Marketing the New Venture

Outline

The Marketing and Entrepreneurship Interface
Marketing Concept and Orientation
  Customer Orientation
  Marketing Research
Marketing Strategy
  Selection of Markets and Segments
  Marketing Activities
Sales Forecasting
Summary

Success is never final.
—Winston Churchill

Learning Objectives

After reading this chapter you will understand:

■ The major marketing activities for an entrepreneur.
■ How marketing research is conducted for new ventures.
■ How the diffusion process can be used to introduce innovative products.
■ How a new venture’s marketing capabilities and plan can be a strategic resource.
■ How a new venture can prepare a reasonable sales forecast.
1. Both are concerned with customer needs. The marketer develops the customer’s psychographic profile and documents buyer behavior patterns. The entrepreneur has seen or intuited an opportunity in the market—a gap between what current firms can deliver and what the customer wants or needs.

2. Both evaluate new product or new service ideas. The marketer conducts tests—concept, product, and market—to gather data concerning the prospects for an innovation. The entrepreneur envisions resource combinations and configurations (both existing and potential) and creates a venture to exploit them. Both need to understand the product and service diffusion and adoption process.

3. Marketing behavior and entrepreneurial behavior have other similarities. Both are continuously scanning the environment and evaluating information. Both are boundary spanning activities, going outside their own organization to build relationships with others. Both are aggressive representatives of their organizations and products to the community at large.

4. Both are growth-oriented. Marketers and entrepreneurs are interested in increasing the scope of their business: selling more to current customers, developing new customers, and finding additional products and services that meet the needs of the customer base.

Thus marketing and new venture creation share common interests. However, just as there are the positive interfaces, there are negative ones as well. These are traps for the entrepreneur and marketer. Four pitfalls marketers and entrepreneurs share are:

1. Both tend to believe that growth is assured by an ever-expanding number of people with wealth who will continue to purchase the product at increasing prices indefinitely.

2. Both tend to believe that there is no competitive substitute and that the product or service offered is unique.

3. Both have unwavering faith in the benefits of the experience curve—the notion that costs decrease over cumulative production. This leads to the strategic obsession with selling more and more of the same product.

4. Both tend to have a preoccupation with product issues; this is especially true of brand managers in marketing and engineer/inventor entrepreneurs.

Marketers and entrepreneurs are therefore linked by common perceptions, goals, and behaviors. Yet many entrepreneurs underestimate the value of marketing and ignore many of marketing’s key functions. A study of venture capitalists indicated that effective market analysis could reduce new venture failure rates by 60 percent. The same study found that 75 percent of entrepreneurs ignored negative marketing information. In this chapter we will flesh out the significant marketing decisions and functions that the new venture must perform. We will follow the format of the marketing section of the business plan presented in Chapter 5. By following the examples and illustrations in this chapter students can develop their own marketing plans.

We begin by considering the new venture’s overall marketing concept and orientation. Then we examine the marketing resources controlled by and available to entrepreneurs and their firms. Next we review the key elements of a new venture’s marketing strategy, with special emphasis on market research—potentially a source of
The opening quote is a reminder that the entrepreneur still faces many challenges after the new venture is created and initial success is achieved. The completion of the business plan is only one milestone along the way. The next four chapters describe the ongoing requirements for the new enterprise. In these chapters we see that the marketing, finance, and organizational functions reflect continuous efforts to develop and maintain competitive advantage and to keep the firm entrepreneurial. There is no rest for those pursuing the entrepreneurial dream.

Effective marketing in today’s competitive international environment requires constant vigilance and effort. “If you can’t sell a top-quality product at the world’s lowest price, you’re going to be out of business,” says Jack Welch, chief executive officer of the General Electric Company. Just having a top-quality product is insufficient. Quality is becoming a commodity—even Americans can do it! Besides, there may be more than one standard for quality, and it may change over time. Without doubt, various top-quality products and services are available at any given time. Determining what represents top quality for a specific customer is often a marketing decision.

The opening quotation also implies that even if you succeed, there are no guarantees for the future. Although business is like a game, there is no clock, and the game never ends. Adding to the complexity, more than one game is going on at one time. Customers are not all the same: They have different preferences and standards, they are located in different parts of the world, and they belong to various demographic groups. The choices of which games to play are marketing choices. They are the result of the venture’s marketing strategy.

Marketing contributes to a venture’s success in two ways: (1) it defines the manner of communicating the firm’s resource advantages, and (2) it can be a source of sustainable competitive advantage (SCA). The first role of marketing is fairly straightforward. Organizations are created to add value to resources for buyers, and the culmination of all this activity is the transaction between buyer and seller and their subsequent relationship. Because marketing activities focus directly on the nature of the transaction—the product, its price, the location and time of transaction, and communications related to the event—marketing activities influence the success of the firm.

The second role of marketing is to be “its own resource.” That is, marketing can be a source of SCA. Marketing capabilities and strategies can be rare, valuable, hard to copy, and nonsubstitutable. Aspects of the marketing strategy can exist across resource categories. Various elements may have technological components, human dimensions, and reputational characteristics, and the effective coordination of these elements also requires organizational resources. The development of marketing capability by the new venture is therefore a double imperative. The omission of a marketing plan by the entrepreneurial team is a red flag for investors and concerned stakeholders.

The Marketing and Entrepreneurship Interface

How are marketing and entrepreneurship similar? Marketing activities have much in common with entrepreneurial activities, and many entrepreneurs equate the ability to sell with entrepreneurial success. Although selling remains an important element, marketing is more than selling. Marketing and entrepreneurship interface at four different points:
SCA. We conclude by describing various methods of sales forecasting. Sales forecasts
(and, concurrently, actual sales) are the crucial outcome of the venture’s marketing
activities and provide the bridge between the entrepreneur’s plans and aspirations
and the organization’s financial potential and performance.

<table>
<thead>
<tr>
<th>E-NOTES 6–1 MARKETING AND ENTREPRENEURSHIP</th>
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<tbody>
<tr>
<td>Marketing and entrepreneurship both:</td>
</tr>
<tr>
<td>• cater to customer needs</td>
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<tr>
<td>• evaluate new product or new service ideas</td>
</tr>
<tr>
<td>• function as scanners, evaluators, boundary scanners and representatives for their venture</td>
</tr>
<tr>
<td>• are growth oriented</td>
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<td>• often have misconceptions about consumers, competition, costs, and product</td>
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**Marketing Concept and Orientation**

Where does the entrepreneur begin thinking about marketing? The initial point is
the marketing concept. The marketing concept is a managerial prescription (an
“ought-to-do”) for setting marketing goals and managing exchange transactions. It
requires an understanding of potential and actual customer needs and of costs of
meeting those needs. The venture then devises and implements a total system that in-
tegrates the marketing function with the other business functions. The single most
important objective of marketing is **customer satisfaction**. Customer satisfaction is
achieved when the firm has provided user-based quality and value (the quality/price
ratio) to its buyers.

**CUSTOMER ORIENTATION**

The total marketing concept is fairly well established in most small businesses and
new ventures. But it is not the only point-of-view that ventures take. The marketing
concept can be contrasted to other business postures, namely, a production orienta-
tion, a sales emphasis, or a social orientation.

A production orientation is preoccupied with manufacturing-based or product-
based quality. It is internally directed at the activities of the firm and its functions.
Production-oriented ventures are often founded by engineers, inventors, or high-tech
wizards—people who are fascinated by the gadgets and gizmos they are attempting to
bring to market.

A sales orientation is not a marketing orientation. Sales-oriented firms are inter-
ested in selling—that is their number one priority. Issues such as developing long-
term relationships with customers, integrating business functions to provide maximum
satisfaction, and working hard to deliver the product or service at the lowest possible
price are not primary concerns. For sales-oriented ventures, moving product out the
doors is job number one.

Occasionally, firms that have a social orientation are successful. Examples such as
Ben and Jerry’s ice cream and The Body Shop prove that a social conscience is not
necessarily in conflict with business effectiveness. Often customers purchase these
firms’ products to affirm their own social tendencies. The firms are able to charge a
premium, which is a form of tax, that customers willingly pay knowing that a certain percentage goes to support the social causes espoused by the founding entrepreneurs.

Even experienced entrepreneurs can and do fail to employ the marketing concept when launching their businesses. Take the case of Minnesota Brewing Co., which almost lost it all by not knowing its market before introducing its products.8 The firm was founded in 1991 and operated out of a closed Heileman Brewing plant. Investors ponied up $3.3 million to produce, distribute, and sell beer to a loyal blue-collar market. But along the way, the company forgot its customer. Laments lead investor Bruce Hendry, “Looking back, I’ve gotten a million-dollar education on how to sell beer—what to do and what not to do.” The lesson: Know your market before you leap.

The venture had a number of important factors going for it: a landmark location, low-interest state-subsidized loans, and a highly reputed management team. It even had the good fortune of having the local St. Paul newspaper run a contest, called “Name the Beer,” for the firm’s first product. The winning name was Pig’s Eye Pilsner (Pig’s Eye was the city’s name before it became St. Paul). But all the momentum was wasted as the venture’s management made marketing mistake after mistake.

• **Mistake 1.** The firm did not name the beer “Pig’s Eye.” It chose “Landmark” as its first product’s name. Hendry said it sounded more dignified. But it had no appeal and was considered boring. Beer drinkers were not impressed by dignity.

• **Mistake 2.** The beer was brewed to taste like old-style European beers—heavy and slightly bitter. Consumers, however, expected the beer to be a light lager like the typical American brew.

• **Mistake 3.** The venture’s advertising campaign was misleading. It promised a lighter-tasting beer, like the Schmidt brand that used to be brewed in the old Heileman plant.

• **Mistake 4.** The price was wrong. Landmark was priced as a premium beer and cost as much as Budweiser. Competitors cut prices when Landmark was launched to make it seem even more expensive. Customers expected to pay $9.99 a case and were shocked when the price was $14.99.

Sales were disappointing and reached only one third of break-even. The investors, who prided themselves on their marketing expertise, had double-crossed themselves by moving away from what they knew to be the customer’s needs. Before they lost it all, they needed a turnaround. Here’s what they did: They developed a new, lighter beer and tested it on hundreds of drinkers at local bars, in focus groups, and in taste tests. They named the beer Pig’s Eye Pilsner and priced it at $8.99 a case. The firm launched a new ad campaign that spoofed Stroh’s “Swedish bikini team” ads. They developed a logo character named Pig’s Eye Parrent (reputedly the founder of the city of Pig’s Eye) whose grinning leer beneath his eye patch makes him appealing to men and women. The results have been impressive. Case sales are well over break-even and rising, intense brand loyalty is developing, and Pig’s Eye Parrent’s image will grace other products through a number of licensing deals. Says Hendry, “Pig’s Eye saved our shirt.”

