Sales Excellence

Parlez-Vous BUSINESS

Building the Language of Business *into the* Sales Process

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This book was set in Scottsdale, Arizona by Mullins Creative, Inc.

To my parents, who always said "you can"
and to Rachel and Hannah, who also "can."

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Why Parlez-Vous Business?

Sales people must not only be able to communicate the value of their products; they must be able to create value by the way they sell. The bar has been raised – good is no longer good enough. Yes, sales people need to be able to sell a product-based competitive advantage. However, they also are expected *to be* a competitive advantage.

Product knowledge and great sales skills alone do not translate into success. Sales people must understand their customers' business processes and the business environments within which they operate at a greater breadth and depth than ever before. That is why we wrote *Parlez-Vous Business* – to provide sales people with the business acumen and savvy to win in today's hyper-competitive marketplace … where being "business smart" is a necessity.

In Chapter 1 you will read about the strategic initiatives that companies are instituting to drive success. Chapters 2 through 7 highlight the building blocks that companies are using to develop more effective and efficient internal business processes.

In Chapter 8 you can explore key financial concepts. A significant part of the shift from good to great involves being able to understand the financial analytics required to identify high potential opportunities and to generate the cost justification of your solutions.

The concluding chapter is different. While the importance of providing value is emphasized throughout *Parlez-Vous Business*, Chapter 9 drills down on the call execution skills required to communicate and create customer value. In the end it is always good to remember it is what happens when you are in front of the customer

that wins the day. In this chapter you will explore best practices around the three key face-to-face sales skills – asking questions, active listening, and establishing credibility – at which all top performing sales people excel.

You will find Information Boxes embedded throughout the text. The Information Boxes are designed to provide more information about a topic. Stop and read these when they are relevant for driving your sales success.

Before you begin, we have one suggestion. Time is enemy number one for every sales person. Therefore, we wrote the chapters so that you do not have to read them sequentially. And, if you are already familiar with some of the content in the chapter, that's great news. You can concentrate your time on those segments of *Parlez-Vous Business* that will really help you to drive your business goals.

We hope you can use the material contained in these pages to win new sales opportunities. We would like you to consider *Parlez-Vous Business* only as your next step in becoming smarter about the business world of your customers. New trends and ideas emerge almost daily, so after you have built a bigger and better foundation, keep reading.

JES and RDR

CHAPTER 1

LEVERAGING STRATEGIC INITIATIVES

You walk into a store to find that new Nike shoe on the shelf. You check out the features, try it on for comfort, and then make your way to the cash register. While you're waiting to pay, take a closer look at the shoe. What does it take for Nike to put that shoe on the store shelf?[1]

Well, the average Nike shoe features 24 parts with many people involved in the making of each pair. Category Product Teams, consisting of Nike designers, developers and marketing specialists are responsible for everything from initial market research to material selection and marketing of an individual Nike shoe – a process that can take up to 18 months. Working with recommendations from coaches, athletes, and consumers, the Category Product Team develops a brief containing the desired product features, target price, target consumer, and trends. The Creative Designer then interprets the idea. The Product Developer manages sketches and concepts as they are passed onto Prototyping to create a physical sample.

The Category Product Team then resolves any issues surrounding design and production before producing a "tech package" to send to Nike's sub-contracted factories in Europe or Asia. Working with Tech Managers and Developers from the Nike liaison office and factory, the factory produces samples. The Category Product Team, Pricing, and Product Testing groups work together to test and

modify the samples. There may be many rounds of samples and testing until all specifications are satisfied and the shoe passes approval by the Category Product Team. The final sample then enters production: cutting, stitching, pressing, assembly, and packaging. And finally, the factory ships the finished shoes to Nike distribution centers around the world from where they are distributed to retailers.

You can see that creating and selling a new shoe is not as simple as it might seem. Plus, this whole process occurs in a world where the pace of business is moving at a dizzying speed because competition is intensifying, operations are going global, time-to-market is accelerating, the balance of power is shifting to the customer, and new distribution channels are revolutionizing sales and brand management. Last, if companies plan to sustain a competitive advantage, they can not forget costs or product quality or customer service. Reducing costs, increasing quality, and improving customer service continue to influence the ability of companies to compete successfully.

This is why Chapter 1 begins by looking at a dozen **strategic initiatives** companies are addressing in order to prosper in the 21st century. We begin *Parlez-Vous Business* with them because these strategic initiatives have an affect on almost all business operations. As such, they provide a broad context for what companies must do to achieve success in today's marketplace.

WHAT STRATEGIC INITIATIVES ARE COMPANIES PURSUING?

Emulating competitors is not enough to succeed in an environment where global competition will continue to increase, technology advances will be rapid, and pressures to contain costs will still be strong. Companies are pursuing strategic initiatives to improve business processes. How? By increasing revenue or gaining operating efficiencies.

IMPROVING BUSINESS PERFORMANCE	
Increasing Revenue	■ Extending product lines ■ Building partnerships with customers ■ Providing better customer service ■ Building in switching costs ■ Building customer loyalty
Gaining Operating Efficiencies	■ Reducing product development time ■ Speeding up time-to-market ■ Improving internal communication ■ Increasing productivity ■ Improving product quality ■ Managing inventories and distributing products more efficiently

Companies are seeking to increase revenue and achieve operating efficiencies by implementing several strategic initiatives. The most prominent ones are:

Bringing New Products to Market — Product development is facing a fundamental challenge as companies are faced with bringing new products to market more quickly and ensuring that these products meet the needs of **microniches** – or narrow market segments. It is more pronounced in high-tech, medical, and consumer goods marketplaces where new product innovations are being introduced constantly. For example, the introduction of drug eluting stents has changed the way cardiologists view patient coronary care options. The medical device companies who are first to market with drug eluting stents, such as Boston Scientific and Johnson & Johnson, find themselves taking marketshare from those companies without them.

Using the Internet to Change Business Models — Even if you have not yet made a purchase on eBay, we all know that widespread use of the Internet is continuing to change the way in which companies reach new customers. Just look at Intuit, a company

that markets finance and tax preparation software, as well as Internet-based financial tools. While only sold initially in retail stores, Intuit has been able to increase its Internet-based services for both individuals and businesses. In addition, Intuit has links to many key banking institutions allowing it to access data as well as offer electronic tax filing. The revenue from these services, enabled by the Internet, is steadily increasing as a percentage of Intuit's overall revenue. Behind the scenes, Intuit uses a range of Internet tools and solutions to link and orchestrate vendors – from banks and brokerage houses to insurers and even office-supply retailers.[2] Without the Internet, Intuit's transition to a service-based company would not be possible.

The Internet has even changed the way we buy high-end items. Electronic diamond retailers have leveraged a niche that brick-and-mortar retailers initially doubted – consumers who would buy without seeing and touching the diamond. With sharp images of the diamond and the ability for customers to get close with 3D and zoom technology, buyers can get a clear picture of the product. But what seems to have solidified the sale of diamonds over the Internet was certification assuring buyers of authenticity. So today, diamond jewelry is sold by established jewelers such as Tiffany's as well as virtual stores like Blue Nile and one-stop shops like Amazon. But certification may be a double-edged sword – while it gives customers confidence, it also has made diamonds a commodity.[3]

Building Customer Loyalty — The underlying premise behind customer satisfaction is simple: it costs more to capture a new customer than to care for the one you have. Growth comes from loyal customers' increased purchases over time, their willingness to pay premiums for additional service, and referrals. A 5 percent increase in customer retention converts, on average, to a 25 percent increase in the value of those retained customers over their lifetimes.[4]

For example, Ford loves its big Grand Marquis, earning $7,000 to $10,000 on each car sold. The Grand Marquis succeeds in a low

volume, niche market because it's the only auto maker selling a non-luxury, full-size, six passenger, rear-wheel drive car with a V-8 engine. And that is the car of choice for drivers over age 65 who tend to pay cash and don't demand the latest gadgets or upgrades. These buyers are loyal to the Grand Marquis and keep buying the vehicle because "It's the path of least resistance, they don't have to do a lot of research, they can go to the same dealers, and there isn't going to be a lot of changes to complicate driving the car."[5]

Customer loyalty is one of those concepts that sounds simple, but is hard to attain. Certainly, delivering the right product at the right time in the right quantity underpins customer loyalty. To build customer loyalty, Walgreens Pharmacy offered its customers online prescription ordering before many of its competitors did. Now Walgreens offers customers automatic refilling of prescriptions – in an effort to increase customer loyalty, and thereby increasing the likelihood that customers will continue to fill and refill prescriptions at Walgreens. Southwest Airlines treats its Rapid Rewards members with birthday cards. Papa John's realizes that customer loyalty can be built by effectively handling customer complaints. That's why customers who call the Papa John's toll free number on its pizza boxes or fill out an online form, receive a written apology and a coupon in the mail.[6]

Forming Extended Enterprises — Companies are developing strategic alliances with key suppliers, distributors, and even competitors to extend beyond traditional corporate boundaries. These relationships are being dictated by the new realities of the marketplace. Why? By forming extended enterprises, companies can market their products to customers they would not have been able to reach because the company did not service the geographic area. This is exactly what brick-and-mortar stores do when they adopt a **bricks-and-clicks** business model. Now they are more than a neighborhood store. A customer anywhere in the world may now purchase their products as a result of companies entering into partnerships with Internet portals to access the products and logistics companies to get the products to the customer. So wherever

you live, you can order from Omaha Steaks or Hickory Farms.

Extended enterprises also allow companies to partner with their suppliers and distributors, developing relationships that create value for everyone participating, such as gaining a time-based competitive advantage through speeding up time-to-market, reducing ramp-up time, reducing lead time through **outsourcing**, reducing distribution time, and handling special requests quickly.[7] That's how gains like these can be achieved. Cable manufacturer Okonite is one of many key suppliers who have partnered with Public Service Electric and Gas. These partnerships allow the utility company to reduce inventory costs. Or, rather than relying on its internal design capability, Whirlpool, by using Eaton's design expertise in gas valves and regulators, launched its gas range months earlier.

Re-evaluating the Supply Chain — When companies focus their efforts on extended enterprises, they often refer to the extended enterprise as the **supply chain**. The supply chain consists of all activities involved in creating, manufacturing, and distributing products to customers. Raw materials sitting dormant in a plant do not have as much value to customers as when they move along the supply chain and are turned into a product. For example, a typical high-tech supply chain would begin with raw material suppliers and move to semiconductor manufacturers, board manufacturers, **EMS (electronic manufacturing service providers) OEMs (original equipment manufacturers)**, distributors, retailers, and finally customers. After the chips are placed onto boards and the boards into computers, the computers are moved to distributors and retailers and finally to the customer. Value to the customer is built along each stage of this supply chain.

Everyone cites Amazon as a company that has redefined the traditional supply chain. While Barnes & Noble delayed its Internet entrance, Amazon rewrote the prevailing supply chain in the retail bookseller industry by turning the costs associated with operating brick-and-mortar stores into disadvantages. Although a somewhat

overused example, Amazon illustrates a critical point about information technology and the supply chain. The threat to a company's supply chain probably will come from outside its industry. After all, unlike a company and its competitors, new entrants are not vested in supporting the old supply chains.

And the supply chain is being further redefined as companies move to outsource all or parts of their supply chain. UPS, for example, manages the TheraSense supply chain – including inventory management, pick and pack operations, transportation management, accounts receivable, charge-back processing, and some customer service tasks. This allows TheraSense to focus its efforts on developing and marketing new technologies in the very competitive medical device marketplace.

Using Knowledge Strategically — Knowledge is redefining business operations as we know them. Why? Companies have become decentralized, with disparate operations spread around the world. Capital intensive jobs have been replaced with people-intensive jobs, for which knowledge is a primary asset. In the past, companies served monolithic mass markets, and there was little differentiation in products and services. Now product offerings are tailored to meet the needs of discrete market segments, or even the needs of an individual. The knowledge requirements for creating a competitive advantage in the marketplace have, therefore, significantly shifted over time.[8]

Given the importance of knowledge, companies now must manage knowledge just as they manage physical assets. That's where **knowledge management** enters the picture.[9] Knowledge management is the process of determining what information a company has that could benefit others within their company and then making that information available to them. By sharing best practices and operational information, companies can improve performance. Chevron has saved more than $650 million since 1991 by sharing best practices among managers in charge of energy use at its oil refineries. Texas Instruments reports saving

more than $1 billion by disseminating best practices throughout its 13 semiconductor plants.[10]

Unfortunately, there is no one-size-fits-all way to effectively translate the information a company has into knowledge supporting its mission-critical activities. Some companies create repositories of information about best practices; others are setting up networks to transfer information between staff who interface with customers and those who create products; others are creating formal procedures to ensure lessons learned are passed on to others who are performing the same task.[11]

Regardless of the type of knowledge-management program a company institutes, the key to its success is organizing and sharing information. Companies with knowledge-management programs have a **data warehouse**, which is a data repository making operations data accessible for analysis. Lexmark, for example, developed an inventory management application that uses a data warehouse of retail sales information that enables it to refine marketing campaigns, develop optimal pricing plans, effectively allocate inventory, and proactively schedule manufacturing production. Companies also use **data mining** to sift through the available data to yield meaningful information. That's what Amazon does when it compiles purchase lists by zip codes. These lists allow Amazon to determine what books are most popular at individual companies, universities, or with any other groups identifiable by a zip code. So if you wanted to send your niece a book and are at a loss as to what to select, just search the web site to find out the most popular books purchased most often at the university she attends.

This is a simple example of data mining. The types of information that can be generated from data mining, however, are mind boggling – ranging from automated predictions of trends and behaviors, like the populations most likely to respond to a planned direct mail campaign, to automated discovery of previously unknown patterns, such as fraudulent credit card transactions. The popularity of data mining is increasing across all industries –

to the point where about one-half of the Fortune 1000 companies often use data mining to identify business opportunities that will generate sustainable competitive advantages for them. They use data mining for such varied purposes as predicting sales, determining optimum inventory levels, and predicting production failures.[12]

Using Information Technology to Redefine the Way in Which Companies Operate — Since the mid-1970s companies relied on information systems to support many business activities, such as accounting, human resources, manufacturing, or inventory systems. While no one questions their importance, the focus of information technology is shifting away from simply cutting costs or changing technology platforms. The reality is that information technology is aligning itself with corporate goals and enabling those goals to become reality. With this alignment, information technology is participating in changing the rules of doing business by redefining and transforming entire markets, accelerating the pace of business change, and, in a figurative way, shrinking the world. For example, Quantum View[sm] allows for viewing a shipment's status in several ways – from email messages sent to the recipients to integrating shipment **visibility** into a company's existing information systems.

The fastest growing segment of the business software industry is **Enterprise Resource Planning (ERP)** systems. ERP systems link all corporate operations, including planning, manufacturing, sales, vendor relations, inventory control, human resources, and accounting.[13] Meritor Automotive, a component supplier, has installed an ERP system that allows it to standardize and integrate global business practices in the areas of order fulfillment, accounting, production, and product design.[14]

Once companies have built their ERP systems, the next step is to deploy web-based applications that allow internal and/or external users to access the data. The key here is to help companies make effective use of the tremendous amount of data generated by ERP

systems. At Kohler, for example, users can directly query the data warehouse without having to request the attention of a full-time business analyst. By making its ERP system a web-based application, technical users in the technical services division can access tactical business information.

Companies can either buy or rent their ERP systems as well as other business application software. Renting business application software from an **application service provider (ASP)** is a twist in outsourcing information systems. Companies gain several benefits from renting, including obtaining new business applications faster and enabling a smoother and more predictable cost model for running the applications over time.

One of the newer trends in software is **open sourcing**. It is the free software movement that started with Linux, works on Intel's microprocessors, and whose growth coincides with the explosive growth of the Internet. Users like open software for more than its price – open software opens its source code, making it easy for users to modify it to suit themselves and for programmers to share improvements. Today, you come into contact with open source-based software when you buy a book on Amazon.com or search for information about a movie on Google. The Sabre travel reservation system uses Linux and open-source data base software. And tomorrow? Open sourcing is predicted to become an inescapable margin eroder for just about every company doing anything in software.

Redefining Performance Metrics — At one time companies relied solely on financial metrics to measure performance, such as **return on investment (ROI), current ratio,** etc. This is no longer true. Because financial ratios alone do not provide management with the broad information they need to measure performance accurately, companies are turning to broader measurement metrics to better understand organizational strengths, weaknesses, and future prospects.

One of those most popular methods for measuring corporate performance using multiple business dimensions is the **Balanced**

Scorecard.[15] Introduced by Robert Kaplan and David Norton, The Balanced Scorecard tracks whether or not a company is achieving its key goals and whether these goals are still appropriate. By focusing on key goals, The Balanced Scorecard moves beyond financial measures by including three other perspectives: customer, internal business process, and learning and growth. Together these four measures all contribute to customer loyalty and profitability. The Balanced Scorecard provides companies with a performance system that focuses on strategic issues rather than on operational issues. Many companies have adopted this tool as their primary corporate management system – using it to set goals, to allocate resources, to compensate staff, and so on.

Kaplan and Norton have expanded upon The Balanced Scorecard with a methodology to measure the strategic readiness of intangible assets – which has always been the holy grail of accounting. For many companies, their intangible assets, like employees' skills or organizational cultures are worth far more than their tangible assets. And because intangible assets are difficult to imitate, they can provide companies with a source of sustainable competitive advantage. By measuring these intangible assets, a company would be able to determine its true competitive position. Kaplan and Norton propose the **Strategy Map** as a framework for linking intangible assets to shareholder value creation through four interrelated perspectives: financial (the tangible outcomes of strategy in traditional financial terms such as ROI or shareholder value), customer (the value proposition the company intends to use to generate sales and loyalty from targeted customers), internal process (the critical processes that create and deliver the differentiating customer value proposition) and learning and growth (the jobs, systems and organizational climate required to support the value creating internal processes.)[16]

Finding a Qualified Workforce — Shifting demographics, advances in technology and increases in global trade are the strongest forces shaping the world of work. The U.S. workforce will be smaller, more diverse, and more vulnerable to global competi-

tion. According to the Rand Corporation[17] the annual growth rate of the nation's workforce is expected to slow to a nearly static .4 percent by 2010. The slowing workforce growth rate is caused primarily by a 25 percent decline in the birthrate that followed the end of the baby boom in the mid 1960s, coupled with a trend toward earlier retirement by men. The influx of immigrant workers and women into the workforce has counteracted these trends so that the workforce continues to expand, although at a slower rate.

At the same time, employees will be more mobile and work in more decentralized, specialized companies with less formal and more individualized employer-employee relationships. While technology has many benefits for the workforce, such as increased productivity, it also forces workers to maintain their skills through lifelong learning. Workers with fewer skills will command much lower salaries and risk job loss to their better-trained counterparts – domestically and globally. At the same time, technology-mediated learning offers promise for worker training and retraining.

Outsourcing — As the marketplace becomes more competitive, companies are looking for ways to strengthen their positions while reducing costs. Procter & Gamble, for example, has outsourced its IT systems services to HP Services. Campbell Soup has outsourced its information technology infrastructure to IBM. Many companies, like Sun Microsystems, outsource their **in-bound call centers** (customers calling the company) and **out-bound call centers** (company calling customers, such as telesales). USAA outsourced to RR Donnelley the production and fulfillment of prospect requests for information about various products, freeing internal resources to focus on its core competencies. Utilities are increasingly outsourcing specific tasks, with one of the most common outsourced functions being bill printing and mailing. About one-third of utilities are outsourcing their bill printing and mailing functions.

Offshoring — During the past twenty-five years, companies have increasingly been moving some of their operations offshore, primarily to reduce costs. This brand of **outsourcing**, sometimes called

offshoring, has received a lot of attention of late as companies have moved beyond manufacturing and/or assembling products; routine, back office tasks that are labor intensive, like insurance claims, personnel records, and billing records; and call centers. Now many U.S. companies are moving knowledge workers' tasks overseas to cheap labor sites outside the United States IBM, for example, is transferring programming work from U.S. locations to Bangalore, India, Shanghai and Dalian in China, and Sumare, Brazil. Accenture Ltd., an IBM competitor is doubling its workforce in India to nearly 10,000.[18]

Taking advantage of cheaper labor makes sense for many companies: Motorola, is creating a research and technology hub in India by adding more employees to its current 1,500 in order to take advantage of the highly skilled workforce that will work for half the salary of U.S. workers; Delphi Automotive, is setting up purchasing offices in Europe, South America, Asia Pacific and Central America in order to lower overall costs; and Gillette is outsourcing packaging to the United Kingdom to improve customer service and to focus on core competencies.

