Feeling the Heat

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More than ever before, marketing is under fire to account for what it spends.

By Jagdish N. Sheth and Rajendra S. Sisodia

EXECUTIVE BRIEFING

Concluding that marketing has overspent and underdelivered, top management now expects other business functions to perform more marketing tasks. CEOs are demanding that marketers prove their worth or be gradually starved of resources. These pressures, coupled with a strong tendency toward "business as usual," spell a productivity crisis in marketing that cannot be ignored. In this first of a two-part series, the authors define marketing productivity and outline a concrete plan for improvement that focuses on horizontal and vertical collaboration and ways to rationalize different elements of the marketing mix.

As a corporate function and a societal institution, marketing is increasingly being regarded as a "necessary evil" rather than a value-creating activity, focusing renewed attention on its productivity. That customers today have a great variety of high-quality products and services available at reasonable prices is attributable, in part, to marketing's ascendancy in the modern corporation. Yet in many companies, the marketing function appears to consume a disproportionately high share of resources, inviting intense scrutiny from corporate cost-cutters. (See "The Productivity Crisis in Marketing" on page 10.)

Furthermore, at a macro level, the correlation between the level of marketing spending and overall financial performance or competitive position is low. Many firms are even getting negative returns on incremental marketing spending.

Because marketing must contend with the uncertainties associated with managing external forces, such as customers and competitors, it has some inherent characteristics that confound measurement. If it's true that "you cannot improve what you cannot measure," then we may never see

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The Productivity Crisis in Marketing

Every business comprises three broadly defined areas: marketing, management, and manufacturing or production—colloquially speaking, the "finders, minders, and grinders." In the quest for greater efficiency and higher quality, the latter two functional areas have undergone fundamental, frequently wrenching changes in the past few decades:

• Manufacturing/production has become substantially more efficient (through automation, the use of just-in-time approaches, product redesign for assembly and manufacture, flexible manufacturing systems, service process blueprinting, and so on) and quality-focused. As a very rough estimate, manufacturing now accounts for about 30% of total corporate costs, down from approximately 50% after World War II.

• "Management" (defined here to include finance, accounting, human resources, and support functions such as legal departments and R&D) has raised its efficiency through "downsizing," "rightsizing," outsourcing, and business process re-engineering. As a result, the approximate share of corporate costs attributable to management has fallen from 30% to 20%.

• That leaves about 50% for marketing (up from 20%), including the costs of product development, outbound logistics, order fulfillment, selling, distribution, advertising, sales promotion, public relations, customer service, and so on.

Marketing costs more today, but it also carries more of the competitive burden. The marketing function's importance—along with the size of its budget—is increasing as companies face higher levels of competition in increasingly global markets. Its exalted status as the generator of corporate revenues, profitability, and visibility often shielded marketing from the deep cuts other departments have endured in the past decade. Indeed, though marketing is the biggest discretionary spending area in most companies, many wish they could devote even more resources to it.

But marketing's heyday may soon be over. In fact, there are already clear signs that CEOs are demanding major cost savings and a higher level of accountability from marketing than ever before. Numerous companies are downsizing the sales force and closing regional sales offices; others are downsizing the headquarters marketing function and transferring marketing personnel and functions to the sales force. In many companies, other functional areas have adopted more outward-looking customer orientations with the expectation that they will do so more effectively and economically. For example, marketing's two major traditional areas of focus—competition and customers—are now the primary concerns of strategic planning and business operations, respectively.

Improving marketing productivity has become a major concern, for several additional reasons:

• As market orientation increases, the cost of marketing goes up. More companies in more industries are becoming more market-driven (because of deregulation, privatization, greater competition, and technological change), adding huge cost centers. For example, marketing costs in the telecommunications, banking, electric utility, and health care industries have been rising rapidly as these industries move toward unfettered competition.

• A major driver of new thinking in marketing has been a dramatic surge in the sales of private label products. The growing success of such products in Europe and the United States suggests that the value-added by intensive (and expensive) marketing programs is often not sufficient to justify a price premium. This has spurred a heightened interest in what has been called "lean marketing."

• Marketing is not done just in the marketing department anymore but dispersed across all the functions. The question of who is responsible for marketing and how to account for it has become an increasingly important issue.

• There is an enormous degree of cross-subsidization across accounts in marketing; a few highly profitable accounts often hide the inefficiency in serving the rest. Such a marketing system is highly vulnerable to bypass or cherry-picking.

• Many marketing phenomena are still not accurately measurable. Without reliable measurement, meaningful improvements in efficiency levels are extremely difficult to achieve. Marketing is beginning to resemble manufacturing in the "pre-quality" days. Whereas the TQM philosophy resolved many of manufacturing's problems, a similar change still awaits marketing. Although a few writers have discussed the concept of "total quality marketing," the idea is still largely unexplored.

—Jag Sheth and Raj Sisodia

the dramatic improvements experienced in manufacturing. But it's still possible for marketing productivity to soar beyond historical levels.

In the past, marketing productivity was viewed purely in terms of efficiency. Early attempts at improvement focused predominantly on minimizing costs. This was driven, in part, by the recognition that it was difficult to measure the output of marketing adequately. But it was also driven by an implicit belief that marketing did not create value in any tangible sense and, hence, was an activity on which the minimum necessary amount of resources should be expended.

Today we have ample evidence that judiciously expended marketing resources can be tremendously productive. For example, the return on $1 of

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advertising for AT&T's early "Reach out and touch someone" campaign (when the company still had a dominant market share in the long-distance telecommunications market) was estimated to be over $4, most of it profit. John Little's advocacy in the late 1970s of "response reporting" was mainly done in this spirit; by determining the elasticity of sales and profits to various marketing stimuli, marketing resources could be expended in a highly productive manner.

As Robert Buzzell pointed out in his seminal dissertation on marketing productivity, marketing does not produce anything; it performs functions around goods and services, making productivity very difficult to measure. Furthermore, many functions performed by marketing become sufficiently routine over time that they are absorbed into other functional areas. For example, many food products used to be sold in bulk to retailers, who would then sell to customers in smaller packages. When manufacturers began shipping their products in multiple sizes, a marketing function became a manufacturing function. In the long term, this type of shift can create the illusion that marketing productivity is diminishing. (See "How We Got Here" on page 14.)

Because marketing initiates most manufacturing changes, this "problem" could become even more acute in the future. As companies adopt mass customization approaches, many more of marketing's value-added contributions likely will be performed by manufacturing.

Measuring Productivity

These challenges notwithstanding, there is so much to be gained from improvements in marketing productivity that even imperfect measurements can be of great value. However, we must measure the right things: otherwise, our attempts at improvement will, by definition, be misdirected.

Traditionally, productivity has been measured in terms of the *quantity* of output for a given amount of input. However, such measures are unsatisfactory in that they fail to adjust for changes in the *desirability* of the output. In an often-cited example, the output of a steel mill is measured in "tons of steel," disregarding the fact that the quality and value-added of such steel may increase substantially over time.

The Intangibles Factor

This problem is especially acute for marketing measurements because marketing deals with so many intangibles. To address it, we suggest that marketing productivity be defined as the amount of desirable output per unit of input; in other words, output should be measured in terms of quality as well as quantity.

The productivity of a salesperson, for example, is more than the number of sales calls made or even the number of transactions that result. It also includes the effectiveness of those sales calls (that is, their long-run impact on the relationship with those customers), the profitability of the resulting transactions, and the impact of today's business mix on the future. Likewise, a productive advertisement could be defined as one that maximizes the quality-adjusted amount of positive exposure for a given budget.

Ultimately, the desired output of marketing can be stated in simple terms: acquiring and retaining customers profitably. A good measure of marketing productivity, therefore, must include the economics of both customer acquisition and retention.

Acquiring customers. This measure consists of the revenues attributable to marketing actions that bring in new customers, divided by the costs of those actions, adjusted by a customer satisfaction index (CSI). This formula reflects the idea that highly satisfying exchanges, rather than "hard sell" techniques or deceptive advertising, form the basis of new customer acquisitions. Overpromising and then underdelivering on heightened expectations usually leads to customer dissatisfaction.

Retaining customers. Because retaining a customer requires more than maintaining high satisfaction, we suggest adjusting the measure of revenues/costs for existing customers by what we call a customer loyalty index (CLI). Even ostensibly satisfied customers can be induced to switch to a rival unless they have been strongly bonded to a firm's offering. The CLI addresses customer "churn," which is a significant problem in a number of industries today. See Exhibit 1 on page 12.

Effective Efficiency

Using this method, the overall marketing productivity for a firm would be a weighted combination of the productivity of customer acquisition and customer retention. The weights should reflect the relative importance of acquisition and retention according to the company's objectives. For example, a startup firm in a growing market would place greater relative emphasis on acquisition, whereas an established firm in a slow-growing market might be primarily concerned with retaining its best customers.

In this broader sense, marketing productivity includes both the dimensions of efficiency (doing things right) and effectiveness (doing the right things), as depicted in Exhibit 1. Ideally, the marketing function should generate satisfied cus-

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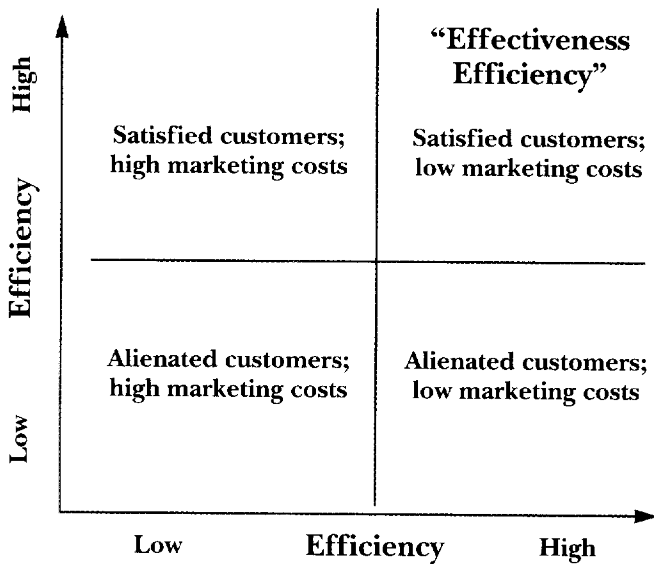
EXHIBIT 1

Marketing efficiency and effectiveness



tomers at low cost. Too often, however, companies either create satisfied customers at unacceptably high cost, or alienate customers (as well as employees) in their search for marketing efficiencies.[1] In far too many cases, the marketing function accomplishes neither. (See "Symptoms of Marketing Malaise" on page 18.)

To make the necessary improvements, we first must adopt a broader view of productivity. Marketing must pursue the ideal of "effective efficiency" in all of its programs and processes; neither objective is adequate by itself.

Achieving Balance

To a certain extent, marketing's productivity problem is simply due to poor marketing; in other words, companies often fail to apply marketing concepts in a balanced manner. Too many, for example, emphasize capturing market share over growing the market—a crucial distinction that leads to an escalating spiral of misapplied marketing dollars and heavy competitive retaliation.

Likewise, many companies demonstrate a poor understanding of how the elements of the marketing mix interrelate and deploy excessive resources on some aspects to the detriment of others. For example, if a company misses the fact that its "weak link" is inadequate market coverage, it might lower prices or end up squandering excessive resources on advertising.

A good business strategy makes marketing much easier and productivity much more achievable. By the same token, even the most productive and enlightened marketing efforts cannot compensate for a flawed strategy in the long run. Marketing can thus be an uphill battle or downhill glide, depending on how sound the business strategy is.

For example, Southwest Airlines has spent far less on marketing over the years than its rivals have, yet it has outperformed them on every measure. That is because Southwest recognized that it didn't have to spend heavily to push a message that is intrinsically attractive to a large and growing part of the market. The airline also has been highly consistent in its marketing efforts over the years and advertises on local, rather than national television to avoid reaching markets where it has no presence. In the markets that it does serve, Southwest's market share now tops 60%.