**MARKETING RESEARCH**

Marketing research eventually put Minnesota Brewing back on track and turned the company around. The marketing concept requires that customer satisfaction be the primary objective, and understanding what customer satisfaction means in any partic-
ular business concept requires extensive knowledge of the potential purchasers. Market-
ing research is designed to provide that information.

Marketing research can be defined as “the systematic and objective process of
gathering, coding, and analyzing data for aid in making marketing decisions.” In
Chapter 3 we introduced a framework for analyzing customers, competitors, and in-
dustry forces, but the needed data came from marketing research. Effective market-
ing research can help the new venture answer such important questions as:

• **Who is the customer?** The customer profile includes demographic characteristics,
  values and attitudes, buyer and shopping behavior, and buyer location. Cus-
  tomers can be local, regional, national, or international. Understanding the cus-
  tomer is the basis for market segmentation.

• **Who are the players?** The competitive profile of existing competitors and poten-
tial competitors can indicate the likelihood of retaliation and the nature of the
reaction. For example, Minnesota Brewing failed to realize that competitors
would cut prices to impede its new product’s introduction.

• **How can the customer be reached?** The distribution networks and channels rep-
resent the actual delivery of the product or service. Sometimes the answer to this
question falls back on standard industry practices: “ship by common carrier,”
“retail channels,” “in-house sales force.” But other times the distribution system
is the business—as at Avon, Domino’s Pizza, and Amway.

**Conducting Marketing Research**

Many entrepreneurs conduct some sort of marketing research in the early stages of new venture creation. Marketing research is also a common practice among small businesses. As many as 40 percent of smaller businesses do marketing research, and the vast majority are satisfied with the results. Marketing research need not be an expensive and time-consuming exercise. Answers to the important marketing questions are frequently well within the grasp of the entrepreneur, and most marketing research can be done by the founders themselves.

Conducting marketing research is a six-step process.

**Step 1.** Marketing research begins with a definition of the purposes and objectives of the study. The entrepreneur must pinpoint the aspect of the product or market that requires the research: product features, design characteristics, packaging. Knowing what questions need answers will help save time and money and make the results easier to interpret. In this important preliminary stage, the researcher should be clear on the specific nature of the problem. The key for the researcher is to determine what facts, knowledge, and opinions would help the entrepreneurs make a better decision.

**Step 2.** The next step is to determine the data sources best suited to the objectives of the study. Data come from two types of sources: primary and secondary. Primary data are generated from scratch by the research team. Three common entrepreneurial primary-data projects are the concept test, the product test, and the market test.

**Concept testing** occurs very early in new venture planning, often before the final venture configuration is complete. The purpose of the concept test is to determine whether customers can envision how the product or service will work and whether they would purchase it. The customers respond to a description of the product or service; no physical representation yet exists. After reading the description, customers are asked if they understand the product and if they are likely to purchase.
Concept testing can also be used for potential investors, suppliers, or members of the managerial team. Each of these groups is in a position to evaluate the new venture concept, and the entrepreneur can gauge whether the concept is likely to be accepted by these important stakeholders. In addition, feedback from these people at the concept stage enables the entrepreneur to make the type of adjustments and alterations to the concept that can save time, money, and reputation down the road.

**Product testing** requires having potential customers or investors react to the actual use of a new product or service. The subjects may use the product briefly, even take it home for a more intensive test. Product testing is less abstract than concept testing, and therefore the responses are more reliable. However, some products are so expensive to manufacture, even as prototypes, that product testing becomes unrealistic, and concept testing must suffice.

**Market testing** is the most complex and expensive approach, but it is also the most realistic and most likely to produce reliable results. In a market test, the product or service is introduced using the full marketing strategy but in a limited area that is representative of the broader market. It is an attempt to duplicate the conditions of actually marketing the product, usually on a limited geographic scale. For ventures with a limited geographic reach anyway, the market test is the actual beginning of business operations. Small manufacturing operations that seek broad product distribution would be candidates for market test research.

Each of the three types of test has its costs and benefits, and proper selection requires a fit between the entrepreneur’s needs and resources and the type of product or service under consideration. Table 6–1 summarizes each test and its appropriateness to a variety of situations.

**Secondary sources** consist of data, information, and studies that others have already completed and published. These sources are useful for planning original data collection activities because they provide in-depth background information on customers and markets. They can be extremely useful for the new venture’s marketing research efforts because most are easily accessed and either free or inexpensive. A virtually unlimited volume of information is available from hundreds of sources. Sometimes already-published studies are examples of concept, product, and market research.

**TABLE 6–1 Marketing Research: Appropriateness of Primary-Data Collection Methods**

<table>
<thead>
<tr>
<th>New Venture Characteristic</th>
<th>Concept Test</th>
<th>Product Test</th>
<th>Market Test</th>
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<tbody>
<tr>
<td>Single-product venture</td>
<td>High</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Multi-product venture</td>
<td>Moderate to low</td>
<td>Low</td>
<td>Moderate</td>
</tr>
<tr>
<td>Importance of product performance</td>
<td>High</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Importance of pricing strategy</td>
<td>High</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Importance of promotion</td>
<td>Moderate to high</td>
<td>Low</td>
<td>Moderate to high</td>
</tr>
<tr>
<td>Importance of distribution</td>
<td>Moderate to high</td>
<td>Low</td>
<td>Moderate to high</td>
</tr>
<tr>
<td>Introduction of innovations, continuous</td>
<td>High</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Introduction of innovations, occasional</td>
<td>Low</td>
<td>Moderate</td>
<td>High</td>
</tr>
</tbody>
</table>

tests similar to those the new venture might conduct itself. These are frequently available in public libraries and always available in the business library of major business schools. Additional resources can be located by searching the Internet.

**Step 3.** The third step in marketing research is to develop the data collection instrument or test. Marketing research data can come from a single source or multiple sources. If a variety of sources are employed, the results are more likely to be valid. For customer studies, personal and telephone interviews, focus groups, and direct observation might be appropriate. Mail studies and surveys are common data sources. Whichever method is chosen in step 2, a properly designed data collection instrument is required. This is self-evident for interviews and survey-type research, but it is also important for secondary data sources. These data sources have the potential to overwhelm the marketing researcher because there are so much data and the researcher will tend to believe that all of it is important. Too much data are as dangerous as too little because of the extra expense and the difficulty of coding and analyzing large data sets. The researcher should have a clear idea of the specific data required before investigating secondary sources.

**Step 4.** The fourth step is the design and choice of the sample. Occasionally the researcher will be able to speak to all of the firm’s customers or collect data on all of the companies of interest. If this is the case, the researcher has not a sample but a census. Usually, however, there are too many people or companies to speak to, so it is necessary to choose a small proportion of them as representative of the total population. This is a sample. The key issues in sample design are representativeness and reliability. A sample does not have to be large to be representative of the whole population. National polls of voters may contain as few as 1,500 participants representing 60 million voters. Yet these polls are often very accurate. For statistically pure national samples, the venture probably should employ professional marketing researchers. For smaller, do-it-yourself efforts, the researchers simply need to ensure that the people they speak to have the information desired. Very small samples of one, two, and three respondents are seldom sufficient.

**Step 5.** The fifth step is data collection. This is the actual execution of the study. Data need to be collected in an unbiased and uniform manner. The correct design of the instrument and of the sample help to ensure this. Additional measures are also needed, such as training survey recorders and telephone interviewers, checking data records for errors, and scanning responses.

**Step 6.** The final stage of a marketing research project is the analysis of the data and the interpretation of the results. Often a final report is written, even when the project is relatively small and the goals of the study fairly narrow. This ensures that a record exists for the future and that others in the organization can refer to the study as necessary.

Many entrepreneurs must do their market research with limited funds. They face a “chicken or egg situation”—they cannot obtain financing without good market research, and they are unable to afford a large market research effort without financing. But the most expensive research is research conducted in a slovenly way. At best, it will lead to repeating the effort; at worst it will lead to erroneous conclusions. Still, the entrepreneur must conduct good market research “on the cheap.” Cost-saving recommendations include:
1. Use the telephone instead of mail surveys and door-to-door interviewing.
2. Avoid research in high-cost cities; test more than one product at a time.
3. Avoid collecting unnecessary data.\textsuperscript{14}

One source of good yet inexpensive research is a university. Professors, students, and staff are often involved in projects that enable them to piggyback their courses and assignments with the entrepreneur’s market research needs. For example, the Small Business Institute (SBI) program of the U.S. Small Business Administration serves thousands of businesses each year on over 500 campuses. Donna Kane of Kane Manufacturing of Des Moines, Iowa, did not pay a penny for a 50-page market research study that was conducted by students at Drake University. Professor Robert Kemp supervised the students’ market research report, which found a new market for Kane’s livestock products in Germany. Kane expects exports to exceed 33 percent of sales. The next study will focus on Brazil.\textsuperscript{15}

Market research is not only for new markets. Ongoing market research, the systematic analysis of sales trends for current customers, is part of the process. In Street Stories 6–1 we see how one company employs the latest technology to procure market information about its customers.

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\begin{tabular}{|l|}
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\textbf{E-NOTES 6–2 MARKET RESEARCH} \\
\hspace{2cm} The six steps of market research are: \\
\hspace{2cm} Define purpose and objectives; \\
\hspace{2cm} Identify data sources, which may include data from primary sources such as: \\
\hspace{3cm} • concept testing, \\
\hspace{3cm} • product testing, \\
\hspace{3cm} • market testing; \\
\hspace{2cm} Design data collection instrument; \\
\hspace{2cm} Conduct a sample data collection; \\
\hspace{2cm} Actually collect data; \\
\hspace{2cm} Analyze data. \\
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\textbf{Marketing Research on Innovation} Marketing research on innovations is particularly relevant for entrepreneurs, and considerable work has been done in this area of buyer behavior. The entrepreneur whose objective is to successfully introduce a new product or service has three intermediate goals: (1) to remove impediments to the purchase of the innovation, (2) to increase acceptance of the new product, and (3) to encourage repurchase over time. Impediments always confront an innovation, and they can take many forms. For example, existing channels of distribution may be difficult to enter, making it hard to present the product to the target market.

Next, the innovative entrepreneur must attempt to appeal to a wide audience and to gain broad market acceptance. Initial buyers may have special characteristics that make innovations appealing to them—for example, high levels of education, literacy, and income, an open attitude toward change, a sensitivity to external changes, and high social status. Age is negatively correlated with the propensity to adopt an innovation. However, the segment of buyers who immediately find the innovation desirable is usually too narrow to support the product and its organization. Wider appeal is therefore
No Belt-Tightening at Leegin

Jerry Kohl, 41, is the owner of Leegin Creative Leather Products of Industry, California. And he is a maniac. He is opinionated, passionate, and emotional about his business and his customers. Throughout most of the 1980s his company’s sales had stagnated, staying at between $9 million and just short of $10 million. In an effort to escape the purgatory of flat sales and increasing foreign competition, Jerry attended Harvard’s Owner/President Management program beginning in the summer of 1986 and for the next two summers.

