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# Marketing Concepts <sup>1</sup>

## Doing it Right

**Marketing** is a general term used to describe all the steps that lead to final sales. It is the process of planning and executing pricing, promotion and distribution to satisfy individual and organizational needs.

From this definition it is easy to see that marketing is more than just the process of selling a product or service. Marketing is an essential part of business, and without marketing, even the best products and services fail.

Companies constantly fail because they do not know what is happening in the marketplace and as a result, they are not fully meeting their customer's needs. They mistakenly believe that with the proper amount of advertising, customers will buy whatever they are offered.

Marketing consists of making decisions on the four P's:

- Product
- Place/Distribution
- Promotion
- Pricing

Before a business owner can make decisions on the four P's, he/she must devise a plan. A plan provides a business with guidance on making decisions. This chapter includes directions on how to devise a plan that will assist in making decisions about the four P's. This type of plan is a six-stage process that is commonly referred to as strategic marketing; a strategic marketing plan is an important part of a business plan.

## Stage 1: The Mission Statement

The first stage in strategic marketing is the development of a mission statement. A mission statement is a brief description of a company, generally no more than a few lines, that describes where the company is and where it wants to go.

A good mission statement should contain:

- target customers/markets
- principal products/services

- geographic domain
- core technologies used
- commitment to survival, growth and profitability
- key parts of the company's philosophy
- company self-concept
- company's desired images

Do not expect a mission statement to be developed quickly. It generally takes various revisions before a complete mission statement is written.

## Stage 2: Overall Company Objectives

Once a mission statement has been created, the company can develop objectives. Objectives are specific goals to be achieved by the business. They are plans that will help a company move toward the mission statement. A business normally creates both one- and three-year objectives. Examples of company objectives are:

- To earn at least 20% after-tax rate of return on our net investment during this year
- To make our cookies the best selling cookies in terms of units sold in Kansas

## Types of Objectives

### 1. Profitability

- Net profit as a percent of sales
- Net profit as percent of total investment
- Net profit per share of common stock

### 2. Volume

- Market share
- Percentage growth in sales
- Sales rank in the market
- Production capacity utilization

### 3. Stability

- Variance in annual sales volume
- Variance in seasonal sales volume
- Variance in profitability

### 4. Nonfinancial

- Maintenance of family control
- Improved corporate image
- Enhancement of technology or quality of life

**Each objective should meet the following basic criteria:**

*Suitable:* Do they fit with the corporate mission?

*Measurable:* What will happen and when?

*Feasible:* Are they possible to achieve?

*Acceptable:* Do they fit with the values of the company and the employees?

*Flexible:* Can they be adapted and changed should unforeseen events arise?

*Motivating:* Are they neither too difficult nor too easy to achieve?

*Understanding:* Are they stated simply?

*Commitment:* Are people committed to doing what is necessary to achieve them?

*Participation:* Are the people responsible for achieving the objectives included in the objective-setting process?

Companies need to ensure that they do not set too many objectives. When too many objectives are set, the company runs the risk of having objectives contradict and interfere with each other.

## Stage 3: Competitive Strategies

Once a company has determined objectives a **competitive strategy** can be developed. A competitive strategy is developed so that a company can create advantages over the competition.

**Examples of creating a competitive strategy include:**

- offering buyers a standard product at a lower price; or
- making the product different than the competition on attributes considered important to the customer.

## Types of Competitive Strategies

### Overall Cost Leadership

This refers to being a low-cost manufacturer and should not be confused with setting low prices. Cost

<sup>1</sup> Adapted from *Reference Guide for Kansas Food Processors*, Kansas State University and Kansas Department of Commerce & Housing, July 1998.

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leadership can be achieved by:

- producing on a large scale
- designing products that are easy to manufacture
- accessing low-cost raw materials
- predicting a broad range of products
- pursuing cost reductions in production, marketing, research and development, customer service, and the avoidance of marginal accounts

### **Differentiation**

Differentiation involves changing the product so it is perceived as unique. Change can be based on:

- technical superiority
- quality
- customer support services
- the appeal of more value for the money

### **Niche Marketing**

**Niche marketing** occurs when a product is sold to a small number of total potential customers. The specialty market is often referred to as niche marketing, since products are marketed to a very small group of buyers. Niche marketing requires the business owner to identify customers with similar demands and serve their needs extremely well.

Niche marketing implies that a company will take a lower overall market share, but possibly with higher profits on the product. Higher profits may be achieved by having higher prices or producing at lower costs.

### **Stage 4:**

### **Marketing Objectives**

**Marketing objectives** can only be developed after stages one through three have been completed. Marketing objectives are designed to help a company attain overall objectives.

The five basic marketing objectives are:

- to achieve a viable level of sales or market share
- to increase market share
- to maintain market share
- to maximize cash flow
- to sustain profitability

Market share is a common term used in developing marketing objectives. It refers to the percentage of the total

industry sales your company attains.

For example, if a company sells 100 units of product, but total consumption for the good is 100,000 units, the market share is 1% (100/100,000).

### **Stage 5:**

### **Marketing Strategies**

**Marketing strategies** outline exactly how marketing objectives will be achieved. For example, if the marketing objective is to increase market share, the marketing strategy states exactly how the market share increase will occur. A marketing strategy is a way to give marketing orientation to a business by deciding to position a product or service in terms of buyer needs and wants. Inexperienced business people often make decisions based on what they like or want, leaving the customer out of the picture. A marketing orientation brings the customer into the center of the picture.

The marketing objectives for profits, cash flow and market share can be achieved by increasing the number of users, increasing the rate of purchase, retaining existing customers or acquiring new customers. The following are examples of various types of marketing strategies.

- I. Increase the number of users by:
  - building willingness to buy
  - increasing ability to buy
- II. Increase the rate of purchase by:
  - broadening usage occasions for the product
  - increasing level of consumption
  - increasing rate of replacement
- III. Retain current customers by:
  - maintaining satisfaction
  - meeting what competition offers
  - developing or increasing relationship marketing
- IV. Acquire new customers by:
  - line extensions (variations of existing products designed for existing markets)
  - leaders (lower prices on certain products to increase the sale of more expensive complements)
  - bundling (selling products - together, usually at a lower price than if bought separately)
  - head-to-head market dominance
  - head-to-head price/cost leadership

- differentiating the product
- serving a narrowly defined target market
- flankers (new brands designed to serve new segments)

### **Stage 6:**

### **Marketing Programs**

**Marketing programs** are the detailed approaches to the four P's. (products, place, promotion and pricing). The approach for making decisions for each of the four P's should closely follow the mission statement, company objectives, competitive strategies, marketing objectives and marketing strategies.

