Chapter

8 Integrated Marketing Communications and Pricing Strategies

There are two things that never live up to their advertising: sin and circuses.

—Anonymous

There is hardly anything in the world that someone cannot make a little worse and sell a little cheaper, and the people who consider price alone are this man's prey.

—John Ruskin

LEARNING OBJECTIVES

Upon completion of this chapter, you will be able to:

1. **DESCRIBE** the basis of a marketing communications plan.
2. **DESCRIBE** the operational elements of a marketing communications plan.
3. **DESCRIBE** the advantages and disadvantages of the various advertising media.
4. **DISCUSS** the four basic methods for preparing an advertising budget.
5. **EXPLAIN** practical methods for stretching a small business owner's advertising budget.
6. **DESCRIBE** effective pricing techniques for both introducing new products or services and for existing ones.
7. **EXPLAIN** the pricing methods and strategies for retailers, manufacturers, and service firms.
8. **DESCRIBE** the impact of credit on pricing.

Every business needs to construct, maintain, and continually evolve an integrated marketing communications system. Such a system is comprised of advertising, publicity or public relations, and personal selling with all parts focusing on the firm's targeted customers and delivering a consistent and reinforcing message that extols the benefits of the firm's product or services. Entrepreneurs who fail to communicate with their customers run a serious risk of declining sales. Their silence may be perceived by customers as a lack of interest on the part of the business.

In Chapter 6, the process of determining who the firm's customers or clients are was discussed in detail. The more precise and accurate this process is, the more highly focused and less expensive it becomes to communicate the messages of the business.

Developing an effective program to integrate marketing communications has become more of a challenge for business owners in recent years. Because of media overflow, overwhelming ad clutter, increasingly fragmented audiences, more advertising options, and more skeptical consumers, companies have had to become more innovative and creative in their promotional campaigns. Rather than merely turning up the volume on their campaigns, companies are learning to change their frequencies by trying new approaches in different forms of communication.

THE BASICS OF A MARKETING COMMUNICATIONS PLAN

1. Describe the basis of a marketing communications plan.

Every small business needs a plan to assure that the money invested in its marketing communications is not wasted. A well-developed plan does not guarantee success, but it does increase the likelihood of achieving positive results.

Some entrepreneurs believe that because of limited budgets they cannot afford the luxury of marketing communications. This mind-set views the process as an expense they undertake only when their budgets permit—a leftover expense, something to spend money on if anything remains after paying the other bills. These owners discover, often after it's too late, that communicating with customers is not just an expense; it is an *investment* in a company's future. Advertising and promotion can be effective means of increasing sales by informing customers of the business and its goods or services, by improving the image of the firm and its products, or by persuading customers to purchase the firm's goods or services. A megabudget is *not* a prerequisite for building an effective communications campaign. With a little creativity and ingenuity, a small company can make its voice heard above the clamor of its larger competitors—and stay within a limited budget!

A Company Example

For example, Scott Fiore, owner of ***The Herbal Remedy****, a natural pharmacy in Littleton, Colorado, keeps his company's name in front of customers by using traditional advertising media, writing articles on herbal remedies for local magazines, and generating lots of publicity. Fiore, who spends about $1,400 a month on traditional advertising media, regularly buys radio ads that run during a popular talk show on health because he knows that the show reaches many of his target customers. On several occasions, the show's host has called Fiore to ask questions about a particular herb, giving The Herbal Remedy a promotional boost that normal advertising just cannot buy. Fiore also sponsors a series of free in-store seminars on a variety of health topics, and some have drawn standing-room-only crowds. One of the most effective forms of promotion for Fiore is word-of-mouth advertising from satisfied customers. Their positive experiences with The Herbal Remedy lead them to recommend the store to their friends, which has helped Fiore's customer base to grow rapidly. Fiore's promotional efforts are not only fun for both him and his customers, but they also create interest in his store's herbal products and keep his business thriving in the face of larger competitors—and for very little money.*[1]

The first step is to define the purpose of the company's marketing communications program by creating "...specific, realistic, and measurable objectives. In other words, the owner must decide, "What do I want to accomplish with my messages?" Some ads are designed to stimulate responses by encouraging customers to purchase a particular product in the immediate future. The object here is to trigger a purchase decision. Other ads seek to build the firm's image among its customers and the general public. These ads try to create goodwill by keeping the firm's name in the public's memory so that customers will recall the firm's name when they decide to purchase a product or service. Still other ads strive to draw new customers, build mailing lists, increase foot traffic in a store, or introduce a company or a product into a new territory. Good publicity promotes the firm or its products in a positive way. All personal selling is consistent with the market image created.