Sales in 1987 pushed through to $10.8 million, $15 million in 1988, $20 million in 1989, and by the end of 1992 had reached $47 million. Jerry expected to do $65 million in 1993. Profits have increased, and there is less debt on the balance sheet. What’s the secret for this little-known company that does no advertising? Leegin’s reinvented itself to deliver total customer satisfaction.

In the 1980s the company resembled many small manufacturers. Leegin’s had a limited line of belts and sold directly to mostly small stores. Salespeople were order takers, and when one quit, accounts were lost. Leegin’s designers kept turning out new styles, but the proliferation threatened to choke the factory. The office was run like a feudal fiefdom, and office politics were normal. Leegin had no advantages and some serious disadvantages.

But Kohl came back from Harvard ready for change. Each salesperson is now a total marketer. They take the entire store inventory of belts. Then they record it on their portable PC. Stored in the PC is the customer’s orders for the past year, current sales volume, and number of belts sold by style, color, or any other feature the store owner might want to see. The last job is selling. The salesperson can tell the customer which styles are selling at similar stores, what new styles fit with the rest of the inventory, and whether the depth and breadth of the line is appropriate for the rest of the product mix.

This information has changed the relationship between buyer and seller. First, the information is objective—the Leegin salesperson looks more like a belt consultant than a pitchman. Second, the information enables the customer to maximize returns on a small and often neglected product line.

All of Kohl’s 60 outside salespeople use their portable PCs. No paper orders are required. Information flows both ways as orders are placed by modem and factory inventories are updated with production. Market information helps with the planning, and the database stays even if a salesperson leaves.

In order to support more productive salespeople, the office staff was reorganized and retrained as account specialists. They are now responsible for customer service, expedited shipping, solving problems, collections, and credit. Through training and computerization, an account specialist can handle roughly 1,000 accounts.

And marketing became a priority on the factory floor as well. Quality, empowerment, and teamwork programs were successfully established. Group incentives were established based on managing inventories and quality. Everyone
required. Also, if the product is to survive for any period of time, repurchase must be encouraged.

What is the diffusion process and why is it important? The marketer who understands the diffusion process is in the best position to meet the objectives outlined. Diffusion refers to the overall market understanding and acceptance of an innovation, whether it is a product, a service, or an idea. The most widely accepted model for the diffusion process has four stages. The knowledge stage occurs as individuals become aware of the innovation. Information becomes available through various marketing communication media and techniques. People are repeatedly exposed to this information and to physical and social stimuli that reinforce awareness of the product. The earliest messages enable the consumer to recognize the innovation and recall its attributes.

The next stage of the process is the persuasion stage, which involves the transmission of favorable attitudes toward the product. These are more sophisticated messages. They describe operating and performance characteristics as well as buyer benefits. The consumer weighs the risks of purchase against the risks of nonpurchase and compares similar or competing products. The firm attempts to link positive images and personalities with the product at this time. This is known as the halo effect. Because consumers are actively engaged in searching for and processing information about the product at this stage, advertising and the various forms of marketing communication become powerful tools.

The decision stage follows. This is the crucial “make or break” time for the entrepreneur. The activities that lead to either acceptance or rejection occur now. Social and economic pressures can be brought to bear at this stage. The customer can be led through a series of smaller partial decisions that lead to the purchase of the product. At this point the entrepreneur must close the sale.

The final stage in the diffusion model leading to the adoption of an innovation is the confirmation stage. Here customers either reverse their decision (no repurchase) or are reinforced to repeat their decision. Between the decision to purchase and the confirmation is the trial period. This is another crucial time for the entrepreneur, since misuse of the product or unrealistic expectations during the trial period can cause the customer to reverse the purchase decision.

The entrepreneur who can successfully introduce innovations is able to communicate important facts and images during the knowledge stage. During the persuasion
stage the entrepreneur can demonstrate both the relative advantages of the product or service and the compatibility of the innovation with the buyer’s values, needs, and behavior. Positive purchase decisions are encouraged by illustrating the ease of use of the innovation and its “try-ability.” The probability that the customer will buy again is increased when the buyer can directly observe the benefits of the innovation. Figure 6–1 illustrates the diffusion process.

Marketing Strategy

What is marketing strategy? Marketing strategy is the set of objectives and activities that enables the new venture to implement the total marketing concept. There are two keys. The first is to identify, develop, and control resources that are rare, valuable, hard to duplicate, and nonsubstitutable. Doing so provides the firm with its distinctive competence and competitive edge. The second key is to be creative and lucky. A recent study reported that among the 20 biggest outlets for the top American brands, the three primary sources of sustainable advantage were location, service, and luck (creativity).18

The study indicated that a venture’s location, the primary aspect of a retailer’s distribution strategy, is the key component of its overall marketing strategy. Good locations are always evaluated relative to the rents paid for them. The research indicated that the rent successful retailers pay is far below the true value of the property. Great service is also part of the product/service mix and another key component of the marketing strategy. For example, the leading Lexus dealer in the United States is located in south Florida. His service included a special washing of all of his customers’ cars after Hurricane Andrew to rid them of acid created by burning debris. Finally, luck and creativity have roles to play because they are so difficult to imitate. According to Philip Kotler, international marketing guru at Northwestern University’s Kellogg School of Management, successful outlets are likely to be “more creative. They may depart from some of the standard procedures—and perhaps even the principles in some cases. . . .”19 Here we hear echoes of Sam Walton’s Rule 10: “Break all the rules.” Table 6–2 reports the results of a study of the biggest and best stores in the United States.

Our resource-based approach to marketing and the total marketing concept require that the marketing concept focus on the firm’s distinctive competencies. Where the firm has advantages, these advantages should be pressed through marketing strategy. The first question to be addressed is: What is our distinctive competence? We
have already explored this topic in Chapters 2 through 4. The second question is: Who values our competence? Although we addressed this question when we discussed resource analysis, we include it here because it entails the selection of target markets and segments. The next questions are: What marketing activities enable us to interact most effectively with our markets? How will the marketing variables of price, promotion, product characteristics, and distribution be set to increase our market? Finally, given a set of marketing activities, how much can we expect to sell? Addressing these questions will complete this chapter.

### E-NOTES 6–3 RESOURCE-BASED MARKETING APPROACH

A new venture's marketing plan in a resource-based approach should consider these questions:

- what is our unique competence?
- who values our competence?
- what marketing activities will help us reach our markets?
- how will marketing variables (price, promotion, etc.) affect our success?
- based on a specific marketing plan, what kind of sales can we project?

### SELECTION OF MARKETS AND SEGMENTS

Not all customers are alike. Our analysis of buyer characteristics in Chapter 3 indicated that buyers differ, for example, in price sensitivity, brand loyalty, and requirements for quality. **Market segmentation** identifies distinct buying groups and develops and implements marketing strategies to fit each group. Market segmentation is important for marketing strategy because it enables the venture to discriminate among buyers for its own advantage. For example, the venture can serve buyers who demand the latest technological innovations if that is where the venture has its distinctive competence; or it can serve buyers who are most price sensitive if efficient operation is the core entrepreneurial competency. Since it is difficult, if not impossible, to be all things to all people (that is, to achieve world-class customer satisfaction levels across all classes of customers), effective market segmentation enables the firm to serve some segment of customers exceedingly well.

**Bases for Segmentation**

Sometimes it is possible to segment markets based on broad market types, for example, consumer end users versus commercial end users. Another basis for segmentation is the type of buying organization: manufacturing businesses, distribution organizations, wholesalers, retailers, service organizations, and not-for-profits. These represent different types of buyers, and each may have a distinguishable set of needs that can be the basis for segmentation. Also, it is possible to segment markets geographically by determining the scope of the venture's operation: global, regional, domestic, or local.

Segmentation methods are widely used by new ventures and small businesses. One study reported that 62 percent of businesses employed some type of market segmentation strategy and that **effective segmentation strategies produced significant differences in return on invested capital**. In other words, not only do segmentation strategies lead to higher customer satisfaction, but this satisfaction also translates
### TABLE 6–2 The Biggest and Best Stores in the United States

The 20 biggest and best stores in the United States owe their success to combinations of luck, service, and location. Because these are retail outlets, location does play a principal role in a way that might not be true in manufacturing businesses.

<table>
<thead>
<tr>
<th>Parent Company</th>
<th>Biggest Outlet</th>
<th>Just How Big?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amoco Oil</td>
<td>Station in Whiting, Indiana</td>
<td>Sold 5.2 million gallons of gas in 1992</td>
</tr>
<tr>
<td>Florsheim Shoes</td>
<td>Herald Square, New York City</td>
<td>Serves most customers; 28,000–30,000 per year</td>
</tr>
<tr>
<td>True Value Hardware</td>
<td>Kabelin True Value, LaPorte, Indiana</td>
<td>Over $7 million in purchases from supplier</td>
</tr>
<tr>
<td>Wal-Mart</td>
<td>Laredo, Texas</td>
<td>Most space, 151,915 square feet</td>
</tr>
<tr>
<td>Fanny Farmer Candy</td>
<td>Rockefeller Center, New York City</td>
<td>Sells most 1-pound boxes (62,000) in country</td>
</tr>
<tr>
<td>Chevrolet</td>
<td>Ed Morse Chevrolet, Lauderhill, Florida</td>
<td>More than 100,000 vehicles sold in 1992</td>
</tr>
<tr>
<td>H&amp;R Block</td>
<td>Downtown Stamford, Connecticut</td>
<td>Most clients served, over 8,000</td>
</tr>
<tr>
<td>Federal Express</td>
<td>Center at 525 Seventh Avenue, New York City</td>
<td>Most volume; over 1,000 packages per day</td>
</tr>
<tr>
<td>FTD Floral Delivery</td>
<td>McShan Florist, Inc., Dallas, Texas</td>
<td>Most flowers-by-wire orders, over 1,100 per week</td>
</tr>
<tr>
<td>Goodyear Tires</td>
<td>Sullivan Tire, Rockland, Massachusetts</td>
<td>Biggest dealer, over 250,000 tires each year</td>
</tr>
<tr>
<td>Hertz Rent-A-Car</td>
<td>Los Angeles International Airport</td>
<td>Most rentals, daily average of 2,000</td>
</tr>
<tr>
<td>Hilton Hotels</td>
<td>Flamingo Hotel, Las Vegas, Nevada</td>
<td>Most rooms—3,530—with 90 percent occupancy</td>
</tr>
<tr>
<td>KFC</td>
<td>Fort Campbell, Kentucky, U.S. Army base</td>
<td>Biggest-grossing franchise, $2.4 million</td>
</tr>
<tr>
<td>Sears</td>
<td>Ala Moana Shopping Center, Honolulu, Hawaii</td>
<td>Highest revenue, over $50 million last year</td>
</tr>
<tr>
<td>Baskin-Robbins</td>
<td>Royal Hawaiian store, Honolulu, Hawaii</td>
<td>Top-grossing unit, estimated $925,000 in 1992</td>
</tr>
<tr>
<td>McDonald’s</td>
<td>On turnpike, near Darien, Connecticut</td>
<td>Serves most customers (8,000/day) in chain</td>
</tr>
<tr>
<td>Domino’s Pizza</td>
<td>U.S. Marine Corps base, near Twenty-Nine Palms, California</td>
<td>Sells most pizza, 4,000 per week</td>
</tr>
<tr>
<td>Midas Muffler</td>
<td>Wood’s Car Care, Vienna, Virginia</td>
<td>Top-selling dealer, over $2 million</td>
</tr>
<tr>
<td>Radio Shack</td>
<td>Dadeland Mall, Miami, Florida</td>
<td>Largest gross sales</td>
</tr>
<tr>
<td>Lexus Automobiles</td>
<td>J.M. Lexus, Margate, Florida</td>
<td>Most sold, over 2,200 in 1992</td>
</tr>
</tbody>
</table>