Companies are also offshoring to use the sophisticated design and management capabilities of their partners in the developing world. Hewlett-Packard provides one example of a U.S. company that works with original-design manufacturers to gain the ability to compete. It has expanded its relationships with digital-original-design manufacturers in Taiwan – collaborating with Tekom Technologies to build on that company's pioneering position in personal-computer cameras and to deepen Tekom's capabilities in higher-performance digital cameras.[19]

Addressing Security Concerns — At one time security concerns were limited. September 11th dramatically changed that reality as nations strive to ensure safety and security for their citizens, and companies strive to ensure safety and security for their employees and their customers. Today the concern for security is expressed in multiple areas, such as intrusion detection and control, asset pro-

tection, access management, information systems integrity and video surveillance, transporting products globally, and systems have been put into place to address them.

Some of these security-based solutions are now being extended to improve efficiencies. For example, by manufacturers applying anti-theft tags (**source tagging**) retailers are realizing secondary benefits beyond loss prevention, such as reducing revenue-generating labor hours.

WHAT ARE THE BUILDING BLOCKS OF BUSINESS?

The strategic initiatives you have been reading about affect all aspects of business. Today successful companies are not only aggressively exploring these strategic initiatives, they are also looking inside their organizations to see how they can achieve competitive advantages and gain operating efficiencies. They are viewing their organizations as a collection of business processes rather than as discrete business activities. Business processes are combinations of the different business activities you will be reading about in *Parlez-Vous Business*. For example, the product development process includes activities performed by research and development, marketing, sales, manufacturing, and customer support. Some business processes, such as order management or customer service, cross external organizational boundaries, extending to suppliers and customers. Now that we've reviewed the initiatives, it's time to investigate in depth the business process building blocks that companies are leveraging to prosper in today's marketplace.

Endnotes

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9. Many companies believe that Knowledge Management is so important that they are creating Chief Knowledge Officer (CKO) and Chief Learning Officer (CLO) positions.
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11. "Do We Know How to Do That? Understanding Knowledge Management," *Harvard Management Update*, February 1999, Volume 4, Number 2, p. 1.
12. Efraim Turban, Ephraim McLean, James Wetherbee, *Information Technology for Management,* John Wiley & Sons, 1999.
13. Initially, ERP system concentrated on back-office functions, such as logistics, manufacturing, and finance. Now ERP systems are focusing on front-office functions, such as sales, marketing, and customer service too. Moving into the front office area puts ERP vendors in direct competition with CRM (customer relationship management) vendors, whose products are positioned to support front-office activities. For more information about CRM, see Chapter 3.
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CHAPTER 2
UNDERSTANDING THE MARKETPLACE

Sears assumed its way of doing business was the right way – ignoring changing customer demographics and their shopping habits. As a result, Sears lost business to: department stores offering customers more ambience; discounters and specialty stores like Home Depot and Circuit City focusing on a single category of goods but offering huge assortments at low prices; and Wal-Mart and Target stores offering the widest possible variety of goods at prices Sears simply could not match.

Rapid marketplace changes often make yesterday's winning marketing strategies obsolete. Increasing global competition is making traditional geographic marketing boundaries irrelevant. All companies feel the effect of booms and downturns in the global economy. And information technology is redefining marketing – from how products are sold by companies to the way companies relate with customers and distributors.

To succeed, companies must be customer-driven *and* market-driven. Just developing the best product or technology is insufficient. The key to success will be a strong focus on the marketplace and a total commitment to providing value to customers.

In this chapter we'll look at:

- What issues do companies face when trying to understand the marketplace?
- How do companies identify marketplace opportunities?
- How are markets defined?

WHAT ISSUES DO COMPANIES FACE WHEN TRYING TO UNDERSTAND THE MARKETPLACE?

Today's successful companies acknowledge that the key to the future is how well they can provide value to their customers. Therefore, the primary issues Marketing faces when trying to understand the marketplace are:

Growing Mass Customization — Customers are demanding solutions that meet their individual requirements. Easy access to data allows many companies to treat customers as individuals rather than as part of a large market segment. That is what Lands' End custom jeans, chinos, and shirts program does – it allows customers to select the features customized just for them. Lands' End customers can go to a "design your jeans page" where they select color, rise, leg style, etc., along with entering their measurements. Production is done in Mexico.

In less than one year, 40 percent of Lands' End customers were buying custom jeans and chinos from its web site, at $20 to $30 more than traditional merchandise. And every garment improves with re-order – increasing customer loyalty and the number of repeat purchases. The re-ordering system allows consumers to target alterations ensuring a one-of-a-kind fit. Re-ordered garments become as unique as the customer who creates them – allowing Lands' End to manufacture a variety of similar, yet uniquely individual products.[1]

Efforts like Lands' End are a type of **Customer Relationship Management (CRM)** program. CRM programs gather and retain information about customers and their interactions with the company. They provide information, ultimately allowing companies to improve customer communication, customer service, and even back-office functions. Big companies have spent big dollars on CRM technology in recent years to hone their sales and marketing processes and now smaller companies are following suit. Why the rise of CRM programs? Competition. As competition for the most desirable customers increases, companies are shifting their empha-

sis toward strengthening customer loyalty. After all, it costs far less to retain and satisfy current customers than to acquire new ones. This concept is not new – back in Alfred Sloan's day, General Motors introduced the "value ladder," where GM would sell a specific line of cars to customers at each stage of their lives. Today, however, the Internet is being used to build customer loyalty by tightening relationships with previously anonymous buyers. (See Chapter 3 for a discussion of customer loyalty programs.) But, hanging on to every customer is not profitable. Some customers buy in low volume, some require a lot of service, and others may have high return rates. CRM systems provide companies with data allowing them to determine the relative value of each customer – and then focus marketing and sales efforts on the most profitable customer segments.

Changing Marketplace — Globalization and the Internet are redefining the marketplace and its dynamics. Customers are more knowledgeable, the number of suppliers and distributors has increased, and the number of competitors is rising as global boundaries are falling. Customers have more ways than ever to purchase products. That is why customers in the Midwest now can go online and order a favorite toothpaste directly from a German pharmacy. Or if they want Tupperware, there's no need to find a Tupperware party – they just access the Tupperware web site.

Globalization also means companies can actively seek out new customers. For example, as U.S. sales shrink because consumers buy disposable butane lighters, or none at all as the number of smokers declines, Zippo looks overseas for new customers. Today, 60 percent of Zippo's annual sales come from overseas. In Japan, Zippo lighters with engraved images of American flags, American eagles, and even logos like Harley Davidson command a premium price. Now Zippo is turning to China selling Zippo lighters engraved with an ideogram or the image of a Peking opera mask.[3]

With globalization, however, comes addressing the requirements of new government regulators. GE found its acquisition of Honeywell

stalled by European antitrust regulators. And Microsoft is facing sanctions from the European community that could lead to PC makers asking Microsoft to make stripped-down versions of its Windows software available outside the United States. Furthermore, as Microsoft discloses technical information about its server software, competitors can use that knowledge to compete globally, not just in Europe.[4]

HOW DO COMPANIES IDENTIFY MARKETPLACE OPPORTUNITIES?

Companies monitor changes in their environment by **environmental scanning**. Through environmental scanning, they identify those external factors that are beyond the company's control yet provide opportunities the company might leverage. The opening of Eastern Europe following the fall of the Berlin Wall provided opportunities to management consulting companies as businesses throughout the world sought assistance when entering these markets. On a lighter note … low carbohydrate diets have led to the largest sales jump in pork rinds since the 1980s. The same dieters are tracking down Laughing Cow Light cheese because the "South Beach Diet" chose it as an officially approved snack.

Not all companies are enjoying sales gains from the popularity of low carbohydrate diets. Sales of Wonder Bread, Twinkies, and Hostess cupcakes, are declining – illustrating how external factors also may present threats companies must minimize. So did the introduction of the plain paper copier. Besides threatening the mimeograph machine market, the Xerox patents closed the marketplace to competitors for years. However, once the patent expired, Kodak, IBM, Canon, Sharp, Minolta, Ricoh, Konica, Lanier, and others entered the market.

A company's business environment is not limited to external factors. To complete an environmental scan, companies must also look at the internal factors, which are those factors under their control. They can include, for example, the products themselves; product

EXTERNAL FACTORS (Beyond the Company's Control)	
■ Competitors	■ New Technology
■ Customers	■ Physical Environment
■ Distributors	■ Entry Barriers
■ Suppliers	■ Economy
■ Government Laws and Regulations	■ International Issues

support capabilities; geographic presence; corporate image and reputation; staff; copyrights, trademarks, and patents; and internal systems, such as manufacturing systems or human resource management systems.

One tool that companies use to analyze the business potential of each of their products is **portfolio analysis**. Portfolio analysis tools look at products given their market growth rate and relative market share. The portfolio analysis tool most often cited is the **Boston Consulting Group (BCG) Model**. The BCG model is a two-by-two table that presents the market growth rate on the vertical axis and the product's market share relative to that of its largest competitor on the horizontal axis. Each of the four cells indicates a different product status. **Question Marks** are those products that are relatively new. When successful, Question Marks become **Stars**. These products are leaders in their market. Over time, when a Star's growth slows down yet still maintains a large market share, it becomes a Cash Cow. **Cash Cows** provide companies with revenue to fund the development of their Question Marks and Stars. Finally, as market growth declines, a product may produce a minimal profit or even a loss. These products are called **Dogs**.

After plotting a company's products on the matrix, it can then determine whether the product portfolio is healthy or if it is unbalanced – that is, too many Dogs or Question Marks, too few Stars and Cash Cows. Achieving a balance is critical because companies must maximize how their resources are invested. After all, if a com-

pany has only Cash Cows, it will be cash rich for a while, but what happens when the growth of these products slows down – where are the Question Marks and Stars to replace them? Or if a company doesn't have a Cash Cow or two, where will the resources come from to invest in new Question Marks and Stars?

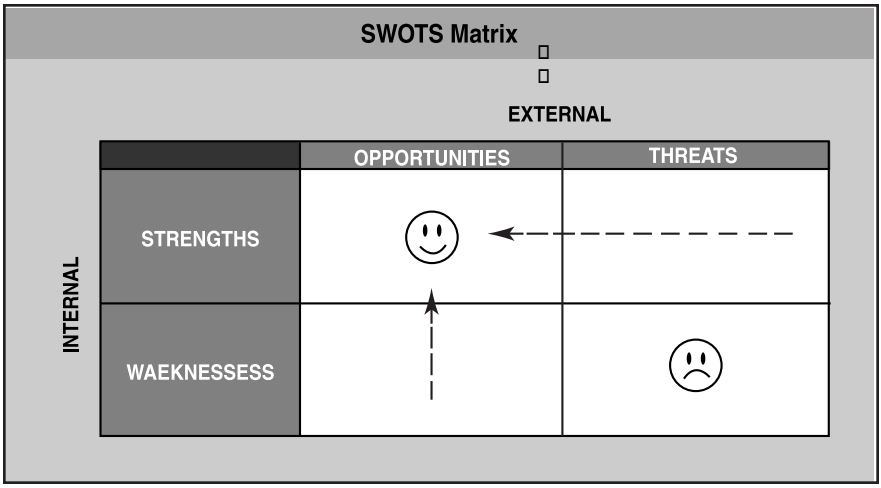
BCG MODEL	
Question Marks Products begin as Question Marks. They operate in high growth markets but have relatively low market share. A Question Mark requires a large cash infusion since the company must add plants, equipment, personnel, etc., to keep up with the fast-growing market. The company must decide whether to keep pouring resources into this product or to invest in other ventures.	**Stars** Stars are successful Question Marks. A star is the market leader in a high growth market. This doesn't necessarily mean that the Star is producing a positive cash flow. The company must spend substantial funds to keep up with the high market growth and fight off competitors' attacks. Stars are usually profitable over time and turn into a company's Cash Cows.
Dogs Products that have weak market shares in low-growth markets are Dogs. They typically generate small profits or losses.	**Cash Cows** Products that operate in a market where the growth rate is falling, but the product still has a large relative market share are Cash Cows. A Cash Cow produces a lot of cash for the company. Yet there is little capacity expansion because the market's growth rate has slowed down. Companies use Cash Cows to pay bills and to support the cash-hungry Stars, Question Marks, and Dogs.

Here's how it works. Do you remember the Apple II computer? Apple used this product as its Cash Cow to develop new products like the Lisa and the Mac. You may not remember the Lisa, a forerunner of the Mac. Its market presence was short lived – quickly moving from Question Mark to Dog status. But the Mac moved from Question Mark to Star to Cash Cow status. As a Cash Cow, the Mac

supported development of the Newton, Apple's first personal digital assistant, as well as the Powerbook, iMac and the iPod.

As you can see, products change their position in the matrix over time. Successful products like the Apple II start out as Question Marks, hopefully become Stars, then Cash Cows, and finally Dogs toward the end of their life cycle. For this reason, companies should examine not only a product's current position in the matrix (like a snapshot) but also its future positions (like a motion picture).

The final step in environmental scanning is to look at the impact the external and internal factors will have on the company. Companies do this by creating a **SWOTS Matrix** (also known as a TOWS Matrix or a WOTS-UP Matrix). The easiest way to think about how a SWOTS Matrix works is to ask yourself the question: What are the implications? First, identify all the external factors that might affect the company, such as increasing competition or new government regulations. Continuing our example, we would ask the question: What are the implications of increasing competition or new government regulations? The answer reveals opportunities the company can leverage or threats it must minimize. You should use the same process to analyze the company's internal factors. This analysis will highlight the strengths the company may leverage and the weaknesses it must minimize.



HOW ARE MARKETS DEFINED?

Companies pursue an **undifferentiated marketing** approach when they assume all potential customers have similar needs. These companies believe most customers can be satisfied with one product or service, one price, one promotional program, and one method to distribute the product. That is how Coca-Cola was first marketed – one soda for everyone. But today the Coca-Cola Company markets more than 40 different beverages in the United States alone.

Few companies follow an undifferentiated approach anymore. You would not market a yacht to everyone interested in buying a boat, would you? After all, some boat buyers might want a kayak while others might want a speedboat. In this case, using one marketing approach for everyone would be wasteful. Instead, you should focus on the portion of the boat market that might want to buy a yacht. Such a group is called a **market segment**. A market segment is a group of individuals or companies within a market that have similar requirements and preferences for a market offering.

The process of dividing a market into segments is called **market segmentation**. Just glance down the hair-care aisle the next time you're in the supermarket. Procter & Gamble markets several shampoos: Pert Plus is its convenience-oriented shampoo, Pantene Pro-V is the more beauty-oriented shampoo, Vidal Sassoon is the salon-competitive shampoo, and Head and Shoulders is the dandruff-protection shampoo. And Procter & Gamble markets Daily Defense, Physique, Herbal Essences, and Infusium 23 shampoos, too. Why invest resources into seven different shampoo brands? Each brand is designed, manufactured, and marketed to meet the needs of a different market segment. In this case, the segments may be drawn from differences in product usage and demographic data. The most common basis for segmenting consumer markets are: product-related, demographic, psychographic or lifestyle, and geographic.

MARKET SEGMENTATION FACTORS	
Customer Segmentation Factors	
■ **Product-related**	Volume usage, End use, Benefits sought, Brand loyalty, Price sensitivity
■ **Demographic**	Age, Gender, Race, Ethnic group, Income, Nationality, Educational level, Occupation, Family size
■ **Psychographic**	Striver, High achiever
■ **Geographic**	Urban, Rural, Suburban
Business Segmentation Factors	
■ **Industry**	Technology, Manufacturing, Financial
■ **Customer Size**	Total sales, Number of employees, Number of locations
■ **Customer Behavior**	Volume usage, Ability to support product, Purchasing process
■ **Geography**	Domestic vs. Foreign, Urban vs. Rural

Business markets are segmented too. Canon, for example, divides the marketplace into multiple segments, including large businesses, government, education, and SOHO (small office/home office). The segments vary in size, usage patterns, purchasing process, and number of locations, among other characteristics. The four segmentation factors most often used to segment the business market are: industry, customer size, customer behavior, and geography.

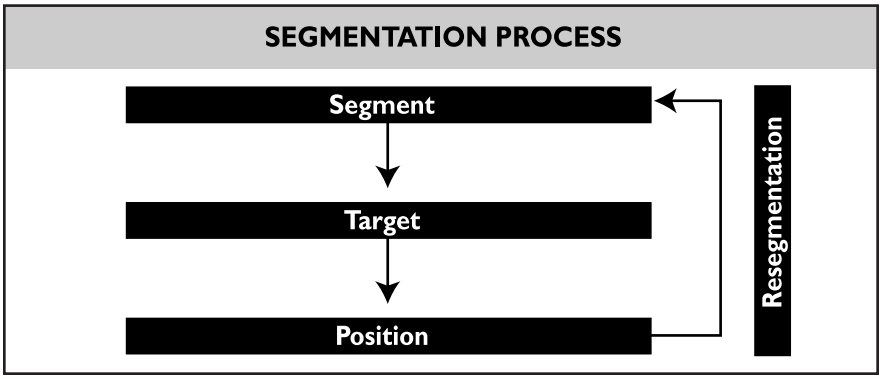
Before we continue, a word of caution … just being able to divide a market into segments isn't sufficient. Market segments must be viable! Viable market segments meet these criteria: identifiable and easily accessible, measurable, potentially profitable, and reachable through effective promotion programs.

Although companies divide the marketplace into segments, they usually don't pursue all the market segments. Rather, companies select the segment(s) that best fit their strategy as the one(s) the company should pursue. The **market segments** a company

chooses to focus on are called **target markets**. Once a target market is selected, products or services are created to meet their requirements. This is called **positioning**. This is what Kellogg's does – positioning different cereals for children and adults. And so does Canon, focusing some products to home and small business buyers while others meet the needs of large companies.

Segmenting the market doesn't stop here. Companies periodically must redefine the market segments because, as we said at the beginning of this chapter, the environment is constantly changing. This means that companies must continuously ensure that they are positioning products or services to the target markets that best meets their needs. The process of redefining market segments is known as **resegmentation**. Without resegmentation two outcomes are possible. First, because the companies are not reassessing the marketplace, they will lose opportunities to create products and services meeting the marketplace's needs. For example, 20 years ago one of the wealthiest population groups in the United States was not older Americans. However, today older Americans are a lucrative target market for many companies. Airlines, hotels, movie theaters, restaurants as well as a host of other businesses are creating products and services to attract this "new" segment.

Second, a company may identify a new target market and provide these customers with a product that better meets their needs. Unfortunately, this new target market might contain a large portion



of your market segment! The Swiss watch industry illustrated this scenario when Seiko brought mid-priced, high-quality watches to market. Seiko resegmented the market and created a product line specifically to meet the needs of its new market segment – baby boomers. The lower-end Swiss watch manufacturers, however, didn't identify baby boomers as a separate market segment at that time. You know the rest of that story.

Endnotes

1. Blake Ives, "Customer Made Apparel and Individualized Service at Lands' End," *Communications of AIS*, Volume 11, Article 3, January 2003.
2. Brian Caulfield and Ting Shi, "An American Icon in China," *Business 2.0*, March 2004, p. 58.
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CHAPTER 3

INTRODUCING PRODUCTS

Remember the first time you saw an OXO Good Grip knife? You know it's the one with the thick, black handle. Many of us chuckled when we first saw it. But today you can buy a Good Grip screwdriver, Good Grip car cleaning tools, or even a Good Grip garden shovel. Why the success? Well, even those of us who don't have arthritic fingers came to realize Good Grip products work quite well. Good Grip handles reflect a trend in marketing – **universal design** where the focus is on functionality of space and design. Universal design is popping up all over. In hotels many amenities originally created for aging and disabled travelers are popular with all guests. After all, baby boomers with their hands full willingly bypass the stairs and wheel their suitcase up the ramp. And when they reach the door, it's easier to open a door with a lever than with a knob.

And that's not all. The next time you're in a hotel room, notice that the room is decorated in primary colors because pastels are often difficult to distinguish. Or you may find hotel brochures are no longer printed on hard-to-read glossy paper. These changes in hotel rooms illustrate how products are morphing.

At the same time, designing new products is a challenge as customer requirements increase in complexity and customers become more knowledgeable consumers. Today, customers would want their Model T's in a variety of colors – not just in black as originally offered by Henry Ford.

In this chapter we'll look at:

- What issues do companies face when introducing products?
- What is the marketing mix?
- What is a product?
- How does marketing services differ from marketing products?
- What role do customers play?

WHAT ISSUES DO COMPANIES FACE WHEN INTRODUCING PRODUCTS?