### **Types of Promotion**

**Promotion** includes all activities designed to inform, persuade and influence people when they are making the decision to buy. Promotion is made up of:

#### **Advertising**

- non-personal communication transmitted through mass media

#### **Publicity**

- free promotion through news stories in newsletters, newspapers, magazines and television

#### **Sales Promotion**

- all forms of communication not found in advertising and personal selling, including direct mail, coupons, volume discounts, sampling, rebates, demonstrations, exhibits, sweepstakes, trade allowances, samples and point-of-purchase displays

In designing a promotional plan, clearly spell out:

- Which objectives to use. It is possible to have more than one objective, but it is recommended that a company target its audience or run the risk of losing focus.
- What to say
- Who to say it to
- Criteria used to measure success

#### **Suggestions for**

#### **Inexpensive Promotion**

Some inexpensive, appropriate and effective methods of promotion for the new food processor include advertising through:

- Personal selling
- Product demonstrations
- Direct mail
- Business cards
- Yellow Page listing
- Seminars
- Newsletters
- Contests
- Flyers
- Statement stuffers
- Window banners
- Greeting cards
- Sports team sponsor
- Home parties
- Ethnic services—languages spoken

Of course, one of the best free methods of promotion is good “word of mouth.”

### Promotion Objectives

The **promotion objectives** need to be clearly stated and measurable. They must be compatible with the objectives of the company, as well as the competitive and marketing strategies. Objectives vary for different products and different situations. For example, producers must promote differently to brokers than to wholesalers. When promoting to a broker, the producer must promote what he/she wishes the broker to present to the wholesaler. When promoting to a wholesaler, the producer simply wants the wholesaler to purchase the product.

There are five general promotional objectives to choose from. The five types of objectives for promotional activities are<sup>1</sup>:

- to provide information
- to increase demand
- to differentiate the product
- to accentuate the value of the product
- to stabilize sales

### Promotional Strategy

Once the producer has reviewed all the possible promotional tools, he/she must devise a promotional strategy. A promotional strategy should address the following issues:

- What is the goal of the promotion?
- What types of promotion should be used?
- What effect should the promotion have on the customer?

- Which promotion is working?
- Which promotion is not working?
- What are the costs of the promotion compared to the benefits?

## Various Forms of Advertising

### Newspapers

**Advantages**—flexibility, community prestige, intense coverage, reader control of exposure, coordination with national advertising, merchandising service

**Disadvantages**—short life span, hasty reading, poor reproduction

### Radio

**Advantages**—immediacy, low cost, practical audience selection, mobility

**Disadvantages**—fragmentation, temporary nature of message

### Magazines

**Advantages**—selectivity, quality reproduction, long life, prestige associated with some, extra services

**Disadvantages**—lack of flexibility

### Outdoor Advertising

**Advantages**—quick communication of simple ideas, repetition, ability to promote products available for sale nearby

**Disadvantages**—brevity of the message, public concern over esthetics

### Television

**Advantages**—impact mass coverage, repetition, flexibility, prestige

**Disadvantages**—temporary nature of message, high cost, high mortality rate for commercials, evidence of public distrust, lack of selectivity

### Direct Mail

**Advantages**—selectivity and speed, intense coverage, flexibility of format, complete information, personalization

**Disadvantages**—high cost per person, dependency on quality of mailing list, consumer resistance

## Cooperative Advertising

**Cooperative advertising** should be looked at as a way to enhance consumer awareness of a product (or brand) in a local market under both the brand and the retailer’s name. Think of cooperative advertising as retailers helping to sell a product by paying part of the expense to promote the product in their local market.

Cooperative expenditures should be examined in the same way as other advertising, public relations and promotional plans. A program can be considered weak if the focus is on generating immediate store traffic through markdown promotions and ads emphasizing savings that could damage the brand's quality image.

Federated Cooperative’s program is a good example of a cooperative program. In order to take advantage of their program, several criteria must be met:

- The product must be sold in the Co-op stores
- The company must be an established supplier
- The company must be able to ship the product to all Co-op stores

Although a cooperative advertising program can be expensive to the producer, the benefits can also be significant. Cooperative advertising averages around 2 to 5 percent of the invoice value. However, every product is different.

The value is put toward purchasing newspaper ads together with the retailer. The ads are usually finalized in December for the following year. Be sure to stipulate that the feature price will be set six weeks prior to the date of the promotion. Consider an average price reduction of 10 percent in the form of an off-invoice case allowance timed to coincide with the cooperative advertising feature.<sup>2</sup>

## Media Rates

Promotional and media costs are the most difficult to allocate because their effectiveness is hard to measure in a concrete manner. Before looking at the dollar costs of different promotional media, it should be decided:

- which media are most likely to reach the target audience
  - which media suit the product image
  - whether any product-specific features make one medium more appropriate than another (i.e., is a visual demonstration necessary?)
  - what the promotional budget is
- Common errors to avoid are:
- trying to focus efforts on too broad a market
  - allowing the quality of a

promotional piece to lapse in order to afford more distribution, or lack of planning and coordination

- no measurement of effectiveness
- relying on one source of media

### Setting Promotional Expenditures

**Market share**—A company that has a higher market share generally has to spend more on advertising to maintain its share.

**Sales from new products**—If a company has a high percentage of its sales from new products, it has to spend more on advertising compared to companies with established products.

**Market growth**—Companies competing in fast-growing markets should spend comparatively more on advertising.

**Plant capacity**—If a company has a lot of unused plant capacity, it should spend more on advertising to stimulate sales of product.

**Product price**—Both very high-priced (or premium) products and very low-priced (or discount) products require higher ad expenditures because, in both cases, price is an important factor in the buying decision. The buyer has to be convinced (through advertising) that the product is a good value.