The next step in developing a communications plan is to analyze the firm and its target audience. A business owner who does not know who his target market is cannot effectively reach it! A marketing communications plan does not have to reach tens of thousands of people to be successful, but it must efficiently reach the people who are most likely to buy a company's product or services. An entrepreneur should address the following questions to focus a company's communications efforts.

- What business am I in?
- What image do I want to project?
- Who are my target customers and what are their characteristics?
- Through which media can they best be reached?
- What do my customers *really* purchase from me?
- What benefits can customers derive from my goods or services?
- How can I prove those benefits to my target customers?
- What sets my company, products, or services apart from the competition?
- How do I want to position my company in the market?
- What advertising approach do my competitors take?

Answering these questions will help entrepreneurs define their businesses and profile their customers, which will help focus the marketing message on a specific target market and get more for their advertising dollars. Defining these issues at the outset enables entrepreneurs to select the media that will reach their target audiences with the least amount of waste. For instance, the owner of a small photography studio specializing in portraits might know from experience that the target customers are "parents, ages 25 to 45, with children under 14" and that mothers are the ones who control the buying decision.

Once business owners have defined their target audience, they can design marketing messages and choose the media for transmitting them. At this stage, the owners decide what to say and how to say it. Creativity and originality count!

Unique Selling Proposition

Entrepreneurs should build their ads around a **unique selling proposition (USP)**, a key customer benefit of a product or service that sets it apart from its competition. To be effective, a USP must actually *be* unique—something the competition does not (or cannot) provide, as well as compelling enough to encourage customers to buy. One technique is to replace your company's name and logo with those of your top competitor. Does the ad still make sense? If so, the ad is not based on your company's unique selling proposition!

unique selling proposition (USP)—*a key customer benefit of a product or service that sets it apart from its competition; it answers the customer's question: "What's in it for me?"*

A successful USP answers the critical question every customer asks: "What's in it for me?" Can your product or service save customers time or money, make their lives easier or more convenient, improve their self-esteem, or make them feel better? If so, you have the foundation for building a USP. The USP becomes the heart of your advertising message. Unfortunately, many business owners never define their companies' USP, and the result is an uninspiring "me-too" message that cries out "buy from us" without offering customers any compelling reason to do so.

The best way to identify a meaningful USP is to describe the primary benefit your product or service offers customers and then to list other secondary benefits it provides. You are unlikely to have more than three top benefits. Be sure to look beyond just the physical characteristics of your product or service. Sometimes the most powerful USPs are the *intangible or psychological* benefits a product or service offers customers—for example, safety, security, acceptance, status, and others. You must be careful, however, to avoid stressing minuscule differences that are irrelevant to customers. Before developing an integrated marketing communications program, it is also important to develop a brief list of the facts that support your company's USP—for example, 24-hour service, a fully trained staff, awards won, and so on. By focusing the message on these top benefits and the facts supporting them, business owners can communicate their USPs to their target audiences in meaningful, attention-getting ways. Building a firm's marketing message around a USP spells out for customers the specific benefit they get if they buy that product or service and why they should do business with your company rather than with the competition.

Table 8.1 describes a six-sentence advertising strategy designed to create powerful ads that focus on a USP.

2. Describe the operational elements of a marketing communications plan.

THE OPERATIONAL ELEMENTS OF A MARKETING COMMUNICATIONS PLAN

The marketing communication plan is made operational by ensuring that all elements of the plan (advertising , publicity, and personal selling) achieve a consistent message that is based on the firm's unique selling proposition. Each element supports the others and is designed to continually reinforce a company's fundamental marketing message.

Advertising

advertising—*any sales presentation that is nonpersonal in nature and is paid for by an identified sponsor.*

Advertising is any sales presentation that is nonpersonal in nature and is paid for by an identified sponsor. The benefit accruing to a business from effective advertising is recognition that lasts for a long period of time. Effective advertising continually reinforces the positive perceptions customers have of the business. Successful entrepreneurs consciously strive to integrate advertising, publicity, and personal selling in ways that achieve the desired image in the mind of the customer and a clear message that is focused on the firm's unique selling proposition.