When creating new products, companies must consider these issues:

Shortening Product Life Cycles — The product development process is being redefined. As the length of time products are on the market decreases, it is more difficult for companies to capture significant levels of market share or to recoup investments. Nor can they stave off competitors. Sony, for example, no longer enjoys a three-year lead on its new products before competitors copy them. Now Matsushita and other rivals copy the products within six months.[1]

Occasionally the reverse occurs and product life cycles are extended. The iMac provides a case study of how Apple extended the life of its technology by repackaging a product. Prior to the iMac, none of the desktop computer manufacturers thought the appearance of personal computers was critical to customer preference, so most of us bought desktop computers housed in bland beige casings. Apple took a different tact, introducing the iMac with little new functionality, but in a new package. Customers viewed the iMac's "Life Saver colors" and styling as innovations and responded – extending the Mac life cycle.[2]

Speeding Time-to-Market — To create new products faster, companies are focusing on streamlining their product development process by instituting disciplined timelines, conducting strict

design reviews, introducing processes that are flexible rather than sequential – allowing them to react to information continually rather than at intervals or in batches, and creating cross-functional product development teams.[3] These teams work together to push new products through development and into the marketplace. So now when a glitch occurs, work proceeds because companies are using a concurrent approach to product development. Before, one glitch held up development.

Many companies are now looking at launching new products more quickly by improving the quality, timing, and synthesis of product and process information throughout the development cycle. For example, **lean development** is a system of principles, tools, and skills by which Toyota has streamlined its product, manufacturer, customer, and supplier relationships. Lean development is now Toyota's most important source of competitive advantage. Toyota has been able to achieve 30 percent reductions in cost at each design cycle as well as to saturate market niches with many more differentiated products than its competitors. Furthermore, Toyota has dramatically improved its development system over the last decade, cutting time to market by 50 percent and dramatically improving its ability to innovate. Speed-to-market is achieved by maximizing effectiveness in both the product design and manufacturing stages.[4]

Some manufacturers are speeding up time-to-market with **CIM** systems. CIM systems combine a company's business and manufacturing plans with **CAD** and **CAM** systems. Allen-Bradley, an industrial controls manufacturer, was able to reduce the time it took to develop an electrical control device from five years to only two years by using CIM. For further information about CIM, CAD, and CAM see Chapter 5.

Speeding Time-to-Market Share — People very often confuse the concepts of speeding time-to-market and speeding time-to-market share. They are not the same. Too often a company is first to market, but a competitor quickly surpasses its market share. When

the competitor launched the product, not only was the product available in sufficient quantities to meet demand, the support systems were also in place. Customer service and technical service staff were trained to support the product; the sales force was trained to sell the product. Although second to market, Boston Scientific did just that – overtaking J&J's lead in the drug eluting stent marketplace.

Changing Competitive Landscape — Only two or three years ago, Sony would have dismissed Dell as a competitor in the flat-panel television monitor market or Nokia in the hand-held video game market. Not anymore. Sony knows that these newcomers to the home entertainment business, and many others like them, can produce what they say they will and do it for less. To move past the competition, Sony is working with others companies – producing next-generation liquid crystal displays with Samsung and working with Toshiba and IBM to develop a high-powered chip that will become the centerpiece of an array of new digital gadgets.[5]

Changing competitive landscapes are not limited to the technology arena. Just look at some of the products on supermarket shelves. Clorox is making a classic up-market push with GladWare by introducing more sizes and shapes. Besides taking market share from Tupperware, these low cost containers have opened up new business opportunities. GladWare is now being used to package Hillshire Farms luncheon meats – allowing the company to slice its meat more thinly and leaving customers with a reusable GladWare container rather than a torn plastic package after they finish their cold cuts.[6]

Involving Customers in Product Development — Speeding up time-to-market is not the only change in the product development process.[7] Companies are increasingly involving customers when developing new products. The rationale? To ensure new products and product enhancements really do meet customer needs. That's what ADT's Sensormatic group does. ADT regularly gathers customers to discuss its Sensormatic anti-theft products throughout

the year as well as during its annual meeting. By getting feedback from potential customers, ADT can find out how it should reengineer a product or service a customer differently. For example, as a result of retailer feedback, ADT developed a Sensormatic hand-held sensor so mobile cashiers could disable anti-theft labels and scan products in the checkout line near the holidays when those lines tend to be long.[8]

Many companies are soliciting customer input by creating customer advisory boards to improve service, products, or ways of doing business. These advisory boards can help companies take the guesswork out of determining new products and services. Many, like CyberGuard, find that when customers take ownership of new ideas, they are going to support them. These advisory boards may also be used to provide a reality check for how a company is performing. When taking this path, companies should commit to some action on customers' feedback or customers are not likely to take their time to give their opinions again. Finally, the composition of the advisory board can create selling opportunities. For example, by talking with smaller customers who represent potentially large opportunities, the advisory relationship may help transform a smaller customer into a bigger customer over time.[9]

Leveraging Information Technology — Information technology is changing how new products are created in several ways. Here are three examples. First, as a result of the Internet, consumers have more choices when purchasing products and are more knowledgeable about the products they purchase. Second, more sophisticated purchasing systems have resulted in companies being able to identify vendors when new supplies are needed to produce new products faster. Third, information systems allow companies to improve their customer support offerings, thereby increasing customer satisfaction. (You may read more about these points in this chapter and in Chapter 4.)

WHAT IS THE MARKETING MIX?

Once a strategy is in place, companies are ready to create their product offerings. To do this, they must decide how to combine the four marketing factors so product offerings fit the target markets they identified. The four factors are the product or service itself, its price, its placement (distribution in the marketplace), and its promotion. Collectively, these elements are known as the **marketing mix** or the **4 P's** of marketing.

MARKETING MIX	
Product or Service Determining the product or service features, brand name, packaging, warranties, etc.	**Price** Determining base prices and discount plans to achieve desired goals, such as gaining market share, defining product status maximizing profit, or even making room for new models.
Place (or Distribution) Selecting channel members, such as wholesalers, distributors, and retailers, plus storage and transportation decisions.	**Promotion** Using advertising, personal selling, sales promotion, and public relations to promote product or service. Many companies are integrating their marketing communications – coordinating communications to deliver a clear, consistent, compelling message about the company and its products.

The 4 P's are interdependent: a decision about one will have an impact on the others. That explains why a $200 shirt is not carried by Wal-Mart or why a $25 wing tip dress shoe is not stocked by Neiman-Marcus. While this example is intuitive, don't make the mistake of thinking that the 4 P's follow strict algorithms. A company can vary how it defines its marketing mix by changing one or more of the P's – using one marketing mix to position products to reach one target market and a different marketing mix to reach another target market. For example, the Gap positions Old Navy and Banana Republic to serve different target markets.

Let's focus on the product portion of the Marketing Mix now. In Chapters 6 and 7, you will have an opportunity to read about product distribution.

WHAT IS A PRODUCT?

Most people define a product only in physical terms – what they can touch, hold, or feel. That's not true. In planning a product or service offering, companies need to think of a product as having multiple parts: the core or generic, the tangible, and the augmented.

Core or Generic — This is the fundamental service or benefit the customer is really buying. For example, when you buy an electric drill, you are really buying holes. Since the holes themselves are not for sale, you have to buy a drill. Here the core portion of the product (the holes) is translated into a tangible product (the drill).

Tangible — The tangible product is the portion of the product that you can touch or hold. Again, the tangible product in our example would be the electric drill. Sometimes the tangible part of the product can be held only in a conceptual sense like computer software, where the tangible part of the product is the computer code.

Augmented — The third part of the product is the augmented product. It consists of additional services and benefits that distinguish the company's offering from its competitor's offering. This might include a toll-free customer service number, warranty, or other guarantees for the electric drill.

Today competition essentially takes place at the augmented level. That's because there's little difference between the products companies produce. Differentiators stem from what companies add to their tangible products in order to provide value to their customers. The added value may come in the form of packaging, services, advertising, customer support/service, delivery arrangements, warehousing, and so on.

Product Line Decisions — Multiple products make up **product lines**. Companies often extend their product lines by adding new products or services. **Downward stretches** are used by companies to add less expensive products to their product line. This is what IBM did when it added PCs to its product line in the 1980s. Levi Strauss created a lower priced line, Levi Strauss Signature, to sell at Wal-Mart. When making a downward stretch, companies face three risks: cannibalizing their high-end products or services, provoking their competitors to move into the high end, and losing dealers who may not be willing or able to handle the low-end products.

Companies operating in the low end of the marketplace might consider entering the high end by implementing an **upward stretch**. These companies may be attracted to entering the high end of the market in order to gain a higher growth rate, higher margins, or a fuller product line. The Avon and Mary Kay cosmetic companies are making upward stretches by creating new products that are being promoted to upscale department store customers. Upward stretches also can be risky. Not only are the high-end competitors well entrenched, but they may also counterattack by downward stretching. Furthermore, prospective customers may not believe the newcomers can produce quality products. Or the sales force and distributors may lack the training to serve the higher end of the market. In fact, distributors who are often independent may feel that the costs of handling the new line exceed the benefits.

When companies in the middle range of the market stretch their line in both directions, it is called a **two-way stretch**. This is what Marriott has done by adding the Ritz Carlton chain to expand its presence in the high end of the hotel market and creating the Fairfield Inns to service the low end.

Product Life Cycles — Some products move through the product life cycle rapidly, such as the Pet Rock. Parker Brothers' Monopoly game, on the other hand, was introduced more than 50 years ago and is still going strong. Both toys illustrate how products move through a product life cycle.

As a product moves through these stages, sales revenue and profit increase, reach a peak, and then decline. Why is it important for companies to determine the status of a product given its life cycle? A company must be able to launch (also called **commercialize**), modify, and delete products and services from its offering in

PRODUCT LIFE CYCLE STAGES

STAGE	DESCRIPTION
Introduction	Consumer awareness and acceptance are low because the product is new. Sales rise gradually and high development and marketing costs yield a small profit or loss. There are relatively few competitors. A company introducing a product that a competitor already markets will devote its resources to building brand awareness since its competitors have already done the groundwork.
Growth	Sales increase rapidly. Other companies have probably begun to market competitive products. Competition and lower unit costs result in a lower price that reduces the profit per unit. Industry profits reach a peak and begin to decline during this stage. Modified versions or enhancements are introduced. The goal here is to stabilize and strengthen the product's position by building brand loyalty.
Maturity	Sales are still growing, but the rate of increase has slowed. The sales curve peaks and sales begin to decline. Profits decline throughout this stage. Increased competition forces out weaker competitors. Refinements and extensions of the original product appear. Redesigned packaging or style changes may strengthen market share. Consumers may be encouraged to use the product more often or in new ways. Pricing strategies include markdowns and price incentives.
Decline	Sales volume decreases sharply. Profits continue to fall. The number of competitors declines, and the survivors are those that specialize in marketing the product. Production and marketing costs become the most important determinants of profit. Few changes are made in the product itself. When a product adds to the success of the overall product line, even though it's in a decline it may be retained. Products often decline because of technological advances, environmental changes or because consumers have switched to competing brands.

response to changes in its life cycle. And companies pursue different strategies at each stage of the life cycle. For example, when a company first introduces a product, it restricts the number of product variations to ensure product quality. That's why Gatorade was introduced in only one flavor. You can learn more about each product life cycle stage in the information box.

Branding Decisions — When developing a marketing strategy for individual products or services, companies have to make branding decisions. The manufacturer brands a product unless it is resold as a **private label** (which may also be called a store brand or a distributor brand), or as part of an **OEM (original equipment manufacturer)**, or as a generic product. There are four strategies available to a company: individual brand names, blanket family names, separate family names, and company trade names combined with product names.

Some companies use a **brand extension** strategy to stretch a successful brand name when launching a new product. That is what Ivory did when it introduced Ivory shampoo and conditioner. Brand extensions offer several advantages like instant recognition and reduced advertising costs since people are already familiar with the name. Yet, several brand extensions like Bic pantyhose and Life Savers gum met early demises. A brand name might be put on a product that is inappropriate (like Exxon Mobil Ketchup, or Wisk milk) or the new product may disappoint the consumer. It may also hurt the company's other products.

Most large companies use multi-brand strategies when they develop two or more brands in the same product category. **Multi-brand strategies** were pioneered by Procter & Gamble when it introduced Cheer as a competitor for Tide. The result? Tide's sales dropped slightly, but the combined sales of Cheer and Tide were higher. This phenomenon is known as product **cannibalization**. Today Procter & Gamble markets seven different detergent brands: Tide, Bold, Cheer, Dreft, Era, Gain, and Ivory Snow. Companies adopt multi-brand strategies so they can gain more shelf space,

BRANDING		
BRAND NAME TYPE	**DEFINITION**	**EXAMPLES**
Individual brand names	Each product is given its own brand name.	General Mills manufacturers: Bisquick, Betty Crocker, Gold Medal
Blanket family name	One name is used by several products.	Hershey's chocolate bars, Hershey's chocolate milk
Family names	For each family of products, a different family name is used.	Kenmore appliances, Craftsman tools
Company trade name combined with product name	The product name is added to the trade name.	Canon imageCLASS C2500 Canon imageCLASS C3500

increase brand loyalty, capture "brand switchers," develop excitement within the company and its distributors, and capture a different market segment. In other words, multi-branding allows companies to gain more market share through **mass customization** or **microniching** (creating finely targeted markets and positioning products to serve each market).

HOW DOES MARKETING SERVICES DIFFER FROM MARKETING PRODUCTS?

Services are different. Everything that we have discussed so far about products also applies to products that actually are services. Many organizations provide only services to customers. You'll find them in the government sector (e.g., courts and police), private nonprofit sector (e.g., some museums, colleges, hospitals), and a large part of the business sector (e.g., airlines, banks, hotels, insurance companies, management consulting companies). However, providing services doesn't stop there. Increasingly many companies, ranging from GE to Microsoft, are including services as part of their product offerings, such as repairing products or providing other

kinds of customer support. And, companies will now look to turn the aftermarket into a profit center by leaving behind their "ship-and-forget" mindset and expanding their revenue base beyond product sales into services delivery. Why? Because product-associated services not only yield much higher margins than the products themselves, but they also have a direct impact on customer loyalty. In addition to the bottom line, working in the aftermarket lets companies gain insights into real-time product usage and performance data, which is needed to overhaul pre-sales activities that ultimately improve operational efficiencies and boost customer loyalty.[10]

Given the diversity of service offerings, it is difficult to generalize about services. However, there are four attributes of services that do affect marketing activities. They are:

Intangibility — Unlike physical products, services cannot be seen, tasted, felt, or smelled before they are bought. To reduce uncertainty, buyers look for signs or evidence of the service quality, drawing inferences from the sales person, the price, the equipment, etc. Therefore, the service provider's task is to "tangibilize the intangible." That's why Allstate advertises you're in good hands and Prudential offers customers a piece of the rock!

Inseparability — Physical products are manufactured, put into inventory, and then distributed for later consumption. But services are typically produced and consumed at the same time, making the service provider a part of the service rendered. Since the customer is also present as the service is produced, provider-customer interaction is a special feature of services marketing. Both the provider and the customer affect the service outcome. This is very true when buying professional services like tax accounting.

Variability — Services are highly variable since they depend on who provides them and when and where they are provided. To minimize variability, companies providing services often install quality control measures wherever possible. Service buyers are aware of

this high variability and frequently talk to others before selecting a service provider.

Perishability — Services cannot be stored. That's the reason many service providers, such as physicians and hairdressers, charge for missed appointments. They are being joined by some restaurants and car rental companies when a reservation is a "no show." In all cases, if the service is not provided at the appointed time, the time cannot be "rebooked" without advance notice.

WHAT ROLE DO CUSTOMERS PLAY?

The 4 P's model that we have been discussing takes a seller's viewpoint. From the customer's point of view, the 4 P's are incomplete. Missing is the concept underlying all of *Parlez-Vous Business* — customer value. While the marketing staff sells products, customers buy value.

Understanding customer value is especially important today because in many cases companies are marketing products that are almost identical. When a company doesn't differentiate its products from the competition, customers will search elsewhere. Today value to the customer is a key differentiator.

Providing quality customer service is not a new concept. Ten years ago we acknowledged customer service was one of the critical factors giving a company a competitive advantage. Consequently, companies began to upgrade their customer service.

Even though it's still necessary for companies to provide high quality customer service, most successful companies aren't stopping there. Today companies are building **Customer Relationship Management (CRM)** programs. As mentioned in Chapter 2, CRM programs include all those activities involved in establishing customer accounts, such as marketing, sales, and customer support. As competition for the most desirable customers increases in a marketplace where companies often can't significantly distinguish

their products from others, the emphasis has shifted to customer service. As this emphasis grows, so does the complexity of the systems required to support high quality customer service. Along with this complexity comes costs, which companies are working to control as well.

Companies are creating **Customer Value Management and Measurement** systems (**or Customer Loyalty Systems**), to provide

TRADITIONAL CUSTOMER SERVICE ACTIVITIES

- Checking on orders to ensure they were received and were correct.
- Installing the product or service at the customer's site.
- Training the customer to use the product or service.
- Providing documentation for the product or service that will make it easy to use.
- Answering customer questions once the product or service is being used.
- Maintaining and/or fixing the product or service as necessary.
- Supporting customers when they have questions about the product or service, often through a toll-free number, pay-for service number, or online.
- Following up after purchase to ensure customer satisfaction (e.g., informal customer phone calls, formal customer satisfaction surveys).

exceptional customer value and enable the company to achieve higher profits. Customer Value Management systems enable companies to know their customers – and their competitors' customers. They allow companies to assess which products and services their customers demand and need, and appropriately define their value proposition relative to their competitors. These systems consist of five elements:

Entity Leadership and Customer Advocacy — provides organizational focus and leadership to the systems and links that drive customer loyalty into strategic priorities. W.L. Gore and Associates implemented a **knowledge management** system by which information gathered by field staff was relayed to product development teams to quickly create customized products. This process that

could last weeks takes only days or even hours now.[11] (See Chapter 1 for a further discussion on knowledge management.)

Customer Loyalty Measurement System — obtains quantitative data about the customer. It focuses on the many dimensions of customer relationships including competitor analysis. Sharing the customer value measures with customers is critical. USAA, the insurance company, has developed a comprehensive customer feedback system that quantifies customer information and improves overall knowledge of its customer base. The results? Increased customer loyalty, reduced sales and marketing costs, and higher profit margins.[12]

Qualitative Customer Voice — listens to customers' and non-customers' opinions. Kodak's Voice of the Consumer program changed the company's product development process by having new product ideas come from customers. Kodak developed its Fun Saver Pocket Camera as a response to customers saying they wanted an easy-to-use, attractive disposable camera.

Value Delivery System — manages the entire customer experience, as provided by the company and its partners, in order to deliver superior value, loyalty, and profitability. Dell Computers follows this strategy by building computers specifically to suit customer requirements. At the same time, by building-to-suit each customer, Dell reduces inventory costs.

Internal Process Metrics — provides indicators of value. For example, The Balanced Scorecard method incorporates the customer as one of the four primary dimensions for measuring performance. (For further information on the Balanced Scorecard and the Strategy Map, see Chapter 1.)

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CHAPTER 4
PURCHASING SUPPLIES

The way companies purchase raw materials, equipment, and services has changed dramatically during the past ten years, and this is just the beginning. There are five reasons why Purchasing's profile is raised:[1]

- External spending on everything from production components to outsourced services is the largest cost center and a growing share of costs for most companies. It ranges from two-thirds or more of operating costs for manufacturers to one-third of costs for most service businesses.
- Purchasing generates profitability. Because external spending represents such a high portion of most companies' cost base, savings on that spending have a significant impact on profit. A five percent reduction in sourcing costs can be the equivalent of a 20 percent increase in sales.
- Purchasing can drive revenue growth through faster time-to-market, exclusive products developed with suppliers, and better service levels. It can also reduce operating costs and lower asset requirements (via **outsourcing** or **vendor managed inventory**).
- Purchasing is a catalyst to transform large, complex corporations with individual departments or functions that rarely collaborate. A redefined purchasing process reaches into engineering and operations as well as marketing and sales. When done right, new sourcing processes can begin to break down traditional functional barriers in order to meet customer needs more effectively.

- Purchasing is also a potential source of cross-business unit gains, particularly for companies that operate as separate divisions or multiple geographies.

So, how are companies purchasing products and services today? In this chapter we'll look at:

- What issues do companies face when purchasing supplies?
- What types of purchases do companies make?
- Who makes purchasing decisions?
- How is E-commerce changing the way companies make purchases?
- In what other ways can information technology support purchasing?

WHAT ISSUES DO COMPANIES FACE WHEN PURCHASING SUPPLIES?