**Key Resources**

<table>
<thead>
<tr>
<th>Location</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location right across Illinois border saves motorists 13 cents per gallon in taxes. Open 24 hours. Automated credit card processing speeds service.</td>
<td></td>
</tr>
<tr>
<td>Location across from Macy's with three window facings. One-hundred-year reputation. Complete inventory, computerized ordering, open 70 hours per week. Extensive service. Creative in-store promotions. Effective direct-mail advertising.</td>
<td></td>
</tr>
</tbody>
</table>

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**TABLE 6-2 (continued)**

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15
into profits. Table 6–3 presents a broad range of segmentation techniques, the percentage of small firms that employ them, and the reported effectiveness of each method.

### MARKETING ACTIVITIES

Four major marketing activities need to be accomplished once the target markets are selected. These decisions are not made in isolation. They are all intertwined—with each other and with the venture’s distinctive competencies, target market, and macro- and competitive environments. The four major activities are pricing decisions, product and service configurations, distribution strategies, and promotional campaigns.

#### Pricing

A price is the exchange value (usually denominated in money) of the venture’s goods and services. Prices go by many names: fares, taxes, tuition, fees, tips, interest, and tolls. The pricing decision is probably the most important of the four major marketing activities because it directly affects the value relationship (quality divided by price). A mispriced product is a misplaced product—misplaced in relationship to the competition, misplaced in the perceptions of the buyers, and misplaced relative to other products and services the firm has to offer.

The entrepreneur must make fairly accurate price decisions, even before the product is introduced to the market, because the price of the product directly enters the sales forecast. If pricing is wrong, forecasts are wrong—and projected cash flow and profits are wrong as well. An incorrect pricing decision can cause the entrepreneur to get a “green light” on launching the business when more accurate forecasting would have produced a “red light” and saved everybody time and money.

---

**TABLE 6–3 Bases For Market Segmentation Usage and Effectiveness**

<table>
<thead>
<tr>
<th>Basis</th>
<th>Usage (%)</th>
<th>Effectiveness</th>
</tr>
</thead>
<tbody>
<tr>
<td>By geographic areas: such as state, county, census tracts.</td>
<td>13.6</td>
<td>3.9</td>
</tr>
<tr>
<td>By demographics: such as age, income, and gender.</td>
<td>15.5</td>
<td>3.6</td>
</tr>
<tr>
<td>By social class: high, middle, and low.</td>
<td>4.9</td>
<td>3.8</td>
</tr>
<tr>
<td>By lifestyle and opinions: such as hobbies, job type, political view.</td>
<td>4.4</td>
<td>2.7</td>
</tr>
<tr>
<td>By personality traits: such as masculinity-femininity, assertiveness.</td>
<td>4.1</td>
<td>2.6</td>
</tr>
<tr>
<td>By purchasing decisions: based on when customers get ideas.</td>
<td>2.4</td>
<td>3.7</td>
</tr>
<tr>
<td>By purchasing timing: based on when buyers buy.</td>
<td>3.1</td>
<td>4.2</td>
</tr>
<tr>
<td>By time of use: based on when customers use the product.</td>
<td>6.3</td>
<td>4.3</td>
</tr>
<tr>
<td>By benefits sought: based on what customers want.</td>
<td>11.8</td>
<td>4.6</td>
</tr>
<tr>
<td>By extent of usage: such as high users, ex-users, etc.</td>
<td>6.9</td>
<td>3.1</td>
</tr>
<tr>
<td>By buyer loyalty status: such as very loyal, ready switchers.</td>
<td>5.2</td>
<td>2.7</td>
</tr>
<tr>
<td>By buyer readiness: based on degree of awareness and intent.</td>
<td>3.8</td>
<td>3.9</td>
</tr>
<tr>
<td>By buyer attitudes: such as enthusiastic, hostile, etc.</td>
<td>5.6</td>
<td>4.1</td>
</tr>
<tr>
<td>By marketing attribute: product characteristic, price sensitivity, etc.</td>
<td>8.0</td>
<td>2.5</td>
</tr>
</tbody>
</table>

*Indicates primary method.

Indicates satisfaction with technique on a scale of 1 to 5. Mean for all dimensions is 3.6.

Different pricing objectives require different pricing strategies. However, the primary objective of the pricing decision is to make profits. Entrepreneurs have five pricing subobjectives, each of which can help the venture achieve its primary objective.21

**Skimming the Market**  The *skimming the market* strategy identifies a segment that is price insensitive (inelastic demand) and charges the highest price the market can bear for short-term profits. It can be used when:

- No comparable products are available.
- There is uncertainty about costs.
- The product life cycle is extremely short.
- A drastic innovation or improvement has been made.
- There is a low probability that competitors will enter the market (due to high entry barriers, high promotion or R&D costs, or other isolating mechanisms).

After price-insensitive segments have been skimmed, prices are gradually reduced to include more sensitive segments. The primary advantages of this strategy are that it:

- Provides cash quickly for reinvestment in promotion or produce development.
- Allows for a market test before full-scale production.
- Suggests high quality in the mind of the customer.

The major disadvantages are that it:

- Assumes that a price-insensitive market segment exists.
- Can cause ill will in the market.
- Can attract potent competitors looking for similar high returns.

**Exploiting the Experience Curve**  As a manufacturer becomes more experienced in producing a product, or a service provider becomes more knowledgeable and efficient in delivering a service, variable costs may decrease. A firm can take advantage of these decreasing costs by “riding down the demand curve.” This means that as costs decrease, prices are set to decrease proportionately. This effectively increases volume and expands the market. Thus, it is possible to maintain margins (price minus variable cost) with increasing market share. This strategy is most commonly employed by established companies that are launching innovations, in durable-goods industries (where the experience-curve effect has been most often noted), and in markets where the product life cycle is moderately long (long enough to ride down the curve). The advantages of this strategy are that:

- It enables the firm to exploit its low-cost position.
- The slow changes in price do not alienate customers.
- Profit objectives do not have to be sacrificed for market share.

The disadvantages are that:

- Some buyers may be discouraged by high initial prices.
- The experience-curve effect must be a documented reality.
- Price reductions could anger early buyers.
Meeting the Market Price  In this strategy, the venture prices its products at the same level as the competition. If this practice is generally accepted by competitors within a segment, then competition will not be based on price. Instead, firms will jockey for dominance based on distribution, promotion, and product improvements. These forms of competition help expand the market for everyone by making the product offerings more attractive, easier to buy, and better known. This type of pricing is most likely to prevail when competitors face each other in a number of markets (and wish to avoid devastating price wars), when costs are reasonably predictable over the entire product life cycle, and when the market is still growing. The major advantages of this strategy are that it:

• Requires less analysis and research.
• Treats all buyers, early and late, the same.
• Signals to other firms that there is no threat of a price war.

The disadvantages are that:

• Other marketing tools must be used to gain differentiation.
• Recovery of investment is slower.
• Errors in initial cost estimates are difficult to overcome.

Achieving Maximum Market Penetration  In this strategy the venture builds market share as quickly as possible by entering with low prices. It stimulates market growth. If successfully executed, the venture will be entrenched as the market-share leader and positioned for long-term profitability. The low price implies low margins, and this will deter some others from entering. It is best used in mass consumer markets when:

• The product has a long life span.
• Market entry is easy.
• Demand is highly price sensitive.
• There is no “top” of the market to skim.
• There is some experience-curve effect.

The primary advantages of this strategy are that it:

• Discourages entry.
• Focuses the customer on value.
• Enables maximum penetration and exposure in the shortest time period.

On the downside, penetration pricing:

• Assumes a degree of price inelasticity that may not be present.
• Stimulates high volumes that the venture may not be prepared to meet.
• Requires large initial capital investment to meet high volumes.
• Can lead to large losses if errors are made.

Establishing Preemptive Pricing  Preemptive pricing is a “lowball” pricing strategy designed to keep potential competitors out or to force existing competitors to exit the market. Prices are set as close to expected variable costs as possible, and cost savings are passed on to buyers. Because costs often decrease over time, initial prices will be below cost. Preemptive pricing is often employed in consumer markets and is sometimes combined with other product-pricing strategies that enable the firm to subsidize this potentially short-term money-losing policy. If this strategy is successful, its
major advantage is that it limits competition and enables the firm to collect monopoly-type rents. If the strategy is not successful, however, and if competitors match the low prices, large losses can occur.

In addition to these five strategies, numerous other pricing tactics can be employed for various occasions and situations. Table 6–4 presents an entrepreneurial primer on creative pricing tactics.

Pricing policies also have legal implications and constraints. The Sherman Act prohibits conspiracy in restraint of trade. Such conspiracy includes collusive pricing tactics and attempts to fix prices. Although entrepreneurs are expected to make pricing decisions independently, market research on competitors’ prices and signaling through price changes are legal.

The Federal Trade Commission regulates pricing practices and prohibits deceptive pricing. Deceptive pricing occurs when it is difficult or impossible for the buyer to actually understand what the price of a product or service is. Some products, like insurance, are complicated and require simplified explanations of price policy. The Truth in Lending Act requires lenders to explain the true price of credit (interest and finance charges) to borrowers.