In contrast, US Air has struggled mightily to compete as a full-line national player, fighting the "Big Three" on one front while staving off regional players such as Southwest and ValueJet on another. US Air's marketing resources are spread thinly, and the company has lost huge amounts of money.

Beyond correcting such fundamental marketing mistakes, we have identified 20 ways to improve marketing productivity and classified them into four broad categories: collaborating, rationalizing, "informationalizing", and managing.

Collaborating

Several collaborative marketing approaches help improve productivity. In particular, three of these approaches—partnering, relationship marketing, and marketing alliances—allow for greater resource efficiency as well as improved customer satisfaction.

Partnering

When buyers and sellers agree to work together, they can achieve dramatic gains in distribution and marketing efficiencies. "Partnering" between members of a value chain, such as retailers and manufacturers, represents a major departure from their traditionally antagonistic relationship; both become part of a single process—distributing products to customers—which technology can greatly streamline and simplify. For example, Black & Decker describes its new distribution philosophy as "Sell one, ship one, build one." Inventory is pulled through the system rather than pushed down, resulting in much lower average levels of inventory, coupled with higher levels of product availability for customers.

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Maintaining such availability is key; when a customer does not find a desired product on the shelf, the manufacturer not only loses the margin on that sale, but also presents a rival with a free customer trial.

Through partnering, buyers and sellers reap the advantages of vertical integration without the attendant drawbacks—sometimes referred to as "virtual integration." With its roots in the apparel industry's "quick response" (QR) movement, partnering is known as "efficient consumer response" (ECR) in the grocery business. A Food Marketing Institute report on ECR says that it has the potential to reduce inventory by 41% and save $30 billion a year. The ECR system is based on timely, accurate, and paperless information flow between suppliers, distributors, retail stores, and consumer households. Its objective is to provide a "smooth, continual product flow matched to consumption," focusing on the efficiency of the total supply system, rather than any of its components.

According to the report, four ECR strategies contribute to performance improvements: efficient store assortments, replenishment, promotion, and product introductions (see Exhibit 2). In addition to cost savings, ECR also provides important intangible benefits to the consumer (increased choice and shopping convenience, reduced out-of-stock items, fresher products), the distributor (increased consumer loyalty, better consumer knowledge, improved supplier relationships), and the supplier (reduced stockouts, enhanced brand integrity, improved distributor relationships).

The impact of ECR on the grocery business is expected to be dramatic, similar to the impact the QR movement has had in the general merchandising industry.

Central to such partnering arrangements are the enabling technologies of barcoded product identification and electronic data interchange (EDI), along with the re-engineering of business processes both within as well as across firms in the value chain. The systems improve efficiencies and customer service, primarily by replacing physical assets with information. They reduce the retailer's inventory while providing a supply of merchandise that is closely coordinated with the actual buying patterns of consumers.

These systems also allow retailers to make purchase commitments closer to the time of sale and deploy resources previously tied up in inventory to increased advertising, new product lines, or the bottom line. The result is a win-win-win: Consumers consistently find the merchandise they want in stock (often at lower prices); suppliers increase sales, lower costs, and cement ties with retailers; and retailers gain increased sales and inventory turns and more satisfied customers.

Relationship Marketing

Related to partnering, but one step short, is relationship marketing—long-term, mutually beneficial arrangements in which both the buyer and seller focus on value enhancement through the

EXHIBIT 2

Efficient consumer response strategies

Strategy	Objective	Major impact areas
Efficient store assortments	**Optimize the productivity of inventories and store space at the consumer interface**	**Increased sales and gross margin per retail square foot, increased inventory turns**
Efficient replenishment	**Optimize time and cost in the replenishment system**	**Automated retail and warehouse ordering, flow-through logistics, reduced damages, reduced supplier and distributor wholesale inventories**
Efficient promotion	**Maximize the total system efficiency of trade and consumer promotion**	**Warehousing, transportation, administrative, and manufacturing efficiencies; reduced forward buy supplier inventories, and warehousing expense**
Efficient product introductions	**Maximize the effectiveness of new product development and introduction activities**	**Fewer unsuccessful introductions, better value products**

Source: *Efficient Consumer Response: Enhancing Consumer Value in the Grocery Industry*, Kurt Salmon Associates Inc., 1993.

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How We Got Here

Marketing efficiency was relatively high when the consumer market was homogenous and mass media dominated. Many basic needs had not yet been met, and the intensity of competition (certainly from global competitors) was much lower. All of these conditions are now the exception rather than the rule.

From Doing Less With More...

Marketing's response to the tremendously heightened competitive intensity of the past few decades has been two-fold. Its first response was to increase expenditures on virtually every aspect of marketing, from greater and more frequent discounting to more pervasive advertising to intensified selling efforts. The second was to proliferate greater variety in products, prices, distribution channels, and so on. Each of these actions, while perhaps justifiable in isolation and on short-run considerations, contributed to making the marketing function increasingly unwieldy and expensive.

In 1980, Fred Webster of Dartmouth College interviewed the CEOs of 30 major corporations to determine their views of the marketing function. Two of the four key areas of concern were the diminishing productivity of marketing expenditures and a poor understanding of the financial implications of marketing actions. A third concern—a lack of innovation and entrepreneurial thinking—also relates to marketing's failure to address the productivity issue in new ways.

Unfortunately, in the ensuing decade and a half, not much has improved. The high-flying '80s left us with even greater marketing bloat. Rapidly expanding markets in many industries obscured underlying problems of waste and inefficiency. Now that growth has slowed, these problems are coming into sharp focus.

...To Doing More With Less

In most industries the new competitive realities are stark: Companies must deliver more performance with fewer resources in every area. Global competition and ever-savvier customers have seen to that. For example, a recent cover story in *Business Week* described the dilemma of companies that are unable to raise their prices. What was once true only for industries such as computing and consumer electronics is now hitting many industries: Customers expect real prices to fall over time while product quality continues to improve. In an era of intensified global competition, there have been plenty of suppliers ready to do just that.

"The auto industry says real costs have to come down by 2%-3% a year, or you won't be a supplier," said Corning Inc. CEO Jamie Houghton in the Jan. 17 issue of *Financial Times*. "Optical fiber has to keep coming down by 5% a year. I operate under the assumption that over time, our costs must go down 3%-5% a year in real terms." Since the 1980s, Corning has worked through eight generations of manufacturing technology for optical fiber. According to Houghton, "It wasn't long ago that we were selling fiber at $1 a meter. Now it's five cents and our margins have been good throughout."

—Jag Sheth and Raj Sisodia

creation of more satisfying exchanges. At the same time, both buyers and sellers are able to reduce their costs; buyers do it by reducing their search and transaction costs while sellers are able to lower advertising and selling expenses.

Maintaining strong relationships with customers involves fulfilling orders faster and more accurately in the short run and managing orders better in the long run. It also requires companies to be responsive to special customer needs, provide personalized service, and continuously increase value to customers over time.

Be Selective. Implied in the concept of relationship marketing is the idea of customer selectivity. It is neither feasible nor worthwhile to establish such relationships with all customers. By channeling resources into customers who can be served profitably, companies can increase marketing productivity.

The profitability of serving different customers can be analyzed using "customer retention economics." For example, data from the banking industry indicate that a customer who has been with a bank for five years is several times more profitable than one who has been with the bank for one year. Likewise, it has been estimated that automobile insurance policies have to be held five years before they turn profitable.

Reward Loyalty. Companies in a variety of industries now recognize the value of customer longevity by offering "frequent buyer" rewards. While these programs are generally inexpensive, effectiveness depends on their uniqueness and the value they provide to customers. Customer retention and overall service quality are closely linked. As evidence, three winners of the Malcolm Baldrige National Quality Award—FedEx, AT&T Universal Card and Ritz-Carlton—also are leaders in customer retention.

Most companies do not measure and monitor loyalty in any formal way; as a result, customer retention often receives inadequate budgetary support. However, this appears to be changing. Recently, consulting firm Marketing Metrics conducted a study of 165 companies and found that 53% of their marketing budgets were allocated (implicitly rather than explicitly) to customer

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retention vs. 47% for customer acquisition, reversing the figures from 1991.

"Ultimately, this will mean a shift of funds out of advertising into customer service programs," said Marketing Metrics president, Terry Vavra in the Nov. 1, 1994, issue of *Investor's Business Daily*. "The goal has shifted from gaining share of market to increasing share of the customer, intensifying his loyalty."

If marketing expenditures for a given customer don't decline over time, they are being misdirected. However, we should be careful to allocate an appropriate amount to customer retention because these customers will drive profitability. Furthermore, the nature of spending has to change over time: Dollars should be shifted away from advertising and sales promotion to consultative selling, customer business development, and logistical enhancements. Such resources could visibly accumulate in a "Customer Business Development" fund, and customers should influence how those resources are spent.

Marketing Alliances

By combining forces with another company interested in reaching a similar target market with a distinctive or complementary offering, companies can almost double the productivity of some of their marketing resources. Marketing alliances are most readily formed for advertising, selling, or distribution purposes, but they could also extend into product development or creative product bundling arrangements.

An increasingly popular type of alliance is co-branding: Kellogg's Pop Tarts made with Smucker's jam; Nabisco's Cranberry Newtons filled with Ocean Spray cranberries; Cracker Jacks packaged with Blue Diamond almonds. Benefits include greater differentiation and thus a greater ability to woo customers away from generics and private labels, the ability of two brands to attract each other's core loyal customers, and lowered costs. Co-branding can also be a way to tap into the equity in a particularly strong brand, in which case the "host" brand might pay a royalty to link itself with a strong "guest" brand.

Marketing alliances clearly improve marketing efficiency because they achieve synergy in resource utilization.

"Affinity-group" marketing is another form of marketing alliance. Under such arrangements, companies can market to a group of customers who are members of an affinity group (such as alumni of a university or members of an association), typically by developing offerings customized for the needs of that group. Marketing efforts often piggyback on the communication efforts of the affinity group.

A third type of marketing alliance is a "cross-selling" agreement. Typically, such alliances are formed between units or divisions of the same company whose separate offerings have appeal to each other's customers. For example, the credit card division of American Express works with the travel and publishing divisions of that company to cross-sell their offerings. Different divisions of a bank might sell diverse services to the same customer. Such capabilities are enhanced through shared customer information files used in database marketing.

The airline and long-distance telephone service industries have proliferated pricing schemes to such a degree that customers are confused and often resentful.

Cross-marketing agreements also can occur across different companies. For example, companies marketing complementary products on the Internet to similar groups of customers engage in "cross-linking": providing direct connections to each other's sites. In this way, companies can raise their customer throughput with little added expense.

Marketing alliances clearly improve marketing efficiency because they achieve synergy in resource utilization. They also improve marketing effectiveness because customers are offered convenient "one-stop-shop" access to more products.

Rationalizing

There are two major ways in which marketing can be rationalized.[2] The first is by better defining where marketing tasks should be performed, up the value chain (outsourcing to suppliers) and down the value chain (getting customers to take over some tasks). Another possibility is to move marketing tasks into other parts of the company, which can achieve the same results more efficiently or effectively (or both). For example, certain tasks performed by customer service could be designed into the product, thus reducing the need for customer service.

The second dimension of rationalizing relates to the problem of poor resource allocation among the elements of the marketing mix. Productivity can sometimes be improved simply by pulling back in

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some areas and deploying all or some part of those resources elsewhere. For example, Procter & Gamble has improved its marketing (and corporate) performance by drastically cutting its spending on sales promotions in favor of advertising and R&D.

Competitive pressures have led marketing to add more and more variations in elements of the marketing mix. If these variations are unrelated to actual differences in customer preferences, though, they can add complexity and cost without adding offsetting value. For example, the airline and long-distance telephone service industries have proliferated pricing schemes to such a degree that customers are confused and often resentful.

For companies serving a wide range of product-markets, marketing activities can become highly scattered and thus very expensive if undertaken in an uncoordinated, excessively decentralized manner. However, such companies also have the opportunity to be very productive in their marketing, provided they can reduce redundancies, increase economies of scale in marketing efforts, develop mechanisms for cross-marketing, and so on.