Purchasing, in fact, is rarely called Purchasing anymore. You will rarely find it called "Procurement," either. Today, Purchasing is more likely to be called Materials Management, Strategic Sourcing, or some similar name. And, it is becoming more and more common to find a vice president or senior-level manager responsible for the function. You will even find CFOs taking a more active role in Purchasing and the entire **supply chain**. Today, Purchasing is viewed as a key component of every company's **supply chain** – and an effective, efficient supply chain is crucial to business success. Let's take a look at some specific reasons behind Purchasing's new role. They are:

Seeking Purchasing Efficiency and Effectiveness — Because external spending is the largest cost center for most companies, many have done the obvious things to cut purchasing costs, such as renegotiating contracts with suppliers and consolidating big-volume purchases. But one-time supplier price reductions cannot drive profitability and revenues. Rather, companies must focus on

the entire life cycle of costs, such as installation, maintenance, and removal to truly measure value. That is why companies today are moving beyond solely seeking cost savings and are emphasizing the strategic components of Purchasing – reducing cycle time for developing new products, providing a high level of supplier reliability, offering good supplier-customer service, charging reasonable transportation costs, or furnishing reasonable credit terms.

With this effectiveness focus comes a new role for Purchasing staff – spending less time on expediting routine transaction-like tasks and spending more time on value-added tasks. Hewlett-Packard reports it is now 20 percent to 30 percent more efficient because its people are no longer expediting purchase orders and performing endless clerical and administrative tasks. Now time can be spent finding different vendors; working with suppliers to reduce costs and to develop new products; rating suppliers and reviewing supplier performance; and working with suppliers on strategic issues such as product development, **Six Sigma** efforts (See Chapter 5 for more information on Six Sigma) or material costs reductions.

Centralizing the Purchase of Volume Items — Companies with multiple divisions traditionally decentralized their purchases because divisions have different needs. The trend, however, is shifting back to **centralized purchasing**. By centralizing purchases, companies can reduce costs not only by increasing their leverage with suppliers but also by reducing corporate-wide redundancies. This purchasing model, called **shared services**, occurs when service organizations are created so individual divisions can take advantage of centralized buying. Knight Ridder Shared Services, for example, was established to consolidate the routine financial transactions and activities of all the subsidiaries, providing consistent and efficient processing and tracking. It is the financial processing center for Knight Ridder companies, managing general ledger, fixed assets, accounts payable and purchasing, and negotiating national purchasing agreements. Its mission is to deliver service, simplicity, and savings by partnering with customers; providing the right information to the right people at the right time; streamlining busi-

ness processes, and leveraging buying power.[2] Shared services are also available to companies and organizations from third parties, such as **group purchasing organizations (GPOs)**. In the health-care marketplace, approximately 800 GPOs collectively contract for about 45 percent of the supplies and equipment purchased by health care institutions.

While most companies initially focused on sourcing **indirect materials** (all the items used to operate a business), they usually represent just about 20 percent of the corporate purchasing tab. Greater savings may be gained by sourcing **direct materials** – all the items that go into the product being manufactured.[3]

Now companies are starting to recognize that applying these purchasing processes to the services they buy can help meet cost-savings targets, too. United Technologies, for example, has reduced costs for services by an average of 40 percent, realizing savings from these purchases in these areas: human resources software (70 percent savings), video conferencing (42 percent savings), insurance actuarial services (51 percent savings), software application services (41 percent savings), engineering services (45 percent savings), demolition services (19 percent savings) and pharmacy benefits (6 percent savings).[4]

Decentralizing the Purchase of Small Quantities — With corporate-sponsored **purchasing (or procurement) cards**, employees may purchase small ticket items, such as a coffee maker or extra nails when needed, yet eliminate the paper work associated with processing authorizations for purchases or employee reimbursements. Allied Signal and National Semiconductor are among thousands of companies that use purchasing cards (such as Visa and American Express) to achieve large cost savings from negotiated corporate agreements with suppliers and by reducing paperwork. Purchasing small quantities is also critical to manufacturing activities for companies that embrace **flexible manufacturing.**[5]

Sourcing for New Products — By using the Internet, companies can conduct complex purchasing tasks, such as parts-list management, quoting, ordering, order change and confirmation in hours instead of days. The Internet also lets companies tap into a larger supplier base to ensure dependable supply and back-up sources. Solectron, a provider of electronics manufacturing services to leading OEMs, uses Internet-based software to reach multiple suppliers and obtain price and availability. By obtaining quotes quickly, Solectron is able to drastically reduce cycle time to support its new product introduction process.[6] Bristol-Myers Squibb, after achieving savings in purchasing supplies for existing products, turned its attention to new product development spending – reducing the cost of new product launches by an average of 20 percent.[7]

Reducing the Number of Suppliers — Long-term contracts with fewer, preferred suppliers is the new mantra. Herman Miller has achieved cost savings not by reducing price or compromising quality, but by working with its top suppliers and cutting off weak performers. By sending top suppliers larger orders, Herman Miller has been able to gain volume discounts while supplier performance also has improved. It has shrunk its supply base from 712 companies down to 298 and reduced the number of errors in every million parts from about 10,000 errors down to 135.[8] In addition, Herman Miller offers these suppliers access to its experts in an effort to help vendors save on manufacturing costs, which can then be passed on.

Sourcing Worldwide — Information technology, along with modern transportation, has made global sourcing a reality for many industries. At Vodafone, global teams comprised of buyers from multiple operating companies deal with selected global suppliers – with an eye to leveraging its corporate scale. And 3M has cited global sourcing effectiveness as one of five key initiatives aimed at delivering hundred of millions of dollars in savings.

Leveraging Information Technology — Information technology has enabled Purchasing to play a strategic role. It allows companies to purchase products more efficiently via **E-Commerce** using such

tools as **supplier Web sites, electronic bidding, electronic catalogs,** and **EDI**. Lockheed Martin has built an online application that gives business units a central source of information about suppliers and is directly tied to the company's purchasing system.

Yet this is just a piece of the puzzle. Information technology is also helping companies purchase more efficiently by using online technology to transmit information between buyers and sellers that have an impact on purchasing. Neoforma, a California-based medical supplies distributor, for example, uses its web site to sell products, to reach more customers, serve them more efficiently, and even provide additional services to them – all aimed at building customer loyalty. And one thing is certain – information technology's role will only continue to grow as it allows companies to coordinate activities with their suppliers, share information, and reduce costs in the supply chain.

WHAT TYPES OF PURCHASES DO COMPANIES MAKE?

As you have read, companies purchase both **direct materials** and **indirect materials** (sometimes called **MRO** materials). MRO items consist of the maintenance, repair, and operations purchases a company makes in order to exist. They include everything from safety products for workers to replacement parts for machinery to cleaning products for the plant. Regardless of the type of item, a purchase will fall into one of three categories: **straight rebuy** or product reorder, **modified rebuy** where alternatives are evaluated prior repurchasing a product, or a **new purchase**.

WHO MAKES PURCHASING DECISIONS?

Purchasing staffs are responsible for obtaining information about vendors and keeping product and pricing information up-to-date. That's why they often dominate straight rebuy and modified rebuy purchases where this type of knowledge is key. But are purchasing staff the only people involved in these purchases? And what about new purchases? Who is involved then? The answers to these questions are simple – "it depends." When a purchasing decision is

TYPES OF PRODUCT PURCHASES	
Straight Rebuy	The company has considerable buying experience and requires little or no new information about the product or service being purchased. It routinely reorders the item from one of the suppliers on the company's approved vendor list. These suppliers are called **preferred vendors**. Companies try to standardize these purchases as much as possible, using programs like **purchasing (or procurement) cards** and **Intranet catalogs.**
Modified Rebuy	The company has experience buying the product or service, but alternatives are reevaluated usually because the company wants to modify the product specifications, price, delivery requirements, or some aspect of the product offering.
New Purchase	Because the product or service is being purchased for the first time, the company may not be clear on what the functional and technical specifications might be. It will begin the purchasing process "from scratch."

being made about packaging, product materials, or other aspects of a product affecting its marketability, marketing staff certainly are involved. Manufacturing plays an active role when new products are being developed or new manufacturing models are being considered for use. Purchasing staff are involved in many MRO purchases and in identifying preferred vendors, as well as assisting other departments in searching for suppliers, analyzing proposals, and finalizing the purchase. Senior management, of course, doesn't become involved in day-to-day purchases. However, large ticket items or those purchases with strategic impact will receive their attention.

Many companies that have upgraded the purchasing function to one of strategic importance have set up buying teams to facilitate the purchasing process. Today buying teams perform both strategic and tactical tasks. They take several forms, including **Commodity Procurement Strategy Teams, Sourcing Teams,** and Sourcing or **Purchasing Councils.**

BUYING TEAMS	
TYPES OF TEAMS	**DESCRIPTION**
Commodity Procurement Strategy Teams	Cross-functional teams that evaluate suppliers based on their quality, cost, technology, and responsiveness within a product or service category. These teams can also certify that selected suppliers have achieved desired quality levels while reducing costs, improving service, and increasing delivery and reliability. At Hewlett-Packard they also determine which suppliers get which pieces of Hewlett-Packard's business and they negotiate long-term contracts with suppliers.
Sourcing Teams	Cross-functional teams that operate for short periods of time. The teams are responsible for addressing a specific problem. For example, an AT&T computer materials sourcing team reduced the number of suppliers, streamlined its buying process, and lowered costs.
Sourcing or Purchasing Councils	Purchasing managers from different groups as well as cross-functional representatives meet periodically to coordinate policies and buying activities as well as to stay up to date on trends. The Eaton Corporation, an automobile components and systems manufacturer, operates a sourcing council comprised of purchasing staff located in different divisions.

HOW IS E-COMMERCE CHANGING THE WAY COMPANIES MAKE PURCHASES?

E-Commerce enables companies to achieve cost savings through volume discounts by consolidating their buying power and cutting down on the number of purchase orders. Costs also are lower because all purchases run through an electronic system where there is no human touch. So, E-Commerce is a way to automate business processes, reduce paperwork and lower the cost of

goods. And, any reduction in the cost of purchased goods – both direct materials and indirect materials – usually goes straight to the bottom line. For example companies, on average, can trim purchased goods costs by 15 percent to 20 percent, with savings varying based on the type of goods purchased – 5 percent for purchased energy, 15 percent to 20 percent for chemicals and adhesives, up to 32 percent for corrugated paperboard, 36 percent for temporary labor and 40 percent for MRO items.[9]

But what actually is E-Commerce? Some people use the term **E-Trading** to mean much the same thing as E-Commerce. Others use **E-Procurement, E-Purchasing** or **E-Marketing**. **E-Commerce**, however, is often used in a much broader sense, to mean essentially the same as **E-Business**, conducting business with the assistance of telecommunications and telecommunications-based tools.

Companies focusing on improving the way they source direct and indirect materials are implementing **strategic sourcing** and **E-Sourcing**. **Strategic sourcing** is the process enabling purchasing managers to select the most effective suppliers for indirect and direct materials procurement while optimally allocating business among the supply base. The decision is not always based on price – delivery times, quality, deadlines, volume discounts, locations, value-added services, and other factors play a role. **E-Sourcing** is the automation of that complex process, using sourcing and collaboration software.

Terminology aside, companies report the following benefits to adding online capabilities to their purchasing process:

- Saving sourcing time.
- Identifying new sources of supply.
- Easily accomplishing comparison shopping.
- Freeing buyers to work on tasks that have more long-term strategic value to the organization.
- Lowering overall operating costs.

- Lowering prices paid.
- Optimizing the supply base.
- Controlling spending and inventory more efficiently.
- Using personnel more efficiently.

The most often used online purchasing tools are: **online catalogs, electronic marketplaces, online auctions, supply chain portals,** and **supplier support systems.**

Online Catalogs — Most **online catalogs** have been placed by companies on their Intranets to control MRO spending. The catalogs contain data on all the products approved by a company through negotiated contracts – product information, drawing specifications, product availability, and pricing information, as well as selection and use of the company's products. These catalogs, also known as **buy-side catalogs**, allow companies like IBM to automate and manage the purchase of MRO supplies. Many companies use online catalogs to extend their reach to their customers. AMP, for example, has put its product catalog in searchable form online.

Electronic Marketplaces — These marketplaces contain electronic catalogs from multiple suppliers in a vertical market. The Plastics Network, for example, allows users to perform a customized search on a data base containing over 9,000 technical material data sheets, to browse catalogs and even to create a custom catalog by specifying the products they prefer to buy and their preferred suppliers. ChemConnect provides a global market for manufacturers and buyers. It enables more than 2,500 members to trade all types of chemicals and plastics round-the-clock.[10] **Market exchanges**, such as Covisint (now owned by FreeMarkets) for the automobile industry, Exostar for the aerospace industry, Converge and e2open for the electronics industry, and Transora for the grocery industry, provide solutions for their members through business-to-business information systems applications and communication services that connect the industry. These exchanges offer their customers a common connection to their suppliers and customers.

Online Auctions — Industrial buyers also can participate in **online auctions**. Buying companies benefit by having new supply sources open to them. While it may not have been cost effective for companies to actively pursue new suppliers without considering geography, the Internet obliterates the concern. With the Internet, new suppliers become accessible regardless of where they are located. And by bringing new competitors and forcing incumbent suppliers to cut prices, the Internet is increasing the supply of many goods, thereby driving down prices. Buyers can then hold down their production costs and the prices charged to consumers for the final product. At Owens Corning, purchasing agents conducted more than 170 online auctions. They can negotiate with vendors more quickly and efficiently because the online auction condenses the negotiating process from two to three months to 90 minutes and gives them the opportunity to bring a lot of suppliers – both new and old – together quickly. And because online auctions allow everyone to see what the current bids are, suppliers know how their bids stack up to the competitors.[11]

Supply Chain Portals — Also referred to as **private trading networks** or **private trading exchanges, supply chain portals** allow all the members of a company's supply chain (the company itself, suppliers and even customers) to access supply chain information online. Investments in supply chain portals with advanced functionality (e.g., e-purchasing, online auctions) are most attractive for high-end volume purchases under long-term contracts with a core group of strategic suppliers. Herman Miller has developed a web-based portal for suppliers helping users make fast, well-informed business decisions and eliminates multiple points of contact. The benefits include, reducing production cycle time and raising product quality by providing suppliers with access to receipt, quality, material inventory, invoice, and payment information.

Supplier Support Systems — Corporate Intranets contain a great deal of detail information about suppliers. They can familiarize a company's employees with approved suppliers by posting supplier profiles. The information posted usually includes how much busi-

ness is being done with a specific supplier, the supplier's annual revenue, and the supplier's capacity. A supplier scorecard may also be available that usually includes a suppliers' performance score.

This information is often shared with suppliers via an **Extranet**, which operates much like an Intranet but can be accessed by authorized external users. Many manufacturers, like GE Power Systems, create Extranets to tie suppliers more closely to their manufacturing process by integrating supplier communications. The Extranets usually contain a current specification library, supplier newsletters, terms and conditions, business policies and practices, carrier selection information, supplier quality plans, and urgent message traffic.

In summary **supplier exchange**, the business-to-business purchase and sale of supplies and services over the Internet is increasing daily. Typically, web sites allow qualified and registered users to look for buyers or sellers of goods and services. Depending on the approach, buyers or sellers may specify prices or invite bids. Transactions can be initiated and completed. On-going purchases may qualify customers for volume discounts or special offers. Companies have seen substantial gains: Texas Instruments has trimmed its cost of processing a purchase order from $80 to $25, Deere & Co., has cut its purchase order administrative expense from $97 to $22, and 3M slashed the price of processing an invoice from $120 to under $40, with its error rate dropping from nearly 30 percent to zero.[12]

IN WHAT OTHER WAYS CAN INFORMATION TECHNOLOGY SUPPORT PURCHASING?

E-Commerce is not the only way in which information technology is changing the way companies purchase supplies.

Materials Requirement Planning (MRP) — This is a system that determines when to reorder supplies used in production. It works by translating product demand forecasts into a master production

schedule spelling out what will be produced, when, and in what quantities. In other words, it plans for and controls the flow of materials through production. It attempts to minimize inventories by placing supply orders to coincide with production requirements.

Yesterday's MRP system doesn't look like the ones that you see today because information technology systems are enabling companies to share information with their suppliers and distributors. A company may add a **supplier support system** to its MRP system, allowing authorized suppliers to automatically refill orders – as well as receive feedback through a supplier scorecard. The result? Reducing inventory costs by purchasing supplies more efficiently and operating more efficiently, too. The tools most often used to achieve these benefits are highlighted here:

Electronic Data Interchange (EDI) — EDI is the computer-to-computer exchange of business documents between companies called **trading partners**. Instead of exchanging paper documents, purchase orders, invoices, and other purchasing-related documents are transmitted electronically between the trading partners. McKinsey & Company reports that manufacturers of standardized industrial products carry out more than 50 percent of their business transactions by EDI, yet spend only .7 percent of revenues on back-office work. Those companies processing fewer than 50 percent of their orders via EDI, spend twice as much. Companies manufacturing more complex, non-standardized products tend to process fewer orders via EDI; however, those processing more than 10 percent of orders via EDI achieved a cost advantage of about 50 percent over companies that did not use EDI.[14] EDI has evolved over the years, so it now does more than simply transmit documents from one trading partner to another.

Consider this: companies place orders electronically through EDI systems directly linking the vendor and customer. Once the vendor receives the order, the computer system directs the warehouse worker to the location of the product. He or she scans the product with a hand-held scanner that transmits the information to the

host computer. After the inventory records are updated, the customer is electronically notified the order was packed and shipped. An **Advance Shipping Notice (ASN)** is also sent to the customer, specifying exactly what is contained in the shipment, the transportation carrier, and the intended arrival time. This enables customers to plan production or warehouse schedules before receiving the shipment.[15]

Sound a bit pie-in-the-sky? Hardly. It's just what Levi Straus does. Sears and other retailers send to Levi Straus the sizes and styles of all items sold daily via EDI. Levi then orders more fabric from the Milliken Company for next-day delivery. Milliken, in turn, orders more fiber from Du Pont. With this system all supply chain partners are using current sales information to determine manufacturing quantities.

One more point about EDI. Companies with complex manufacturing operations that depend on the sharing of lead time, inventory and manufacturing schedules usually view EDI as a tool in managing production output as well as a procurement tool. It provides a true picture of production line needs. And, it allows companies to send change orders, trigger releasing systems, and issue RFPs in a secure computer-to-computer environment.

EDI also has its detractors. To use EDI effectively, trading partners must use standardized language and protocols – usually through translation software (e.g. XML, X12EDI, HOM). In most cases, suppliers have to pick up the bill for using of the software, installation, and training of people to use it. For many small suppliers these extra cost factors are a significant negative.

Although some companies use EDI alone, others have expanded their EDI programs to support the large amounts of information that must be transmitted to implement their **Just-in-Time (JIT)** efforts as well as **Efficient Consumer Response (ECR)** programs.

Just-In-Time (JIT) — Companies purchase products using JIT to reduce their on-hand inventories. The underlying principle behind

JIT is simple: if products arrive at a location when they are needed, there is no need to maintain inventory. Successful JIT programs report stunning benefits. Toyota, for example, has reduced its production time from 15 days to one day and reduced costs by 30 percent to 50 percent – while at the same time improving quality.

Some companies interface their JIT program operationally with other purchasing initiatives. This means that JIT will interface with the MRP system, financial and accounting systems, and production scheduling. Hewlett-Packard's manufacturing software illustrates this interface. Its software supports multi-location tracking and JIT component ordering; extensive MRP and inventory control execution; and interfaces to financial management, budgeting, and CAD/CAM applications.[16]

Efficient Consumer Response (ECR) — ECR is another consumer-driven system to replenish products used in the grocery, automotive, and retail industries. It was designed as a way to streamline distribution by removing excess inventory from the supply chain. The key to ECR is focusing on the flow of information from the production line to the check-out counter through EDI. ECR uses product categories as the organizing unit for products. This is called **category management.**

A second hallmark of ECR is **continuous replenishment**. Continuous Replenishment Programs (CRP) are customer-driven replenishment systems where a buyer's purchase triggers the manufacturing and movement of a product through the supply chain. Its goal is to improve distribution channel efficiency by reducing production costs as well as inventory and logistics costs by introducing a new way of ordering. CRP uses EDI or other data transmission documents to handle the volumes of data sent between companies and their suppliers. For example, Dell's factories receive orders from the web site and Dell's call centers. Dell relays to suppliers details of which components it needs, how many components, and when they are needed. The components appear at bays in the back of the building and become complete computers a

few hours later. Because Dell's suppliers have real-time access to information about Dell's orders, suppliers can plan production and delivery of components to ensure that Dell always has enough components to keep its production line running smoothly.