The Robinson-Patman Act and the Clayton Act prohibit discriminatory pricing. Illegal price discrimination exists when identical products or services are sold, under

<table>
<thead>
<tr>
<th>Table 6–4 A Creative Pricing Primer: Approaches and Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approach</td>
</tr>
<tr>
<td>Bundling</td>
</tr>
<tr>
<td>Unbundling</td>
</tr>
<tr>
<td>Trial prices</td>
</tr>
<tr>
<td>Value-added pricing</td>
</tr>
<tr>
<td>Two-fers</td>
</tr>
<tr>
<td>Pay one price</td>
</tr>
<tr>
<td>Constant promotional price</td>
</tr>
<tr>
<td>Pricing tied to variable</td>
</tr>
<tr>
<td>Captive pricing</td>
</tr>
<tr>
<td>Fixed, then variable</td>
</tr>
<tr>
<td>Price point breaks</td>
</tr>
</tbody>
</table>

similar circumstances, at different prices to different customers or to different market
segments. What actually constitutes discrimination is the subject of many volumes of
legal text, briefs, torts, and statutes. Basically, however, the following tenets of price
discrimination are established:

1. Different prices cannot be charged based on buyers’ membership in different so-
cial, ethnic, or religious groups.
2. Factors such as age, income, and gender may not be used as a basis for price dis-
crimination.
3. However, sellers can charge different prices in different markets when the mar-
ket is defined as the circumstances of location and cost.
4. If the costs of serving a market are variable, then the prices charged in those
markets may also vary, for example, through trade discounts and volume dis-
counts.
5. Lower prices are legal if they are necessary to meet the competition, for exam-
ple, discounts for children and senior citizens and group rates on travel and in-
surance.

Setting prices in arbitrary and capricious ways is bad business and may be against
the law. It is bad business because it affects the value relationship in unanticipated
ways. When the customer receives a product or service with unpredictable value, the
probability is high that you will have an unhappy customer.

Product and Service Configurations Product decisions determine the bundle of
physical and psychological attributes that form or are associated with the core benefit
to be delivered. Physical products require decisions about the style of the product, its
packaging, the colors it comes in, the sizes to be offered, and the extras that can be
purchased separately. The product decision also includes the type of image the prod-
uct will generate, the likelihood that the product can be branded, and the warranty
and after-sale service that will be provided.

The product mix of a new venture may consist of a single product of a single de-
sign. However, because many companies are launched with more than one product,
we may speak of a product mix with three attributes:

The width of the product mix refers to how many different product lines are
found within the company. The depth of the product mix refers to the average num-
ber of items offered by the company within each product line. The consistency of the
mix refers to how closely related the various products are in terms of end use, produc-
tion and distribution requirements, target markets, or segment appeal.23

Service-related decisions parallel product-related decisions with a few important
differences. Services usually incorporate some degree of customer involvement and
participation. Part of the service design decision involves the extent of cooperation.
For example, in the design and delivery of educational services, the customer’s in-
volve ment can range from passive listener to active “hands-on” learner. Restaurant
concepts can be designed with various levels of involvement, from traditional
menu/table service, to self-service salad bars, to cafeteria self-service and table clear-
ing—with many variations possible. The three major service-related decisions are:

• Service Intensity. The degree of depth and development that the customer expe-
riences while receiving the service. Roller coasters provide an intense experi-
ence within a narrow (literally confined to the track) service range. Package delivery services are less intense, but they are more extensive.

- **Service Extensiveness.** The range or scope of services provided. The package-delivery service can handle a wide range of parcels and deliver them just about anywhere in the world. The more types of subservices or variations provided, the more extensive the service.

- **Time.** A pervasive decision for service design. When will the service be available and how long will it take? Will services be provided continuously or will interruptions be acceptable and appropriate? How frequently can the service be provided while maintaining server quality and customer interest?

Taken narrowly, product and service decisions include all the variables that make up the concept of product quality (see Chapter 1). Because these variables refer to the object produced or the service delivered *before* user-based quality and value are assessed, good product decisions are necessary but not sufficient to guarantee success. They must be made in the context of all the other marketing decisions within the marketing concept.

**Distribution**

Distribution decisions and activities relate to the location of the business and the choice and availability of distribution channels. These decisions are strongly affected, if not completely constrained, by the type of venture being considered. Businesses of certain forms and functions—retailers, wholesalers, warehousers, cataloguers, telemarketers, franchisers—are themselves types of distributors or channels. This reality limits the choices for entrepreneurs unless they are willing to reconfigure their venture in some nonobvious way. If they are, the decision is more strategic and less tactical and therefore is not a distribution decision at all. The major objective of a distribution or location decision is to get the venture’s product or service to the target market. When the product or service is defined carefully and the target market is known, the distribution and location decisions should be clear. Effective distribution and channel activities match product to customer and complement these previous decisions.

**Consumer Distribution Channels**

Consumer distribution channels can employ as many as three intermediaries between producer and consumer. There are occasions, of course, when no intermediaries are used, such as the “factory-direct sales” system. In this case the venture manufactures a product and sells to the customer right from the factory. Since most manufacturers do not possess resources to do this well, they generally employ intermediaries. Figure 6–2 illustrates a consumer distribution chain. Any of the segments of the chain can be eliminated if industry practice, cost considerations, or venture resources dictate.

**Industrial Distribution Channels**

Industrial distribution channels are employed when the producer is selling to another organization, especially one that uses purchasing agents and has a specialized purchasing organization. The possibilities are diagrammed in Figure 6–3. Just as in consumer channels, certain nodes can be skipped or eliminated at various times, depending on circumstances. One of the major obstacles faced by an entrepreneur can be securing distribution. Street Story 6–2 shows how difficult placing a product in a store can be. But because the entrepreneurs were persistent, the story has a happy ending.
FIGURE 6–2 Distribution Channels for Consumer Goods

FIGURE 6–3 Channels of Distribution for Industrial Markets
Working the Distribution Treadmill

The “Squirrel Mixer” may be a brilliant invention, but Ronn King can tell you that a good product just isn’t enough to make a new venture successful. King invented the Squirrel Mixer one day when his wife wanted to do some painting around the house. The paint cans they had were old and the paint separated, but King attached the kind of slotted cylinder that engineers call a “squirrel cage” (similar to the exercise wheel in a hamster’s cage) to a power drill, lowered it into a gallon can of paint, and turned it on. In just a few seconds the paint was completely blended and ready to use.

Convinced that he had created the paint industry’s next hot product, King formed the Site-b Corp. with an old high school buddy to market the invention. They hired an attorney to lock up the worldwide patents, found a job shop to manufacture the device, produced a demonstration video, and mounted a direct mail campaign to U.S. paint and hardware retailers from their Ridgecrest, California headquarters.

Nobody doubted the ingenuity of the Squirrel Mixer, but almost every retailer still said “No.” Sears, Sherwin-Williams, and Menards all said that the Site-b Corp. was simply too small. They claimed the administrative cost of dealing with a vendor with just one product was too high. Wal-Mart said they liked the product, but in the end refused to carry it due to a company policy of not doing business with any vendor too dependent on Wal-Mart for sales.

With some research, King discovered that a small group of dealers and distributors act as wholesalers to the paint and hardware industry, creating a product line with items from many vendors. To reach those distributors, Site-b would have to hire independent sales representatives. They did that, and sales started to come in, although at a much lower volume than King expected. Sales picked up more when Site-b licensed the Squirrel Mixer to two paint tool companies who wanted to market the product under their own brand name, but the margin of profit was lower.

After a year of intensive promotion, Site-b sold less than 100,000 units at a couple of dollars each. “You’ve got to learn the industry,” says the persistent King. “You’ve got to form relationships. And even with the best product in the world, you’ve got to take a lot of nos for a maybe.”

It was a relationship formed by one of Site-b’s sales representatives which may now pay off for Ronn King. Hardware industry giant Home Depot agreed to a Squirrel Mixer demonstration, and went on to negotiate a large sales contract with Site-b. “When we see people with new and cool and unique products, we take them seriously,” said Kim Curtin, one of Home Depot’s top buyers. That may be true, but Home Depot was one of the many retailers who repeatedly rejected King’s earlier requests for a meeting. Just like the hamster in the cage, King now knows that you have to work the distribution treadmill over and over again to put some spin into your new venture.

Promotional Campaigns  Promotional activities encompass the methods and techniques that ventures use to communicate with their customers and with other stakeholders. The purposes of promotion are to inform and persuade. Included in the promotional mix are advertising, personal selling, sales promotion, publicity, and public relations. Each of these sets of activities has distinctive characteristics that make the design of the promotion strategy complex—complex enough to be a source of sustainable competitive advantage.

Advertising  Advertising can be defined as “any paid form of nonpersonal presentation and promotion of ideas, goods, or services by an identified sponsor.” There are many different forms of advertising, such as television, radio, newspaper and magazine, and yellow pages. Infomercials (commercials disguised as news and information shows), outdoor displays, direct mail, and novelties are also advertising media. Because of the complexity of their form and message, it is difficult to generalize about advertising activity and campaigns. However, the following attributes can be noted:

1. Advertising is a public presentation. Its very publicness confers credibility to the product and service. Because it is delivered anonymously to a large group, it implies a certain standardization of the product.
2. An advertising message can be repeated over and over to impress the message into the (sub)conscious of the buyer. The extent to which one brand’s advertising is more embedded in the buyer’s consciousness (top-of-the mind recall) is clearly an advantage for convenience goods and impulse shopping.
3. Advertising can be used not only to inform and persuade but also to associate other favorable images in the buyer’s mind. Through copy, artwork, sound, and music, advertising can influence the buyer’s mood.
4. The impersonality of advertising enables consumers to turn away, switch off, or ignore the venture’s messages without cost or obligation.

New ventures are usually operating on limited budgets and targeting niches that can be defined geographically or by consumer interest. This makes techniques such as use of local media or special-interest publications applicable. Yellow pages advertising is often effective. Direct mail, well designed and targeted, can be successful on a limited budget.

Today the Internet has also become an innovative tool for marketing new ventures. Fledgling novelist Nan McCarthy spent $5,000 to promote her self-published romance “Chat” with a Web page featuring excerpts and an order form. Sales were slow until McCarthy corresponded with humor columnist Dave Barry, and their letters were printed by several Internet news groups. Visits to McCarthy’s web site skyrocketed overnight, and almost all the copies of her novel’s first printing sold immediately. In addition to making her first book profitable, the web site enabled McCarthy and her Rainwater Press to compile a database of names to market her second novel.

Obviously the Internet offers distinct advantages for some new ventures. The start-up costs for establishing a Web presence are low, and technologically astute companies can use the Internet to target particular niches and respond quickly to shifting demand. The Internet is an attractive advertising arena; market research indicates that the median household income for today’s Web surfers is 65 percent higher than the national average. One computer consulting firm predicts that more than 50 million Americans will be on-line in the next few years.
Many analysts believe that companies who establish an Internet presence now may lead the pack during the next century. While the Web is currently dominated by male baby boomers, experts predict that nearly 33 percent of Internet users will be under 30 by the year 2001, and that more women will shop on-line. However, high-tech products such as computers and software will continue to dominate on-line sales as we enter the next century, followed by travel services and entertainment products such as books and compact disks.

On the down side, the sheer size of cyberspace makes it difficult for vendors and consumers to interact. Analysts also predict that the expected increase in Internet users may bring the median income down, and at the same time attract on-line competition from retailing giants such as Wal-Mart.27

**Personal Selling**

Personal selling is oral presentation, supplemented by other media (for example, overhead slides or computer graphic demonstrations), either in a formal setting or in informal conversation, for the purpose of making a sale to prospective buyers.28 The decision to use personal selling is as much a management and human resource decision as a marketing one, because frequently a sales force is required to execute the strategy. (Exceptions are the use of manufacturers’ reps or personal selling by the entrepreneur.)