For example, 3M sells an astounding variety of products—approximately 60,000 in all. All of those products carry the 3M brand name, giving the company so much visibility that very little corporate advertising is needed. In its quest for marketing efficiencies, 3M also has developed sophisticated information systems that allow salespersons from any part of the company to sell all 3M products to a particular customer.

Companies can spend marketing dollars at several different levels: brand, divisional, corporate, and even the industry level. Productivity improvements can sometimes be realized simply by shifting resources from one level to the next (usually, though not always, to a higher level).

For example, a company can try to use advertising to grow the overall market for a product by pointing out new uses or highlighting its advantages over substitute products. Unless a company has the lion's share of the market, it would probably be more productive to undertake such an effort in cooperation with its rivals in the industry. In the 1970s, Pioneer Electronics tried to develop the hi-fi market using its own advertising dollars, despite having a relatively small share of the market. Even though this did result in a substantially larger hi-fi market over time (benefiting Pioneer as well as its competitors), it is probable that the same effect could have been achieved at less cost to Pioneer if it had led an industrywide effort in this direction.

In a similar vein, reallocating marketing dollars between the areas of advertising, sales promotion, public relations, and the nurturing/managing of word-of-mouth communications among customers can have a significant impact on marketing productivity. PR and word-of-mouth have received inadequate attention from most companies, but the latter type of communication will likely take on greater import with the increased use of online networks for marketing purposes. We discuss these developments in detail in the next issue of *Marketing Management.*

Make Vs. Buy

Every marketing activity should be evaluated in terms of a "make vs. buy" decision, but this is especially important for advertising, sales, and distribution. In the Spring 1986 issue of *Sloan Management Review*, Erin Anderson and Barton Weitz suggested that a transaction cost analysis framework is useful for determining the most efficient way to perform these functions.

Specifically, they maintained that efficiency is a function of scale economies, company-specific capabilities, the ability to monitor performance, the extent of free-riding potential, and environmental uncertainty.

The framework suggests outsourcing when there is a high degree of specialization in performing a marketing activity. Over time, more marketing activities are becoming specialized, making them good candidates for outsourcing.

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The trend to outsource marketing activities is picking up momentum: By one estimate, PepsiCo now outsources approximately 80% of its marketing activities; RJReynolds outsources many things, including package design; and P&G outsources 90% of its custom market research projects.[3] With noncore marketing activities being outsourced and core activities being spread among other functional areas, it becomes evident that the marketing department faces a squeeze from two sides.

Some activities, such as advertising, have traditionally been outsourced, and others, such as market research, are heading in the same direction. Many companies do too many activities in-house while others outsource activities they should retain control over. For example, firms can profitably outsource the *creation* of relationships (via third-party distribution channels and so on) but not relationship *management*; maintaining a relationship with the customer is too important to be left exclusively to an intermediary. This is why marketers themselves should make informed evaluations of which tasks should be outsourced and which should be done in-house.

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Some marketing activities that are candidates for outsourcing include sales, sales management (just as many companies are already outsourcing the human resource function), sales promotion, logistics, marketing information systems, customer service, and so on.

Outsourcing can contribute tremendously to marketing productivity if it involves taking a secondary or "back-burner" activity and handing it over to a specialist for whom it is a "front-burner" activity. The specialist enjoys economies of scale and scope in performing the activity and provides leading-edge capabilities through investments in emerging technologies. Direct marketer Laura Ashley, for example, successfully outsourced its inbound and outbound logistics functions to Federal Express' Business Logistics Division. The result was a 10% reduction in costs, coupled with a dramatic improvement in product availability and the launch of a new worldwide, 48-hour direct delivery service.

Bringing Customers Into the Value Chain

One of the ironies of marketing is that customers are often more satisfied when they perform some tasks that marketers normally would perform. Companies could simultaneously lower their costs and increase customer satisfaction by identifying such areas. For example, the leading telecommunications companies have accomplished this by providing billing information to their business customers on floppy disk, CD-ROM, or computer tape. Rather than the telecommunications company providing detailed reports, customers use software (also provided by the telecommunications company) to analyze the data themselves.

Numerous activities—from ATM banking to pumping gas to direct dialing long-distance calls—today are routinely and preferentially performed by customers. Direct dialing is an interesting case. Until 1970, almost half of all long distance calls were being placed by operators. In 1971, AT&T launched a marketing campaign to get customers to dial direct, with the advertising theme, "We have two reasons for urging you to dial direct. You save and we save too." By the end of 1973, 75% of calls were direct dialed, and AT&T estimated productivity savings of $37 million a year. In recent years, the use of direct dialing for calling cards reduced costs for phone companies and made customers happier.

Companies can increase customer satisfaction and lower personnel costs by allowing customers direct access to company databases. For example, FedEx, UPS, most major airlines, and a number of banks are currently using this technology. FedEx and UPS have had great success by providing customers with terminals and software to access their information systems for queries regarding package pickup, tracking, and delivery. Likewise, telecommunications companies provide customers the ability to "self-provision" certain services instantaneously, instead of waiting for hours or days for the company to do it for them. For example, Cellular One now allows customers to set up their own voice mail service immediately.

The win-win aspect of all such changes is critical. Lacking a "win" for the customer, productivity enhancing measures are viewed as self-serving and lead to customer defections. In some instances, the "win" is not immediately evident, and may require extensive customer education or the continued provision of traditional service for some segments. The "high-tech" aspects of such service changes must be balanced by adequate attention to "high-touch" issues.

In the early 1980s, Citibank attempted to speed the use of ATMs in New York by requiring customers with total account balances below a set amount to use only ATMs for a specified list of transactions. This policy led to protests by customers, much adverse publicity, and many account closings. Customers like multiple options and usually will not stand for ultimatums.

As Benjamin Schneider and David Bowen note in their new book, *Winning the Service Game*, "Customers may...be delighted if their participation leads to productivity increases in which they get to share through lower prices. But this is not the most important point. The important point is that customers who are offered an opportunity to participate are more likely to be satisfied *regardless of whether they actually participate*—because customers like *choices*."

Conversely, there are many tasks customers now perform that could be performed more productively by specialists. The intensifying time shortage facing many consumers today has led to burgeoning demand for a whole variety of convenience-oriented services. Consumers are "outsourcing" more and more tasks such as house cleaning, lawn care, food preparation, and so on.

Many of these functions are more accurately classified as operational rather than marketing. But the boundaries between the two functions need to be redrawn; all customer-involving operations should be treated, at least indirectly, as marketing concerns. Beyond that, there are opportunities to get the customer to perform more purely marketing tasks, such as self-qualifying, order placement, order follow-up, and so on.

Companies can also leverage their own satisfied customers as salespeople, either directly, as MCI has done with its highly successful Friends & Family program, or indirectly, through word-of-mouth marketing.

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The following checklist can help determine if customers should be asked to perform tasks ordinarily performed by marketing or customer service.

• Does the change save the customer time?

• How much additional effort does it entail?

• Does it protect the customer's privacy?

• Can the customer automate the process to any extent? Can we provide tools to accomplish this?

• Can the customer customize it to a greater degree?

• Does the change maintain or increase the accuracy with which the task is performed?

• Is personal (human) help available immediately if the customer needs it?

Reducing Product and Attribute Proliferation

The adoption of flexible manufacturing systems and various software-driven manufacturing processes now enables many firms to increase the assortment

Symptoms of Marketing Malaise

Several recent reports from prominent consulting firms have contributed to a growing sense of urgency within the marketing function. In 1993, Coopers & Lybrand surveyed 100 of Great Britain's leading companies and found that marketing departments were "ill-focused and over-indulged." They tended to overstate their contribution to the corporation, but could not specify what the nature of the contribution was. The measures frequently used—such as sales growth and market share—are affected by other functional areas as well as marketing.

"The marketing department is critically ill. Marketing...has been outflanked by other disciplines, in finance and manufacturing," concluded Coopers & Lybrand in the study report. "Companies certainly need a marketing philosophy. But many marketing departments aren't making it live within the organization."

Likewise, management consultant Booz Allen & Hamilton issued a report in early 1994 warning that "brand managers were failing to get to grips with commercial realities." In 1993, McKinsey released a report attacking the failures of marketers: "Doubts are surfacing about the very basis of contemporary marketing." Marketing departments have shown themselves to be "unimaginative," generating "few new ideas," and have simply stopped "picking up the right signals. Fairly or unfairly, many consumer-goods CEOs are beginning to think that marketing is no longer delivering."

Although the comments from CEOs and consulting firms are quite broad, we can provide some particulars:

• Many companies today practice "just-in-time" manufacturing but "just-in-case" marketing. The data on this are clear: Between 1982 and 1993, manufacturers reduced their inventory levels dramatically, from 2 times monthly sales to around 1.4 times monthly sales. In contrast, retail and wholesale inventories actually rose during the same time period. Companies are failing to leverage their efficient demand-driven production systems by coupling them with similar marketing systems; they continue to practice forecast-driven marketing. Once these forecasts are enshrined in formal targets and budgets, companies deploy their marketing arsenals to achieve those (almost always top-line) goals—too often at the expense of profitability and the long-run health of the business.

• Companies misallocate marketing resources. For example, advertising is most effective when there is a strong product to sell; however, a recent McKinsey study found that advertising spending is highest where product differentiation is lowest. For most products, differentiation based purely on image cannot be long sustained. As a result, customers are becoming ever more willing to purchase private label products.

• Many companies rely too heavily on expensive internal sales channels and fail to leverage more efficient third-party distribution channels. For example, Compaq has cut its sales force in half while doubling sales, and AT&T is one of many companies closing unproductive regional sales offices and requiring laptop-computer-equipped salespersons to work out of their homes and cars.

• Companies engage in wasteful and even harmful sales promotion activity. *Forbes* reported that packaged-goods manufacturers spent $6.1 billion on more than 300 billion coupons in 1993. Of these, only 1.8% were redeemed, and of those, 80% were redeemed by shoppers who would have bought the brand anyway. Of the other 20%, many are redeemed by pure deal shoppers, who are unlikely ever to purchase the brand without a large incentive.

• The vast majority of trade promotions are ineffective and almost all actually lose money. Excessive trade promotions add an estimated $20 billion a year to the grocery bills of U.S. consumers, much of it due to the practice of "forward buying." As a result, it takes almost three months for a product to get from the manufacturer to the consumer.

• Management focuses too much of the marketing arsenal on getting new customers; in most companies, keeping the customer is somebody else's (or nobody's) job. In many industries such as long-distance telecommunications, customer "churn" has become a major drain on marketing resources and company profitability.

—*Jag Sheth and Raj Sisodia*

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of products they can produce without substantially increasing unit costs. Ironically, this capability frequently contributes to declining marketing productivity because the ability to produce products efficiently does not mean that they can be marketed efficiently.

In many cases, firms have expanded the range of their product offerings beyond what the market needs. This has fragmented as well as increased the need for advertising and sales forces. It has also increased the difficulty of forecasting sales, resulting in more unsold inventory. As a result, the marketing costs for the product line increase substantially, lowering or eliminating profits for the line.

For example, when it sold its housewares business to Black & Decker in 1984, General Electric produced 150 products in 14 product categories, including 14 models of steam irons. To obtain distribution support for its entire line, the company had to administer a whole range of incentive programs for retailers, including early-buy allowances, full-line forcing programs, and so on. Black & Decker is gradually backing off of this approach, offering a rationalized product line and relying on a replenishment logistics approach instead to move toward its goal of "sell one, ship one, build one."

A similar argument can be made about product attributes. Many add much more value than they do cost, leading to higher margins. But, more often, numerous incidental attributes add more cost than value, creating a drain on profitability. Some attributes may cost little, but mean even less to customers, such as the ability to program VCRs a full year in advance.