Effective advertising, in any form or format, is constructed on a strong, positive, and well-researched product/brand positioning statement that represents a precise understanding of whom your target audience is, how your product or services are capable of satisfying their needs and wants, and what message customers will respond most positively to.

Figure 8.1 illustrates the characteristics of a successful ad.

A company's target audience and the nature of its message determine the advertising media it will use. However, the process does not end with creating and broadcasting an ad. The final step involves evaluating the ad campaign's effectiveness. Did it accomplish the objectives it was designed to accomplish? Immediate-response ads can be evaluated in a number of ways. For instance, an owner can include coupons that customers redeem to get price reductions on products and services. Dated coupons identify customer responses over certain time periods. Some firms use hidden offers—statements hidden somewhere in an ad that offer customers special deals if they mention an ad or bring in a coupon from an ad. For example, Scott Fiore of The Herbal Remedy puts a "bring this ad in for 10 percent off" message in his print ads so he can track each ad's success rate and adjust his expenditures accordingly.

Business owners can also gauge an ad's effectiveness by measuring the volume of store traffic generated. Effective advertising should increase store traffic, which boosts sales of advertised

TABLE 8.1

A Six-Sentence Advertising Strategy

Source: Adapted from Jay Conrad Levinson, "The Six-Sentence Strategy," *Communication Briefings*, December 1994, p. 4.

Does your advertising deliver the message you want to the audience you are targeting? If not, try stating your strategy in six sentences:
Primary purpose. What is the primary purpose of this ad? "The purpose of Rainbow Tours' ads is to get people to call or write for a free video brochure."
Primary benefit. What USP can you offer customers? "We will stress the unique and exciting places our customers can visit."
Secondary benefits. What other key benefits support your USP? "We will also stress the convenience and value of our tours and the skill and experience of our tour guides."
Target audience. At whom are we aiming the ad? "We will aim our ads at adventurous male and female singles and couples, 21 to 34, who can afford our tours."
Audience reaction. What response do you want from your target audience? "We expect our audience to call or write to request our video brochure."
Company personality. What image do we want to convey in our ads? "Our ads will reflect our innovation, excitement, conscientiousness, and our warm, caring attitude toward our customers."

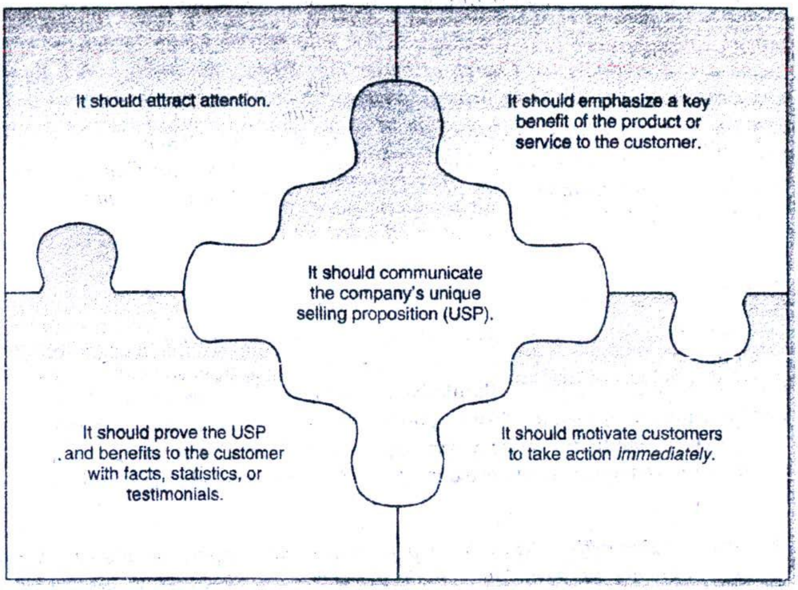


FIGURE 8.1 Five Fundamentals of a Successful Advertisement

Source: Adapted from Jerry Fisher, "Fine Print," Entrepreneur, November 1994, pp. 145–147.

and nonadvertised items. Of course, if an advertisement promotes a particular bargain item, the owner can judge its effectiveness by comparing sales of the items to preadvertising sales levels. Remember: The ultimate test of an ad is whether or not it increases sales!