**Product quality**—Higher quality products require greater advertising effort because of the need to convince the consumer that the product is unique.

**Breadth of product line**—Companies with a broad line of products have to spend more on advertising compared to companies with specialized lines.

### Trade Shows

Budgeting for a trade show, and including this venue in the overall marketing plan is a highly focused way to:

- establish a presence in the marketplace
- gain an overview of the industry at present
- obtain a list of serious buyers more quickly than would be possible with a traditional sales approach

Although trade shows are relatively expensive, they are widely used in the food industry. They offer the potential for a high return in sales and contacts if

planned properly and presented well. Several months to a year may be required to obtain a well located booth and prepare the appropriate materials and displays.

### Choosing the Trade Show

1. List several trade shows that would be suitable

Various directories are available that contain a complete index of trade shows listed chronologically, geographically and by subject. Each listing has a phone number of the trade show contact. Two sources of Trade Show listings are:

#### USDA, Foreign Agricultural Service

Washington, DC 20250

Phone: (202) 720-7115

Fax: (202) 720-1727

<http://www.fas.usda.gov>

The FAS home page on the Internet's World Wide Web is a direct link to information on U.S. agricultural trade and export programs, including a list of upcoming trade shows.

#### Trade Show Week

12233 West Olympic Blvd.,

Suite 236

Los Angeles, California 90064-9956

Phone: (310) 826-5696

Fax: (310) 826-2039

“Trade Show Week” contains a listing of trade shows in the United States, Canada and Mexico (in its Domestic Edition) and other countries (in its International Edition).

2. From the list of potential trade shows, choose to participate in the one(s) that:
  - attract the most appropriate customers, not necessarily the largest volume of customers
  - will draw an audience from the geographic area the company is prepared to serve
  - are well supported by others in the industry (i.e., if the competition never misses it, there could be a reason)
  - are well organized and promoted
3. Obtain all information needed to begin preparing for the trade show(s). The contact person for the

trade show will provide information. Additional materials and information that should be requested (if not offered) include:

- a floor plan (preferably with other exhibitors indicated) so a high traffic area can be chosen. Note: Do not hesitate to pay extra for a good location; the whole point is exposure
- booth specifications, including dimensions, lighting, tables, chairs, skirting and any display or sample restrictions
- information on all services being offered, such as accommodations, equipment rental, assistance with set up, tear down or packing storage. Note: It is a good idea to exploit the services being offered on site, as there are many details to be concerned with at a trade show event.

### Preparation

- Set clearly defined goals for the trade show. This will help in development of the presentation strategy and display.
- Set a budget allowing for enough personnel, accommodations, product and travel. If the trade show is out of the country, allow for insurance costs, and plan to spend a day in the host country before and after the trade show.
- It is advisable to choose professional design and marketing consultants to help prepare the materials for the booth. Effective material can also be prepared by the company – just remember the target audience and the image you wish to project. Materials will include:
  - a high-impact display to attract the audience
  - professionally prepared information handouts (Remember, the people attending are coming to gather knowledge.)
  - samples of the product
- 4. Prepare the sales presentation. Exhibit selling must be polished, brief and convey information. If the presentation lacks impact, the audience will quickly move on.
- 5. Prepare a system for recording

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leads. Several options include:

- lead sheets for sales staff
- a business card exchange system
- sign up sheet for more information
- a guest book

6. Ensure everyone at your booth is well-informed about your company, its product, prices and terms of sale

### At the Trade Show

Staff will be presenting the product and working with customers the entire time they are in the booth. Ensure that adequate breaks are given so the quality of presentations remains consistent.

It is important that the customer relate the product to their situation. Sales staff should encourage customers to handle the product and talk about their situation so the most relevant points about the product can be presented. Encourage customers to take information and samples: Just because the materials are there does not mean they will be examined.

### Follow up

Be sure to prepare a plan for follow-up before the trade show, with deadlines for re-contacting interested parties. Follow-up should be immediate, and it is best to let customers know in advance when and how they can expect to be re-contacted.

### Publicity

Publicity provides free advertising for the producer through news stories in newsletters, newspapers, magazines and television. Publicity can be attained by sending a media release to radio, television, newspaper and magazine offices. A media release is a one-page letter identifying a newsworthy event and outlining the who, what, when, where and why of the story. A media release is appropriate to announce the start-up of a new business, introduction of a new product, or any other success story related to the company. The media will publish or announce the story as a news item and, consequently, there is no expense for the processor. Publicity is one of the most effective and least costly means of advertising.

### In-Store Demonstrations

Demonstrations, sometimes referred to as product samplings, are an effective and inexpensive means to promote a new or existing product.

#### Types of Demonstrations

There are three types of in-store demonstrations:

- Live demonstrations
- Mobile demonstrations
- Static display

**Live Demonstrations** include a staffed area with activity, such as simple preparation. They are best with a new product that requires information or answers to questions, or for a product that requires special preparation. One advantage of a live demonstration is that you can encourage the customer to purchase the product.

**Mobile Demonstration** is a form of live demonstration that occurs when a demonstrator walks through a store offering samples. The demonstrator usually has a base operation near the product sales display. Not all stores allow for this type of demonstration.

#### Static Display

Includes an area displaying the product and offering unattended samples. One advantage of a static display is that they are cost effective. One disadvantage is that there is no control on how much sample is used or on the purchasing decision. This type of demonstration requires consumer familiarity with the product.

#### Steps in Planning Demonstrations

- Determine what type of demonstration you are going to use.
- Decide which stores you are going to target.
- Choose a store that stocks your product.
- Find out the store policy on setting up in-store demonstrations. Every store has different policies.
- Decide if you wish to hire a demonstration company or if you will do it yourself. Consider time, energy, ease of demonstration and budget when making this decision.
- Talk to the store managers. The better the relationship you have with them and the better they know your product, the more cooperative

they will be. Talk to them about two weeks prior to the demonstrations, so they will have the product on hand and on the shelves.