The third hallmark behind ECR is that inventory is managed by vendors. With **vendor managed inventory (VMI)**, suppliers, not customers, decide how and when to replenish the customer's inventory. VMI benefits a company by requiring lower inventory levels and replenishing stock faster. Suppliers also benefit by achieving increased efficiency, higher customer satisfaction, and lower costs. In the mid-1980s, Baxter, the hospital supply company, developed a powerful new type of partnership with its hospital customers. In one of the first VMI systems, Baxter developed a strategy for managing its customers' inventories within their hospital. How does it work? A hospital specifies its stock requirements for each ward; an on-site Baxter employee counts the stock in each ward each day or every few days; the employee enters this information into a handheld device and transmits it to Baxter's warehouse where a replenishment order is created; at the warehouse, the order is picked into ward-specific containers; the order is delivered the next day or in a few days directly to the ward, and the Baxter employee puts the stock away; and finally, Baxter invoices the hospital.[17]

Procter & Gamble and Wal-Mart also used VMI early on. Its success helped make VMI a cornerstone of ECR. In fact, Procter & Gamble estimates that over 40 percent of its products are sold via VMI.[18]

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CHAPTER 5
MANUFACTURING PRODUCTS

Every company creates products. However, just creating a product is no longer sufficient. Today companies must produce the required number of products, meeting the required quality standards in the required time frame ... at the lowest cost. Meeting this goal is the major challenge facing Manufacturing as international competition and new technologies have forced companies to re-examine and redefine the way they manufacture products.

Since the 1980s a slew of enhancements have revolutionized the way products are manufactured. Today, companies strive to have:

- Materials flow through the factory at a rate matching the rate of sales.
- Incoming customer orders specify what is to be produced and trigger the immediate manufacturing of the product.
- Manufacturing and assembly synchronized to ensure on-time delivery.
- No interruption to the flow, no scrap or rework, or quality defects in any material.
- Short cycle time so customers receive their goods before they can change or cancel their orders.

Not only is the manufacturing process very complex, the way each company manufactures its products is somewhat unique. Therefore, this chapter does not focus on the manufacturing process itself. Instead, in this chapter we'll focus on:

- What issues do companies face when manufacturing products?
- What manufacturing techniques are companies using?
- How are companies ensuring product quality?

WHAT ISSUES DO COMPANIES FACE WHEN MANUFACTURING PRODUCTS?

It goes without saying that the manufacturing process certainly has changed dramatically since Henry Ford introduced the assembly line. Today several issues are facing the manufacturing function including:

Reducing Manufacturing Costs, Yet Maintaining High Levels of Product Quality and Superior Service — As pressure increases for companies to increase their **ROI (return on investment)**, they look toward Manufacturing to contribute to this goal. For example, Ocean Spray has installed computer software that automatically determines which components to add to a batch and in what strength. By making these determinations automatically, operators are freed from performing essential, yet mundane calculations. Instead, they have the time to add value to the manufacturing process by doing a better job identifying problems and recommending solutions.

Cost savings are coming not only from improving the processes by which products are manufactured but also by improving product quality. Of course, improved product quality also has a direct effect on customer satisfaction. As companies strive to provide value to their customers through superior customer service, manufacturing is being called upon to modify its operations – ranging from meeting customer demands for **Just-In-Time (JIT)** product deliveries to manufacturing customized products – yet maintaining cost efficiencies and product quality.

Investing in Information Technology — Today manufacturing-oriented information technology investments are viewed as strategic business tools. Manufacturers are using the Internet for

e-CAD files and automatic transfer to **product data management (PDM)** for multi-location companies, virtual plant tours, and concurrent **manufacturing execution systems (MES).** For example, General Motors has provided its dealers with GM Access – an Internet-based configure-to-order tool that historically models trends to help dealerships order the appropriate number of vehicle models and their features based on past popularity. If a customer's vehicle choice is not available on the lot, the dealership can use GM Buy Power, an Internet-based network identifying all available General Motors products (by vehicle type and dealership), to locate vehicles matching a customer's specifications across General Motors and its dealerships. If no such vehicle exists, GM Prospect is a point-of-sale, specification-to-order tool a sales person can use to input the customer's order directly into General Motors' production facilities.[2]

Today most manufacturers are able to produce and deliver a larger quantity and wider variety of products in a shorter time frame than ever before. And they are doing this while carrying less inventory and with fewer people on staff. The ultimate impact? Operating costs are going down, enabling companies to make a profit without constantly raising prices.

Increasing Outsourcing — **Outsourcing** is not new – companies have traditionally used **contract manufacturing** when demand unexpectedly surged and outstripped manufacturing capability. What is new is that contract manufacturing has matured. More than any other business function, manufacturing has embraced outsourcing. For example, IBM and Hewlett-Packard have handed over production to third-party contractors, like Solectron.[1]

And, much manufacturing is going offshore. Radio Flyer, maker of the little red wagon, has moved manufacturing of its metal wagons to China while keeping its headquarters and distribution business in Chicago. Radio Flyer's tricycles, scooters, and most of its other products are already made in China.

Handling a Potential Flood of Manufacturing Worker Retirements — Beginning in 2001, the first baby boomers turned 55 years old – an age often signifying retirement for many blue collar workers in unionized plants. This demographic represents only a portion of the problem. Since advances in manufacturing technology have reduced the need to hire new workers, few younger workers have been hired. Layoffs further weeded out the number of younger workers as "last hire, first fired" policies were followed. Mercury Marine, for example, expects to lose 1,500 employees to retirement, 1,000 of whom are in manufacturing. Mercury Marine is far from alone among manufacturers in facing a graying work force.[3] For companies, then, the question becomes how many workers retire – and when. And, will a skilled workforce be ready to replace the retirees?

WHAT MANUFACTURING TECHNIQUES ARE COMPANIES USING?

For many years, companies have been gaining operating efficiencies by automating production lines. Automation, however, is just one source of production gains. Other improvements in the manufacturing process come from **lean manufacturing, flexible manufacturing, mass customization,** and **integrated manufacturing systems.** They are described on the following pages.

Lean Manufacturing — An old idea, conceived in Toyota's automobile plants more than 30 years ago, **lean manufacturing** is surfacing again in boardrooms and manufacturing plants. Lean manufacturing is a philosophy that shortens the timeline between the customer order and the shipment by eliminating waste. The Toyota Production System defines seven types of waste:[4]

- Overproduction — to produce more than demanded or produce before needed as a result of responding to speculative demand.
- Inventory or Work-In-Process (WIP) — is material between operations due to large production runs or processes with long cycle times.

- Transportation — does not add any value to the product. Instead of improving the transportation, it should be minimized.
- Processing waste — should be minimized by asking why a specific processing step is needed and why a specific product is produced. All unnecessary processing steps should be eliminated.
- Motion — of the workers, machines, and transport (e.g. due to the inappropriate location of tools and parts) is waste. Instead of automating wasted motion, the operation itself should be improved.
- Waiting — for a machine should be eliminated. The principle is to maximize employee efficiency instead of maximizing the use of the machines.
- Making defective products — is pure waste. Instead, prevent the occurrence of defects instead of finding and repairing defects.

Flexible Manufacturing — Remember when U.S. automobile manufacturers shut down for a week or two during the annual model change-over? This happened because Ford and General Motors had to revamp production lines in order to produce different automobile models. Detroit's automobile manufacturers found it costly to revamp their lines each time they wanted to produce a new model. This is one of the reasons why Detroit sold family sedans designed to meet the automobile buying needs of large target markets. Yet at the same time Mazda was able to introduce the Miata roadster.

Companies like Mazda that are able to produce small quantities of a product cost effectively use **flexible manufacturing**. To compete with Japanese companies, General Motors is creating a global network of flexible manufacturing plants to shift production of different lines and models to different plants as needed. Ford has re-created two factories – replacing assembly lines with cutting-edge flexible manufacturing production tools and techniques – in order to keep up with consumer demand for new vehicles, colors, and features while keeping costs under control. Now factories can more quickly respond to demand – switching from making one vehicle type to another in record time and building different models in

different factories using the same assembly platforms. The benefits? Ford estimates flexible manufacturing could save $2 billion over six years by slashing operating costs – allowing Ford to switch production to a completely different kind of vehicle in as little as 15 percent of the time it used to take – and a single Ford plant can now simultaneously produce nine different models.[5]

With flexible manufacturing, companies use computerized machines to perform many production activities. **CAD** systems allow companies to design, modify, and update products electronically. **CAM** uses computers to manage the manufacturing process. When CAD and CAM are combined, computers control all of the manufacturing activities as well as link manufacturing to the rest of the company. This is called **computer-integrated manufacturing** or **CIM**.

Mass Customization — As discussed in Chapter 1, companies give customers exactly what they want because they build products to match the customers' specifications. Dell assembles a computer based upon each customer's requirements. How? If Dell has twenty or so product features that make up every computer (e.g., RAM, disk space, processor speed, modem, operating system), the customer picks and chooses between all twenty, resulting in a computer customized to that customer's needs. Or Nike, allowing customers to go online and choose from a handful of "uppers" and a handful of "soles" to create their athletic shoes – down to having the customer's name embroidered on the back of each shoe.

For mass customization to be viable, companies must have a cost-effective way to manufacture their products. Interestingly, these made-to-order products usually do not cost more to make than mass-produced products when companies are able to standardize large components of the customized product.

Integrated Manufacturing Systems — Along with flexibility, integration is a distinguishing characteristic of state-of-the-art production. Integrated systems enable companies to reduce costs

FLEXIBLE MANUFACTURING TOOLS		
TOOL	**DEFINITION**	**EXAMPLE**
CAD Computer-aided design	Computers are used to design products. With CAD, drawings are constructed, electronically. CAD speeds up the design and drafting process and makes it easier to explore design alternatives.	McDonnell Douglas uses CAD to design hydraulic tubing while Canon uses CAD to design new cameras and copiers.
CAM Computer-aided manufacturing	Computers control production of the product at the facility. CAM ensures that the process moves smoothly from design to production.	Toyota uses CAM manufacturing to plan and control its production process.
CIM Computer-integrated manufacturing	Combines CAD and CAM so computers control all manufacturing activities as well as linking manufacturing to the rest of the organization.	Liz Claiborne uses CIM to design clothes, establish patterns for new fashions, and cut cloth required to produce the finished product.

while improving customer satisfaction. Four commonly used integrating tools are **MRP II (Manufacturing Resources Planning**), (**JIT) Just-in-Time**, **Kanban**, and **CONWIP**. Each tool is defined along with an example in the next two boxes.

HOW ARE COMPANIES ENSURING PRODUCT QUALITY?

Regardless of how cost effectively a company is able to manufacture its product, it must strive to achieve high product quality levels. This is true – whether a company sells products, services, or both!

The heart of performance improvement is ensuring the quality of the products and services a company offers. Techniques and

FLEXIBLE MANUFACTURING TOOLS		
INTEGRATED SYSTEM	**DEFINITION**	**EXAMPLE**
MRP II Manufacturing Resources Planning	MRP II is an integrated information system that ties MRP to the rest of a company. IT integrates logistics, order entry, billing, accounts receivable and payable, purchasing, and receiving processes. In addition to the output from MRP, MRP II also can determine the cost of parts and the cash needed to pay for the parts as well as the cost of labor, tools, equipment repair, and energy. It also provides a detailed budget.	Lipton, the international food processor, uses MRP II to smooth out variations in production levels that occur, for example, when demand rises during holidays and in the summers. Lipton annualizes these fluctuations by integrating planning, inventory, control, and sales forecasting. It also has shortened lead times and processes orders faster.
JIT Just-in-Time	Companies keep supply inventories at the minimum levels needed to keep a production system running as planned because parts arrive at work stations exactly when needed.	Bose took JIT to the next level by instituting JIT II. JIT II moves beyond reducing inventory by reducing the costs and time involved in supplier interactions. At the supplier's expense, employees ("implants") are at the Bose site to streamline operations.

processes to increase the quality of products are being applied to all operations as companies strive to improve performance. This movement toward improving quality has significant implications ... quality slips may be very costly!

Just ask Coca-Cola. If you were traveling in France or Belgium during the spring of 1999, you might have found it difficult to buy a

FLEXIBLE MANUFACTURING TOOLS		
INTEGRATED SYSTEM	**DEFINITION**	**EXAMPLE**
Kanban	While not synonymous with JIT, Kanban helps JIT work. Kanban uses a card or other signal to "pull" the product from one stage of manufacturing to the next.	Hallmark stores place a reorder card in a stack of greeting cards to indicate when a greeting card is ready for reorder.
CONWIP	A new job is introduced to the line whenever a job departs. Once the parts are released, they are processed as quickly as possible until they wind up as finished goods.	Woodward Aircraft Engine Systems uses CONWIP to promote better flow in the plants by placing a cap on the WIP (work-in-progress) levels.

Coke. That's because Coca-Cola pulled 17 million cases of its products off the shelves in five European countries after several children took ill. Upon investigation the company discovered there were quality control lapses in some bottling plants. It's unclear exactly how much these lapses actually cost Coca-Cola, but it posted approximately $60 million in charges alone during the quarter following the fiasco. And it immediately began to take steps to rectify these quality problems as well as to shine its tarnished image.

Companies serious about improving their performance don't view quality as a one-time effort. To them the way to improve quality is through **kaizen** (the Japanese word for **continuous improvement)**. With a continuous improvement program, companies are never satisfied with what they are doing or with the results. Rather, they are continuously striving to improve their company's operations by measuring, adjusting, and improving performance.

Several tools are available to help companies improve product quality. There are so many, in fact, that they all can't be discussed here. Let's focus on five commonly used techniques.

Six Sigma — Dozens of Fortune 500 companies, with GE in the forefront, have adopted the **Six Sigma** method that was pioneered by Motorola in the 1980s. Six Sigma goes beyond earlier quality approaches by requiring more stringent quality standards. What is Six Sigma? Six Sigma is a statistic measuring how many defects or failures are likely to occur per million occurrences. The larger the number, the fewer the defects. For example, the average product or process defect rate at most major companies hovers around four sigma, or more than 6,000 defects per million. At the Six Sigma level the expectation is just 3.4 defects per million. While aiming for Six Sigma may seem extreme, consider that at 3 or 4 sigma (which is close to 99 percent perfect): 5,000 incorrect surgical operations would occur each week, two short or long landings would occur at every major airport each day, 200,000 wrong prescriptions would be written each year, and you would have no electricity for about seven hours each month.[6]

Six Sigma efforts focus on the premise that rather than wasting time and money fixing defective products and dealing with the customer service fallout and refunds that result, companies should work toward achieving "zero defects" – or as close as possible to that mark in the first place. The Six Sigma methodology, consisting of the steps "Define - Measure - Analyze - Improve - Control," is the roadmap to achieving this goal. An improvement team, is responsible for identifying the process, defining the defect, and creating the corresponding measurements. Six Sigma is not just training. Team members, either **green belts** (they lead and execute process-level improvement projects) or **black belts** (they implement the Six Sigma principles, practices, and techniques maximum cost reductions) are integral to achieving success. In addition, the **executives** are the leaders who will communicate, lead, and direct the company's overall objectives toward a successful and profitable Six Sigma project. Finally the **champions** are the senior managers who lead the implementation efforts from Six Sigma projects.

Six Sigma methods are moving beyond its initial manufacturing focus to other business functions. Dow Chemical, for example, esti-

mates the application of Six Sigma to environmental health and safety services has saved the company $130 million in two years.[7] GE, DuPont, International Paper, and Raytheon use Six Sigma methods to improve cash generation by reducing costs within their legal groups. Raytheon's legal administrator expects Six Sigma projects to cut expenditures by 30 percent this year, saving the company $20 million. International Paper believes that Six Sigma has a huge impact not only on legal costs but also on the way law is practiced.

Statistical Quality Control (SQC) — SQC is a set of statistical techniques used to monitor on-going manufacturing operations and quality. Let's take a look at both of these goals, beginning with monitoring on-going operations. Wouldn't it be nice to know your tire was going flat before you found yourself on a ride in the bucolic countryside? Or is leaving it to chance a better idea? When you drive a car with a tire slowly going flat, the car is not operating at its peak performance level. Nor is a production line operating at its peak performance if it has a worn or dirty tool. Fortunately, SQC can instantly identify system malfunctions and report them almost immediately back to the machine operator. The machine operator can then correct the problem in real time. SQC also measures the impact of any performance change on the entire manufacturing process.

When monitoring quality, SQC uses several different types of statistical sampling methods. One method, **acceptance sampling,** is used by companies to assess the quality of their finished goods. When conducting acceptance sampling, the company evaluates a sample of the finished goods. While acceptance sampling occurs once products are completed, companies also monitor quality during the manufacturing process through **in-process sampling**. Here products are assessed during the manufacturing process for quality to determine if changes need to be made. As opposed to acceptance sampling, in-process sampling allows companies to detect problems before they accumulate. By the way, when you cook and keep tasting your spaghetti sauce or soup broth while

simmering, you are conducting a type of in-process sampling. When the meal is served and you wait for your guests' reactions, that is acceptance sampling.

ISO 9000 — **ISO 9000** refers to a series of standards, developed and published by the International Organization for Standardization (ISO) that define, establish, and maintain an effective quality assurance system for manufacturing and service industries. The standards cover a variety of areas, such as product testing, employee training, record keeping, supplier relations, and repair procedures. The ISO 9000 standard is the most widely known and has perhaps had the most impact of the 13,000 standards published by the ISO. It serves many different industries and organizations as a guide to quality products, service, and management. Companies seeking ISO 9000 certification believe it will gain them a competitive advantage and generate new business. They might be correct since many large companies, such as GE and DuPont, are urging, if not requiring, their suppliers to attain ISO 9000 certification.

Benchmarking and Best Practices — Why do copier companies routinely buy competitors' copiers? Companies use benchmarking to assess competitors' products and services to determine how their products stack up. They test them to measure how well they perform, such as the number of pages copied per minute and copy quality. They even take them apart to see how they work, (**backward engineer** or **reverse engineer**).

Best Practices analysis is a form of **benchmarking** that doesn't focus solely on competitors, but selectively looks at those companies that are "best of breed." Companies considered to be "best of breed" are recognized as excelling at specific tasks. So if your company is interested in adding a catalog component, you might travel to Maine to learn how L.L. Bean operates its catalog business. Or you might go to Orlando and visit with Disney to learn how they recruit and train staff if that's an area in which your company wants to improve.

Benchmarking usually focuses on competitors while Best Practices crosses industries to locate "best of breed." Together, however, both techniques assist companies in improving their quality by identifying, studying, and building upon "what works" in their industry and across industries.

Even the best-designed competitive benchmarking programs can find it difficult to operationalize the findings. First, it's not easy to persuade employees that a competitor does something better. This is especially true if the competitor's reputation is mediocre. Second, a company's infrastructure may not support the new process. Ford found this out when it benchmarked GE's process for getting managers to share ideas. At GE sharing ideas is rewarded, but not at Ford. As a result, Ford had to implement a corporate-wide program to guide people through using the idea-sharing process. Third, without senior management involvement an initiative will have little priority within the organization – and probably will have no resources budgeted. Last, corporate cultures differ. In an environment where employees are rewarded for following orders, it would be very difficult to try to get them to take risks or not fear failure. Continental Airlines learned this lesson in the mid-1980s when it initially tried to cross utilize its personnel after benchmarking Southwest Airline's processes.

Endnotes

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CHAPTER 6

CREATING GO-TO-MARKET STRATEGIES

Since the start of commerce, companies have had to determine the best way to sell their products to customers. But solving that quandary has become much more complex now.

Distribution channels have evolved since the 1960s when most companies sold products through independent retailers or their own sales force. Those not large enough to support a sales force relied on independent distributors to sell their products. In the 1970s this distribution model began to change as many companies started to use their own sales force plus independent distributors to sell their products. In the 2000s, selling directly to customers using the Internet became another go-to-market strategy.

The number and types of distribution channels is exploding. It is not uncommon for a company to distribute products through multiple distribution channels, such as its own sales force, retailers, direct marketers, and **E-Commerce** (electronic commerce) – both **B2B** (**business-to-business**) and **B2C** (**business-to-consumer**).

In this chapter you will have an opportunity to read about the following topics:

- What issues do companies face when creating go-to-market strategies?
- What issues do companies face when selecting distribution channels?

- How do companies select a distribution channel?
- How does E-commerce affect go-to-market strategies?
- Why do companies use multiple distribution channels?
- How do distribution channels change during a product's life cycle?
- How do companies manage channel conflict?

WHAT ISSUES DO COMPANIES FACE WHEN CREATING GO-TO-MARKET STRATEGIES?

As we said, the way companies distribute their products is changing dramatically. Why?