Ad tests can help determine the most effective methods of reaching potential customers. An owner can design two different ads (or use two different media or broadcast times) that are coded for identification and see which one produces more responses. For example, a business owner can use a split run of two different ads in a local newspaper. That is, he can place one ad in part of the paper's press run and another ad in the remainder of the run. Then he can measure the response level to each ad to compare its effectiveness. Figure 8.1 illustrates the characteristics of a successful ad, and Table 8.2 describes seven tests every advertisement should pass.

TABLE 8.2

Can Your Advertisement Pass These Seven Tests?

Test 1. The scan test. Scan the ad quickly, reading only the headline and any copy that is designed to stand out and looking at the photos or drawings that it includes. Can you tell what the ad is offering and, more importantly, does the benefit jump out at you?
Test 2. The comprehension test. Give the ad to someone who fits the profile of your target audience but who is unfamiliar with the product or service you are advertising. After reading the ad once, can that person tell you what the product or service is, what benefits it provides, what the offer is, and how to order?
Test 3. The differentiation test. Does the combination of ad copy and graphics differentiate your product or service from those of your competition? If a prospective customer read your ad and one of your chief competitor's ads, would she be able to tell how your product is different and better?
Test 4. The puffery test. Go through your copy and highlight every word or phrase that can be considered "sales puffery," such as "best," "greatest," "finest," and others. Can you eliminate these words and replace them with specific facts? If not, can you support the ad's claims with customer testimonials?
Test 5. The believability test. Give your ad to a potential customer and ask her to read through it. Ask her to highlight any claims in the ad that she finds hard to believe. Can you change them to make them more believable or offer facts to support them?
Test 6. The immediate clarity test. After the potential customer conducts the believability test, ask her to circle any words, phrases, or abbreviations that are not clear to her. Rewrite those parts of your ad.
Test 7. The USP test. Is the ad built around your company's USP? Does the USP come through in the message the ad sends to potential customers?

Source: Adapted from Galen Stilson, "Put Your Advertising Through These Quick Tests," Smart Business Supersite, www.smartbiz.com/sbs/columns/stil6.htm.

A Company Example

Greg Schirf is the founder of ***Schirf Brewing Company*** *in Park City, Utah. You might ask yourself why anyone would open a brewery in the state of Utah where 70 percent of the population are members of the Church of Latter Day Saints (Mormons), which forbids the consumption of alcohol. Greg Schirf's advertising creates great controversy in the conservative state of Utah, and the reaction of authorities to his ads generates a world of free publicity. Consider his irreverent ads, including "The Other Local Religion, Wasatch Beer" and "Polygamy Porter: Why Just Have One." Greg Schirf's ads have been successful in drawing attention to his products, but it's important to recognize that this style has great risk if the target market is offended by the message.*[2]

Publicity

publicity—*publicity - any commercial news covered by the media that boosts sales but for which a small company does not pay.*

Publicity or public relations is an intentional process of gaining positive recognition about a business or its products or services by writing interesting and newsworthy articles about what the business is doing or plans to do. **Publicity** is any commercial news covered by the media that is positive in nature, with the distinct possibility that it will increase recognition of the firm or its products. Publicity, unlike advertising, is free. In addition to being free, publicity has great power to influence an interested reader because it is viewed as more objective than advertising.

A Company Example

After the launch of ***Pumpkin Masters****, a company that makes pumpkin-carving kits complete with carving tools, elaborate templates, and instructions, John Bardeen was disappointed by the company's lackluster sales. Then, with the help of a loyal customer, the power of publicity changed Pumpkin Masters' fortune. With Bardeen's permission, the customer contacted ABC television and convinced the network to display pumpkins carved with the likenesses of the announcers on Monday Night Football. ABC showed the pumpkin carvings throughout the broadcast and opened the show with a scary pumpkin called "Skull" that Bardeen himself had carved. The national exposure jump-started Pumpkin Masters' sales immediately, and the company now sells more than 2 million pumpkin-carving kits each year.*[3]

The following tactics can help any small business owner stimulate publicity for her firm:

Write an article that will interest your customers or potential customers. Business owners often overlook the fact that newspapers and magazines are almost always in search of interesting and newsworthy material that fits their readerships. One investment advisor writes a monthly column for the local newspaper on timely topics such as retirement planning, minimizing your tax bill, and investing strategies for the new century. Not only do the articles help build her credibility as an expert, but they also have attracted new customers to her business. When writing articles, remember to keep them short, with 200 to 300 words for a new product release, 500 to 1,000 words on how your products or services solved a unique problem or helped a customer, and at the most a 3,000-word feature article if addressing a very relevant issue on which you or your firm is considered an authority or expert. Whenever possible, support your article with photos, charts, or diagrams that further illustrate your message and improve reader understanding.