The decisions required to develop a sales force strategy are complex and, as in advertising, contingent on product, distribution, and pricing decisions. The major issues are sales force size, sales force territory, recruitment and selection of salespersons, training, incentive schemes and promotions, and supervision and evaluation.29 Because of the large number of variables, and particularly the social complexity of the relationship between salespeople and their customers, an effective sales force can be a source of SCA.

“Selling” is only one of the tasks of salespersons. Although the design of the sales job depends on the rest of the marketing mix and the characteristics of the market, salespeople perform as many as five additional functions:

1. **Prospecting** is the search for additional customers. Sometimes these have been previously identified by the company. These are known as “leads.” At other times the salesperson makes “cold calls”—contacts with individuals and companies that have not expressed previous interest in the product or service.

2. **Communicating** information to existing buyers or potential buyers. The subject of the communication may be about price, product characteristics, new product developments, or competing product comparisons.

3. **Servicing** customers by consulting with them on their problems, providing technical or managerial assistance, or helping with financing or delivery schedules.

4. **Information collection** and the gathering of competitive intelligence is also a salesperson’s job. The salesperson is a source of market research, passing on customer satisfaction information and data on how customers are receiving the competition’s offerings.

5. **Allocating** scarce products at times when supply cannot keep up with demand.30

Personal selling is most appropriate when a relationship that goes beyond mere transaction is necessary. This relationship between salesperson and buyer is based on the salesperson’s recognition, knowledge, and understanding of the buyer’s problems and needs and the ability to help the buyer solve problems. Personal selling is one of the
most expensive ways to reach customers, but because of the intensity of the salesperson’s involvement with the buyer’s situation, it can be the most appropriate method of marketing a product.

One of the keys to successful personal selling is the sales incentive scheme. At Electronic Systems Perspectives of Minneapolis, about 20 percent of the compensation package for new hires is based on personal-selling activity. The $2 million executive search firm tracks and rewards three basic activities: daily calls to potential job candidates, company visits, and “balls in the air,” or contacts that could lead to sales. Meeting monthly goals earns a bonus of $400 a month. Averaging 30 calls a day is worth an extra $100 bonus. “Balls in the air” can earn another $100 a month. CEO Bob Hildreth understands that this bonus scheme is a risk, but a calculated one. His reps bill about 66 percent above the industry average.

Publicity

Publicity can be defined as “nonpersonal stimulation of demand for a product, service, or business unit by planting commercially significant news about it in a published medium or obtaining favorable presentation of it on radio, television, or stage that is not paid for by the sponsor.” Although by definition publicity is free, many firms allocate significant budgets to public relations—the activities that create a favorable image in the mind of the public. These are reputation-building tactics that, if successful, can be a source of SCA. For example, many recent start-ups have emphasized their “all natural” products and image. These companies are selling an altruistic image.

Publicity has three distinctive attributes:

1. High level of legitimacy. Many people believe almost everything they read, especially when it comes from a previously credible source such as the local newspaper or television station. Sometimes the media report publicity releases as if they were the efforts of objective news reporting.

2. Elements of surprise. It catches buyers at a time when they are not expecting a sales pitch. Publicity is packaged as news, not sales communication. A buyer who may not be receptive to an advertisement or sales call may listen intently to communication that is perceived as news.

3. Attractiveness of message. Like advertising, publicity can be dramatic and attention-getting. The context within which it is presented can connote other favorable images in the minds of the customers.

Because the media are inundated with requests for publicity, it is not always easy for a firm to stand out from the others. A well-organized event coupled with a well-written press release is needed. Good organizational citizenship may be a good source of publicity: Participation in civic events and clubs, members associations, philanthropic activities, and well-regarded political causes are examples.

Sales Promotions

Sales promotions are designed to stimulate customer purchasing and dealer effectiveness. Examples include point-of-purchase displays, trade shows and exhibitions, promotional events, and other non-routine selling efforts. Sales promotions attempt to provide inducements for buyers—reduced prices for items through coupon promotions, volume discounts, or attractive financing terms. By effectively reducing the price, the seller increases the value to the buyer.

Sales promotions are attention-getters. They often have an urgent quality, offering a once-in-a-lifetime opportunity, communicating to the buyer that quick action is
needed. This has a certain appeal to the economy-minded, low-income, non-brand-loyal shopper. If the buyer is price sensitive, sales promotion can be effective. One of the most important sales promotions for the new venture is the grand opening sale. This represents a one-of-a-kind opportunity for the firm—to be followed by anniversary sales. For retail and service businesses, remote broadcasts by local media are popular. Introductory price discounts can attract customers to your location. Business can be generated by offering coupons or discounts for future dates.

Other sales promotions are event-based. Mother’s Day, Father’s Day, and Christmas are examples of events created or exploited by marketers’ promotional campaigns. Some promotions are contests, like the magazine sweepstakes that offer $10 million for returning the direct-mail response cards. Sales promotions have become so ubiquitous that entrepreneurial opportunities exist for individuals who are particularly creative or experienced in these activities. Telemarketing firms, contest promoters and organizers, mailing list sellers, and event consulting firms have sprung up to serve these needs.

The persistent use of sales promotions can have negative effects on a business. The first is that the consumer will expect promotional discounts and not make purchases unless a discount is offered. This happened to auto manufacturers when they repeated factory-rebate sales promotions many times over the years. Car shoppers, expecting the sales promotion, would not buy until the rebate was offered. Manufacturers, seeing slow sales, then offered the rebates and reinforced customers’ wait-and-see behaviors. The second negative of sales promotions is that they have a way of demeaning the image of the product or service. A sales promotion implies that without it people would not be interested in buying the product. To buyers who are concerned about brand image and status, frequently and carelessly used promotions raise doubts.

Sales forecasting is the intersection of marketing research and marketing efforts. It is the first step in determining whether the new venture can and will be profitable. Thus, as we saw in Chapter 5, the sales forecast is the logical conclusion to the marketing analysis and the very first part of financial analysis.

Two broad techniques for forecasting sales are available data-based methods and judgmental methods. Examples of data-based methods are correlation analysis, multiple regression, time series analysis, and econometric models. Examples of judgmental models are sales force estimates, executive consensus, historical analogies, and “intention-to-buy” surveys. Most of these methods are appropriate for larger firms in well-established markets. The best guess at next year’s sales is almost always last year’s sales. But knowing this does not do the new venture much good.

A method that combines elements of both judgmental and data-based techniques, that is useful for new ventures, and that provides important insights into the finan-
cial consequences of the forecast is the market-potential/sales-requirement (MP/SR) method. This method provides two different perspectives for the venture—likely sales and needed sales. The market-potential technique is a “top-down” method. It looks at the big-picture market. The sales-requirements technique is a “bottom-up” exercise. It starts with the firm’s costs and expenses and builds up to the sales needed.

**FIGURE 6–4 Market-Potential/Sales-Requirement Approach**

1. Determine market potential
2. Define the target market or segment
3. Define trade area and venture reach
4. Estimate market potential:
   1. Number of customers
   2. Purchase frequency
   3. Total expenditures
5. Derive sales requirements
6. Estimate fixed asset costs
7. Estimate one-time start-up expenses
8. Estimate operating expenses—fixed and variable costs
9. Compare market potential to sales requirements. Factor in competitive reactions, market growth, competitive advantages.
10. Revise?
   - Yes:
     - Market potential: Target market? Trade area?
   - No:
     - Prepare forecast
       1. Optimistic
       2. Pessimistic
       3. Most likely
   - Yes:
     - Sales required: Investment? Operating plan?

for profitability. These techniques can be conducted simultaneously. Figure 6–4 illustrates the two techniques diagrammatically. The emergency medical center (EMC) case in the appendix to this chapter provides a detailed example of how the MP/SR method works.

In the EMC case, the owner’s first step was to determine the market potential for the emergency health-care facility. Trade association data and guidelines were used to help estimate the market targets and average incidents of usage. Census data provided the total population and number of households. The chamber of commerce was consulted to determine the direction of population trends. From this information the total number of patient visits per year was forecast. The second step in the process was to determine sales requirements and break-even for the EMC. Fixed-asset costs for the building and medical equipment were developed from quotes from local suppliers. One-time start-up expenses were estimated from the owner’s previous experience. Estimates of operating expenses, both fixed and variable, were made from supplier data and from the owner’s experience.

Since the essence of the sales-requirements approach is to develop a sales budget, the break-even number of patients was calculated. The third step was to forecast the likely market share. If the share were forecast above the break-even estimate of sales, the project was feasible. EMC estimated that a 25-percent market share was required. Determining whether this was realistic was a complex question incorporating analysis of competitive advantages and likely responses by competitors. At this point in the process the decision was made to raise the price per visit, thereby lowering the break-even point and the market share required.

Step 4 was to prepare the forecasts. Three forecasts were developed: an optimistic forecast showed the profitability with break-even at 6 months, a conservative but likely forecast had break-even within 10 months, and the pessimistic forecast delayed break-even market share until month 14.

Although the future is always uncertain, the forecasts did lead the owner to a hard look at the market and the firm’s cost structure, and to a change in its pricing scheme. The forecasts provided a rational basis for negotiating credit and bank financing. And it gave the venture a set of performance standards that can be used to evaluate progress.

**Summary**

Marketing and entrepreneurship interface in a number of ways, with marketing being key to the success of any new venture. It is important for the new venture to take a total marketing approach to the customer and attempt to design a business system that ultimately can provide a high level of customer satisfaction.

Marketing research need not be extensive, sophisticated, or expensive, but it must determine what customer satisfaction means for the target market. Marketing research also provides other critical information about the target market that can be used to develop marketing strategies and activities. These activities—pricing, product/service decisions, promotion, and distribution—form the core of the venture’s marketing effort. Because these activities are complex and the relationships between them ambiguous, the marketing strategy, organization, and resources can be a source of sustainable competitive advantage.
Sales forecasting is the bridge between the venture’s marketing decisions and its financial decisions and outcomes. The sales forecast represents the “top line” of the venture’s financial picture. Both a bottom-up and top-down approach to sales forecasting should be employed to produce a range of forecasts that indicate the prospects for venture success or failure.