Southwest Airlines has eliminated many frills to concentrate on providing a better core service: on-time arrivals, no lost baggage, no complaints. Some "frills" may be relatively inexpensive in dollar terms—such as baggage transfers between airlines—but have the potential to hurt the quality of the core offering by delaying some flights or causing luggage to be misrouted.

Umbrella Branding

Product proliferation typically leads to brand proliferation, which lowers the economies of scale associated with advertising. Because each new brand requires a high threshold of advertising spending just to be noticed, the breakeven market share becomes very high.

While "brand equity" is a powerful force in consumer decision making, it can be very expensive to create and sustain. The typical "national" brand name can cost $50 million-$100 million a year to support. Companies are finding that, by capitalizing on existing brand names whenever feasible, they can achieve the benefits of a powerful brand without investing the resources to create a new one.

Of course, this can only be done if the same image is appropriate for both products. The problem with extending a brand is that many brands have been defined (mostly through past advertising) in too narrow a fashion; as a result, they have become very product-specific and difficult to extend.

Conversely, some firms have been slow to recognize the value of the brand equity in some of their products and have underutilized those assets. For example, P&G discovered some years ago that Ivory was really an umbrella brand that didn't just stand for soap. It has since leveraged Ivory's considerable brand equity into leadership positions in dishwashing liquid, shampoo, conditioner, and laundry detergent.

Japanese companies, such as Matsushita (Panasonic), Mitsubishi, and Yamaha, have been very successful at using their brand names across an extremely wide variety of products as has GE in the United States.

Rethinking Advertising

By making information sources such as newspapers, magazines, TV, and radio virtually free to most end-users, advertising has played a tremendous role in creating huge and profitable markets for these media. However, advertising is so rife with productivity problems that its role as a marketing tool is under increasingly harsh scrutiny.

An estimated $159 billion will be spent on advertising in the United States this year. This amount will buy an average of 1,500 person-exposures every day! Of these messages, perhaps one-tenth are actually noticed at all, a fraction of that are remembered, and fewer than that are remembered in a positive way. Little surprise, then, that some industry experts estimate that advertisers waste as much as $40 billion a year in the United States alone on ineffective campaigns in pursuit of largely intangible results.

Given these dismal numbers, it is not surprising that the advertising industry is being transformed—even reinvented—through the evolution of information technology. For example, Ed Artzt, the influential former chairman of Procter & Gamble (one of the largest advertisers in the country) has called for the advertising profession to reinvent itself for the coming information age, suggesting that "business as usual" will simply not work. The key problem is the poor targetability of current advertising and its highly intrusive nature.

The overall thrust of future changes in advertising will be to make it more "yield-based," with the costs of advertising directly linked to its effectiveness. Early forms of yield-based advertising can already be seen in TV ads for which advertisers are charged only for the calls generated from their 800-number, rather than on some estimate of viewership.

Advertising does create value for customers,

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and many seek out advertiser-generated information on their own. Unfortunately, much advertising today still is developed for broadcast to mass markets, many of which long ago fragmented into smaller markets. To be successful in the future, advertising will have to move from its broadcast mode to more narrowcasting and eventually "monocasting" or "pointcasting" to segments of one. Meanwhile, managers can improve advertising productivity by managing expectations, budgeting carefully, adjusting compensation methods, and recycling campaigns.

Manage expectations. In most companies, advertising sets customer expectations, and the rest of the marketing function—along with operations, customer service, and so forth—must deliver on them. Unfortunately, most companies exercise inadequate control over the setting of expectations, allowing advertising agencies too much discretion in the matter. These agencies typically set such unrealistic expectations that even a high level of actual performance may still leave the customer dissatisfied. Managers at client firms and ad agencies must take responsibility for better managing customer expectations, by underpromising and overdelivering rather than the reverse.

Budget better. Advertising must be very carefully budgeted, since the effect of advertising spending on profitability is extremely high. Additions to the advertising budget reduce immediate profits by a like amount and reductions enhance it. In many cases, a reduction in R&D spending also accompanies advertising spending increases. John Philip Jones of Syracuse University has shown that sales of large brands can be maintained with a relatively low (and sometimes declining) level of advertising spending. Similarly, brands with very small market shares (usually newer entrants) typically must spend at a level exceeding that suggested by their market share.

Adjust compensation. The traditional practice of compensating ad agencies with a negotiated percentage of media billings creates a perverse incentive. Research has shown that an outstanding commercial is many times more effective than an average one. For example, Campbell Soup Co. found that the quality elasticity of advertising was 18 times greater than the quantity elasticity. Outstanding ads need to be run much less frequently than mediocre ones to achieve a given exposure level. However, under the traditional practice, this would result in lower total compensation for the agency.

Clearly, agencies should be compensated for the effectiveness of their advertising and given incentives to achieve effective results with the lowest possible expenditure on media. One solution is to unbundle the creation of advertising from media scheduling and purchasing, as the Coca-Cola Co. and others have recently done.

Recycle. When struggling with the issue of advertising wearout, marketers make two kinds of mistakes: sticking with poor campaigns long after it becomes evident that they are failing and prematurely terminating very successful campaigns. Several companies have successfully "recycled" old ad campaigns, often (but not always) tied in to a nostalgia theme.

Marketers should ask their ad agencies to create advertising that is not time-sensitive to avoid material that rapidly becomes dated. Also, agencies can recycle their own creative work by converting approaches that have worked well in one context into another, noncompeting context. Technology can be a great help here. P&G is developing an expert-system database of commercial advertising copy aggregating over 3,500 commercials. P&G personnel in any part of the world will be able to access tried and proven advertising copy sorted by the "sizzle" being sold. If copy conveying "shine" is needed, for instance, whether for shampoo or floor wax, the database will provide it.

Focusing Promotions

Sales promotion activity has gotten out of hand, especially in the packaged-goods industry. While advertising can be viewed as an investment, sales promotion is a purely short-term fix, typically intended to buttress the top line or market share.

Consider the sales promotion activity of couponing.Traditional coupons are of four broad types, and each has been found to be inefficient as well as ineffective:

- Magazine and newspaper coupons reach people who might throw away free-standing inserts (FSIs) or direct mail coupons without looking at them; however, they have high media costs and low redemption rates (1.6% in 1991).

- In- or on-product coupons always reach the users of a product and so are appropriate for encouraging the purchase of product line extensions and increasing brand loyalty. However, they are not effective for gaining trial among non-users.

- Direct mail coupons are sent directly to consumers' homes. When they are mass mailed, redemption rates are very low. If the coupons are matched to a desired customer profile (often based on Zip-code analysis), the redemption rate rises (4.3% in 1991).

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• Free-standing inserts make up the bulk of traditional coupons, representing 88% of the 323 billion coupons distributed annually and $1.8 billion of the $2.1-billion coupon industry in 1992. However, their shotgun approach yields a national redemption rate of only 1.8%-2.3%. FSIs have a tremendously high "cost per coupon redeemed by the user of a competitive product." The cost of running an FSI, including processing and redemption, is approximately $19.75 per 1,000 coupons distributed. Of these 1,000, only three on average are redeemed by users of competing brands, making the cost per competitive trial $6.58. This type of couponing can be effective for companies with very low market share because most redeemers are likely to be users of competing brands.

In addition to these failings, traditional coupons have a long redemption process, meaning that information on the coupon promotion is not available to brand managers until three to six months after the expiration date on the coupon. Furthermore, the amount of information available is very limited; the brand manager can only find out the total number redeemed, the total dollar value, and how quickly they were redeemed.

One company, Catalina Marketing Corp. of St. Petersburg, Fla., is making consumer promotions much more productive. Catalina has created a unique niche for itself based on its ability to address the tremendous inefficiency of traditional coupon promotions in the packaged-goods industry.

Catalina's Checkout Coupon system works by printing out coupons based on products "just purchased." With a redemption rate of between 6.5%-10%, the cost per competitive user trial is $2.22-$2.42. It is interesting to note that the average cost per coupon redeemed is in fact substantially higher for Catalina compared to FSIs ($2.30 vs. 90¢); the main advantage is in virtually eliminating windfall redemptions by customers who would have bought the product anyway.

Besides the lower cost, Catalina's automated system enables brand managers to obtain information on the results of promotions in a much more timely manner. Catalina can provide several types of coupons: competitive, continuity, tie-in, cross-category and own-user coupons, as well as ones with specific advertising messages on them. Coupons can also be created for retailers, for example, offering X dollars off the next visit to entice heavy shoppers to return to the store (the amount can be related to the average amount spent by that shopper per visit).

While Catalina and its competitors offer a substantially better way to do coupon-based sales promotions, manufacturers such as P&G prefer to gain trial through advertising. Advertising is considered the highest value way of gaining trial because customers are buying the product "for the right reasons." In other words, they have been convinced that the product is superior, whereas with a coupon-induced trial, they might be buying it simply because it is less expensive.

Also, P&G believes that people who use coupons are very likely to switch again, which further lessens the value of trial. The implication is that the lifetime value of customers gained through advertising is greater than that of a customer gained through couponing. Unfortunately, there is no reliable way to track advertising-driven trial, though that too will change when interactive advertising becomes more widespread.

Dynamic Pricing

Many companies continue to use some variation of cost-plus pricing. By so doing, they tend to sacrifice significant profit opportunities in the long run as well as shield many operating and marketing inefficiencies. By moving to more market-driven pricing—and, consequently, price-based costing—they force many of their costs down because no artificial umbrella exists to shield high costs. For example, a company might use cost-plus pricing to sell cellular phones for several hundred dollars apiece and then charge a high per-minute rate based on an average cost formula (dividing the cost of building and running the network by the minutes used and adding a markup).

Unfortunately, there is no reliable way to track advertising-driven trial, though that too will change when interactive advertising becomes more widespread.

With these high prices, a company can have high margins on paper that allow it to spend heavily to acquire new customers. However, if it were to move to a price-based costing approach (as most in the industry have done), the company would determine that the profit-maximizing strategy is to subsidize the phones to get them in people's hands and then price calls low to drive up usage. Even though total spending on marketing would rise in the process, so would marketing productivity because costs on a per-customer basis would have to fall.

Southwest Airlines has created a very low cost-structure that allows it to turn a profit on a $50 ticket. Clearly, it cannot afford to spend $25 of marketing effort on getting that customer! The use of price-based costing leads to a price that "hits the sweet spot" in the market, making marketing's task that much easier.

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Another major way pricing can improve marketing productivity is through the use of modified yield management (YM), systems, such as those used in the airline and hotel industries to maximize revenues and profits.

YM systems can streamline pricing and capacity management processes, especially for service businesses. However, as Rashi Glazer of the University of California at Berkeley points out, they also have important implications for companies using flexible manufacturing systems. Because such systems produce customized products on demand, they represent expensive fixed assets with varying levels of capacity utilization over time; the systems become idle when demand does not materialize, and YM helps smooth out demand.

Dynamic pricing systems will increase in importance as flexible pricing permeates education, health care, and other domains. Flexible pricing also could be used in retail to give shoppers lower prices at off-peak shopping times.

Unbundling and Rebundling Services

Customer service is rightly viewed as an essential component of good marketing but many firms have become trapped in an escalating spiral of increasing service costs. When service is bundled with the core product, it can rapidly raise the costs of marketing and erode profitability. It also leads to the cross-subsidization of heavy users of service by light users, which contributes to marketing inefficiency and provides opportunities for competitors to steal the profitable low-service customers by offering them lower prices.

The answer is not to reduce or eliminate service but to package it in different ways. Firms can provide a base level of service to all customers and then offer different levels of service to different customer groups for a fee. Alternatively, they can choose to continue offering the service free to their most frequent and profitable customers.

Such an approach increases marketing productivity by increasing revenues (through the sale of value-added services to high-end customers) and lowering costs (by reducing the incidence of unprofitable service provision to other customers). The personal computer software industry has been particularly successful in making this transition, offering varying levels of support under different fee structures for different segments of consumers and businesses.