Sponsor an offbeat event designed to attract attention. Karen Neuburger, owner of Karen Neuburger's Sleepwear, throws pajama parties in stores across the country to promote her line of sleepwear. Local news media almost always cover the party, giving Neuburger's company lots of free exposure.[4]

Involve celebrities "on the cheap." Few small businesses can afford to hire celebrities as spokespersons for their companies. Some companies have discovered other ways to get celebrities to promote their products, however. For instance, when Karen Neuburger learned that Oprah Winfrey is a "pajama connoisseur," she sent the talk show host a pair of her pajamas. The move paid off; Neuburger has appeared on Oprah's popular television show on three separate occasions.[5]

Contact local TV and radio stations and offer to be interviewed. Many local news or talk shows are looking for guests to talk about topics of interest to their audiences (especially in January and February). Even local shows can reach new customers.

Publish a newsletter. With a personal computer and desktop publishing software, any entrepreneur can publish a professional-looking newsletter. Freelancers can offer design and editing advice. Use the newsletter to reach present and potential customers.

Contact local business and civic organizations and offer to speak to them. A powerful, informative presentation can win new business. (Be sure your public speaking skills are up to par first! If not, consider joining Toastmasters.)

Offer or sponsor a seminar. Teaching people about a subject you know a great deal about builds confidence and goodwill among potential customers. The owner of a landscaping service and nursery offers a short course in landscape architecture and always sees sales climb afterward!

Write news releases and fax or e-mail them to the media. The key to having a news release picked up and printed is finding a unique angle on your business or industry that would interest an editor. Keep it short, simple, and interesting. E-mail press releases should be shorter than printed ones—typically four or five paragraphs rather than one or two pages—and they should include a company's Web site address.

A Company Example

*Steve Hoffman, cofounder of **LavaMind**, a CD-ROM game and Web site development company, uses e-mail press releases to generate publicity for his company. Hoffman's e-mail press releases have led to articles in the* New York Times, Wall Street Journal, *and* Business Week, *and others as well as to television coverage on ABC, PBS, and CNBC. Hoffman says that half of LavaMind's sales have come as a result of the publicity generated by his e-mail releases.*[6]

Volunteer to serve on community and industry boards and committees. You can make your town a better place to live and work and raise your company's visibility at the same time.

Sponsor a community project or support a nonprofit organization or charity. Not only will you be giving something back to the community, but you will also gain recognition, goodwill, and, perhaps, customers for your business.

The owner of a dry cleaning business received the equivalent of thousands of dollars' worth of advertising from the publicity generated by a program called "Give the gift of warmth." Customers donated winter coats, which the company cleaned for free and then distributed to the needy.

Promote a cause. Business owners who have a passion for a cause should act on its behalf. Socially responsible acts often turn into highly successful public relations efforts that attract valuable publicity.

Sponsorships and Special Events

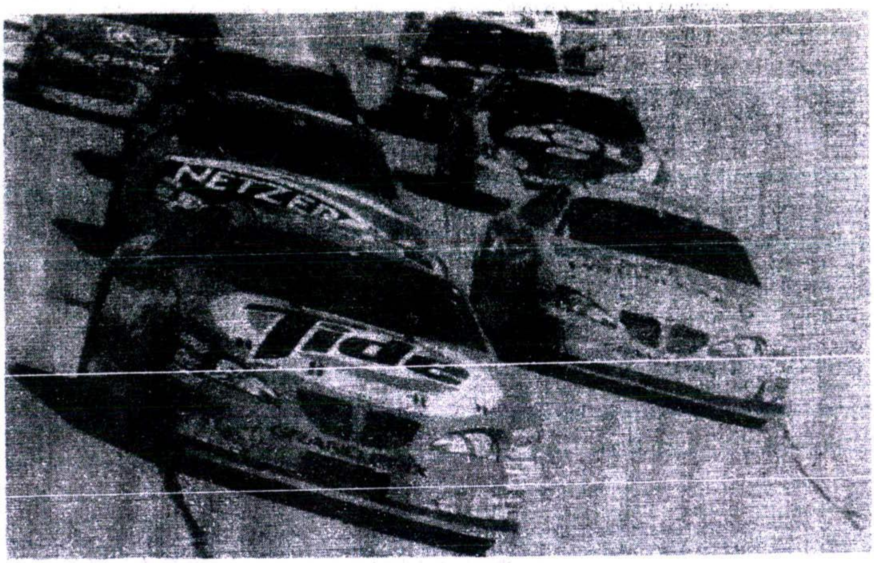
Although sponsorships of special events are a relatively new advertising medium for small companies, a growing number of small businesses are finding that sponsoring special events attracts a great deal of interest and provides a lasting impression of the company in customers' minds. As customers become increasingly harder to reach through any single advertising medium, companies of all sizes are finding that sponsoring special events—from wine tastings and beach volleyball tournaments to fitness walks and car races—is an excellent way to reach their target audiences. According to the *IEG Sponsorship Report*, companies in North America spend more than $7 billion each year on sponsorships.[7]