Emerging E-Commerce Capabilities — As you read in Chapter 4, E-Commerce is revolutionizing the way companies purchase products. It is also revolutionizing the way they distribute products. The impact of E-commerce includes:

- **Expanding global markets** — providing access to new markets and suppliers, and extending alliances to new geographical areas.
- **Lowering costs** — lowering costs of entering new markets, as well as acquiring new customers.
- **Empowering customers** — allowing for on-going, one-to-one dialogue with customers.
- **Pressing prices downward** — eliminating inefficient intermediaries, offering simplified electronic distribution, and allowing for differentiating product options that protect product offerings from commodization.
- **Increasing consolidation and convergence** — facilitating economies of scale, making it easier to place orders and fill them, and enabling revitalized products that add value.
- **Increasing specialization and collaboration** — automating transactions between electronic enterprises, supporting the real-time exchanges of information, and enabling collaborative processing.

Growing Number of Strategic Alliances — Many buyers are entering into strategic alliances where they seek lower unit prices for guaranteed higher volume contracts that run for longer periods of time. But strategic alliances don't always focus on price. Through strategic alliances, companies are able to support their growth strategies by increasing product offerings, growing their customer base, and increasing customer satisfaction. For example, Psion, a small software company that developed an operating system for a handheld device, knew that to be successful it needed to have its system adopted by industry leaders. It joined forces with Ericsson, Motorola, and Nokia to create Symbian to support the adoption of Psion's operating system – to the benefit of all parties.

Growing Demands From Buyers — Buyers are asking intermediaries to take on value-added tasks, especially **inventory management**. They want intermediaries to reduce the amount of inventory in the supply chain, yet meet the buyer's requirements.

A supply chain initiative promising greater profits through improved efficiencies and increased collaboration between trading partners is **Collaborative Planning, Forecasting, and Replenishment (CPFR)**. Some of CPFR's predecessors – electronic data interchange (EDI), vendor-managed inventory (VMI) and efficient consumer response (ECR) – were introduced in Chapter 4. However, CPFR differs from its predecessors in that it is designed to link the supply and demand processes allowing for a more consumer-driven supply chain. CPFR aims to seamlessly link trading partners, allowing them to see the entire supply chain from one end to the other. CPFR calls for complete collaboration and information sharing between trading partners, including the merchandising process, item/category selection, and seasonal and promotional planning. The apparel, automotive, high-tech, and packaged goods industries have been quick to adopt CPFR. ACE Hardware, for example, has implemented a CPFR initiative with several of its major suppliers – resulting in improved service levels, increased sales and decreased supply chain costs – positioning ACE to compete more effectively with its big box competitors.

Another type of buyer demand in the supply chain is **radio-frequency-identification (RFID)**. Wal-Mart is at the forefront, requiring its top suppliers to fit their cases and pallets with RFID tags – a chip that can automatically transmit to a scanner all of the information about a container's contents or about individual products. Wal-Mart is building a network in which every consumer item will have an RFID tag and an **electronic product code (EPC)**.

How might RFID work in the retail supply chain? Let's use shirts as an example. At every step of the shirt's journey, a reader scans the tag and updates the information. First, at the manufacturer an RFID tag is added to every shirt and shipping box. A reader scans the tag as it leaves the factory. At the distribution center a reader in the unloading area scans the tag on the arriving shirt box and updates inventory without opening the package. The shirt tag then is scanned upon arrival at the retail store to update inventory. A reader scans the tag as the shirt is put on a rack. Finally, at the checkout counter a cashier scans the shirt tag with a handheld reader that automatically updates inventory – and provides manufacturers and retailers with data about sales patterns in real time to make decisions about production ordering and pricing.[1]

Information technology is redefining the ways distributors are traditionally providing value to customers – by reducing inventory costs. But it doesn't end there. Companies want their intermediaries to negotiate on their behalf and offer alternative products rather than to simply pass on price increases from their suppliers; to reduce transaction costs; and to be more proactive in providing technical training. It's easy to see the ultimate outcome will be a fundamental redefinition of distributor functions.

Changing Look of Distribution — The types of distributors is continuously morphing. Whether it is the corner drug store closing, the rise of mega marts, or the ease of purchasing online, new options continue to appear for both companies and for consumers. Some distribution options that are having an impact on business today are:

- **Emergence of Large Distributors** — Large distributors will emerge as a result of consolidation. They will not only be able to operate more efficiently, but these large distributors will also be able to provide a one-stop shopping venue to their customers – as we have all seen when accessing Amazon. Although intermediary consolidation certainly is occurring, the threat of **disintermediation** is not. Rather, electronic distribution channels are appearing that provide new ways to reach customers – provide products and services to them, gather customer feedback to help develop new products, provide better customer service, and strengthen customer loyalty.

- **Emergence of Large Retailers** — In some industries, the emergence of large retailers has had a significant effect. In the home-construction market, for instance, the top ten distributors (such as The Home Depot) command more than 70 percent of industry revenues and many regional lumberyards and flooring distributors are disappearing.[2]

- **Emergence of Internet Search Engines and Portals** — Traditionally, companies advertised in local publications, television, the telephone directory, and specialty publications, like the *Thomas Register*. However, many companies are finding they can reach substantially more customers by optimizing their position when customers use search engines, and even by advertising on search engines. On Google, every time someone searches for an advertiser's key term, the sponsored ad pops up. If clicked, the advertiser pays anywhere from a nickel to $50 per click. While most of the advertisers are small businesses, more big companies are signing up, including Gateway, Marriott, and eBay.[3]

- **Blend of Multi-channel Online and Mortar Fulfillment** — Online and mortar (or in-store) fulfillment options are being combined for the companies to obtain a competitive edge. Circuit City customers may place orders online and then pick them up at a store location, eliminating waiting. CVS and other pharmacy

chains, provide customers with the ability to order refill prescriptions online and then pick them up at the pharmacy counter. These systems have been expanded to allow customers to reorder via telephone, too.

WHAT ISSUES DO COMPANIES FACE WHEN SELECTING DISTRIBUTION CHANNELS?

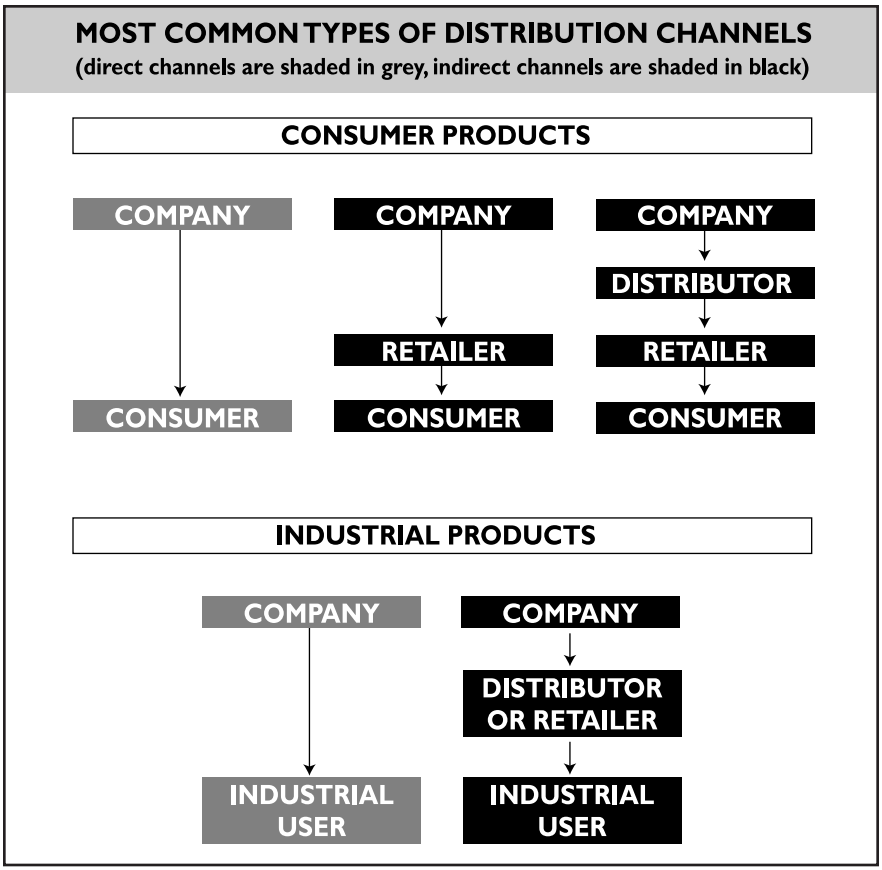
A distribution channel consists of the players involved in bringing products or services to the marketplace. Every distribution channel begins with a company and ends with a consumer. The in-between players (called **intermediaries**) vary, both across and within industries.

Direct vs. Indirect Distribution Channels. Several different types of distribution channels are generally used to move industrial and consumer products. Distribution channels using no intermediaries are called **direct distribution channels**. When at least one intermediary is part of the distribution channel, a company is using **indirect distribution channels**.

Regardless of the type of customer, companies may directly sell to end users and/or through intermediaries:

Sell Directly to End Users — This scenario is a direct distribution channel where most companies sell their products and services through their own sales force. Direct distribution channels are most often used when companies sell services or expensive, complex products, such as Ernst & Young and GE Power Systems.

Few consumer goods traditionally have been sold through a company's own sales force because the cost per sale is too high. The growth of direct marketing, E-commerce, and manufacturer-owned retail stores and discount outlets, however, have expanded the use of the direct distribution channel for many companies. That's why today anyone can buy jewelry from Tiffany's catalogs, copiers from the Canon web site or leather goods at Coach's web site, retail stores and outlet stores.



Sell to End Users Through Intermediaries — Intermediaries come in a variety of types. Some buy products from companies and then sell them to customers. Most of us purchase groceries, automobiles, and furniture this way. Other intermediaries purchase products from companies and then sell them to other channel members who in turn sell the products to customers. This model is often used in high technology where they sell products to VARs, OEMs, systems integrators, or catalog houses that in turn sell the products to customers.

Some companies will use all available distribution channels to distribute their products because they want the widest possible exposure in the marketplace. This type of coverage – called **intensive distribution** – is most often used for inexpensive products like

chewing gum and candy. Other companies choose a **selective distribution plan** where they use only a portion of the available outlets for their product in each geographic area. Furniture, major electrical appliances, and clothing manufacturers typically prefer selective distribution. A limited number of companies will pursue **exclusive distribution** where they use only a very small number of outlets for their product in a market. Exclusive distribution is most often used for big-ticket items, luxury goods, and products that require extensive customer support.

HOW DO COMPANIES SELECT A DISTRIBUTION CHANNEL?

Selecting the appropriate channel is not an easy task. There is no algorithm to follow. In fact, companies that appear to be similar may use dissimilar distribution channels. This is true in the automobile insurance industry where State Farm sells policies through independent agents while GEICO sells policies directly to customers. Why do seemingly similar firms use different channels?

Well, if a company wants to:

- gain more control over its products or services, image, costs, sales transactions, post sales activities, it will use direct channels.
- get its product or service before consumers quickly and without resources to set up a sales force, it will use indirect channels.
- sell to a mass market when it can't cost-effectively reach potential consumers, it will use indirect channels.
- sell a new product when it does not have the requisite contacts in the marketplace to get the product or service before the buying public, it will use indirect channels.

Who are the most commonly used intermediaries? Although different industries tend to use different types of intermediaries, the eight most common types of intermediaries are **Distributors, Dealers** or **Resellers**, **VARs**, **Systems Integrators, OEMs**, **Retailers**, **Manufacturers Sales Representatives,** and **Catalog Houses**.

TYPES OF INTERMEDIARIES	
TYPES OF INTERMEDIARIES	**DESCRIPTION**
Distributors	Purchase products from a manufacturer and resell the products directly to the end user (the customer who will use the product) or to other channel members, such as dealers or VARs, who then sell the products to end users. Distributors that sell only to the consumer market are called **wholesalers**.
Dealers or Resellers	Purchase products directly from a manufacturer or distributor and then sell to customers.
VARs (Value-Added Resellers)	Perform the same activities as resellers plus they add products or services so the customer can one-stop shop.
Systems Integrators	Like VARs, except they provide technical services to customers as part of their value-added services.
OEMs (Original Equipment Manufacturers)	Provide repackaged equipment, such as computers that are manufactured by others. Unlike VARs, OEMs don't necessarily add anything to the equipment, except their name.
Retailers	Provide companies access to consumers. With low-price items, it would be difficult for the company to access these consumers otherwise.
Manufacturer Sales Reps	Independent sales force by selling products. When operating in the consumer marketplace they are called Brokers or Independent Sales Agents, depending on the industry.
Catalog Houses	Buy products and then place them in a paper or electronic catalog for resale to consumers.

HOW DOES E-COMMERCE AFFECT GO-TO-MARKET STRATEGIES?

E-commerce opens new opportunities for traditional intermediaries. By adding online capabilities, retailers and distributors can bring more value to their customers by providing information about goods, the status of orders, and customer support after the sale – in a more timely fashion and at a lower cost.

New kinds of intermediaries also are emerging as a result of electronic channels. The electronic channel intermediaries are revolutionizing distribution channels by linking a company with its suppliers' suppliers and its customers' customers – perhaps, even with its customers' customers' customers – as well as with all the other entities that make business possible. The most commonly found types of electronic intermediaries are Market Makers, Seller Agents, Buyer Agents, Context Providers, Payment Enablers, and Fulfillment Specialists.

Given the proliferation of enterprises playing these new intermediary roles, the risk of **disintermediation** (i.e., elimination) of middle men as online commerce brings buyers and sellers together is false. Intermediaries will not only continue to exist but indeed will flourish in the new electronic economy.

WHY DO COMPANIES USE MULTIPLE DISTRIBUTION CHANNELS?

Have you purchased a shirt lately? The choices of where you shop have increased dramatically from brick-and-mortar stores to catalogs, outlet stores, and web sites. Few companies rely on only one distribution channel. Why?

The traditional sales force offers control. With their own sales force, companies can control to whom sales calls are made, the number of calls made, the product and company image, the pricing, etc. A very short distribution channel (because there are no intermediaries between the company and the consumer) allows companies to

TYPES OF ELECTRONIC INTERMEDIARIES		
INTERMEDIARIES	**DESCRIPTION**	**EXAMPLE**
Market Makers	Bring buyers and sellers together while simultaneously managing the market for efficiency.	Online auction sites, such as BAND-X, a bulletin board for international telecom-munications bandwidth bids and offers.
Seller Agents	Make markets more accessible to providers.	List brokers, like Metromail, target narrow markets by pinpointing those prospects where the sales potential is greatest.
Buyer Agents	Search and evaluate goods and services for purchasers and provide information to aid customers in making decisions.	AutobyTel help users identify the product that best meets their needs at the right price.
Context Providers	Help buyers and sellers use an electronic channel by simplifying and making it accessible.	Online service providers, such as AOL and search engines, such as Google.
Payment Enablers	Handle purchase transactions and their related funds transfers as well as risk management.	Credit card companies, such as services like PayPal.
Fulfillment Specialists	Handle the transfer and storage of goods and coordinate relevant information.	Logistics companies, such as UPS.

provide their customers with expert and timely services, such as delivery, installation, customer support, repairs, and special terms/conditions.

However, a traditional sales force isn't always the right distribution solution. Some companies can't afford to set up their own sales force. Others choose to leverage independent distributors rather than to create a home-grown one. If there are many potential customers in the marketplace who will generate small sales, it may not be cost effective for a company to invest its own resources in these sales. Or if potential customers are geographically dispersed where some locations have a small number of customers, a company may chose to use distributors rather than its own sales force in those geographic areas. By using an indirect distribution channel, companies can gain access to these potential customers cost effectively – such as reaching certain markets more efficiently, reaching different types of markets, reaching different segments or groups within a market, or capturing a larger market share.

HOW DO DISTRIBUTION CHANNELS CHANGE DURING A PRODUCT'S LIFE CYCLE?

Another reason companies change distribution channels is the product life cycle. By altering distribution channels, companies are able to place their products in front of customers who might not be introduced to them otherwise. Why? In the introductory stage of a product, new products tend to enter the market through specialized intermediaries (such as hobby shops or boutiques) that attract early buyers. They add value to the product by searching for and educating these early buyers. As buyers' interest grows and the product enters the growth stage, higher volume intermediaries are used. These intermediaries, such as retail chains or department stores, offer customer service but not at the same level as the previous intermediaries. In the maturity stage when growth slows, customers wait for prices to come down and patronize lower value-added outlets. As the decline stage begins, intermediaries that provide little, if any value-added services, carry the product. These include mail-order houses and off-price discounters. These remaining potential buyers can be reached only by creating extremely low value-added outlets.

Think back to the last time you bought a new suit. You witnessed this cycle in operation. If you went into a boutique, you were shown current season suits because boutiques carry apparel when first introduced. As the suit style became popular, you were also able to find the suits in up-scale department stores. As months passed and growth slowed, mass merchandisers carried the suits. Finally you'd find the suit at discounters and off-price stores.

HOW DO COMPANIES MANAGE CHANNEL CONFLICT?

When companies use more than one distribution channel, conflict often arises among channel members. Channel conflict can appear in any industry from computer retailing where we comparison shop in stores, online, and in catalogs to the brokerage industry. Here traditional investment brokers are competing with online brokerage services charging a fraction of the price for a stock trade.

SOURCES OF CHANNEL CONFLICT

SOURCES OF CHANNEL CONFLICT	DESCRIPTION
Over-distributed product	Too many distributors sell the product forcing distributors to fight for business.
Insufficient stocking levels	Distributors do not maintain the levels of stock required by the manufacturer.
Direct vs. indirect channel	Pursuing the same customers, resulting in price wars, implementation complaints (when product availability is limited), incompatible goals (when strategies conflict), and customer confusion.
New products	Distributors may be unwilling to invest the resources required to sell and service a manufacturer's new product. Or, manufacturers may be unwilling to allow their distributors to sell a new product.

Endnotes

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CHAPTER 7
DISTRIBUTING PRODUCTS

Traditionally logistics has been viewed as merely a business cost. Companies selected transportation carriers based on the lowest rate available. Carriers began to pay more attention to their own costs as their customers began to focus on maintaining leaner inventories, adopting JIT (just-in-time) distribution, and demanding reliable service. This interest in gaining transportation efficiencies continues and opportunities certainly exist for reducing these costs even further. But it is difficult to excite senior management by simply forcing down transportation costs, which account for more than half of the total logistics costs but only a small portion of corporate revenue.

Today companies are positioning logistics as a tool to help attain their strategic objectives. Their logistics systems are designed to: take assets off the **balance sheet**, accelerate cash-to-cash cycles, increase **inventory turns**, attract market share by increasing customer satisfaction, and so on. As with Purchasing, the new role of Logistics is reflected in increased resources being earmarked for Logistics, and upgrading Logistics to the senior management or vice president level. At some companies, the CFO is responsible for the supply chain – incorporating logistics.

All indications are that this new interest in Logistics will continue.[1] Logistics is no longer viewed as just a cost. Now, companies view logistics as an integral part of the supply chain – and they are looking to the entire supply chain for ways to increase efficiencies, improve customer service, and reduce costs. Senior management

believe that successfully managing the supply chain is central to a company meeting its strategic goals.

Logistics activities occur throughout a company. As we discussed in Chapter 4, companies must purchase raw materials to manufacture their products (**direct materials**), and they purchase materials to support the running of their businesses – ranging from brooms and rags to pens and computer disks (**indirect materials**). The type of logistics a company uses to purchase supplies is called **inbound logistics**. (See Chapter 4 for an in-depth discussion.) Companies, of course, must also transfer products to customers. This process is called **outbound logistics**. Regardless of whether a company is dealing with inbound or outbound logistics, it is involved in inventory, warehousing, order processing and billing, and transportation.

In this chapter we'll look at:

- What issues does logistics face?
- What is inventory and how do companies manage it?
- How do companies warehouse inventory?
- How are products transported?

WHAT ISSUES DOES LOGISTICS FACE?

There are several reasons behind the new look of logistics. They are:

Relying on More than Quality and Price — Unable to attain a competitive advantage through quality or price, companies are trying to gain an edge by delivering the right products to customers, in the right amounts at the right time. The underlying premise? Logistics can play a key role in increasing a company's market share. Ask Toys 'R Us. During the 1999 Christmas season, Toys 'R Us was unable to deliver many of the toys ordered by customers online. This shopping fiasco left a negative image in the minds of both customers and potential customers in spite of the $100 gift certificate that Toys 'R Us offered to disgruntled customers.

Increasing Outsourcing — Not all outsourcing is going off shore. (See Chapter 1 for a discussion on **Offshoring**.) Companies are increasingly outsourcing portions or all of their logistics activities in order to reduce costs and gain flexibility. Scotts Company outsourced the fulfillment of print products – transferring inventory from over 50 vendors and ten fulfillment houses to RR Donnelley. As a result, Scott has been able to identify how much it is spending on printing, eliminate obsolescence, decrease ordering time, and reduce freight costs. UPS provides product repair and refurbishment services in the United States for InFocus, the digital projection company.