Service costs also can be reduced and service quality enhanced through the redesign of products for greater serviceability. "Smart" products can diagnose themselves (using sensors and expert systems) and alert the service provider (through wired or wireless telecommunications) of impending problems. Such features are becoming commonplace in high-end copiers and medical diagnostic equipment, where the costs associated with downtime are very high. They allow companies to price service contracts very attractively and still make a large profit margin on them.

Computer software and hardware companies are increasingly designing their systems for remote trouble shooting; technicians can take control of a user's computer from afar and find and fix problems. The enabling technologies are becoming so affordable that the day of the smart toaster may not be too far off.

In the next issue, we expand on the role of information technology in boosting marketing productivity and discuss how the marketing function can be better managed for effective efficiency. MM

Endnotes

[1] The classic example of this is telemarketing; with $40 billion-$60 billion a year in estimated telecommunications fraud in the United States alone, this is fast becoming the most efficient way ever devised to alienate customers.

[2] The term "rationalizing" in this connection has been used by Fred Wiersema of the CSC/Index Consulting Group. See CSC Index Alliance presentations on *Lean Marketing: The Immediate Imperative* by Fred Wiersema ("More Bang for the Buck") and Michael Treacy ("The Strategic Context for Lean Marketing") at the 1993 Executive Forum in Tucson.

[3] P&G has even outsourced its central switchboard, with receptionists provided by an outside vendor.

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by Jagdish N. Sheth and Rajendra S. Sisodia

Feeling the Heat—Part 2

Information technology, creative management boost marketing productivity.

In the last issue, we talked about the growing productivity crisis in marketing and how difficult it is to measure the true output of an activity that involves so many intangibles. Even so, with cost cutters demanding accountability, even imperfect measures help make the case for marketers if they measure the right things.

The desired output of marketing is to acquire and maintain customers profitably. To accomplish this, marketing must pursue the ideal of "effective efficiency"—doing things right and doing the right things. We have identified 20 ways to improve marketing productivity and classified them into four broad categories: collaborating, rationalizing, "informationalizing," and managing. (For an overview, see "Improving Marketing Productivity" on page 20.)

In Part 1, we focused on the first two categories, collaborating and rationalizing. Now, we discuss how to boost marketing productivity by using information technology and better managing the function for effective efficiency.

'Informationalizing'

Many of the productivity improvements in aspects of business other than marketing have occurred through the deployment of information technology (IT). Particularly in the last decade (since PCs infiltrated the workplace), IT spending has been impervious to economic recessions or industry downturns because of its anticipated impact on productivity. In the last few years, the impact of that spending has indeed become apparent, and the so-called "Productivity Paradox"—a perceived lack of correlation between IT spending and overall productivity—has been laid to rest.

Several of the productivity enhancers discussed in Part 1 are based on the use of the new capabilities of today's computing and communications technologies. Technology can improve and eventually alter marketing practice, in several ways.

EXECUTIVE BRIEFING

When marketing becomes more productive, everyone wins, especially customers. Part 1 of this article described collaborative marketing strategies that improve marketing productivity as well as various ways to rationalize expenditures. Part 2 emphasizes the huge role information technology plays in the quest for "effective efficiency" and offers some innovative management strategies. With all of this focus on refining the science of marketing, though, we must take care never to lose sight of marketing as an art.

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Improving Marketing Productivity

Collaborating

- Partnering: Treat suppliers and customers as partners in lowering system-wide costs and adding value.
- Relationship marketing: Be selective about customers, and take a long-term win-win perspective.
- Marketing alliances: Share resources and opportunities with other companies serving the same customers.

Rationalizing

- Make vs. buy: Focus on your marketing core competences, and let outside experts handle the rest.
- Bringing customers into the value chain: Lower costs and increase customer satisfaction by adding customers to the value chain.
- Reducing product and attribute proliferation: Variety does not always equate to value; reduce customer confusion and marketing costs by matching product lines with distinct market segments, and by adding product attributes that matter.
- Umbrella branding: Increase "Return on Branding" by developing brand names with broad applicability to multiple products and markets.
- Rethinking advertising: Better manage the setting of customer expectations, budget for advertising based on objectives, remove conflicts-of-interest and perverse incentives in agency compensation methods, unbundle advertising creation and placement, and understand advertising wearout.
- Focusing promotions: Stop creating "deal junkies," end windfalls to existing customers and surgically target promotional incentives to achieve greater trial.
- Dynamic pricing: Use market-based pricing to increase profits and decrease marketing waste, and consider the use of dynamic pricing approaches such as yield management systems.
- Unbundling and rebundling services: Uncover the hidden costs of free service, and create new revenue sources.

'Informationalizing'

- Market response modeling: Use well-established marketing models when high quality data is available.
- Database marketing: Target marketing efforts more precisely, but ensure that you are creating additional value for the customer and are acutely sensitive to privacy concerns.
- Front-line information systems: Deploy information tools where they have the greatest impact on customer service and satisfaction—at the front-line.
- Net-based marketing: Prepare now for a radically different, more integrated mode of marketing in the future, predicated on "total customer convenience;" Position yourselves for a future of one-to-one interactive marketing.
- Re-engineering marketing processes: Develop radically different and information technology-enabled ways of conducting key marketing processes.

Managing

- Activity-based costing: Understand where resources are being spent, where customer value is being created, and where money is being made or lost.
- Zero-based budgeting: Overcome inertia in marketing budgets and improve accountability by linking marketing spending with specific objectives.
- Adjusting compensation of marketing personnel: Compensation drivers must be linked with the need for effective efficiency in all marketing activities.
- Continuous assessment of marketing practices: Beware of creeping marketing incrementalism; take a periodic "zero-based" view of marketing practices.

—Jag Sheth and Raj Sisodia

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IT is not an automatic solution to marketing productivity problems; simply "automating" aspects of an otherwise unchanged marketing process leads to the classic result that students of business process re-engineering know very well: marginal improvements at best, and many new and hidden costs. Clearly, the fundamental processes of marketing must be addressed first, with the redesign recognizing and appreciating the power of new technologies. Even then, IT can prove to be a productivity hindrance in the short run as the organizational culture adapts to accept and integrate the new technology into various marketing processes.

For sustained competitive advantage, companies need an IT "platform" that uniquely blends core marketing competencies with seamless technology. Over time, IT becomes less of a driving force and more of a requisite infrastructure. And this leads to the development of technology-based core competencies that are not readily duplicated by others because they cannot be purchased "off-the-shelf."

Companies such Frito-Lay, FedEx, Citibank, and American Airlines, for example, are outstanding at technology assessment, integration, and absorption. They have developed close partnering relationships with technology vendors and work with them on state-of-the-art solutions to problems others have not even experienced yet.

IT can improve marketing productivity in a number of ways. It can lower the cost of providing a particular service to customers as well as make it more convenient. It also can reduce the demand for personnel-based customer service. At FedEx, for example, customers with access to the World Wide Web can track the status of their package in seconds, without ever dealing with a live representative.

At 3M, customers used to select and order products from a five-inch thick catalog listing the company's 60,000 products. Known among sales representatives and customers as the "bible," this catalog was a burden to thumb through, expensive to produce and distribute, and subject to rapid obsolescence. To replace it, 3M has developed a CD-ROM version that can be produced for $1.50. In addition to eliminating the paper barrage of brochures, mailers, and product binders the company sent to clients to keep them updated, the technology has also decreased the demand for customer service. In the past, many customers called a customer service rep because it was faster and easier than using the catalog.

Marketers have only begun to feel the impact of IT. In the past decade, scanner systems allowed packaged-goods marketers to make better informed and more timely decisions, but without appreciably changing what they did. However, the availability, affordability, and capability of IT are fast approaching a level where wholesale changes will be made—changes that offer the promise of raising marketing productivity to a new level.

The primary technological drivers are:

- Greater computing power in more portable form at increasingly affordable prices. Computing power that used to cost a million dollars can be had today for less than a dollar.

- Greater communication band width, along with more availability of wireless data transmission capabilities.

- Increasingly sophisticated and user-friendly software, including the popularization of embedded and stand-alone expert systems, as well as a variety of "performance support systems."

- Real-time capture and distribution of pertinent marketing data, including transaction data as well as various stimulus variables such as advertising.

- Rapid progress in the area of voice recognition technology.

The impact of these enormously powerful technologies on marketing will be profound. To attain their full benefit, many marketing processes will have to be *re-engineered*, or redesigned "from the ground up" to take advantage of available information tools.

The relationship between IT and marketing productivity will manifest itself in five areas: analytical marketing models, database marketing, front-line information systems, net-based marketing, (the likely impact of the so-called information highway), and the re-engineering of key marketing processes.

Market Response Modeling

Market response models help companies develop strategies that lead to increased marketing effectiveness as well as significant cost savings. Most companies could benefit from a more analytical approach to marketing decision making than they have had in the past. Used in the appropriate contexts and with the right data, models can be very effective. For example:

- In over a thousand applications, the new product pretesting model "Assessor" is highly accurate in predicting a new brand's eventual market share. Studies have shown that actual market shares are within 10% of predicted market shares 90% of the time. Furthermore, companies can use Assessor

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and similar models to "fine-tune" the marketing mix before launching their product.

• The sales planning system "Call Plan" is very effective in improving decisions pertaining to optimal sales force size and deployment, as well as call planning at the salesperson level.

• Media planning systems such as "MEDIAC" are indispensable tools for making effective decisions on media selection, scheduling, and budgeting.

• The use of analytical approaches to evaluating advertising has allowed companies such as Anheuser-Busch and Campbell Soup to reduce advertising spending while increasing its overall impact.

The usefulness of models and the quality of their performance depends greatly on the availability of good data. For many aspects of marketing today, there is no dearth of highly accurate, timely, and affordable data. For example, supermarket scanners have created a virtual avalanche of clean, timely data. The ability to leverage these data into actionable insights is greater today than ever before. The potential value of models is thus higher.

Two relatively recent developments augur well for the increased use of market response models in the future. First, many such models now incorporate expert system approaches, providing managerial judgment as well as analytic insight. They are able to respond to "What if?" queries with a richer set of responses as well as make proactive suggestions for managers to consider.

The second development pertains to the interface. Models are increasingly shielding the user from their inner complexity through the use of graphical interfaces as well as through more natural language capabilities. For example, an expert system called Cover Story provides managers of consumer products with a one-page memo in English summarizing the key insights gleaned from enormous quantities of scanner data.

Clearly, such tools lead to more effective and efficient marketing decisions, and it will be increasingly necessary for firms to adopt them in order to compete. Widespread availability and affordability will no doubt reduce their value as a source of competitive advantage, though some proprietary advantages might accrue to firms with sophisticated internal "knowledge bases."

Database Marketing

Just as all politics is local, once upon a time all marketing was local—and personal. Marketers had long-standing one-to-one relationships with their customers. However, the rise of mass markets, mass advertising, and mass merchants led to the onset of impersonal mass marketing. Customers are now quite remote from marketers, buffered by time, place, and multiple intermediaries. Database marketing (DBM) is once again starting to close the gap between marketers and customers.

This should not be surprising; more and better information about customers is at the heart of marketing. Marketers are recognizing that past behavior, as recorded in transaction records, is the best indicator of future behavior. DBM is now rightly moving into the marketing mainstream, and increasingly must be used by almost all marketers.

The use of DBM is spreading fast:

• Donnelley Marketing Inc. found that, in 1994, 56% of manufacturers and retailers were building a database, an additional 10% planned to do so, and 85% believed they would need database marketing to be competitive beyond the year 2000.

• GM now has a database of 12 million GM credit card holders, giving the company access to a great deal of data on their buying habits. GM also surveys these customers to get information on driving habits and needs.

• Blockbuster has a database of 36 million households and 2 million daily transactions. It uses the technology to suggest additional movie choices and cross-promote its affiliates such as Discovery Zone for children.

• Philip Morris' database of 26 million smokers is used to market cigarettes as well as solicit support in lobbying efforts.

• Claridge Hotel and Casino now distributes a "frequent-gambler" card, known as CompCard Gold, to 350,000 "members."