- Be prepared to work the whole weekend, not just peak hours. The normal run of a demonstration is during store hours on Thursday, Friday and Saturday.
- The store may want incentives from you, such as cost cuts on the product. If possible, get the store to offer special treatment for your product during the demonstration. Be prepared to pay for this opportunity.
- Try to place the demonstration area where the product is stocked.
- During the demonstration, hand out simple information on the product and any coupons.
- Be unique. Try new ideas, as you must stand out from the competition.
- Know the competition, but do not downgrade them during the demonstration.
- Demonstrations normally do not provide access to a very wide market and, consequently, are only used as one segment of a marketing and promotional package.

### Coupons

**Coupons** can be an effective way to increase sales and profits, but there are certain costs to consider:

- costs of physical distribution, mailing, placing advertisements and paying the retailer a handling charge for redeeming the coupons.
- reduced contribution margins associated with the fact that coupons are price reductions.
- coupons will be used by new customers as well as existing customers who would have bought the product at the regular price.

Any printer can print coupons.

Managers must estimate various rates to determine the effectiveness of a coupon promotion. The estimations could be based on past performance or on experiments that run coupons in one city or in one part of a city. These rates include:

**Redemption rates:** the percentage of buyers responding to the incentive.

**Displacement sales:** sales made

during a promotion that would otherwise have been made to regular buyers at the regular rate.

**Acquisition rates:** non-regular buyers who purchase the product during the promotion.

**Stock-up rates:** sales made during a promotion that are borrowed from future periods because the customer stocks up on the product at the discounted price.

**Conversion rates:** the conversion of nonregular buyers into regular buyers.

To estimate the effect on profitability, one must:

- estimate the increased contribution from incremental sales to new buyers
- estimate the reduced contribution from displaced and stock-up sales
- subtract the direct costs of the sales promotion

## Coupon Distribution

Coupons can be distributed in a variety of ways. The most common vehicles for issuing coupons are:<sup>3</sup>

### Products:

- In- or on-package self
- In- or on-package cross
- Instantly redeemable

### Media:

- Newspaper
- Free standing insert
- Flyers
- Magazine
- Direct mail (solo, co-op or selective)

### In-store:

- Shelf pads (or shelf dispensers)
- Handout (with product demonstration)
- Entrance (crew handout or self-serve dispenser)
- Cash register (bag stuffers, cash register tapes)
- Electronic coupons printed in-store

There are three organizations that can help the handling of coupons. The following is an outline of the services performed by redemption agents, clearing houses and billing agents.

### Manufacturer's Redemption Agent

- Performs coupon redemption service for manufacturer's marketing department.
- Receives coupons sorted, counted,

and tabulated from retailer, retailer clearing house, or billing agent.

- Verifies retailer, checks coupons and reimburses retailer or retailer clearing house.
- Sends coupon redemption report to manufacturer with invoice. Provides complete audit of moneys received from manufacturers and paid to retailers.

### Retailer Clearing House

- Performs coupon accounting service for retailer's accounting department.
- Receives, unsorted and uncounted, all coupons accepted by retailer.
- Sorts, counts, and tabulates.
- Bills out to applicable manufacturers or agents.
- Reimburses retailer, deducting service fee per coupon, plus any shipment adjustments.

### Retailer Billing Agent

- Performs coupon accounting service for retailers.
- Receives, unsorted and uncounted, all coupons accepted by retailer.
- Sorts, counts and tabulates.
- Bills out to applicable manufacturers or agents in the name of the retailer.
- Invoice retailer service fee per coupon.

## Value Pricing

Pricing is much easier with one product than with multi-products. When a single good is being produced, all fixed costs associated with the business are applicable to that one product. When several products are produced, fixed costs must be applied proportionately to the various goods according to use.

Many companies want to have both extensive marketing programs and the lowest price. In most cases this is not feasible. The money for the marketing programs must come from the consumer and this is not always possible with low prices.

Traditionally, companies have used costs as the basis for setting prices, with no regard as to the value a customer places on a product or how competitors are pricing. A market-driven company will "price on value, knowing costs."<sup>4</sup>

This is known as target pricing.

**Target pricing** is where a company studies the competition and the customer to identify a point where the product must be priced to be competitive. Once the target price is identified, the company identifies a desired profit and works backward to calculate cost at which the product must be produced to meet the profit and target price. These calculations must take into account the target profit margin, price reductions for retailers, costs of promotion and future distribution costs.

This is the reason that pricing is the last of the four P's to be covered. To properly calculate the costs incurred by a company, include present and planned activities for distribution, promotion and product development.

## Pricing Strategies

**Pricing strategies** specify the role of price in implementing marketing strategy. It states what the company wants to achieve by setting a particular price. Pricing strategies are not necessarily mutually exclusive.

Price strategies should be determined for each marketing strategy set by the company and must be consistent with distribution and promotion strategies.

## Pricing Programs

Pricing strategies are arrived at through various **pricing programs** such as:

### Penetration Pricing

- a low price to stimulate demand.

### Used when

- lower prices result in overall increased growth in the market or increased demand for the company's product
- the company sells higher margin complementary products that are being pulled along with the sale of lower priced products
- the company enjoys economies of scale
- competitors have high-cost structures.

### Parity Pricing

- setting the price near or at competitive levels, and using other marketing variables to implement strategies

### Used when

- total market volume will not grow with lower prices
- competitors can easily match any price decrease

### Premium Pricing

- setting a price above competitive levels

### Used when

- a company can differentiate a product in terms of higher quality or special features
- a company has little excess capacity and where it is difficult for competitors to enter the industry

### Monitoring Costs

A multi-product company cannot get the information it requires from the conventional profit and loss statement. Instead, it needs to track costs for the company and for each product. Without product-specific information, it cannot tell which products are doing well and which need additional marketing support.

To gather all the relevant information, a company needs to track two types of costs:

- **Variable costs** (direct costs of manufacturing): costs specific to the manufacturing of the particular good or service under scrutiny (i.e., labor, raw materials and supplies)
- **Fixed costs**: ongoing costs that occur whether a business is shut down for a period of time or in full production (i.e., depreciation, insurance, taxes, selling and administration costs, utilities, and other costs)

### Contribution Analysis

**Contribution analysis** studies how the final selling price will contribute to fixed costs. Ideally, a product would cover all the fixed costs and contribute a new profit, but this does not always happen. Many products in a company's business only cover their variable costs and part of the fixed costs. A company must decide if these products are worth continuing (i.e., whether the product is necessary to the product line). Fixed costs exist whether the product is produced or not. The question that must be answered: "Is it better to produce a product that pays for itself and part of the overhead, or do nothing (i.e., not produce it) and cover none of the overhead?"