Key Terms

- Customer satisfaction
- Marketing research
- Concept testing
- Product testing
- Market testing
- Secondary sources
- Diffusion process method
- Halo effect
- Marketing strategy
- Market segmentation
- Skimming the market
- Preemptive pricing
- Sherman Act
- Truth in Lending Act
- Robinson-Patman Act
- Clayton Act
- Product mix
- Product width
- Product depth
- Product consistency
- Service intensity
- Service extensiveness
- Public relations
- Market-potential/sales requirement (MP/SR)

Discussion Questions

1. In what two ways does marketing contribute to new venture success?
2. Discuss the marketing-entrepreneurship interface. What are the points of similarity, differences, and potential pitfalls?
3. What questions can marketing research help answer for the entrepreneur?
4. What are the steps in conducting market research?
5. Compare and contrast concept testing, product testing, and market testing.
6. Describe the diffusion process. How can the entrepreneur use this knowledge to design effective marketing campaigns?
7. What are the bases for market segmentation?
8. What are the pluses and minuses of the following pricing tactics?
   a. Skimming the market
   b. Exploiting the experience curve
   c. Meeting the market
   d. Achieving maximum penetration
   e. Establishing preemptive pricing
9. How do the product and service configurations influence the marketing strategy?
10. What are the key elements of promotional activities?
11. Describe the market-potential/sales-requirement forecasting method. What are its benefits and costs?

Exercises

1. Develop a list of questions that you would like answered regarding the marketing of your product or service described in your business plan. Prioritize the questions from “required to know” to “would be nice to know.” Using the six-step process described in the chapter, conduct market research to answer these questions. Start with the highest-priority and work towards the lowest-priority question. If you run out of resources (time, money, cooperation), you may stop.
2. Develop the marketing section for your business plan. Discuss customer orientation, marketing strategy, and
tactical decisions such as price, product/services offered, distribution, and promotion.

3. Develop sales forecasts for your business plan. Develop three scenarios: pessimistic, optimistic, and most likely. What level of sales is required for break-even? Review your marketing strategy for consistency with the sales forecast.

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**DISCUSSION CASE**

**A Serving of Aura, Well Done**

In 1992, 29-year-old Tom Baron laughed when one of Pittsburgh’s weekly newspapers named the fast-food chain Chi Chi’s as the best Mexican restaurant in town. He couldn’t resist calling his high school buddy Juno Yoon in Colorado to share a chuckle over the story. “That’s pathetic,” agreed Yoon. “We can do that.”

Neither Baron nor Yoon had ever been to Mexico, and their joint business experience was a midtown Manhattan coffee shop that failed after eight months. But that didn’t stop the two of them from raising $90,000 from family, charge cards, and bank loans to open Pittsburgh’s Mad Max Mexican restaurant, or keep them from building a mini-empire of seven restaurants which has posted $6.8 million in sales after just 3 years of business.

Although technically they are in the food business, Baron and Yoon have made their success serving up image and attitude to customers who are tired of the cookie-cutter chains. Each of their restaurants serves an ethnic or exotic cuisine, and has a unique and funky decorative theme. “We’re hoping to create an aura,” explains Mr. Yoon. Mad Max’s southwestern decor features wooden bar stools with carved cactuses and green lights inside the legs. The rock music blares, and the bar serves an assortment of microbrew beer not usually available in Pittsburgh. The first Mad Max (there are now two) opened at a prime location close to a university and major medical centers, so there’s a steady stream of young image-conscious customers every night.

Baron and Yoon started out as real hands-on entrepreneurs. They helped tear down walls to build their first Mad Max, rolled burritos in the kitchen, and even drove the van to pick up their beer from a distributor four hours away. The hard work and long hours paid off when a student from the University of Pittsburgh brought her father and his business partner in for lunch one day. The two men, who comanaged a $4 million real-estate investment fund, liked the restaurant and its owners enough to pledge their assets as collateral for new financing, which led to the opening of the second Mad Max. Today Baron and Yoon’s Big Burrito Inc. partnership has bank loans totaling $1.6 million, and hopes to secure financing of $5 to $7 million to enable future expansion.

The restaurant entrepreneurs toured trendy eateries in New York City before developing the concept for Soba, their newest pan-Asian restaurant, which features red-velvet couches along the walls, extra-large candles for lighting, and two-story windows. Their empire also includes the Caribbean-style Kaya, the eclectic Vertigo (where the menus are covered in fur), and the campy Mr. Jones, which specializes in home-cooked meatloaf and mashed potatoes.
Baron and Yoon are hands-on managers, too. They report that some of their best ideas come from informal market research over drinks with customers. They continue to read every customer comment card, and sometimes pick up the phone to personally respond to a complaint. They’re still actively involved in planning the decor and advertising for their restaurants, and work to fine tune any concept that isn’t working. When weeknight business at the Mr. Jones restaurant lagged, they revamped the menu, added kids’ meals, and distributed discount coupons to local video, book, and appliance stores.

While all of Baron and Yoon’s restaurants are currently making money, and attract long lines of customers every night, they’re still aware that they’re riding the crest of a risky business. “People wonder, ‘Is the next (restaurant) going to fail and take down the whole house of cards?’” says Mark Riley, Big Burrito’s controller. Start-up restaurants often experience high-volume sales and rapid expansion, but sometimes end up with no profits. Three out of ten new restaurants close in the first two years, and according to the Pennsylvania Restaurant Association, half of those who survive don’t make it past three years.

But these unlikely restauranteurs appear to have beaten the statistics with their copy-what’s-hot-in-New-York approach. Big Burrito, Inc. hopes to expand to both Philadelphia and Columbus, Ohio in the near future, and may even make an initial public offering of stock soon.

CASE QUESTIONS

1. What entry wedge (Chapter 4) are these entrepreneurs using?
2. What marketing strategies are used in this case?
   • segmentation
   • pricing
   • promotion
   • product
   • location
3. What strengths and weaknesses do you see in this strategy?
4. Would you invest in this business’s expansion? Why or why not?


Notes

6. There are many fine marketing text-


12. One of the best guides is G. Breen and A. B. Blankenship, *Do-It-Yourself Marketing Research*, 2nd ed. (New York: McGraw-Hill, 1982). It covers almost every marketing research problem and offers practical advice on how to collect and analyze information. Especially appealing are the examples of surveys, telephone scripts, and cover letters for urging participant response. In addition, most marketing textbooks have some guidelines and describe techniques for marketing research. However, in the vast majority of cases, these guidelines and techniques are appropriate for large firms with established products.


30. This follows Kotler, 1991.
tional medical facilities. They proposed the construction of a single-story building on the site and offered to finish a 2,000-square-foot section to Dr. Petrillo’s specifications. A three-year lease with renewal options at an annual rental of $7.50 per square foot was available. Dr. Petrillo required a sales forecast for the venture in order to make a decision regarding the expansion and, if the decision was positive, to negotiate with a bank and an equipment leasing firm.

**STEP 1: DETERMINING MARKET POTENTIAL**

**Target Market.** The market for ambulatory health care includes the entire population. All people are subject to both minor injuries such as cuts, sprains, or fractures, and to minor illnesses such as colds and flu.

Consultants to the industry and the National Association of Free-Standing Emergency Centers (NAFEC), the industry trade association, focus on a more narrowly defined target market. They report that the primary targets for EMC services are families with young children, working women, and individuals with no regular physician. While these refinements will be of value in designing and placing advertising messages, it is best to consider the total population as the target market for feasibility purposes.

**Trade Area.** The city is a small community. The proposed site can be reached in 10 to 12 minutes driving time from anywhere within the city limits. The site is on the opposite side of town from the general hospital. Virtually none of the population would have to drive past a competitor to reach the EMC site. Hence, the trade area is defined as the entire city.

**Market Potential.** The 1980 census of population reports that the city and immediate residential areas were the homes of 27,531 people. The residents make up 8,924 households. The town has enjoyed substantial growth over the decade from 1970 to 1980. The number of housing units grew 55 percent over the decade. This is a positive sign, in that the people relocating to the area are less likely to have established physician relationships. Based on discussions with city officials and members of the Chamber of Commerce, growth is believed to have continued, but at a slower rate, during the 1980s.

In terms of market potential, NAFEC estimates that on the average, individuals experience between one and two incidents of minor trauma or illness per year. Based on assumed rates on population growth, estimates of total market potential in terms of patient visits can be developed.

<table>
<thead>
<tr>
<th>EXHIBIT 2</th>
<th>Logan Total Patient Visits Based on Growth and Annual Incident Assumptions (1984)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Population Growth</strong></td>
<td><strong>Average Visits per Person-Year</strong></td>
</tr>
<tr>
<td></td>
<td><strong>1</strong></td>
</tr>
<tr>
<td>1.0% (pessimistic)</td>
<td>28,649</td>
</tr>
<tr>
<td>2.5% (likely)</td>
<td>30,389</td>
</tr>
<tr>
<td>4.0% (optimistic)</td>
<td>32,207</td>
</tr>
</tbody>
</table>
The Emergency Medical Center was founded by Dr. Anthony Petrillo as a free-stand-
ing emergency center (FEC). The FEC concept, which was relatively new at the time, is a cross between a physician’s office and a hospital emergency room. The typical FEC offers extended hours (8:00 am to 11:00 pm), has lab and x-ray facilities, and will treat any non-life-threatening trauma or medical problem on a no-appointment basis.

The EMC opened in 1982 and grew rapidly its first year. When Dr. Petrillo was informed that a good location in another section of the same city had become available, he considered opening a second office. From a study of traffic patterns and population density in the area, proximity to area hospitals, and the sales experience in EMC #1, sales forecasts for EMC #2 were prepared. After leasehold improvements, equipment costs, and operating expenses were estimated, the decision was made to open EMC #2.

The facility was opened with a fanfare of advertising and press releases. Sales immediately exceeded the first month’s forecast. After several months of continued growth, sales (that is, patient visits) leveled off at a point below break-even. Forecasted growth did not occur, and cumulative operating losses were mounting. Remedial action, in the form of intensified media advertising, was taken. A personal selling program directed at business establishments was started in an effort to treat more work-related injuries. Neither effort stimulated the necessary growth. Less than one year after opening, EMC #2 was determined to be a failure, and operations were consolidated with the original and still successful EMC #1.

Nonetheless, multiple sites offered important economic advantages in advertising, supply ordering, and management. Consequently, Dr. Petrillo continued to search out feasible locations for a second EMC facility.