Direct marketing and database marketing are not synonymous, although direct marketers have long led the way in using databases. With better targeting of prospects for products and promotions, greater ability to customize marketing messages and programs, and so on, DBM clearly contributes to greater marketing efficiency. When practiced properly, it yields double-digit response rates, compared to 2%-4% for "junk mail."

For example, Hilton Hotels offers targeted promotions to senior citizens through its Senior Honors program, prompting almost half of the members to take previously unplanned trips that included stays at Hilton.

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While DBM is not inexpensive and must be cost-justified like any other initiative, it can "piggy-back" on existing costs. American Express, for example, has initiated what it calls "relationship billing," or customized monthly bills that include offers triggered by specific purchases, such as flights and special store sales. Relationship billing has been rolled out in Europe, Canada, and Mexico, and AMEX claims an increase of 15%-20% in year-over-year cardmember spending in Europe.

Relationship billing allows AMEX to move closer to "mass customization," the tailoring of communications/offers to individual customers. For example, rather than using broad demographics, AMEX might now define a market segment as "female business travelers who bought jewelry abroad on their last trip." Some of the company's offers have gone out to as few as 20 people, but received very high response rates.

DBM provides tremendous opportunities for cross-selling related products. For example, Canon Computer Systems maintains a database of its 1.3 million customers. The company obtained a 50% response rate in a direct mail solicitation asking printer owners if they wanted information on a new color scanner; buyers of scanners received four free ink cartridges for their printers.

We see several issues affecting database marketing in the future:

• Privacy issues will increasingly come to the fore. Unless the marketing profession (not just the Direct Marketing Association) develops an approach to deal with privacy concerns, it could lead to very restrictive government-imposed rules on the use of customer information, such as those already in force in Europe.

• DBM must focus on greater value creation for the customer in addition to marketing efficiency enhancement; in other words, the customer's "profit" in the relationship must increase.

• As technological capabilities expand, companies will have access to virtually unlimited data and broadband interactive multimedia communication channels with their customers. The winners will be companies that are best able to use these efficiency-increasing capabilities to satisfy customers.

• The analytical processes used in DBM have been quite basic—in many cases, limited to sorting and weighting. With the increasing accessibility of fuzzy logic and massively parallel technology, more can and will be done to extract real value from customer and prospect databases.

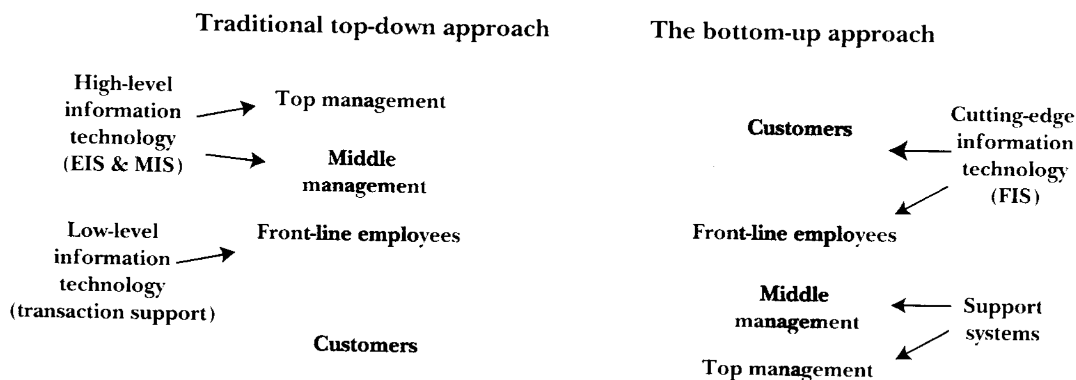
• In particular, the use of better models in conjunction with database marketing can identify customers with a high propensity to buy and a low likelihood of attrition.

Front-Line Information Systems

In the traditional hierarchical corporation, customer contact personnel occupy the lowest tier in terms of status, responsibility, and compensation levels (see Exhibit 1). However, their impact on

EXHIBIT 1

Front-line information systems (FIS)



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customer satisfaction is arguably greater than that of any other group. Typically, in such corporations, the most sophisticated IT is deployed at the top tier of management for "executive information systems" (EIS). The next priority tends to be "management information systems" (MIS) for middle managers. Employees below that level have traditionally been provided with low-level transaction-support technologies.

> The most powerful impact of technology is felt when it is harnessed at the front lines.

This represents a misplaced sense of priorities, however, because the most powerful impact of this technology is felt when it is harnessed at the front lines. Companies that invest in and deploy cutting-edge "front-line information systems" (FIS) achieve breakthrough improvements in service quality and reliability, and thus very high levels of customer satisfaction. By adopting sophisticated FIS, firms will achieve quantum improvements in the effective efficiency of their marketing activities.

Many of today's FIS models were designed primarily to process customers efficiently and were not conceived as marketing tools. This has started to change, however. Dollar Rent-A-Car, for example, is rebuilding its counter systems to include a graphical interface that gives the sales agent access to a customer's complete itinerary. Dollar's system will be integrated with those of travel agents and airlines to take advantage of distributed processing capabilities. As car reservations are made, they will be combined with other information and downloaded to the counter database.

Classic Hawaii, a travel agent, uses ANI (automatic number identification) to identify customers, call up their travel itinerary, and greet them by name. The system also automatically routes customers to the agent who made the original booking, providing a high level of familiarity and comfort.

Other examples of companies using high-end FIS include FedEx, Frito-Lay, and Hertz, each of which equips front-line personnel with technologies that enable them to do their work faster and better. Not incidentally, such companies also tend to have high levels of front-line employee satisfaction. Furthermore, because they are using sophisticated tools to perform the work, they're gathering all the data needed for managerial control purposes; such data then "trickle up" to the MIS and EIS levels.

Well-conceived investments in FIS (such as those used by salespeople and customer service representatives) provide very substantial returns, far more so than those intended to automate back-office operations or improve management information systems. FIS investments tend to promote efficiency (through faster and more accurate processing) as well as effectiveness (by improving the quality of service received by the customer).

For example, many companies that provided their sales forces with sophisticated laptop computers and wireless communications have improved their performance and productivity in the areas of account management, lead management, literature fulfillment, reporting (using templates), proposal generation, customer inquiry response, quote status, inventory checking, and so on. Salespeople spend less time on sales administration and paperwork; there is no need for a salesperson to contact marketing for literature or manufacturing for inventory availability. And, because salespeople are not available 24 hours a day, IT can be used to answer customer questions and fulfill their needs around the clock.

For example, by providing an FIS capability to its sales organization at a cost of $30 million, Campbell Soup Co. expects to save $18 million a year through shorter order cycle time, more accurate invoicing, and better control of product promotion funds.

Anderson Consulting now equips its consultants with a CD-ROM called the "Global Best Practices Knowledge Base," which contains best practice information on about 170 business processes. By deploying FIS capabilities for their sales forces, AT&T and Compaq have largely freed salespeople from the constraints of reporting to an office. They now employ the concept of "hoteling," whereby permanent office space for salespeople is replaced by temporary space on an as-needed basis. This lowers costs as well as encourages salespeople to spend as much time as possible in contact with customers.

> Interactive broadband communication will reconfigure industries such as retailing, health care, and education while significantly affecting nearly all others.

Net-Based Marketing

The long-awaited "information highway" will be the most significant driver of dramatic change in marketing processes in coming years. Widely available, interactive broadband communication will allow companies to integrate advertising, sales promotion, personal selling, and even distribution to a far greater extent than is now possible, possibly spelling the end of time and place constraints on customers.

Predicted to become widespread in the United

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States by the year 2005, this technology will dramatically transform the marketing functions of advertising, personal selling, and physical distribution. It will reconfigure industries such as retailing, health care, and education while significantly affecting nearly all others.

Marketing in this new environment will be predicated upon "monocasting" or "pointcasting" of communications, mass customization of all marketing mix elements, a high degree of customer involvement and control, and greater integration between marketing and operations. Companies that successfully make the transition to this new way of marketing will be characterized by fewer wasted marketing resources and minimal customer alienation resulting from misapplied marketing stimuli. All companies will experience enormous pressures to deliver greater value, more global competition, and intense jostling for the loyalties of "desirable" customers.

Some are calling the World Wide Web the most important new marketing tool since the television commercial.

An early version of the information highway is already here. Some are calling the World Wide Web (WWW) the most important new marketing tool since the television commercial.

The WWW is a part of the global Internet system of linked computers. Those with access to the Internet (now numbering over 35 million in the United States alone and growing rapidly) can be connected to a company's "Home Page" in an instant. From there, they can receive information, order product literature or purchase products, submit queries, check the status of orders or shipments, interact with other customers, "link" to any other related site worldwide—and anything else an imaginative designer can concoct. All of this incorporates multimedia capabilities as appropriate, including audio and video clips and full-color photographs and illustrations.

While the WWW represents a true breakthrough with major implications for marketing, it really represents only a glimpse of more dramatic changes to come, as processing power continues to improve, two-way communication bandwidths explode, and imaging moves toward high definition.

Marketing has a great deal riding on the information highway (which some are calling the marketing highway); it is here that much of the waste that seems inescapable with traditional marketing can be removed. It is also here that new forms of customer-company and customer-customer communication can take place, giving rise to many new opportunities for value creation.

The Internet, as it has evolved in the last two years, gives us an early glimpse of the possibilities for marketing on the information highway. Though constrained by its availability to a small subset of the population and its very narrow communications bandwidth, the power of the medium is already apparent to many and is leading to an explosion of activity in establishing new "sites."

Some industry observers are calling the kind of marketing that will prevail in this new medium "Intelligent Marketing." We refer to it as "Net-Based Marketing" (NBM). In any event, it will be a mode of marketing that is cost-effective, accountable, individualized, interactive, and relationship-based—the very essence of "effective efficiency."

Several characteristics of this new medium make it a significant development.

Few barriers. Although only 7% of the U.S. population currently subscribes to any kind of online network, growth rates are increasing exponentially and eliminating barriers to use. The absence of encryption and other means of providing for the security of network transactions has also hindered the spread of commercial transactions thus far. However, such standardization and security issues are expected to be resolved by the end of 1996.

Customer interaction. Customer relationships and satisfaction will become even more important. NBM will greatly raise the stakes for the delivery and management of customer satisfaction. To a far greater extent than ever before, a company's customers will have the ability to interact among themselves, rather than simply with the seller. This can be a tremendous source of value-enhancement because loyal and satisfied customers can be creatively used as resources to support the needs of newer customers.

The potential clearly exists to foster unprecedented levels of customer loyalty. As Nick Gassman, a participant in the Internet-based INET discussion group, said, "The Internet creates personal relationships. They choose to visit you on the Web, they talk about you with others in the newsgroups, and you join in. And you talk to them privately by e-mail. If you do it right, you make good friends with your customers."

However, the nurturing of such "customer communities" (akin to organizations such as the Acura Buyers Club, where communication among customers is enabled through more cumbersome traditional means) can also backfire. By drastically increasing the "connectivity of opinion," net-based marketing can create a snowball effect in which one customer's complaint can rapidly escalate into a customer relations nightmare (as with Intel's

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Pentium debacle). Companies must develop realistic contingency plans for such scenarios.

By the same token, however, companies providing superior products and services will probably prosper even more than before at the expense of those for whom reality falls short of promises. In all likelihood, the Internet promises to be an inhospitable habitat for marginal performing companies of any kind.

Customer retention. As we mentioned in Part 1, too much of marketing's attention is devoted to customer acquisition and too little to customer retention and growth. It appears that NBM has the greatest potential for the latter, primarily because of its greatly enhanced ability to provide superior customer service through the WWW.

For example, FedEx's site allows customers to key in their package tracking code and immediately receive details on every stop made by a package on its journey. To the extent that NBM can facilitate longitudinal data capture and store a customer's transactions and preferences, value delivery can increase over time.

Egalitarianism. In many ways, the Internet promises to become a "great equalizer" for businesses:

• "Store-fronts" on the WWW are as readily created by individuals or small businesses as by large corporations.