If a company has excess capacity, it would be better to keep the products that are covering only part of the costs. If capacity is full, selling a product with low or negative total contribution may not be advisable. If resources and sales are going to the low-contribution product instead of higher contribution products, a company is not maximizing profitability.

Salaries can be split according to hours spent on a product or some other reasonable basis. Rent and utilities can be split on the basis of volume allocation.

Company advertising and general and administrative overhead cannot be allocated to specific products, so are non-traceable fixed costs.

Determining which products should receive additional support becomes clearer after we calculate the percentage variable contribution margin.<sup>5</sup>

$$PVC\% = \frac{\text{selling price} - \text{variable costs}}{\text{selling price}}$$

PVCM shows which products contribute the greatest amount to overhead and profit for each additional dollar spent to increase sales.

### Setting Prices

Two tools that are important for setting prices are:

- break-even analysis
- cost-volume relationships

### Break-even Analysis

**Break-even analysis** can be used as a tool for initially setting a product's price or for calculating the effects of a price change. It helps the owner/-manager understand that for certain prices, different levels of production are required to break even (i.e., covering all variable and fixed costs).

The break-even point is where total revenue equals total cost. Below break-even, losses are incurred. Above break-even, profits are realized.

"Sunk" costs, such as research and development, should be ignored. Use equipment depreciation, rather than deducting full equipment costs.

### Cost-Volume-Profit Relationships

**Economies of scale** measure the impact of changes in volume on fixed costs. In many cases, a company's ability to increase the volume of output allows them to decrease the per unit cost.

The experience curve effect is where variable costs decline as volume increases. This can cause better results from increasing the volume of products.

Table 1: Break-Even Analysis

The following table shows an example of a break-even analysis for five different prices of one product.					
Unit Selling Price	\$21.95	\$23.95	\$25.95	\$27.95	\$29.95
Unit Variable Cost	\$ 7.95	\$ 7.95	\$ 7.95	\$ 7.95	\$ 7.95
Unit Contribution(A)	\$14.00	\$16.00	\$18.00	\$20.00	\$22.00
Estimated Sales	27,500	27,500	25,000	20,000	18,000
Revenue	\$603,625	\$646,650	\$648,750	\$559,000	\$539,100
Fixed Costs(B)	\$400,000	\$400,000	\$400,000	\$400,000	\$400,000
Variable Costs	\$218,625	\$214,650	\$198,750	\$159,000	\$143,100
Profit (loss)	(\$15,000)	\$ 32,000	\$ 50,000	\$ 0	(\$4,000)
Break-even (units)(C)	\$28,571	\$ 25,000	\$ 22,222	\$ 20,000	\$ 18,182

Experience curves may be due to:<sup>6</sup>

- more efficient production processes
- higher discounts due to greater volumes of purchases
- workers becoming more efficient

### Calculating Mark-Ups

When setting prices, companies must take into account their own costs as well as the various mark-ups required as a product moves toward the consumer. In the food business, mark-ups are usually calculated from the

retail price working back, rather than from the cost working up. As a rule of thumb, retailers' margins average around 30% with distributors' margins being as high as 30%, depending on what services are being provided.

The approach is similar when dealing with food service distributors such as Associated Food Distributors, but with allowances made for volume rebates. Volume rebate schedules are stepped with higher volumes, which means a higher percentage volume rebate is payable by the processor. The

processor must build in anticipated costs, which will be invoiced to the company at year-end for the rebate, based on the processor's total sales to the food service distributors.

The processor should not jump into a volume rebate schedule without first calculating the impact of the increased volumes in the form of lower per-unit costs. Many processors offer a volume rebate schedule that reduces profit ability because the volume rebate is greater than the cost savings of the increased output.

Table 2: Cost-Volume Relationships

Product 1		
	2000 Units	4000 Units
Unit Variable Cost	\$40	\$40
Total Variable Cost	80,000	160,000
Total Traceable Fixed Costs	<u>240,000</u>	<u>240,000</u>
Total Direct Cost	320,000	400,000
Divided by Volume	<u>2000</u>	<u>4000</u>
Average Unit Cost	\$160/unit	\$100/unit

Increases in volume have the greatest impact on products with high PVCm because most of the costs are fixed for these products.

$$\text{Break-Even Point (C)} = \frac{\text{Total Fixed Costs (B)}}{\text{Unit Contribution (A)}}$$

Other features of the marketing program to consider when setting prices:

1. A minimum delivery size is set to capitalize on freight. Minimum Order Size for freight prepaid shipments is 2300 pounds or more. An industry standard for minimum order size is 30% contribution..
2. New Store opening. In the case of a new store or a change of ownership, 15% off invoice for a period of seven days, with a case allotment of 15 cases per checkout.
3. "Deal prices." It is important to recognize that "deal" periods are set by retailers in December, so the processor has to have the year's promotion program agreed to by the store prior to December 31 for the following 12 months. Most processors have some type of maximum order volume to avoid the wholesaler/retailer stocking up on the product while "on deal."

4. Floor stock protection is a contentious area whereby the store asks that any downward adjustment in price apply to the wholesaler's/retailer's inventory of a product. Most processors do not offer floor stock protection in the belief that it is up to the store to control its inventory.
5. Some businesses charge prices according to "rules of thumb," such as price is twice labor plus materials, or price is materials and labor plus 20% for fixed costs and 25% for profit. These methods for setting prices are not recommended, as calculating actual costs is the only sure means of ensuring that prices cover costs.

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## What Needs to be Done

Marketing is the transferring of goods from producers to consumers. Marketing a new product may seem simple, but actually finding consumers to buy the product and getting it to them requires marketing managers to overcome many hurdles. Some of these hurdles, such as the market structure, cannot be changed but must be understood; others simply require time and hard work to overcome.

One of the first issues managers or owners must decide is which area is best suited to their interests, experiences and expertise.