Sports events, such as basketball tournaments, soccer matches, and NASCAR races, draw the greatest interest from sponsors. In fact, NASCAR events boast the largest increase in attendance since 1990 of any professional sport, a fact that has not escaped sponsors.[8] Companies also have discovered that NASCAR sponsorships work. Research suggests that NASCAR fans have the highest degree of loyalty to a sponsor's product than any other sport (72 percent versus 52 percent for tennis, 47 percent for golf, and 36 percent for football).[9] Getting your company's name on a race car is not cheap, however. The least expensive part of the car on which to put a company logo is the lower quarter panel, with the cost ranging from $25,000 to $75,000. The most expensive part of the car to sponsor? No surprise: the hood, at a cost of $4 to $6 million![10]

Although most small companies cannot afford the cost of sponsoring a NASCAR race car, there are plenty of more affordable events that generate impressive opportunities for increasing name recognition and customer awareness. For instance, according to the International Festival and Events Association, the number of festivals and events in the United States has doubled to more than 50,000 in the past 15 years.[11] Because of their local character, many of these festival, fairs, and events are ideally suited for small business sponsors. For instance, the owner of one small art gallery generates thousands of dollars' worth of publicity and

NASCAR fans exhibit high levels of loyalty to sponsors' products. NASCAR sponsors also benefit from reams of publicity for their companies and the products they sell.

Courtesy of Nigel Kinrade Photography.



recognition for her company with her sponsorship of a local art show. The gala event features a sidewalk art exhibit, a "meet the artists" luncheon, and a competition among local artists. Hundreds of potential customers flock to her gallery on the night the winners are announced. The sponsorship costs the gallery owner a few thousand dollars, but the "buzz" it generates for her company is worth many times the cost!

Small companies do not have to rely on other organizations' events to generate advertising opportunities; they can create their own special events. Creativity and uniqueness are essential ingredients in any special event promotion, and most entrepreneurs excel at those.

A Company Example

For example, the owner of ***For Paws****, a California pet boutique, sponsors free "doggy brunches" each week, complete with "kibble quiche" and "wheat-germ woofies." The shop also caters birthday parties, beach parties (picture a dog with a whistle around his neck, a muscle T-shirt, and a dab of Noxzema on his nose), and other gala events for its four-legged customers and their owners.*[12]

The following tips will ensure that a small company gets the most promotional impact from its sponsorship of an event:

- Do not count on sponsorships for your entire advertising campaign. Sponsorships are most effective when they are part of a coordinated advertising effort. Most sponsors spend no more than 10 percent of their advertising budgets on sponsorships.
- Look for an event that is appropriate for your company and its products and services. The owner of a small music store in an upscale mountain resort sponsors a local jazz festival every summer during the busy tourist season and generates lots of business among both residents and tourists. Ideally, an event's audience should match the sponsoring company's target audience. Otherwise, the sponsorship will be a waste of money.
- Research the event and the organization hosting it *before* agreeing to become a sponsor. How well attended is the event? What is the demographic profile of the event's visitors? Is it well organized?
- Try to become a dominant (or, ideally, the only) sponsor of the event. A small company can be easily lost in a crowd of much larger companies sponsoring the same event. If sole sponsorship is too expensive, make sure that your company is the only one from its industry sponsoring the event.
- Clarify the costs and level of participation required for sponsorship up front.
- Get involved. Do not simply write a check for the sponsorship fee and then walk away. Find an event that is meaningful to you, your company, and its employees and take an active role in it. Your sponsorship dollars will produce a higher return if you do.