• The entry cost is low. It has been estimated that a sophisticated site could be created for $200,000—less than half the cost of a single 30-second spot on a top network TV program.

• Advertising and other marketing materials can be created for less, can be modified more easily, and can be reused as appropriate.

• Establishing a brand name becomes a potentially less capital-intensive proposition.

Co-op marketing. A major key to success with NBM is the ability to attract traffic to a site. Some of the more popular sites (such as the one maintained by *Wired* magazine) already charge upwards of $30,000 a month to provide an advertising link into a sponsor's site. For small companies, more affordable alternatives exist. For example, they could "co-market" their site with others targeting the same customers by providing mutual cross-linkages. The power of such networking will increase the prevalence of cooperative marketing. In either case, the marketing skill set differs considerably. Content and value will drive browsers (prospects) and buyers (customers) to a site.

Micromarketing. The Internet is an ideal tool for targeting market fragments—market segments far smaller than any considered before. Interactions with fragments are usually characterized by very high levels of customer involvement. Such niche markets can be reached at a fraction of the cost of direct mail and other forms of advertising.

Integrated functions. NBM integrates marketing sub-functions and marketing with other functions. It will redefine sub-functional boundaries within marketing as well as across business functions. For example, marketing, sales, and order processing are integrated functions with NBM.

The need for such integration has been keenly felt; according to a Chilton Publishing report, sales tends to ignore 85% of leads generated by marketing through trade shows and advertising. In Web-based marketing, however, "A person visits the site, gathers information, qualifies himself, asks questions, provides answers to questions, builds an interactive relationship, and offers or responds to an offer to do business," said Ken Sethney of the Sethney Group in INET discussions.

NBM also promotes integration beyond the marketing function. The same resource can be used also to perform customer service and order-processing functions as well as address suppliers, business partners, shareholders, and employees. And all of this communication occurs faster, more accurately, interactively, and at lower cost through NBM than is possible with any other alternative.

Value-added. As a result of this ability to integrate functions and services, and because customers will gain the ability to obtain the lowest price instantaneously on a given stand-alone item, the locus of competition will shift to providing bundles of benefits—combinations of products and services enhanced through customization, database capabilities, updates, and so on. Marketers will slowly shift from treating buyers as customers to regarding them as clients.

Redefined advertising. Given a higher level of customer involvement, marketing communication in the new medium will move from providing simple (and, companies hope, memorable) messages to delivering real information (based on the customer's requirements) and eliciting a response.

"Think content, not hype," said Jill Ellsworth, author of *Marketing on the Internet* and another INET discussant. Highly creative, hype-dominated advertising serves the needs of the advertiser far more effectively than those of the client. While visual style and panache are every bit as important in

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NBM, they must be accompanied by real substance.

Devastate "traditional" marketers. The strategy for many new NBM entrants might be based primarily on technology. This is already true for a host of online businesses. Many new entrants will be powerful companies looking to expand geographically, primarily in a virtual sense. Others may be telecommunications or credit card companies leveraging their information assets and detailed customer databases to provide a wider array of products and services to customers.

Such competitors will come in without any organizational inertia or sunk investment in existing ways of doing business. If the new entrants are successful (as some inevitably will be), traditional marketers will end up with huge "stranded assets": networks of warehouses around the country, distributed customer service operations, expensive retail real estate, and so on.

Just as cellular companies have historically been valued on "potential customers in licensed region" rather than on physical assets, NBM companies may be valued on the basis of analogous measures, such as "potential customers served." Over time, of course, potential customers must become actual customers for this type of company to sustain its value.

Empower customers. Though it has become almost a cliché to talk about increasing customer power, it is indeed the case that future customers will call the shots to a far greater extent than ever before. Marketing must move quickly to make customers their allies rather than uneasy adversaries. Customers will no longer be innocent bystanders or passive targets of marketing; they will seek to control it to their advantage.

Indeed, with IT, the very nature of the relationship between buyers and sellers could be altered, with buyers becoming marketers and sellers becoming prospects. In this environment, marketing management becomes demand management. Databases containing information on product image, prices, inventory availability, and so forth will be used by customers as well as by marketers. Purchase decisions in the future may be influenced by database search and display programs, instead of salespeople.

Re-engineering Marketing Processes

Rather than upgrading with piecemeal IT additions, companies will achieve far better results by re-engineering their marketing processes (based on the principles of effective efficiency) and incorporating technology as an inherent element of the redesign.

In the last few years, the re-engineering wave has swept through corporations worldwide. However, relative to other business functions, marketing has been slow to adopt a re-engineering mindset.

As Thomas Davenport pointed out in *Process Innovation*: "...Nothing is more critical to a firm's competitive success than its ability to develop new products and services and deliver them to customers... . Product/service development and delivery are [thus] likely candidates for innovation in virtually any company. *Yet few companies have adopted a process view of these activities, applied*

EXHIBIT 2

Re-engineering's effect on key marketing processes

Process	Problem	Nature of rethinking	I T enablers
New product development	Slow, costly, too much iteration, results in products lacking "integrity"	Involve marketing, manufacturing, design, and so on in a platform team from day one; facilitate communication among them through technology	CAD/CAM, photorealistic visualization, groupware, holography, videoconferencing
Order management	Expensive, slow, frequent errors	JIT marketing, automatic replenishment, vendor managed inventory, virtual inventory, partnership, cross docking	EDI, POS terminals linked to vendor, bar-coding, expert systems, locational systems
Customer retention/ relationship management	High churn, deal-prone customers, focus on last transaction, no learning	Lifetime revenues, win-win relationships, process and goal convergence	Linked information systems, database marketing, mass customization

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innovative thinking to the processes, and employed IT or human resources to enable radical change" (italics added).

Davenport suggests that the reason for this has to do with the very nature of marketing activities: "The open-ended nature of marketing makes it difficult to know when and whether a particular set of activities results in a transaction or relationship. The primary output of a marketing process is thus highly uncertain, and this accounts for many companies' unwillingness to consider marketing in process terms."

Although we won't be able to address re-engineering marketing processes in detail, Exhibit 2 illustrates how re-engineering might affect three key marketing processes: new product development, order management, and customer retention/relationship management.

Ultimately, to be successful, companies will need to have competency in both marketing and technology. Neither alone will suffice.

Managing

Tasks such as planning, analysis, control, compensation systems, and the like all require better marketing management—in the traditional sense of that word. One of the key reasons for poor marketing productivity is that most companies—approximately 70%, according to a 1989 survey by the Institute of Management Accountants—treat marketing activities as revenue centers rather than profit centers. As a result, most marketing managers are under little pressure to deliver high contribution margins.

> Most marketing managers are under little pressure to deliver high contribution margins.

Many companies that do treat marketing as a profit center rely too much on transfer pricing based on actual costs, rather than standard costs. By using standard costs, it becomes possible to separate manufacturing cost performance from marketing performance; the former is typically outside the control of the marketing manager.

Marketing productivity would be greatly enhanced by (1) adopting activity-based costing, (2) budgeting better, (3) linking compensation with effective efficiency, and (4) conducting an ongoing auditing of marketing activities.

Activity-Based Costing

As Philip Kotler points out in the latest edition of his classic *Marketing Management* text, companies such as General Foods, Du Pont, and Johnson & Johnson have established a "marketing controller" position to help improve efficiency. However, this practice is still limited to a few companies and focuses heavily on efficiency of expenditures and profitability; it does not address the effectiveness dimension. To develop a comprehensive marketing accounting discipline, marketing must work with the accounting function.

Developments in this field are occurring rapidly, from the concept of "Economic Value Added" (linking corporate spending to shareholder value creation) to more recent attempts at measuring intellectual capital. These efforts grapple with the measurement of the largely intangible elements that constitute much of the assets and added value in today's businesses. As such, they are potentially very valuable tools for measuring (and thus improving) marketing productivity.

One accounting tool that is clearly of great importance for marketing is activity-based costing. According to Robert Kaplan, one of the pioneers in the ABC field, "Failure to [completely] understand cost drivers leads to SKU proliferation; pricing divorced from actual operating costs; poor understanding of product, brand, and customer profitability; ineffective vendor relationships; and hidden costs from inefficient processes."

The fundamental question posed through the use of ABC is: "Would the customer pay for this activity if they knew you were doing it?" For many marketing activities, the answer is "No."

Traditional accounting methods allocate overhead as a percentage of direct labor. ABC is based on some fairly simple principles. The first is, because most business activities support the production and delivery of goods and services, they should be regarded as direct product costs. ABC thus abandons the traditional accounting practice of treating large blocks of corporate and overhead expenditures as "fixed costs" allocated evenly across all products. Rather, it defines a much wider section of corporate activities and costs as "variable," allocating them as directly as possible to specific goods and services.

> By lowering total system costs, both partners are able to benefit without an adverse impact on profitability.

Activity-based costing becomes especially critical when a company achieves the "preferred supplier" status. In such situations, the customer/partner typically requires that the supplier open its company books, detailing costs for materials, assembly, labor, sales, marketing, and so on. Customers can then bypass entire categories of cost; for example, they may see no need to pay for sales and marketing because the partnership arrange-

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ment makes most of those activities unnecessary.

Understandably, activity-based costing is an element that frightens many suppliers and makes them wary of customer partnerships. Indeed, it can expose suppliers to strong-arm abuse; a customer might insist that a supplier sell at 10% over its cost of manufacturing, with no allowance for research and development, technical support, or other activities considered essential to the businesses.

In successful partnerships, however, customers appreciate the supplier's need to make a good profit. By lowering total system costs, both partners are able to benefit without an adverse impact on profitability. A striking illustration of this comes from Chrysler, a company that works very closely with its suppliers. Chrysler currently has the lowest cost structure of the Big Three carmakers, makes the highest profit per vehicle, and has the most profitable suppliers.

In the grocery business, the use of direct product profitability (DPP) has led to substantial improvements in overall productivity. Marketing productivity can be measured at the account level in a similar way, using a combination of activity-based and account-based costing for marketing activities. ABC enables companies to eliminate the unintended (i.e., hidden) cross-subsidies between accounts that often invite "cream-skimming" competitors to take away highly profitable customers.

The use of ABC in marketing raises effective efficiency through possible reduction in, and more balanced application of marketing resources.

Zero-Based Budgeting

Marketing budgets should be set to achieve specific objectives, rather than fund self-perpetuating commitments. This requires a greater degree of resource flexibility than is traditionally present in most companies.

Marketing dollars also should be reallocated across brands. Well-known, mature brands, for example, should be able to prosper with greatly reduced marketing expenditures. Consider P&G's Ivory brand, which has extraordinarily high levels of consumer awareness and trial. Allocating a large advertising budget to Ivory would be far less productive than using those resources to support a less well-established brand.

Some companies also are experimenting with budgets based on customer acquisition, customer relationship management, customer relationship enhancement, and so forth. This is a sound approach because it forces the integration of marketing elements to achieve a particular objective.

Adjusting Compensation

"The customer pays the bills, but not the wages," said Robert Heller in a January 1994 *Management Today* article. "...[D]ecisions on promotions, powers, positions, perks, punishments are made internally. The practice of internal politics, in most companies, heavily outweighs the theory of putting customers first and foremost."

To improve effective efficiency, companies must create transparent incentive schemes to focus all marketing personnel on the essentials: increasing the profitability of what they do and increasing customer satisfaction. Companies such as IBM have adopted precisely those two criteria in determining sales force compensation, and such approaches could be spread into all areas of marketing.

To improve effective efficiency, companies must create transparent incentive schemes to focus all marketing personnel on the essentials.

One area that companies need to look at more carefully is the use of commissions. Many companies, such as Best Buy, Home Depot, and Charles Schwab, have come to the conclusion that commission-based selling is inherently antithetical to achieving a high level of customer satisfaction. While we would not go that far, we do recommend designing sales incentive mechanisms with utmost care so salespeople are rewarded for effective efficiency.