Instead of hiring someone to distribute products – known as **third party logistics providers (3PL)** – **fourth party logistics providers (4PL)** work on the basis that a company hires someone to take care of not only distribution, but a lot more. The other services include transportation, warehousing, inventory management, and packaging. Simply put, 3PLs integrate services to facilitate the movement of parts and material from suppliers to manufacturers, and finished products from manufacturers to customers. 4PLs take the next step – moving beyond logistics to include everything from design and development to manufacturing, transaction processing, after-sales support, and delivering products to customers.[2] Ideally, 4PLs manage all aspects of a supply chain. Alcatel, the network solutions provider, uses UPS to manage its entire supply chain activities – including interactions with customers and suppliers.

Increasing Productivity — As pressure mounts for companies to increase their **ROI (return on investment)**, they are leery to add physical facilities, equipment, or employees. Rather, they seek ways to decrease costs, yet maintain flexibility by adopting initiatives, such as **Just-in-Time (JIT)** production where they produce only enough to satisfy customer demand, cutting out intermediaries, and integrating the supply chain whenever possible. In its effort to regain market share, Harley-Davidson instituted an integrated logistics system that included a JIT inventory system to improve customer service and strengthen its relationships with dealers.

Shifting From a Supply Focus to a Demand Focus — Although babies are consistent in their use of diapers, Procter & Gamble was surprised the demand at retailers was variable. And demand variability increased as orders were passed up the supply chain from retailers to Procter & Gamble to its suppliers. This phenomenon is known as the **bullwhip effect** – the variability of demand increases at each stage of the supply chain resulting in increased costs. Procter & Gamble found the variability was caused by the supply chain's pricing structure, incentives, and planning and ordering processes. It reduced the bullwhip effect by eliminating pricing promotions causing demand spikes, synchronizing planning cycles, sharing forecasting and demand information, replenishing through VMI programs, and changing allocation schemes when product is in short supply.[3] The result is a supply chain where there is a rapid flow of products and information between all members of the supply chain.

Integrating Information Technology — Real time information leads to more efficient production and distribution with improvements in order processing, inventory control, warehousing, and customer service. Companies are creating integrated logistics systems leveraging several parts of the supply chain, such as transportation, inventory, warehousing, materials handling, and order processing – all of which are closely linked to the company's information technology systems and many operate worldwide. Changes in the way logistics operates may be traced back to innovations derived from information technology, such as point-of-sale terminals, product bar coding, satellite tracking, **EDI** (**electronic data interchange**), **EFT** (**electronic funds transfer**), and the Internet. Besides increasing a company's operating efficiencies, being able to share this information with business partners is critical.

Investments in better demand information are allowing companies to capture shifts in consumer demand, reduce forecasting errors, and thereby reduce the mismatch between supply and demand. In other words, the information is being used to drive supply chain

decisions. Sport Obermeyer, a ski wear company, was able to increase its profitability dramatically by understanding the costs of discounts, markdowns, and lost sales.[4] Information technology investments are now focusing on **pricing and revenue optimization solutions (PRO)** that allow companies to influence demand through pricing decisions.

With the proliferation of customer data, companies are faced with the challenge of navigating through all of this data. Yet there rarely is a need to communicate most supply chain data details to supply chain members in real time. For example, data captured from Gillette's 500 million RFID-tagged items must be mined for significant drivers, before overloading the users. When significant drivers are surfaced, the appropriate supply chain functions are notified. In 2001, Cisco's channel partners knew there was a massive inventory build up. Comparing current inventory levels in the channel with historic and forecasted demand would have averted Cisco's infamous $2.1 billion inventory write-off. Today, companies must have supply chain **visibility** – the capture and analysis of supply chain data to inform decision making, mitigate risk, and improve processes – that is actionable.

Gaining Efficiencies from Restructuring Logistics Flows — The Internet allows information flows to substitute for some of the inefficient physical flows. For example, about three-quarters of Cisco's sales are conducted over the Internet. This means that Cisco can outsource most of its manufacturing, while focusing sales efforts to creating new customers by leveraging systems that link Cisco and its supply chain partners. In fact, the majority of Cisco's sales are shipped directly from contract manufacturers to the customers, without stopping at Cisco's distribution centers. This results in lower inventory, faster and more accurate order fulfillment, and reduced costs.[5]

Going Global — Throughout *Parlez-Vous Business* we have referred to globalization. Globalization is an equally important factor when it comes to logistics. With globalization, new competi-

tors are entering the marketplace and in some cases leveling the playing field. As the ability to reach international customers grows, companies are required to understand customs and duties, obtain overseas warehousing, understand taxes, acclimate to local customs, operate in a different political environment, and reduce shipping times exponentially.

New Ways of Working with Distributors — As competition increases, companies are looking for new ways of working with their distributors. By seeking out these new methods, they are able to develop closer relationships with customers, as well as simultaneously gain market information and reduce costs. For example, the Fruit of the Loom's Activewear division supports its network of wholesalers by allowing retailers to locate specific products in stock using a "Product Locator." Wholesalers are sorted by zip code to help find products located closest to the user.

Distributing Products in New Ways — Companies are looking at new ways of distributing products. Many have opened their own retail outlets in shopping malls and discount malls. GMAC took a different approach when disposing of its lease cars. Rather than ship the cars to non-GMAC auction houses, GMAC runs five digital auctions. GMAC gains revenue from the vehicle sales as well as obtains detailed information about the weekly value of the vehicles throughout the United States. With this information, GMAC has more timely data from its own sources than it could obtain from third parties. And, the information can be fed back to General Motor's new vehicle marketing, promotions planning, and product planning groups.[6]

Reverse Logistics — Reverse logistics consists of those activities required to retrieve a used product from a customer – either to dispose of it or for reuse. Companies also rely on reverse logistics to get faulty products back from customers quickly – to analyze the root cause of the fault. Most of us regularly participate in a reverse logistics program when we place a Hewlett-Packard used toner cartridge in the box our new cartridge came in and send it back to the

manufacturer, using the UPS label enclosed. The process of easing customer returns, another aspect of reverse logistics, is becoming more prominent as online purchasing increases.

WHAT IS INVENTORY AND HOW DO COMPANIES MANAGE IT?

We think of inventory usually as the finished goods a company manufactures and then sells. This, however, is just one of the five different types of inventory that a company carries. An easy way to distinguish among the different types of inventory is to follow a product being made. Let's look at a simple example – bicycle flashlights that strap to a rider's leg.

The flashlights are assembled from several parts. The list of parts, called the **bill of materials,** is like a recipe. It lists each part needed and the required quantity to make one flashlight. To produce the flashlight, two supplies are required: plastic tops and plastic cylinders. They are stored in the **raw materials inventory**, which contains all materials and parts required to manufacture the flashlight. After the needed raw materials are secured, work is done simultaneously on the two components of the flashlight in order to reduce manufacturing time. When the two components are completed, they are assembled into the flashlight and placed in the **finished goods inventory**. This inventory contains all completed products not yet sold, which is called **stock**. By the way, this example assumes that each flashlight is made from start to finish every time. But this doesn't always happen. If at the end of the day the two parts of the flashlight were only partially completed, they would be placed in the **works-in-progress inventory**, also called the **semi-finished goods inventory**. This inventory consists of materials that have undergone only a portion of the manufacturing process. Supplies not used in the manufacturing process are placed in the **scrap inventory**.

In addition to direct materials a company must purchase to manufacture its products, it must also buy indirect or non-production

materials which are maintenance, repair, and operating supplies, such as adhesives, sealants, ball bearings, and office supplies. They are stored in a fifth type of inventory called the **MRO inventory**.

Since companies want to keep a minimum amount of inventory on hand, how much inventory is enough? Unfortunately, there are no ideal inventory levels. Marketing and Sales would like companies to carry enough inventory to fill all customer orders immediately. That's probably not realistic. Manufacturing might also favor high inventory levels to keep production lines up and humming.

Finance, in contrast, wants minimal inventories in order to reduce

INVENTORY TURNS

The most commonly used inventory control measure is the inventory turnover rate or inventory turns. Inventory turns is the number of times a stocked item is replenished within a year. The more often a company is able to turn over its inventory, the better. The reason is simple: Businesses seek to convert merchandise and materials into cash as quickly as possible. Holding on to inventory costs a lot of money, both in terms of the capital tied up in unsold products and in the expenses associated with warehousing them. So, the quicker a company is able to push its inventory out the door, the higher the return on its inventory investment and the better its cash flow.

Inventory turns are calculated by dividing annual sales by the average value of the inventory. The number of inventory turns considered to be acceptable, good, or even excellent varies by industry. When a company's inventory turn rate is below the industry average, profits are usually lower.

For example, Dell, considered by many experts to be one of the leaders in inventory management, has from 30 to 40 inventory turns annually. By tying up as little capital as possible in inventory, Dell can use the cash on hand to expand product lines, increase its advertising budget, or buy back shares. It eases the strain on cash flow considerably, allowing management much more flexibility in planning for the long term.

See Chapter 8 for more information about the Inventory turns ratio.

carrying costs (storage charges, taxes and insurance, cost of capital, depreciation, and obsolescence) and to release capital for other purposes. After all, items sitting in the finished goods inventory are a sunk cost, not an asset. Therein lies the inventory dilemma – too

much inventory increases carrying costs and the risk of product obsolescence. Too little inventory, on the other hand, can cost a company sales because of running out of the desired product (called **stockouts**).

One final point about inventory: **SKUs** or **Stock Keeping Unit** is a number associated with an item for inventory purposes that distinguishes it from all others. It is the smallest unit of measure applied to an item when it is issued from or returned to a warehouse.

HOW DO COMPANIES WAREHOUSE INVENTORY?

Companies store their products while they are waiting to be sold. Storage overcomes discrepancies in desired quantities and timing arising because production and consumption cycles rarely match. **Storage warehouses** store goods for time periods ranging from short to long. **Distribution warehouses**, or **distribution centers**, receive goods from various manufacturing plants and suppliers and move them out as soon as possible.

A company might own **private warehouses** or rent space in **public warehouses**. Companies have more control when they own warehouses, and they can be cost effective when used at or close to capacity. However, private warehouses tie up capital and are inflexible if sales volumes or locations change. **Public warehouses** rent space and provide additional services for inspecting, packaging, shipping, and invoicing goods. When using public warehouses, companies have a wide choice of locations and warehouse types, including those specializing in cold storage, etc.

As with other business functions, warehousing is beginning to be viewed as a way for companies to gain strategic advantages. Companies can view warehousing as an opportunity for cost savings as well as increasing customer satisfaction by serving customers more effectively. It's very common for companies to use third parties, such as UPS, to provide their warehousing functions.

Companies also ship products directly to customers, eliminating the intermediate step of storing products in **warehouses.** Known as **direct-to-customer delivery** or **distribution center by-pass**, companies significantly reduce their transportation, inventory carrying, and distribution center costs. In addition, the time from suppliers to stores is reduced, increasing cash flow and generating cost savings. Birkenstock, the sandal company, has U.S. retail orders sent directly from the manufacturing facility to retail stores, bypassing the distribution function and reaching retailers faster.

HOW ARE PRODUCTS TRANSPORTED?

Transporting products to customers is the most expensive part of logistics. Transportation choices affect not only product prices but on-time delivery performance and the condition of products when they arrive as well – all of which affect customer satisfaction. Managing transportation is now critical to a company's success.

When making transportation decisions, companies must consider the complex trade-offs between different types of transportation modes and their impact on other logistics components, such as warehousing and inventory. That's exactly what Sanofi-Synthelabous, the U.S. division of the global health care company Sanofi-Synthelabous, did. Sanofi-Synthelabous installed transportation management software to link transportation carrier selection with rates charged. The software selects the lowest cost shipment method based on the rates and geographic data Sanofi-Synthelabous enters into the system. However, if the low-cost option does not meet all requirements, the software recognizes this. For example, if a hospital needs a drug delivered the next day, air express rather than ground transportation will be required. Or if a drug is temperature sensitive, the air express option may also be selected. These special shipping instructions are entered into the company's order-entry software and then passed to the transportation software (where special instructions for selecting a transportation carrier are housed).[7]

When shipping to its warehouses and customers, a company can choose among five different modes of transportation: rail, water, truck, air, and pipeline (used primarily for petroleum, coal, and chemicals). **Intermodal transportation** consists of combinations of the five.

Shippers are increasingly combining two or more transportation modes, because of **containerization**. Containerization consists of putting goods in boxes or trailers that are easy to transfer between transportation modes. **Piggyback** is using rail and trucks; **fishyback**, water and trucks; trainship, water and rail; and airtruck, air and trucks. Each coordinated mode of transportation offers specific advantages for the shipper. For example, piggyback is cheaper than trucking alone and yet provides flexibility and convenience.

In choosing transportation modes, shippers can decide between private, contract, and common carriers. If the shipper owns the truck or air fleet, it becomes a **private carrier**. A **contract carrier** is an independent organization selling transportation services to others on a contract basis. A **common carrier** provides services between predetermined points on a scheduled basis and is available to all shippers at standard rates (e.g., Sea-Land, APL).

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Chapter 8
And the Financials

Remember watching *Jerry Maguire* and hearing the now famous line: "Show me the money?" That question holds true in sales. Demonstrating a grasp of a company's financial position is becoming increasingly critical to sales success. Product alone will not carry the day. Pricing and discounts will not suffice. Sales people must present financial evidence enabling the buyer to cost justify the purchase.

But let's not stop there. Top performing sales people do not limit their use of financial analysis to cost justification. They use financial analysis tools to identify potential sales opportunities, too. How do they do it? Top performing sales people understand how the companies they sell to make money. They don't assume that companies only make money from the products they sell. Rather, these sales people know that many companies, from automobile dealerships to computer manufacturers, generate substantial revenue from services and repairs. Financial companies, like credit card companies make their money from a combination of sources: the discount charges paid by merchants who accept credit cards (a percentage of each sale), interest charges for carrying late balances, late-payment fees, and sometimes annual fees. By knowing how the company you are trying to sell to makes money, you can look for ways that your solution can help a company generate additional revenue.

Top performing sales people know it is just as critical to understand how companies spend their money, too. By having a clear picture

of where company revenues are being spent, top sales people can identify potential sales opportunities where they can help the company reduce their expenditures – or sometimes even avoid taking on new expenditures.

This chapter is not designed to turn you into a financial analyst. However, we do want to take a look at some basic financial principles that sales people can use to both identify sales opportunities and to cost justify their offerings.

In this chapter you will have an opportunity to read about the following topics:

- Where can you get financial information about a company?
- What are the most common financial statements?
- How can you use financial ratios to identify sales opportunities?
- What should you consider when cost justifying your solution?

WHERE CAN YOU GET FINANCIAL INFORMATION ABOUT A COMPANY?

There are several sources that you can use to get a handle on a company's financials. First, look at its web site. It is the easiest place to get a quick overview about a company, its products, locations, strategic interests, and financials. You also get a picture of the image the company is presenting to the public. But don't stop there. A number of reports are good snapshots of a company's operations. The Annual Report can provide sales people with insights as to the company's financial condition, performance, and strategies. The 10-K Report contains all of the reports required by regulatory agencies not contained in the Annual Report. It is sent directly to the Securities and Exchange Commission. The Proxy Statement is a package of information that each shareholder receives as part of its annual meeting announcement.

Second, the general business press, such as *Fortune, Forbes, Business Week, Barron's,* and *The Wall Street Journal* contains a

wealth of information about a company and its industry, as well as business trends. Local newspapers where a company is headquartered or where it has large installations also run stories that can help you further create a picture about a company. Third, industry-specific publications also are an invaluable source. Fourth, services such as *Hoover's Online* and *Morningstar* can provide you with financial data about the company – and in some cases comparative financial data within the industry.

Finally, when researching a company and its financial situation, don't forget to do the same research on your customer's primary competition, too. The more knowledgeable you are about your customer, the more successful you will be in creating value through the products and services you offer.

WHAT ARE THE MOST COMMON FINANCIAL STATEMENTS?

As just mentioned, companies – especially publicly held companies – generate an enormous number of financial reports. Delving into each of them in depth would be the equivalent of taking an "Introduction to Finance" course at your local university. Instead, we will highlight some of the key reports and what insights you can glean from them to identify sales opportunities.

THREE COMMONLY USED FINANCIAL STATEMENTS

- **Balance Sheet** – depicts the company's financial position at a specific point in time, such as at the end of a fiscal year.
- **Income Statement** – summarizes the company's revenues and expenses over an accounting period (generally a quarter or a year).
- **Cash Flow Statement** – shows all of the cash that flowed into and out of the company during a period of time.

The Balance Sheet represents a company's financial health at a particular point in time. It lists the assets that the company owns and the liabilities that the company owes to others. Every Balance

Sheet is divided into three sections: assets, liabilities, and shareholder equity. And every Balance Sheet must "balance" – the total value of all assets must be equal to the combined value of the all liabilities and shareholder equity. For example, if a company had $1 million in assets and $300,000 in liabilities, the shareholder equity would be $700,000.

- **Assets** are anything that has value. Companies determine the dollar value of everything they own and put it under the asset side of the Balance Sheet. Items on a Balance Sheet are listed in order of liquidity.

  For assets, liquidity means nearness to cash. That is why cash is the first item on the Balance Sheet. After cash, the other current assets are listed in order of liquidity: marketable securities (which can be converted to cash by selling them), accounts receivable (which may be sold to a financial institution), and finally, inventories. Inventories are listed last because it is generally harder to convert to cash a half-finished item than it would a U.S. Treasury bond. Following current assets come those assets that would take more time to convert to cash. Buildings, land, and equipment would all be considered long-term or **fixed assets**.

- **Liabilities** are the opposite of assets. They are anything that costs the company money. Liabilities include monthly rent payments, utility bills, the mortgage on a building, corporate credit card debt, and any bonds the company has issued.

- **Shareholder equity** is the difference between assets and liabilities. This difference is what is left for the stockholders after all debts are paid.

The Balance Sheet illustrates a company's ability to meet its obligations. It also can be used to measure a company's operating performance. The individual elements of a Balance Sheet change from day to day and reflect the activities of the company. Analyzing how the Balance Sheet changes over time will reveal insights about a company's business trends.

Income Statement — While the Balance Sheet indicates the financial health of the company over time, the **Income Statement** is a short-term indicator of how a company's business is doing. Also called a **Profit and Loss (P&L) Statement**, it displays a company's revenue, the expenses required to produce the revenue, and the resulting profit. The difference between revenues and expenses incurred is called **profit** or **net income**. If the company's net income increases month to month, over time, cash will be increasing on the Balance Sheet, which in turn increases the **current assets**.

INCOME STATEMENT
Revenue
- Cost of Goods Sold
= Gross Margin
- General and Administrative Expenses
- Depreciation
- Net Income Before Tax
- Federal Income Tax
= Net Income

The first line in any Income Statement is **Revenue** – the value of products or services delivered to customers. The second line is the **Cost of Goods Sold** – the cost of producing or purchasing the goods that are delivered to customers. The Cost of Goods Sold is composed of raw materials, purchased components, labor costs, costs to operate and repair equipment, and other manufacturing expenses, such as plant maintenance and utilities. When the Cost of Goods Sold is subtracted from Revenue, what remains is the **Gross Margin or Gross Profit**. Gross margin measures a company's profitability as a result of producing and selling its products and services. It illustrates a company's manufacturing efficiency

and the desirability of the company's products in the marketplace. Gross Margins should be closely monitored to make sure the business is operating at the same profitability levels as it grows.

But, as we all know, there is more to profitability. For example, **General and Administrative Expenses** – the cost of operating the company itself, such as staff expenses, selling expenses, promotional expenses, and research and development – are deducted from **Gross Margin**. Then **Depreciation** expenses are deducted. Depreciation expenses are the portion of prior capital expenditures that have been allocated to the current year and are considered an expense. The result is a company's **Net Income Before Tax**. Federal taxes are then deducted, yielding **Net Income** – the amount of profit the company has earned during the year.

At this point, all expenses related to purchases from vendors and all other operating expenses have been taken into account. The shareholders may take this profit for personal use (distributed as **dividends**) or reinvest all or part into the company to finance expansion and modernization (**retained earnings**). The items in an Income Statement are summarized in the Information Box. (See previous page)

Cash Flow Statement — This statement depicts all of the cash that came into a company and flowed out during a period of time. The Cash Flow Statement supplements the Income Statement in two ways. First, it focuses attention on what is happening to a company's cash position over time. Even very profitable companies can run out of cash. So, by analyzing the Cash Flow Statement you can see whether a company is building up or drawing down its cash. Second, accounting definitions that the Income Statement is subject to does not influence the Cash Flow Statement. By studying the differences between a company's Cash Flow Statement and its Income Statement you can determine the impact of accounting definitions on net income.[1]

HOW CAN YOU USE FINANCIAL RATIOS TO IDENTIFY SALES OPPORTUNITIES?