Hybrid Forms of Promotion and Advertising

In some cases the line between what is advertising and what is promotion has become blurry. In recent years, entrepreneurs have begun to explore new methods of placing their products or services before the targeted market in a more subtle fashion. *Sponsorship* of participants in sporting events or entertainment comes first to mind, such as laundry detergent manufacturers that sponsor NASCAR race teams or musical group tours. The key is to have your product or service identified with an individual, group, or sport that your target customers admire.

The next step up the hierarchy is *product placement*, a term that broadly describes the strategy of having your product seen in successful movies or television programs. It is highly sophisticated yet subtle brand exposure. For example, Roxy, the California clothing company that targets younger consumers with its trendy clothing styles, coproduces a television show for MTV. Throughout the show, the cast wears Roxy clothing exclusively.[13]

Branded content is the ultimate integration of advertising and entertainment. Branded content creates an entertainment product (documentary, music video, book, or even Broadway play) to reflect the brand's image or spirit. As an example, Nike's documentary, "The Road to Paris," profiles champion cyclist and Nike endorser, Lance Armstrong.[14]

Personal Selling

Advertising often marks the beginning of a sale, but personal selling usually is required to close the sale. **Personal selling** is the personal contact between salespeople and potential customers resulting from sales efforts. Effective personal selling can give the small company a definite advantage over its larger competitors by creating a feeling of personal attention. Personal selling deals with the salesperson's ability to match customer needs to the firm's goods and services. Top salespeople have the following profile:

personal selling—*the personal contact between salespeople and potential customers resulting from sales efforts.*

- They are enthusiastic and alert to opportunities. They realize that the next great account they may find through a chance social meeting rather than a scheduled sales call. Star sales representatives also demonstrate deep concentration, high energy, and drive.
- They are experts in the products or services they sell. They understand how their product lines or services can help their customers and, they are able to articulate this to customers.
- Top salespeople concentrate on select accounts. They focus on customers with the greatest sales potential.
- They plan thoroughly. On every sales call, the best representatives act with a purpose to close the sale.
- Top salespeople use a direct approach. They get right to the point with customers.
- They work from the customer's perspective. They have empathy for their customers and know their customers' businesses and their needs.
- They use "past success stories." They encourage customers to express their problems and then present solutions using examples of past successes.
- They leave sales material with clients. The material gives the customer the opportunity to study company and product literature in more detail.[15]
- Top salespeople see themselves as problem solvers, not just vendors. Their perspective is "How can I be a valuable resource for my customers?"
- They measure their success not just by sales volume but also by customer satisfaction.[16]

Effective selling is never an accident, and it is wrong to assume that anyone can be successful at personal selling. Selling requires training about the product or service. You cannot effectively sell what you do not understand. And what may be worse, an uninformed salesperson may misrepresent the firm's products or services. Hire capable individuals who display empathy for customers, are personally motivated to succeed, are patient, and possess the ability to focus on the satisfaction of the customer's buying needs.

Sales training needs to be a blend of product or service knowledge as well as the most important basic selling skills of listening to customers and closing the sale.

The Selling Process

Small business owners can improve their sales representatives' "batting averages" by following some basic guidelines:

ESTABLISH A SELLING SYSTEM. A successful sales call usually is the result of a systematic sales approach.

1. *Create a feeling of mutual trust and respect.* Establish a rapport with the prospect at the outset. Customers seldom buy from salespeople they dislike or distrust.
2. *Ask the prospect questions that will reveal the key criteria that must be met to obtain the sale.* Customers tend to have a few "must" criteria that will influence their willingness to buy; identify these and then base your selling approach on meeting or exceeding these key criteria. The goal is to identify the prospect's needs, preferences, concerns, and problems.
3. *Demonstrate, explain, and show.* Make clear the features and benefits of your product or service and point out how they meet the prospect's needs or solve his problems.
4. *Validate.* Prove the claims about your product or service. If possible, offer the prospect names and numbers of other satisfied customers (with their permission, of course). Testimonials really work.
5. *Overcome objections.* Listen for objections from the prospect. Try to determine the *real* objection and confront it. Work to overcome it. Objections can be the salesperson's best friend; they tell you what must be "fixed" before the prospect will commit to an order. Remember to focus on the customer's buying criteria.
6. *Close.* Ask for a decision. Good sales representatives know when the prospect flashes the green light on a sale. They stop talking and ask for the order.