### Production

Production is developing new products or modifying existing ones, organizing production schedules, and keeping equipment operational. It includes buying decisions about equipment, whether to buy new or used, and what equipment is actually needed to produce the products.

### Marketing

Marketing involves collecting information, analyzing alternative market outlets, developing different product forms, pricing products to compete in the marketplace, deciding the scope of the proposed market area and meeting consumers' needs at the right prices.

### Procurement

Procurement is contracting with sellers of inputs, maintaining an adequate supply for production and scheduling deliveries to the local plant.

### Labor management

Labor managers hire and supervise employees to obtain optimum production and maintain good working relationships.

It is difficult for one person to satisfactorily do everything, such as making decisions concerning production, marketing, procurement and labor management. Without concerted effort and attention to all details, the chances of success are lowered. A management decision to organize production and separate marketing activities for each new product is often the difference between

success and failure.

The marketing manager should concentrate on marketing plans that will best serve the company and reach the most consumers, because these are the centerpieces of the marketing process. A good marketing plan should identify problems or hurdles to overcome and collect the kind of information needed to solve them.

## Marketing Structure

A successful study of the marketing structure must include a marketing plan specific to the product and the market share goal. A market cost feasibility analysis should be formulated. This information should be used to determine production practices, changes in the products, if needed, and where products should be sold for the greatest return.

An assessment of the current business environment also is required. Although the business environment of a particular area may be beyond the control of local managers, it needs to be understood, because it often influences the type of marketing organization required for success.

An understanding of customer requirements, including the following, is needed.

### Market territory

The physical locations where the product is going to be sold must be decided. It must be determined whether it is local, national or somewhere between.

### Population concentrations

There have to be enough people within a market who will buy the product on a timely basis. It is easier to sell a given level of production throughout the year in urban areas where there are many different types of consumers. In rural areas, a greater percentage of people will have to buy the product in order to sell the same amount. A major factor in selling products is how many times a year the product will be purchased: once a day, week, month, or year. The fewer times a product is purchased by a specific consumer per year, the more buyers needed.

## Income levels

Different customers have different income levels, tastes and preferences for products. Some may consider a product essential, others, conspicuous consumption.

## Number of market outlets

The number of market outlets is the number of places consumers can purchase the product, whether in one large store, many small ones, roadside stands or mail order.

## Participants in the Marketing Process

Many firms are involved in the marketing process. This section focuses on who is involved. There are a variety of middlemen and organizations who specialize in performing various marketing functions. There are no limits as to how they are organized. There are several types of middlemen:

### Wholesalers

Wholesalers sell to retailers, other wholesalers and industrial users, but do not sell in significant amounts to ultimate consumers. There are two main kinds of wholesalers.

#### Agent wholesalers

Agent wholesalers can act as representatives of their clients. They also can provide access to market territories that would be available only if the producer expended additional time and cost. This activity requires a great deal of specialization, and they charge fees for these services. For this fee, however, they can help locate alternative buyers, locations, prices, products, and various retail market outlets. In addition, some may specialize in a certain kind of product, in different market locations, or in a large number of different products.

#### Merchant wholesalers

Merchant wholesalers buy and sell for their own gain based on their knowledge of the market situation. For example, they buy directly from processors and sell products to retailers, other wholesalers, and industrial users. They usually specialize in similar types of products in which they have storage

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and transportation investments.

## Brokers

Brokers act only as representatives for their clients. Brokers' incomes are from fees and commissions and are payments for their knowledge of market outlets and contacts. Brokers do not assume physical control of the products. They follow directions of each principal and have less discretionary power in price negotiation.

## Commission people

Commission people usually control the physical handling of the product, moving it from one location to another. They arrange for the terms of sale and collect money from the buyer for the sale of the products. They deduct predetermined fees and send the balance to the processor.

## Speculative middlemen

Speculative middlemen take title to the products. They buy products based on their knowledge of the possibility of selling at a higher price. Their goal is to make a profit from price differences in various locations.

## Retailers

Retailers buy from many processors and wholesalers to develop a product mix that will attract consumers to their stores. They rely on consistent quality and availability of products. They buy and sell for their own gain.

Managers need to decide what kind of a market territory they want to serve and how they can use any or all of the participants in the marketing process. Their selection will depend on different population concentrations, income levels, number of competitive products and number of market outlets. All these should be used to develop the type of market organization that will best serve consumers and sell the product. If these data are too difficult to personally collect, they can be purchased from various marketing consultants and middlemen.

## Pitfalls to Avoid When Devising a Marketing Plan

Care must be taken when devising a marketing plan. The buying public, unfortunately, is very choosy, and

producers need to understand the pitfalls of producing too few or too many products.

## Surplus

Too many products at a given price in a certain market location are called surplus and will lower income potential. Consumers may consider buying the surplus at a lower "sale" price. This is a signal to producers to send fewer products to that location.

## Shortage

There is a shortage when consumers want to purchase more products than are available at specific locations. When this happens, consumers who want the products are usually willing to pay higher prices to get them. This will result in local retail managers offering higher prices to wholesalers to get additional volume. When these additional prices are offered to processors, it is a signal to move more products to that location. This information is valuable. Information from all locations should be combined to decide whether or not to expand production.

## Organizing to Sell New Products

When selling new products, managers are faced with problem areas that are unique for each product. Products have to be delivered to locations where consumers will be able to buy them. For some products this is complicated, but for others the marketing process is fairly straightforward. In any case, managers should gather the kind of information needed to fully understand and be able to choose the most profitable alternative. To start this process, managers must have enough information in all of the following problem areas.

## Consumers— Convincing Them to Buy

### Identify consumers

Who will most likely buy the product, how often will they buy it, what price they are willing to pay, and where will they be buying it?

Consumers have specific wants and needs. Their incomes vary from high to middle or low. They are given choices

of thousands of products, from luxury items to basic necessities. They have many different traditions and tastes, ranging from ethnic to generic products. Consumers affect production decisions every day.

Consumers are the final buyers and users of products. The intent of any business is to make and sell a product. The manager must do the following.

- Make it in the form that consumers want.
- Make it when consumers want it.
- Sell it in places where consumers want it.
- Sell it at prices consumers are willing to pay.

Managers have to get market information in order to make the following day-to-day decisions.