Reading financial statements provides an overview of a company's financial performance, but sales opportunities will not "pop off a statement." To gain insights into where your solutions might have an impact, you need to dig deeper by looking at some key **financial ratios**.

Financial ratio analysis can be used to measure internal corporate performance, to compare company performance to the performance of similar companies, and to conduct trend analysis. There are four primary types of financial ratios: liquidity ratios, working capital management ratios, measures of profitability, and financial leverage ratios. Each is described on the following pages.

Before we move on, a caveat: We have selected the most commonly used financial ratios to highlight here, but they are by no means a complete list. For each industry, and even for each business function, some of the financial ratios discussed in this chapter may not be used very often or there may be others that are more relevant.

FINANCIAL RATIOS	
Liquidity Ratios	Current Ratio Quick or Acid-Test Ratio
Working Capital Management	Days Sales Outstanding Inventory Turns Ratio
Measures of Profitability	Return on Assets Return on Equity Return on Sales
Financial Leverage Ratios	Debt/Equity Ratio Interest Coverage Ratio

Liquidity Ratios indicate a company's ability to meet financial obligations. The better a company is at meeting these obligations, the more liquid it is.

- **Current Ratio** is calculated by dividing the dollar value of a company's current assets by the dollar value of its current liabilities. It indicates a company's ability to meet its financial obligations in the short term. For example, if a company has $10 million in current assets and $5 million in current liabilities, the current ratio would be 2.0 (10/5 = 2). A ratio below 1.0 means that current assets are less than current liabilities – indicating liquidity problems. However, a ratio in excess of 1.0 does not mean that a company is adequately liquid. Higher is not necessarily better. The current ratio can be high because a company has too much inventory or it does a poor job collecting accounts receivables. The converse is also true. The current ratio may be low because a company does not have or cannot afford the levels of inventory it needs to serve its customers.

  A current ratio of 1.5-2.0 is normally sufficient to meet near-term operating needs. Generally speaking, the more liquid the current assets, the smaller the current ratio can be without cause for concern. Companies that have ratios around or below 1.0 should only be those whose inventories can immediately be converted into cash. If this is not the case and a company's number is low, it means the company is short on its working capital. A current ratio that is too high – such as 3.0 or 4.0 – can suggest that a company is hoarding assets instead of using them to grow the business, potentially having an impact on long-term returns.

  You always should check a company's current ratio (as well as any other ratio, for that matter) against its primary competitors. Each industry has its own norms as far as a current ratio number that is appropriate.

- **Quick Ratio**, sometimes called the **Acid-Test Ratio**, is computed by subtracting inventory from current assets and then dividing the difference by current liabilities. The quick ratio is the same as the current ratio except it does not include inventory in current assets because inventory can be difficult to convert into money or securities. So what does a quick ratio tell you? It reflects

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the liquidity of a company by measuring its ability to come up with cold, hard cash literally in a matter of hours or days. Generally a quick ratio in excess of 1.0 ensures there is enough cash on hand so a company does not have to rely on the sale of inventory to pay the bills.

Working Capital Management Ratios reflect a company's performance in measuring its credit function. It is reflected in accounts receivable and inventory management.

- **Days Sales Outstanding (DSO)** measures the average number of days it takes a company to collect accounts receivable from its customers. If a company's DSO is 60 days, it means that it takes 60 days on average for the company to collect owed funds from its customers. The existence of bills more than 45 days old indicates customers' inability or unwillingness to pay or a feeling of no pressure to pay. These are called **Aging Accounts Receivables**.

- **Inventory Turns Ratio** reflects a company's ability to manage its inventory. It describes the relationship between the cost of the goods sold and the average inventory a company maintained to support those sales. The optimal amount of inventory a company keeps on hand is a fine line. Not having enough inventory or having the wrong inventory often leads to unhappy customers, lost market share, higher production costs, and purchasing small quantities at short notices.

  Yet by tying up as little capital as possible in inventory, a company can use the freed up cash for other things, such as creating new products, opening more stores, increasing its advertising budget, or buying back shares. This difference in efficiency can make a tremendous impact on the bottom line, as well as easing the strain on cash flow – allowing management more flexibility in planning for the long term.

  The number of inventory turns that is acceptable varies greatly by industry. Retail stores and grocery chains have high inventory turn ratios since they are selling products that are usually priced

at under $50. Heavy equipment manufacturers have much lower inventory turn over ratios since each of their products may sell at much higher price points.

Measures of Profitability indicate overall profitability and where areas of improvement are possible.

- **Return on Assets (ROA)** measures the profitability of a company relative to the total amount of assets invested. This ratio highlights whether a company is realizing enough net profit given the total dollars invested in assets.

- **Return on Equity (ROE)** measures a company's ability to use borrowed funds effectively as well as its own money. This ratio affects a company's ability to attract new investors. The more debt is used to expand the business, the greater will be the improvement in ROE compared with ROA. Without debt, a company's ROA and ROE will be the same.

- **Return on Sales (ROS)** measures the overall operating efficiency of the company. It indicates whether a company is making an adequate net profit given total dollars coming into the company.

The final group of ratios, **Financial Leverage Ratios**, indicates how well a company uses borrowed funds to expand its business. The goal is to borrow funds at a low interest rate and invest in a business activity that produces a rate of return exceeding the target rate of return for investments. Unlike liquidity ratios concerned with short term assets and liabilities, financial leverage ratios measure the extent a company is using long-term debt.

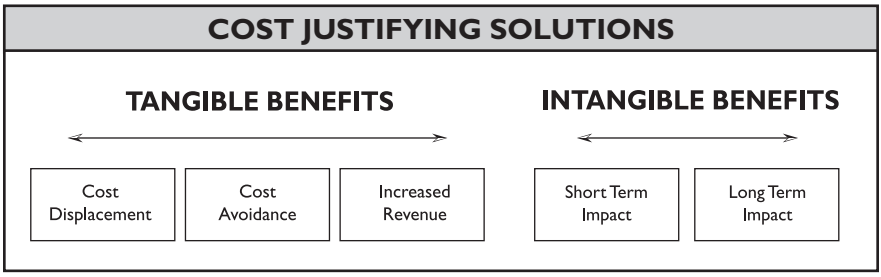
- **Debt/Equity Ratio** measures risk from the perspective of both the company and lenders. The primary risk to the company is that both principal and interest payments on debt are fixed costs. They must be paid even if the company's business and cash flow declines. The other risk to the company is that if its ratios decline, it may violate a loan agreement – potentially triggering higher interest rates or even calling of the loan.

- **Interest Coverage Ratio** describes the cushion the company has between the amount of cash it generates before interest expense and taxes and the amount of interest it must pay on its debt. The lending institution as a condition of making the loan usually specifies this margin.

WHAT SHOULD YOU CONSIDER WHEN COST JUSTIFYING YOUR SOLUTION?

Let's say you are selling an automated call system to a company that will reduce waiting times, boost customer satisfaction, and increase customer loyalty. Although these benefits are important, they alone are probably insufficient to close the sale. Rather, you have to translate these benefits into how the new system will increase profits and how it will reduce costs. No company approves spending money without knowing what the economic return – or **return on investment (ROI)** – will be.

When companies consider a new purchase, they seek to quantify the "bottom line" benefits they will receive and then compare the benefits to the costs of purchasing the solution. Unfortunately, sales people too often provide their customers with an incomplete set of benefits. The total picture looks like this:



Take a closer look, starting with **tangible benefits**. Tangible benefits are those benefits that can be quantified. The most common tangible benefits are cost savings. Cost savings may be realized when current expense items are eliminated as a result of the proposed solution. This is called **cost displacement**. While cost

displacement opportunities depend upon the customer's business, some common areas of cost displacement are:

- Reducing the number of people required to complete the task
- Reducing paperwork and/or processing
- Eliminating existing equipment
- Eliminating maintenance for existing equipment
- Reducing supplies

Second, cost savings may arise because future expenses may be avoided by purchasing the proposed solution. These savings, stemming from **cost avoidance**, occur because the proposed offering enables a company to expand its capabilities without adding resources. As with cost displacement, sources of cost avoidance vary from one company to the next, but common areas of cost avoidance are:

- Avoiding the need to hire additional staff
- Avoiding additional maintenance costs
- Avoiding the need for additional equipment or facilities

A third set of tangible benefits stem from **increasing revenues** as a result of gaining operating efficiencies. Ways in which companies can increase revenues through operating more efficiently are:

- Increasing the number of sales by processing more orders faster
- Reducing the number of orders lost to the competition by improving customer retention
- Expediting new pricing announcements
- Improving customer service

As we said, too often, sales people stop here when cost justifying their offerings. When they do, they sell their solutions short because the picture is incomplete. To complete the picture, sales people must also include the **intangible benefits** of the solution.

Intangible benefits, frequently referred to as **value adds**, generally focus on tactical benefits that improve the quality of business operations. To optimize intangible benefits, it's also critical to take a strategic perspective.

As is the case with any benefit, the payoffs of intangible benefits depend on the customer's needs and how the sales person helps the customer see the fit between customer needs and their solution. Some examples of value adds that could provide both a tactical and strategic benefit to the customer are:

- Providing better and more timely information
- Improving customer good will
- Improving service image
- Developing internal capacity to expand a company's capabilities
- Protecting from losing market share
- Overcoming competition
- Increasing market share
- Capturing new markets

To optimize the tactical and strategic intangible benefits to customers, it's useful to think in terms of **short term impact** and **long term impact**. Although tangible benefits have short and long term impacts too, it's particularly important to consider this perspective with intangible benefits. If not, the strategic payoffs to the customer will be missed or underleveraged.

While tangible benefits are inherently quantifiable, that is not the case with intangible benefits. Albeit more difficult to quantify, the importance of quantifying them is no less important.

To achieve the quantification, creativity is the key. You might be able to leverage your institutional resources to show the results other customers have had as a result of using your solution. These proof sources can take the form of percentage improvements or even success stories (when approved by your company for use as a

reference) illustrating the benefits achieved. Or, you might use industry benchmarks to illustrate the value of a particular end result, such as the average percentage increase in new sales or customer retention by improving customer good will.

Finally, to be able to cost justify the solutions you propose, you must have a clear understanding of how the customer's business currently operates and how your proposed offering will make a difference by providing operating efficiencies and/or creating competitive advantages. We have already noted that cost justification opportunities vary by industry. Cost justification opportunities also vary by business function. Marketing is seeking ways to get their product to market faster, Customer Service is trying to improve the customer service experience, Manufacturing is looking to reduce production costs, and so on. We hope that reading about these business functions in *Parlez Vous Business* will trigger new ideas for cost justifying your proposed solutions.

Endnotes

1. The Income Statement is based on accrual accounting methods. As a result, every revenue item is not an inflow of cash nor does every expense item reflect an outflow of cash. A company's net income is affected by many management judgments about such issues as how to value inventory or how quickly to depreciate tangible assets.

CHAPTER 9

IN THE END, IT'S ALL ABOUT CUSTOMER VALUE

Sales people must do more than sell product – they must create value. That's easy to say, but difficult to do. You cannot create value for the customer and separate yourself from the competition by talking about features. You must have the ability and confidence to carry out both a business and technical conversation with the customer about the unique benefits you can provide. Customers care most about solutions to problems.

The good news: this is not about some rare talent only the chosen few possess. Three skill sets are fundamental. First, you cannot get on the customer's side of the table unless you understand the importance of **asking questions** and get skillful at asking them. If the challenge is to provide solutions to problems that matter, you have to uncover and clearly understand the problems before you can provide a viable solution.

Second, it is difficult to carry on an effective technical or business conversation unless you're skillful at **active listening**. It is one thing to hear, it is another to listen. And the real test is whether customers know you've listened carefully and have understood their issues and concerns.

Last, you must establish your credibility before anyone will thoughtfully answer your questions or listen to what you have to say. And, **establishing credibility** is not just about saying smart

things. What it is really about is delivering some small piece of value to the customer.

CREATING VALUE BY
■ Asking questions ■ Active listening ■ Establishing credibility

Before we examine some of the best practices for using each of these three skill sets to sell value, let's explore the notion of value itself.

Exploring Value – There are two or three important defining characteristics of customer value to consider. A fundamental one is **value migration** – that is, what constitutes value tends to shift over time. Whether you analyze it from the perspective of an individual, a company, or an entire industry, the expectations about value are dynamic. Business history is rich with examples of companies that had very viable value propositions but failed to accurately judge the shift in the market's value expectations, subsequently they were not able to be responsive to their customer base.

Value is **situational and positional**. What value means to a COO is different for every company. And individuals holding different positions in the same organization have differing views on what constitutes value. While there are some commonalities, understanding these differences is what enables sales people to differentiate and separate themselves from their competition. After all, there are no generic customers, so how you sell value must be customized in each sales situation.

Finally, it is helpful to remember your **products have no inherent value**. Products possess features; they do not possess value. Value is a relative idea that is all about fit – the fit between the customer's needs and your solution. If the product does not address a need, then it has no value to that customer. This is why top sales per-

formers make such a big deal about the distinction between features and benefits. Features simply describe the characteristics of the solution. Benefits, on the hand, are about the degree to which a solution meets a customer's need. To create value, you must focus on selling benefits, not features.

With these characteristics of customer value in mind, let's look at how to use the three skill sets, discussed previously, to provide value for your customer. Learning to ask the right questions is a good place to start selling value.

Asking Questions — According to research, in successful sales interactions, the sellers ask more questions than they do in unsuccessful calls, and the buyers talk more than the sellers. Unfortunately, most sellers ask too few questions and end up talking more than the customer. Interestingly enough, when these same sellers are questioned about it, many report that they talk very little and ask lots of questions in their calls. So, how do you get better at this very important skill?

First, **planning ahead of time**. It's difficult to ask effective questions if you don't plan them ahead of time. A good approach is to determine two or three areas of focus for the call, and then jot down some starter questions – but avoid the laundry list.

ASKING QUESTIONS BEST PRACTICES
■ Plan ahead of time ■ Explore the customer's issues ■ Avoid an interrogation

Second, **exploring the customer's issues**. High-impact questions are not those that simply provide the seller with background information. More than ever, it is now possible to find out that sort of information without even talking with the customer. The questions that have greater power are those that help the seller and the customer explore the problems and opportunities that are most

important to the customer. The desired end state is to be confident you have a shared understanding of the customer's needs and know which ones are more important than others. If you really understand the customer's issues better than anybody else, you will probably win the sale.

Finally, **avoiding an interrogation**. Unfortunately, if questions are not skillfully integrated into the business conversation, customers may feel like they're being interrogated. There are several useful techniques for avoiding this potential trap:

- Ask permission up-front to ask questions.
- Make sure you ask questions at an appropriate time and that they are of an appropriate nature.
- Tell the customer why you are about to ask a series of questions. And make sure the why is something related to the customer's self-interest.
- Make sure your questioning has a pay-off for the customer, for example, helping the customer clarify their problems.
- Avoid too many closed-ended questions.

Listening — It has been said, "A good listener is not only popular everywhere, but after a while, they actually know something." While most people involved in sales have come to agree asking questions is a key skill set, many still underestimate the contribution of good listening to achieving top performance. For them, the first step is awareness. The second step is to actually becoming more skilled. So, let's explore some listening best practices.

Begin by **listening actively**. As noted earlier, it's important not only to listen, but also to make sure the other person knows you've listened and has understood what they've said. Think back. Like most sales people, you can probably imagine one of your customers thinking after the call, "I'm not sure that guy really understands the importance of what we were talking about," or "I think she's really smart, but I don't think she quite understands our priorities." So, how does active listening work?

Two key interactive techniques are **testing understanding** and **summarizing**. Testing understanding and summarizing involve paraphrasing what the customer has said to be sure you fully understand its meaning and significance. It is important to note that paraphrasing and parroting are not the same things. In practice the difference is enormous! Paraphrasing is helpful; parroting drives people crazy. Paraphrasing is concise and reflects only the essentials of what the customer said – it cuts through the noise. "So, from the perspective of your colleagues, the most important ..." "Let's see if I understand where you want to go with that ..." "So, to summarize the priorities ..." By paraphrasing, the seller ensures not only that they have heard and understood, but in so doing, also gives the customer an opportunity to hear back what they've said and make sure it's really what they mean or to change their minds if it doesn't make sense upon hearing it the second time.

LISTENING BEST PRACTICES
■ Listening actively
■ Testing understanding and summarizing
■ Staying focused
■ Tuning in to high-fidelity situations

Always **staying focused**. The research studies in communication suggest most of us can listen four to six times faster than we can talk. What do we do with the extra time? There are at least two options. First, we can let our mind wander and tune in and out of the conversation. Everyone's been in a conversation in which the other person has chosen this option. When you are the other half of the conversation, this behavior is, at best, rude and annoying.

The second option takes more work, but it also has a higher payoff. We can use the time to take notes and really evaluate what's being said by asking ourselves questions such as: Is this consistent with other information I've gathered in the account? Do we have a track record in the area under discussion? What can I do in this case to deliver a little bit of value?

Finally, **tuning in to high-fidelity situations**. Sometimes it is necessary to turn up the listening volume. For example, if an existing customer suddenly starts saying or doing things that deviate from previous behavior, it pays to find out why. Often in such situations, there are things lurking under the surface that are causing the behavior, and what you hear is merely a smokescreen. The seller needs to get past the smokescreen. Examples of other high-fidelity situations that require turning up the volume might include ones in which the customer contact is facing a new challenge, or the consequences of a mistake for the customer are particularly high, or perhaps you're dealing with a situation or type of individual that is a substantial departure from your experience base.

Establishing Credibility — It takes time to establish; it's a cornerstone for success; and, it can be lost in the wink of an eye. The ability to establish credibility is an absolutely fundamental skill in selling value, because without it, a whole lot of other things become much harder to achieve.

ESTABLISHING CREDIBILITY BEST PRACTICES
■ Doing what you say you're going to do ■ Being respectful of time ■ Getting help from others ■ Developing common ground

If your company is a market leader, then you have an advantage. Nonetheless, the challenge to establish credibility still exists. So, what are some of the best practices used by top performers?

First, always **doing what you say you're going to do**. One of the loudest messages emerging from customer sales surveys is: "If you promise it – then do it." The key point is follow-up must be responsive and consistent – getting it right part of the time is not good enough. Particularly if the commitment is more involved, it is best to develop and review the plan of action with the customer and regularly report back as the milestones are reached.

Being respectful of time. There is no quicker way to lose credibility than to be disrespectful of time. This is particularly true when calling on senior executives. Plan the call – know where you're going and how you're going to get there. Think about the payoff of the call, not only from your perspective, but also from the customer's point of view. Ask, "Will this call be of value to the person on the other side of the table?" Finally, always confirm expectations about the time and purpose of the call in advance.

Third, **getting help from others**. Particularly in a new situation or if you are new to the job, plan how you can use others to help you achieve a "credibility kick-start." Your manager can help, as well as the technical support staff or perhaps the National Account Manager if you're involved in a large account. Or, if you work in a division of a large company, seek out people in the other divisions also selling to your prospective customer. It is your responsibility to organize whatever assistance and resources are needed to establish credibility for your company, your products, and yourself.

Developing common ground. When planning the call, think about the common ground that already exists between you and your customer and how you can best leverage it. Build additional common ground by using their language – not yours – and by looking for opportunities to share success stories in situations like theirs.

In the Introduction to *Parlez-Vous Business* we said sales people must not only be good enough to sell a competitive advantage, they must be good enough to be a competitive advantage. For this to be true, sales people must possess the confidence and ability to do more than just communicate the value of their solutions. Sales people must be able to create value by *how* they sell, as well as *what* they sell. That's why we wrote *Parlez-Vous Business*. By adding to your knowledge and skill arsenal a better understanding of how businesses operate and the issues they must address, you will be in a stronger position to provide value to your customers. The more you do that, the more you will differentiate yourself from your competition. Good luck!

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About Sales Momentum

For more than 20 years, the leadership team at Sales Momentum has been working with Fortune 500 companies to help improve sales productivity. We have learned what it takes to make a difference – working with market leaders such as UPS, RR Donnelley, ADT, GE, J&J, and Guidant.

Sales Momentum has built a new generation of highly customized sales training programs and consulting engagements for today's hyper-competitive marketplace. We look forward to having an opportunity to work with you in building your world-class sales force. In electing to participate in a Sales Momentum engagement, you will have taken the first step toward building a partnership, not just made the down payment on another sales training project. Please contact via our web site (www.salesmomentum.com) or in Scottsdale, Arizona at 480-513-0900.

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Notes