Continuous Assessment

As in any other human or business endeavor, marketing practices suffer from substantial inertia; new practices are added on slowly and old ones are discarded even more slowly. As with creeping product proliferation, marketing programs have a way of accumulating by perpetuating themselves even after they have outlived their usefulness.

Michael Treacy of CSC/Index Consulting Group has suggested that innovative marketing programs start to lose their effectiveness after three or four companies adopt them. It's important to distinguish here between marketing innovations that are short-lived and those which represent a lasting improvement; the latter may cease to be sources of competitive advantage after others adopt them, but are certainly not candidates for termination. We believe that the relationship marketing paradigm falls under this category.

Marketing could achieve "addition through subtraction" by periodically reviewing and rationalizing the whole gamut of marketing activities, programs, and offerings—a "marketing productivity audit." As always, the criterion to use should be whether or not the elements in question contribute to the achievement of effective efficiency.

In Exhibit 3 on page 30, we have classified the

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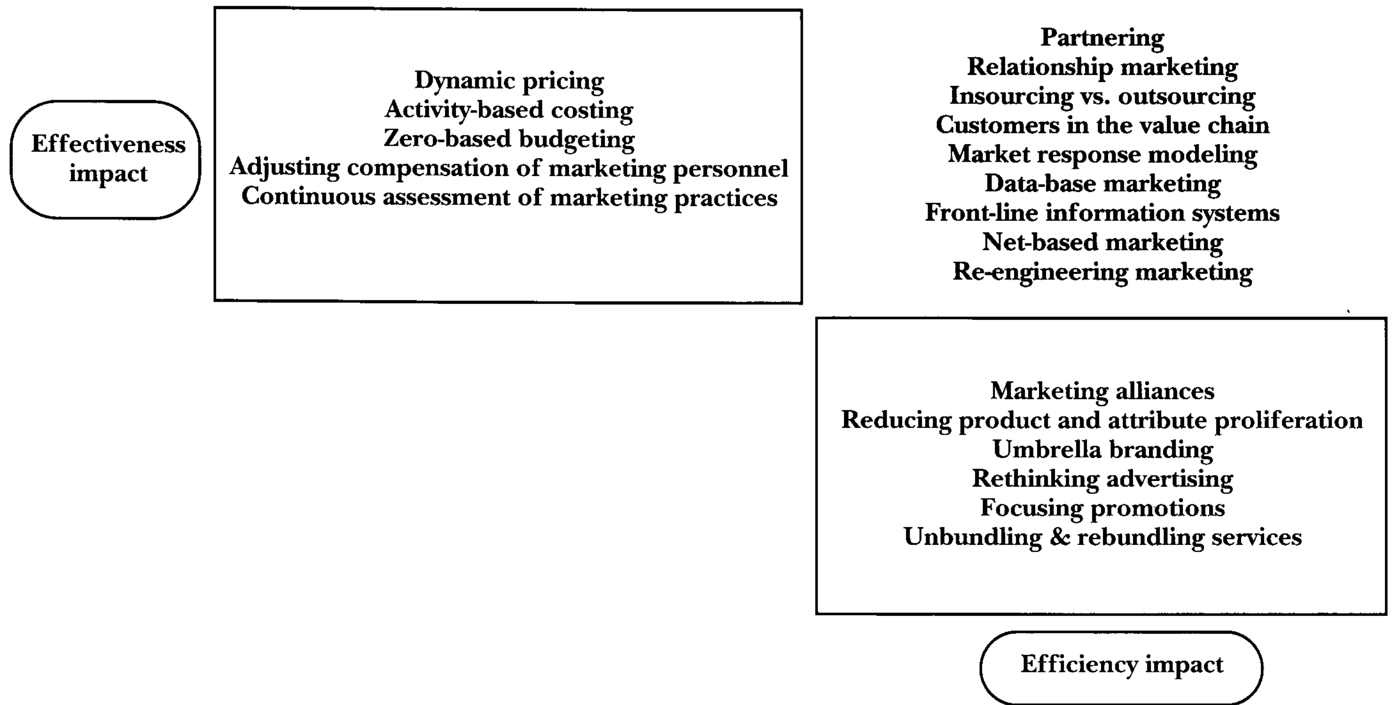
EXHIBIT 3

Classifying approaches to improve marketing productivity



20 approaches to improving marketing productivity on the basis of their primary impact. Each approach has both efficiency and effectiveness enhancing potential, though the primary impact may be only in one area. For a number of approaches, the impacts are strong and nicely balanced between efficiency and effectiveness; most of these have to do with collaborative strategies and the informed use of information technologies.

Science *and* Art

Conducting business in today's globalized, highly competitive marketplace is risky and unpredictable. Customers worldwide are becoming accustomed to outstanding levels of quality at affordable prices. They are no longer willing to subsidize unproductive expenditures by companies, be they on convoluted product development processes, ruinously expensive attempts to push inventory down the distribution pipeline, inefficient purchasing strategies, inefficient provision of support services, or a host of other areas.

Marketing is ultimately about pleasing (even delighting) the customer to such an extent that he or she is willing, even anxious, to engage in a continuous relationship with the seller (see "Productivity Lessons From Most-Admired Companies" on facing page). Incessant pressures to increase marketing efficiency without regard for marketing effectiveness can easily lead to customer alienation, rebellion, and ultimately defection.

Companies must excel at both the art and science of marketing but, unfortunately, most attempts to improve marketing practice focus on the latter. Even though we agree that marketing needs to become more scientific (in so doing, it's bound to become more productive in the traditional sense), this must not occur at the expense of devaluing the art of marketing.

The goals for improving marketing productivity are not all quantifiable. For example, at 3M, marketing goals include increasing earnings by 10% a year as well as achieving the "preferred supplier" status with top customers. The marketing department is assessed in terms of its overall effectiveness to the company—specifically, the amount of sales brought in by a particular product line, customer satisfaction ratings, and budget/cost analyses.

Ideally, the science of marketing must incorporate within it those human elements normally asso-

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Productivity Lessons From Most-Admired Companies

The most-admired company in the United States for two years in a row, according to *Fortune* magazine, has been Rubbermaid. In 1994, Rubbermaid experienced its 43rd consecutive year of sales growth, its 57th consecutive year of profitable performance, and its 40th consecutive year of increased dividends paid per share. The company uses a number of internal programs to assess and improve its marketing productivity.

Its Value Improvement Process (VIP) program focuses on continuous value improvement in three areas: productivity, supplier rationalization, and administrative and technology standardization. For example, as part of its product development process, Rubbermaid has sped up mold and color changes. It has also reduced the number of hues from 426 to 109 (it went from 18 shades of black to only 2). And the number of SKUs has been reduced, for a 35% improvement in inventory turns.

With regard to supplier rationalization, the company has a plan to reduce its supplier base by 80% over three years, leading to closer partnerships and greater economies of scale. Rubbermaid uses electronic data interchange (EDI) and vendor-managed replenishment to standardize links with customers and suppliers. These technologies allow Rubbermaid to improve its market forecasting, inventory management, and customer service. Other computer systems (CAD/CAE/CAM) are used to design, engineer, and manufacture new products more efficiently, reducing the average product development cycle by up to 11 weeks.

Rubbermaid gains a further advantage in the marketplace by forgoing test marketing of its new products, relying instead on focus groups and other evaluation methods. As a result, the company brings out products faster and thwarts copycat competitors. Despite the speed of entry, Rubbermaid's efforts are highly successful, with more than 90% of its new products turning a profit.

Another approach to improving marketing productivity begins with analyzing the top 100 Rubbermaid accounts with respect to percent of purchases, how many products they sell, what colors they stock, and so on. This information is fed into the company's "Best Practices" program, which helps retailers stock and display Rubbermaid products in the most effective manner. The company even has a "Best Practices" room where retailers can view sample displays of various product mixes and other ways to increase sales.

Finally, Rubbermaid's customer service function is handled by a group called "Invincible Customer Service," which is a part of operations. "Invincible" refers to a commitment to provide customer service on a real-time basis. ICS has complete autonomy and needs no authorization from other areas to fulfill its responsibilities to customers.

Another widely admired company, Home Depot, has one simple rule: Spend only on what directly benefits customers. Its stores are cement-floored, warehouse-style outlets with little ambiance. The company does very little advertising and rarely entices shoppers with promotional sales. It employs EDI to reduce the expenses associated with ordering, shipping, receiving, and paying for merchandise. Because all of its suppliers must make shipments directly to individual stores, the company has eliminated all costs associated with product storage and distribution.

Marketing at Home Depot is based on great value and outstanding customer service. The company hires only 2% of job applicants, searching for the right mix of attitude and ability to learn. The bottom line for the company is satisfied customers who keep coming back for more.

—Jag Sheth and Raj Sisodia

ciated with the art of marketing. Continued, intense pressure for efficiency improvements alone can only lead to an increasingly dehumanizing experience for employees as well as for customers. Such a downward spiral benefits no one except competitors.

Over time, the market will become more efficient through the increased availability of information and knowledge. Companies that improve marketing productivity by today's standards will still be vulnerable. Marketing productivity must be considered relative to other companies. As the overall market becomes more efficient, the companies that make more than marginal profits will be those best able to tailor their offerings for market fragments and discriminate by price across customer groups. In a highly efficient market, effectiveness becomes all the more crucial.

The push for productivity in marketing spending is in no way contradictory to creating and maintaining a market orientation. Being customer-

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oriented, however, does not automatically mean spending more on marketing. The fact is that too many companies use marketing dollars as a blunt weapon, believing that if they spend enough, they will become customer-oriented. Instead, they subject existing customers to a barrage of redundant advertising and sales promotions. Focused and tailored marketing spending not only is more efficient, but also reduces the amount of marketing noise and improves customer contentment.

Marketing reform must come from within, rather than being imposed from above. That is the only way to ensure that the changes increase the efficiency as well as the effectiveness of marketing actions.

In the future, marketing will be called upon to make even greater contributions to the corporation than it has in the past. More and more, corporate "top line" success (revenues and market share) will depend on the quality of marketing efforts; at the same time, corporate "bottom line" success (profitability) will depend on how cost-effectively marketing is able to perform its tasks. MM

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Additional Reading

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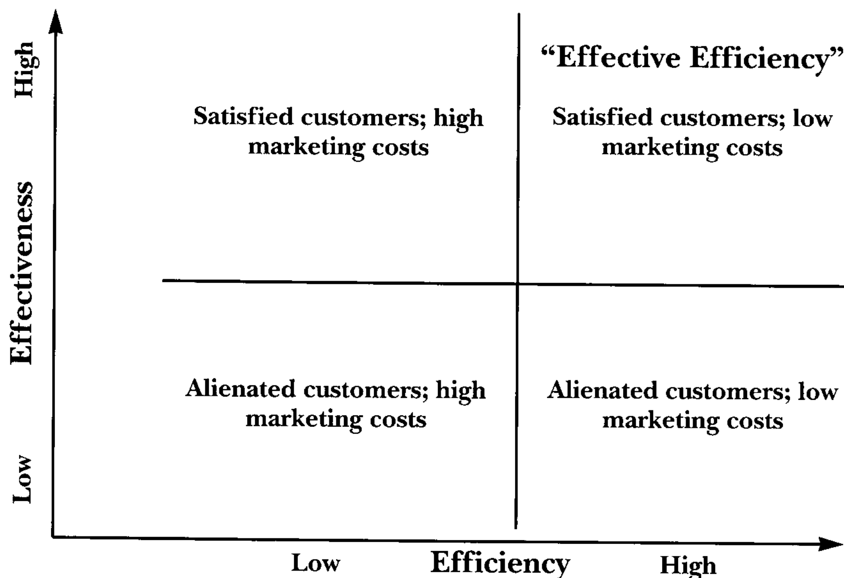
Correction

Exhibit 1 in Part 1 of this article in the Fall 1995 issue contained some errors. The correct exhibit appears below. We apologize for any inconvenience this may have caused.—*The Editors*

Marketing efficiency and effectiveness



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