A real estate developer contacted Dr. Petrillo concerning a site being developed in a small town about 22 miles outside the headquarters city of EMC. The site was at the intersection of an interstate and a state highway and offered excellent visibility. The town had one general hospital, a student health service on the campus of a university, and about 18 private physicians’ offices. The developer and several of his financial backers felt that the growth of the community had created the need for addi-

<table>
<thead>
<tr>
<th></th>
<th>Exhibits 1</th>
<th>Population Projections Based On Various Growth Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Annual Growth</td>
<td>Annual Growth</td>
</tr>
<tr>
<td></td>
<td>(pessimistic)</td>
<td>(likely)</td>
</tr>
<tr>
<td>1980</td>
<td>27,531</td>
<td>27,531</td>
</tr>
<tr>
<td>1981</td>
<td>27,806</td>
<td>28,219</td>
</tr>
<tr>
<td>1982</td>
<td>28,084</td>
<td>28,925</td>
</tr>
<tr>
<td>1983</td>
<td>28,365</td>
<td>29,648</td>
</tr>
<tr>
<td>1984</td>
<td>28,649</td>
<td>30,389</td>
</tr>
<tr>
<td>1985</td>
<td>28,935</td>
<td>31,149</td>
</tr>
<tr>
<td>1986</td>
<td>29,225</td>
<td>31,928</td>
</tr>
<tr>
<td>1987</td>
<td>29,517</td>
<td>32,726</td>
</tr>
</tbody>
</table>
Total patient visits for 1984 are estimated to be somewhere between 28,649 and 64,414. This is a rather broad interval, perhaps too broad to be of use. The middle column of Exhibit 1 represents a more reasonable interval. Based on an average incident rate of 1.5 per person-year, total market potential for the area would be estimated at 43,000 to 48,000 patient visits per year (Exhibit 2).

**STEP 2: DERIVING SALES REQUIREMENTS**

**Fixed-Asset Requirements.** Fixed assets required for the site are entirely equipment costs. Leasehold improvements such as plumbing modifications and remodeling will be avoided due to the developer’s new construction. The required equipment includes both medical equipment and standard office furniture and equipment.

Local medical supply and office supply dealers were the source of price estimates presented in Exhibits 3 and 4. These dealers are familiar with the used equipment markets in the area. Price estimates reflect a mix of new and used equipment. Total fixed asset requirements are estimated at $64,500.

**Deriving Sales Budgets.** The essence of the sales requirements approach is to develop a sales budget necessary to support the business. The break-even sales budget is easily calculated from Exhibit 5-6. Estimated monthly fixed operating expenses are $26,350. The average patient charge at the original EMC is $37.00. Assuming the charge would average the same amount at the new facility, each patient visit will contribute $31.63 to these expenses ($37.00 minus $5.37 variable expenses). Therefore, a total of 833 patient visits per month will be required to break even ($26,350/$31.63). The break-even point is graphically displayed in Exhibit 7.

The break-even computation ignores financing costs. Regardless of the sources of capital used, a rate of return must be earned. If Dr. Petrillo personally supplies all the capital, he will require a rate of return. If in fact the required capital is borrowed

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**EXHIBIT 3  Medical Equipment Requirements for Proposed EMC Facility**

<table>
<thead>
<tr>
<th>Medical Equipment ($51,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Laboratory ($6,000)</strong></td>
</tr>
<tr>
<td>Refrigerator X-ray system</td>
</tr>
<tr>
<td>Microscope Processor</td>
</tr>
<tr>
<td>Blood gas analyzer Float table</td>
</tr>
<tr>
<td>Autoclave Bucky table</td>
</tr>
<tr>
<td>Stain tray</td>
</tr>
<tr>
<td>Urinometer</td>
</tr>
<tr>
<td>Centrifuge</td>
</tr>
<tr>
<td>Microcrit reader</td>
</tr>
<tr>
<td>Incubator</td>
</tr>
<tr>
<td><strong>X-ray ($30,000)</strong></td>
</tr>
<tr>
<td>Trauma stretchers</td>
</tr>
<tr>
<td>I.V. stands</td>
</tr>
<tr>
<td>EKG</td>
</tr>
<tr>
<td>Oxygen</td>
</tr>
<tr>
<td>Suction unit</td>
</tr>
<tr>
<td>Suture sets</td>
</tr>
<tr>
<td>Ambu bag</td>
</tr>
<tr>
<td>Wheelchair</td>
</tr>
<tr>
<td>Crash cart</td>
</tr>
<tr>
<td>Head lamp</td>
</tr>
<tr>
<td>Surgical table</td>
</tr>
<tr>
<td>Cast cutter</td>
</tr>
<tr>
<td>Defibrillator</td>
</tr>
<tr>
<td>Woods lamp</td>
</tr>
<tr>
<td>Laryngoscope</td>
</tr>
</tbody>
</table>
from a commercial bank or an equipment leasing firm, the facility must generate revenues sufficient to cover interest expenses. The required capital investment includes medical equipment ($51,000—Exhibit 3); office equipment ($13,500—Exhibit 4) and nonrecurring start-up expenses ($17,729—Exhibit 5). In addition to these capital requirements, operating expenses in the early months will exceed revenue. If we establish, as a reserve, three months of operating expenses, approximately $80,000 in additional capital will be required. Total start-up capital is, therefore, estimated at $162,229. At a cost of capital of 18 percent, the facility will have to generate an additional $29,201 per year or $2,433 per month to cover its capital costs.

Break-even patient visits have been estimated at 833 patients per month. The sales budget to break even and cover anticipated capital costs would require 910 patients per month ($26,350 + $2,333)/$31.63).

STEP 3: JUDGING LIKELY MARKET SHARE

A comparison of the results of Steps 1 and 2 indicates that of an estimated 43,000 to 48,000 annual patient visits in the trade area, EMC must capture a 23 to 25 percent market share to break even and cover its cost of capital. This share represents substantial market penetration. The question facing Dr. Petrillo is, how likely is it that EMC could achieve such a market share? This is, of course, a complicated question. In order to formulate an answer, judgments regarding patient reactions and competitive reactions must be made.
EXHIBIT 6  Estimated Monthly Operating Expenses for Proposed EMC Facility

**Fixed Expenses**

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising</td>
<td>$2,000</td>
</tr>
<tr>
<td>Rent/utilities*a</td>
<td>1,500</td>
</tr>
<tr>
<td>Legal/accounting</td>
<td>200</td>
</tr>
<tr>
<td>Manager salary</td>
<td>1,600</td>
</tr>
<tr>
<td>Nonphysician salaries</td>
<td>8,050b</td>
</tr>
<tr>
<td>Physician salaries</td>
<td>10,000</td>
</tr>
<tr>
<td>Postage</td>
<td>200</td>
</tr>
<tr>
<td>Security/housekeeping</td>
<td>250</td>
</tr>
<tr>
<td>Telephone</td>
<td>250</td>
</tr>
<tr>
<td>Depreciationc</td>
<td>1,075</td>
</tr>
<tr>
<td>Sundry</td>
<td>1,225</td>
</tr>
</tbody>
</table>

Total Fixed Expenses $26,350

**Variable Expenses**

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malpractice Insurance</td>
<td>$.70 per patient</td>
</tr>
<tr>
<td>Suppliesd</td>
<td>4.67 per patient</td>
</tr>
</tbody>
</table>

Total Variable Expense Per Patient $5.37

*a$1,250/month rent + $250/month average utility expenses.
*bEstimated at 115 percent of salaries to cover FUTA, FICA, workmens’ compensation, and state unemployment.
*cFixed assets of $64,000, straight line, 5-year life (60 months).
*dEstimated from experience at EMC #1.

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EXHIBIT 7  Break-Even Analysis for EMC Facility at Logan

Revenue @ $37/patient

BEP = 833 patients

Fixed Costs $26,350

Monthly dollar volume

Patient volume/month
**EMC Competitive Advantages.** EMC offers convenient service without the usual appointment necessary for a doctor’s office, or the usual wait at a hospital emergency department. Due to lower overhead expenses, EMC is less expensive than a hospital on virtually all procedures. The combined advantages of economy and convenience have contributed to a favorable reception in the original EMC trade area and in other cities around the country where EMC-type facilities have been opened.

**Competition.** The trade area is served by a general hospital with an emergency department and 18 physicians’ offices. Several of the physicians’ practice specialties, such as obstetrics, are not considered direct competitors of EMC. Nonetheless, 11 of the physicians either are general practitioners or practice family medicine. The EMC sales forecast will be affected by the behavior of these competitors. Faced with the entry of EMC into the market, how are these competitors likely to react?

In rapidly growing markets, the entry of a new competitor does not usually evoke a strong competitive response. The success of the new entrant is less a function of taking market share from existing competitors than it is of meeting a growing demand. Yet only under optimistic growth projections is it conceivable that EMC could prosper serving only new residents in the proposed site. EMC must attract patients from existing medical facilities. Physicians in private practice with established patient relationships are less likely to be injured by the entrance of EMC. However, because they generally view advertising and aggressive promotion allies as inappropriate, their likely response will be to “bad-mouth” EMC and raise questions regarding the quality of care offered. The hospital, as an institution with resources, and with the most to lose if EMC should enter, is expected to react more strongly. Hospitals have recently adopted advertising programs, modified fee schedules for minor emergencies, and changed staffing and triage activities to reduce waiting time in emergency departments. In short, the hospital, if forced, has the capabilities to negate EMC’s competitive advantages.

In summary, EMC possesses some very real competitive advantages over traditional medical care providers. However, the hospital may react strongly to EMC’s entrance into the market. Faced with high fixed costs of its own, the hospital administrators will be forced to do something if EMC approaches a 25-percent market share. Dr. Petrillo feels the operating plan of the facility must be changed in order to lower the break-even market share. A review of the estimated operating expenses indicates that expenses can’t be reduced. Based on the historical costs incurred at EMC #1, Dr. Petrillo feels these estimates are accurate, and to expect lower expenses is unrealistic. This focuses attention on the fee structure. By raising the fees on certain routine procedures and lab tests, the revenue per patient visit can be raised to $41 from $37. This will lower the break-even market share to about 20 percent. This is considered an achievable level of penetration.

**STEP 4: PREPARING THE FORECASTS**

Due to the uncertainty surrounding the new facility, Dr. Petrillo and the EMC staff prepared three separate sales forecasts based on different assumptions of growth in the average number of patients treated per day. An optimistic forecast assumed that the break-even number of patients per day would be reached in the sixth month of op-
eration. A pessimistic forecast assumed it would take 14 months to reach break-even patient flow, and a conservative but likely forecast assumed month 10 to be the break-even month.

Exhibit 8 is the sales forecast for the optimistic case. Once sales revenue is estimated, it is a fairly straightforward task to project the estimated cash flows. Similar forecasts were prepared for the pessimistic and likely break-even cases. By adding interest expenses into fixed costs, the same series of forecasts could be developed reflecting the costs of capital performance level as opposed to the break-even performance level. Having gone through this forecasting effort, Dr. Petrillo commented:

The forecasting activity has provided us with a couple of advantages. First, it forced us to look hard at the market, the competition, and our costs structure. It also forced us to modify our fee schedule in light of those conditions. Second, it gave us a rational basis for negotiating a line of credit with our bankers. They can see where the money is to go, how much we will need, and at what rate we will be able to pay the line down. Finally, the forecasts set some standards by which we can evaluate our progress. If we’re behind our forecast come month 4 or 5, I know I’ll have to get our credit line raised, and intensify our promotion efforts. It also gives my managers some targets to shoot for regarding expenses.

This case was written by Kenneth E. Marino for his book, *Forecasting Sales and Planning Profits* (Chicago: Probus, 1984). It is reprinted here with the generous permission of its author.