small number of important customers in ways that traditional marketing never conceived of. Instead of arm-wrestling with their major accounts for value capture, these vendors collaborate with them to create a larger value pool on which both parties can draw. This chapter lays out the logic of such alignments and explores ways in which suppliers can collaborate for greater value creation and capture. The chapter also highlights the barriers and gateways to aligning with customers.

- **Chapter 4: The Marketing of Services: How is it Different?**
  In this chapter we will look at what is different about intangible services – as opposed to tangible products – and what it means for marketing, in particular what needs to be done differently to attract customers and to retain them. In this context the following issues will be addressed: making the intangible tangible, selling the service and the ability to serve, pricing for peaks and troughs, quality of delivery (doing it right the first time) and managing the customer mix and involvement. The chapter also includes a useful classification of service businesses and the different roles of 'soft factors' in their success. It ends with an examination of

the role of the marketing function in a service organization and the specific issues related to the internationalization of services.

- **Chapter 5: The Missing 'P' in the Marketing Mix: Putting Passion into Brands**
  Traditional marketing has recognized that strong brands are the rewards offered by the market for good management of those brands. Many businesses have focused on communicating the benefits of their brands externally; but few have gone the extra mile to create and manage the extra 'P' (for Passion) in their marketing mix: turning strong brands into 'passion brands'. Innovations in brand building show that managing passion brands is not only about external communications; it is also about communicating effectively internally and about making sure that employees become the best brand ambassadors by creating a strong emotional link between the company and the market. Only then can executives expect to dramatically differentiate their brands of products and services from their competitors'. Building on the experience of companies such as Starbucks, Nike and Ducati, the chapter will also suggest why internal branding is a worthwhile exercise; what an appropriate internal marketing strategy might be; and what tools are necessary to better engage employees for better results.

- **Chapter 6: Beyond Beating Competition: Shaping Markets for Profitable Growth**
  Many traditional marketers are too focused on winning and beating competitors, sometimes at almost any price. However, a few leading companies focus not only on winning, but also on ensuring that the market will generate attractive margins for them. This requires marketing executives to think beyond their customers and competitors,

and focus attention on the other market forces that impact profitability. These include potential entrants, substitute products and services, complementary products and services, and suppliers. This chapter will explore some of the many strategies and tactics that companies can, and do, use to manage each of these market forces and thus increase the likelihood of achieving high profits in a market. Moves that on the surface make good sense can sometimes have serious, unanticipated, deleterious impacts on the long-term profitability of a market. The strategies and tactics will be illustrated with examples drawn from a variety of industries.

- **Chapter 7: New Frontiers in Pricing for Profit**
  Until recently, many marketing managers grappled with setting the one 'right' price – set too high or too low and profits suffered. Opportunities to price-discriminate were few and far between. Today the combination of databases and technology presents marketers with a multitude of ways in which to offer different prices to different customers. While the opportunity here is clear – charging more to those willing to pay more – the pricing decision has become much more complex. It has moved from setting just one number to setting many, and to determining a plethora of payment structures. This chapter will deal with the economic and psychological factors at play in this new world that permits almost infinite flexibility in pricing. What should managers consider in setting their price structures? And how should we handle customer perceptions of differential pricing? Issues covered include: the impact of technology and customer information on price setting; a survey of approaches to price discrimination; the psychology of pricing and its potential impact on consumer behaviour.

- **Chapter 8: Beyond the Matrix: An Organization-wide Solution for Creating and Sustaining Customer Value**
  For decades companies have struggled with what exactly is the role of the marketing function and indeed what is its role, if any, in driving or realizing a customer-value orientation. The startling evidence from several studies is that the concept of focusing the entire firm on customer-value creation simply hasn't caught on in practice. At best customer satisfaction and retention rates are mediocre, companies struggle with implementing a customer-value orientation and CEOs often subjugate it to the interests of other stakeholders. This chapter will examine how organizational structure and company culture work hand in hand to focus the entire organization on customer-value creation. It will reveal how, counter to prevailing notions about empowerment and network organizations, customer-value orientation thrives in environments where clarity and simplicity are valued and hierarchy is appreciated. This organizational vision demands that we revisit traditional notions of structure. We recommend revisiting the traditional matrix organization and respecifying the role of marketing.

References

[1] Sony, facing declining margins, recently announced its withdrawal from the PDA markets in North America and Europe. Others are likely to follow.
[2] Ghemawat, Pankaj, 'The Forgotten Strategy', *Harvard Business Review*, November 2003, Vol. 81, Issue 11, p. 79.