- What quantity of a product are consumers willing to purchase?
- Who is making those products, and who is competing for those consumers?
- What prices are consumers willing to pay?
- What is the speed with which products and information travel through the channels of distribution?
- How long does it take for a price increase to reach the producer?
- Based on this information, should production be increased or decreased?

## Food Ingredients— Availability and Seasonality

Ingredients are one of the more important factors in maintaining a consistent quality, especially in food products. The producer must know where to locate ingredients at different times of the year, especially if they are seasonal. Proper storage and handling should be considered, as well as transportation and packaging. Costs of ingredients that change frequently can create problems when estimating production costs. This may require contracting for future delivery (discussed later). Seasonality of some produce will require purchases in different locations during the year. Products that require special handling, such as fresh meat or vegetables, present a

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different set of problems and cost factors. Also, shelf life of ingredients needs to be considered.

One very important thing should be noted: The only way to maintain consistent-quality products is to buy consistent-quality ingredients. This cannot be emphasized enough. People might be willing to buy the product once, and if it is of good quality, they will continue to buy it. However, if they notice a difference in quality each time they purchase it, they will cease to buy the product, and it will be almost impossible to get them to buy the product again.

### **Alternative Retail Outlets**

There are many ways to distribute products once they have been produced. These marketing channels need to be set up before production, not after. These include large chain stores, mail-order sales, neighborhood stores, roadside stands, and door-to-door sales. Alternative retail outlets can help producers reach a specific consumer group with income levels suitable to the product, ethnic preferences that match the products, and lifestyles that are served by the products. Different retail outlets that will be able to sell products should be considered.

### **Large chain stores**

These stores can provide an opportunity for a larger number of consumers than a local store. They offer thousands of choices of different products from which consumers must decide to spend their money. Large chain stores usually require large quantities of a product delivered at specific times to specific places at predetermined prices. Getting shelf space can require substantial fees.

### **Neighborhood stores**

These stores often work with local producers if the managers feel the products will be accepted by their clientele. Each store has developed a clientele unique to that store, and new products have to be a part of that image.

### **Specialty stores**

Specialty stores are often single-line stores or discount houses that, like

neighborhood stores, have a unique clientele. Again, the products must match the clientele and image of the specialty store.

### **Roadside stands**

A roadside stand may be an alternative for fresh products or other seasonal products, such as jams, jellies or pickles. These are open for part of the year at a time when consumers are willing to drive to a specific stand to buy them.

### **Mail-order sales**

When using mail-order outlets, sales volume can be controlled by the number and type of catalogs sent. When using mail-order catalogs, it is important to know the number distributed and the characteristics of the readers. If, for example, 400,000 people receive the catalog, and 1 percent of them order the product, that means there will be 4,000 orders. If 5 percent of them order the product, there will be 20,000 orders. Producers need to understand and be prepared for the potential volume of mail orders. Conversely, there could be very few sales, and there could be products left over.

### **Government contracts**

Government contracts cover such outlets as prisons, military bases and government cafeterias. Contracts with various government purchasing agencies can provide sales opportunities as long as government specifications are met.

When formulating distribution plans, be sure to inquire about terms of sales. Some large discount chains and government procurers do not pay within 30 days. In fact, sometimes payment is not received for at least 60 days. Marketers must take this into consideration when planning cash flow statements and making marketing plans.

### **Test Marketing**

Regardless of the outlet chosen, test marketing a product in potential sales areas is essential. This is especially true if the product is new or different from what is already on the market. Producers must work with retail managers to decide how much advertising and promotion will be

required to convince consumers to buy their products.

A good way to begin test marketing is to take samples to store managers and convince them the products will sell and make them money. Samples should be ready for consumers to test. Selling them at reduced prices or giving them away is a good way to entice consumers to try new products. It is important to seek immediate feedback about what consumers think of the products and any suggestions they may have for improvement.

When doing test marketing, it is important to determine how the products are competing with other brands. Count the number of competing brands in the stores. Buy some and compare them.

Do not forget that location within any store is very important. Certain locations have "higher traffic" than others. This means more consumers will see products in those areas and will be more likely to buy. The highest exposure for new products in stores is at the ends of the aisles or at the checkout counter. There is a preferred height on store shelves where people can see your product without looking up or down.

### **Advertising**

Advertising is controlled communication about a product. Through symbols and language, it tells what a product or service can do for the consumer.

Advertising, when properly understood, is a powerful tool for management. It can be most effective with products that can be differentiated from similar products based on consumer-accepted quality differences. Consumer information is gathered by giving small samples to consumers in stores or retail businesses. This information can give a direct consumer response to a new product for that location.

Regardless of the quality of a product's advertising, it is important to remember a product has to compete on its own. Brand preference cannot be established if the product fails to meet consumer expectations. A well developed overall advertising program

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can tell consumers what a product or service can do for them compared to similar products on the market. If consumers are convinced, they will buy the products.

“Business is built best which attracts the kind of customer and only the kind of customer it can best serve. Every business is qualified by its management’s beliefs to serve a particular segment of the total market, and by reflecting its essential character, its advertising can most effectively reach this segment and keep it a long time.” (Maynard)

### **Pricing Competitively**

One question to ask is whether the product is priced similarly to other competing brands but above costs of production. For more information on this, see K-State Research and Extension bulletin *Economic Analysis of a New Business—Doing it Right*, MF-2184.

Once consumers have been identified, a retail outlet has been located and test marketing completed, producers need to determine at what price a product will sell and still be profitable. Price is the only means for generating income and profit for the producer.

There is no one method of setting prices. It is imperative to keep in mind that costs of production do not determine the price of the product. Consumers are only interested in the lowest price they can get, and they do not care what it costs to produce the product.

If the consumer’s desire for the product is great, set the price high enough to ration the available supply for sale. As production increases, prices may have to be lowered to sell additional products. However, do not lower prices below the cost of production. Always know your cost of production, and never price your product below that if the goal is to remain in business.

If the consumer’s desire for the product is not great, and if the product is in a competitive market, sales will depend on the success of convincing consumers to buy products for prices above total costs.

The marketing manager for a product must find a price that satisfies both consumers and producers. Consumers are always willing to pay lower prices for any product. Producers are always willing to offer products for sale at higher prices. A market price for long-term production is established when the price of any product is equal to or above the average total cost of production and at a price consumers will pay.

### **Frequency of Consumer Purchases**

Frequency of consumer purchases is very important. Repeat purchases are the keys to a successful outlet selection. Not all products are purchased at the same frequency, and marketing managers need to understand how often consumers will be purchasing their products when determining production rate, transportation, storage, etc. The most common purchasing patterns are as follow.

#### **Daily**

Some products – such as milk, bread, and doughnuts – might be purchased daily, meaning the producer will have to deliver the product frequently. These products are usually quite perishable.

#### **Weekly**

These are generally products with a 3- to 6-week shelf life. For these products, careful control of production inventory will be necessary. A producer must have the ability and capacity to store products between deliveries.

#### **Monthly**

These require a larger consumer territory if the consumer only buys one item per month compared to one per week. Delivery will be less often, and storage will have to be increased, either on the shelf or in the back room.

#### **Seasonal**

These are products that generally are associated with a specific growing season or holiday. These types of products usually are sold only during one time period each year.

### **Packaging**

The purpose of a package is to protect the product from spoiling and keep it clean until it is opened by the consumer. Many producers overlook the importance of product packaging, but this is the first thing consumers see. When the package is appealing, consumers are more likely to buy it. As long as the anticipated quality is there, consumers will be satisfied. They will buy the product in the package they like and will not buy it in one they do not like – even though the product is the same.

The consumer decides the size of package most suited to each product. The size and type of package will depend on knowing what the consumer will accept for each type of product. Consumers are more likely to buy smaller food packages of items that are used occasionally. They will buy large packages of items used frequently and in a relatively short time, if the product remains safe to use during this period.

Most plant and animal products must be packaged appropriately to be preserved: pickled, canned, smoked, cooked, dried, or frozen. The type of processing will determine the length of time the product can be safely used from the time processed.

### **Storage and Transportation of Food Products**

Products must be stored from the time they are processed until they are transported and sold to consumers. Various products require different types of storage and transportation facilities.

Storage and transportation are critical to the marketing process. Obviously, different products require different types of storage and transportation facilities. For example, frozen products should not be allowed to thaw during storage and transportation. Keeping the product frozen requires additional expense. Part of the storage and transportation cost includes spoilage and breakage.

Fresh products have to move to consumers quickly. Dried products can remain in storage and be moved through marketing channels at a slower

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pace without lowering quality. They can be shipped further to reach different consumer areas.

Regardless of the type of storage and transportation required for a product, it is imperative to maintain the same quality from the time the product leaves the processor until it reaches the consumer.

Plans must be made to store ingredients for processing and finished products until shipment. This is especially critical if you can buy large quantities of ingredients at lower prices.

## Contracts

Contracts are legal obligations made between two or more business people for the sale and purchase of products. Major points in a contract spell out price of the product, quality requirements, amount to be delivered, specific location and time of delivery. This ensures that buyers know when to expect the product and sellers know when and how much of the product has to be delivered at a specific time and place. Care should be taken when finalizing a sales contract that production can provide the product as specified in the contract. The risks of change in price and volume are eliminated until the next contract is negotiated.

Whether completing a contract with buyers of products or sellers of inputs needed for processing, sound legal advice should be obtained to make these transactions simple to understand and clarify legal obligations of all parties.

## Consumer Feedback

Consumer feedback involves having people try the product and then asking them their opinions of it. A first step would be to ask friends and neighbors for help, and to establish options for testing the new product.

It is vitally important to continue to seek consumer feedback as the product continues to sell. This process should be included in a marketing plan. Ask consumers the following questions.

- How do they view the product and company?
- Do they like the product?
- Will they buy it again?
- How soon?

Information should be gathered continuously in each location about sales volume and changes in competitors, life cycles of the product, new products, service to vendors, and competitors.

Remember that general information will provide general results, and detailed information will allow for more detailed analysis and more accurate results. Each manager has to decide what type of information is needed and how much to collect to maximize usefulness. The more producers know about customers, the better chance they have of satisfying them.

## Summary

Creating a marketing plan takes a lot of hard work. The benefits of doing this work before you start to market your product, however, are immeasurable. This groundwork will make it much easier to borrow the necessary capital to start a business. Because lenders are interested in accurate information about a potential investment, a well-done marketing plan demonstrates the management level for a company. If there is no plan, lenders will not look favorably on lending capital to someone who has no alternatives in mind for the future if changes occur.

A well-developed marketing plan demonstrating knowledge of production, how much capital will be required, cost of production, specific market location and an understanding of consumer purchasing activities will be beneficial in creating a profitable operation.

The most difficult part of developing a marketing plan is estimating total marketing costs. Each marketing organization uses labor, management, land and capital resources in varying degrees of concentration. Each expenditure item should be included in a cost analysis. If any expenditure is not included in an analysis, it will be paid out of a private account, which could mislead the decision-maker concerning total costs.

Various marketing functions will have different costs, depending on how much of each is needed to move products from the place of production

to consumers. Each entrepreneur has to evaluate information using estimates of cost and the pricing system to decide to continue operation. When a firm is in operation for a longer period of time, these estimates can be based on actual expenditures, which are more accurate.

Total marketing costs per unit have to be paid by the consumer. The marketing system also has to be profitable for every marketing function and every stage along the system. Understanding the cost of each marketing function is necessary for every phase and has to be paid if all of the functions are to be continued. Consumers make final decisions about any product based on quality, price, disposable income, quantity and price of substitute products.

By doing the research necessary to create a thorough marketing plan, a producer can more clearly understand the needs and demands of the consumer, can identify the best potential markets, and can find the most effective and efficient means to get products to those markets. It is important to remember that a marketing plan is only as good as the information it contains. If correct data are used, the marketing plan will be accurate.

It is important to have a contingency fund available. This will provide a reserve in case any of the other estimates are incorrect. It will be impossible to accurately figure every item in the marketing plan, so this contingency fund provides extra cash in the start-up phase of your business. Of course, any money not needed in the contingency fund can be used for other purposes once the company is up and running.

By following these guidelines, producers will be well on their way to success!

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