BE EMPATHETIC AND STRESS VALUE. The best salespeople look at the sale from the customer's viewpoint, not their own! Doing so encourages the sales representative to stress *value* to the customer.

SET MULTIPLE OBJECTIVES. Before making a sales call, salespeople should set three objectives:

1. *The primary objective*—the most reasonable outcome expected from the meeting. It may be to get an order or to learn more about a prospect's needs.
2. *The minimum objective*—the very least the salesperson will leave with. It may be to set another meeting or to identify the prospect's primary objections.
3. *The visionary objective*—the most optimistic outcome of the meeting. This objective forces the salesperson to be open-minded and to shoot for the top.

MONITOR SALES EFFORTS AND RESULTS. Selling is just like any other business activity and must be controlled. At a minimum, the business owner should know:

1. Actual sales versus projected sales
2. Sales generated per call made
3. Total sales costs
4. Sales by product, salesperson, territory, customer, and so on
5. Profit contribution by product, salesperson, territory, customer, and so on

Learning Objective

[illegible]. Describe the advantages and disadvantages of the various advertising media.

SELECTING ADVERTISING MEDIA

One of the most important decisions an entrepreneur must make is which media to use in disseminating the advertising message. The medium used to transmit the message influences the consumer's perception—and reception—of it. By choosing the proper advertising media, a business owner can reach his target audience effectively at minimum cost. Similarly, the right message communicated in the wrong medium will not increase sales.

A Company Example

For instance, when they launched ***Micro Express****, a computer services firm, the founders allocated an annual advertising budget of $50,000, most of it for ads in large newspapers. For seven years, major newspapers remained the company's primary advertising medium. Then managers began to examine their customer base more closely and discovered that their customers were large companies rather than the small companies and home users at whom its ads* *were targeted. Realizing that Micro Express's advertising had been missing its mark, the company switched to direct mailings to* Fortune *1000 companies. Not only do the direct-mail ads cost the company less, but its sales are also climbing again. "We see a much higher return now that we spend $10,000 a year on the right promotional efforts compared to the $50,000 we spent per year targeting the wrong customers," says President Jim Mickel.*[17]

Key Advertising Concepts

Although no single formula exists for determining the ideal medium to use, there are several important characteristics that make some media better suited than others. Understanding the qualities of the various media available can simplify an owner's decision. Before selecting the vehicle for the message, the owner should consider several questions:

How large is my firm's trading area? How big is the geographical region from which the firm will draw its customers? The size of this area influences the choice of media.

Who are my target customers and what are their characteristics? Determining a customer profile often points to the appropriate medium to use to get the message across most effectively.

Which media are my target customers most likely to watch, listen to, or read? Until he knows who his target audience is, a business owner cannot select the proper advertising media to reach it.

What budget limitations do I face? Every business owner must direct the firm's advertising program within the restrictions of its operating budget. Certain advertising media cost more than others.

What media do my competitors use? It is helpful for the small business manager to know the media his competitors use, although he should *not* automatically assume that they are the best. An approach that differs from the traditional one may produce better results.

How important is repetition and continuity of my advertising message? Generally, an ad becomes effective only after it is repeated several times, and many ads must be continued for some time before they produce results. Some experts suggest that an ad must be run at least six times in most mass media before it becomes effective.

How does each medium compare with others in its audience, its reach, and its frequency? **Audience** measures the number of paid subscribers a particular medium attracts and is called *circulation* in most print media such as newspapers and magazines. **Reach** is the total number of people exposed to an ad at least once in a period of time, usually four weeks. **Frequency** is the average number of times a person is exposed to an ad in that same time period.

What does the advertising medium cost? There are two types of advertising costs the small business manager must consider: the absolute cost and the relative cost. **Absolute cost** is the actual dollar outlay a business owner must make to place an ad in a particular medium for a specific time period. An even more important measure is an ad's **relative cost,** the ad's cost per potential customer reached. Relative cost is most often expressed as **cost per thousand (CPM),** the cost of the ad per 1,000 customers reached. Suppose a manager decides to advertise his product in one of two newspapers in town. The *Sentinel* has a circulation of 21,000 and charges $1,200 for a quarter-page ad. The *Democrat* has a circulation of 18,000 and charges $1,300 for the same space. Reader profiles of the two papers suggest that 25 percent of *Sentinel* readers and 37 percent of the *Democrat* readers are potential customers. Using this information, the manager computes the following relative costs:

audience—*a measure of the number of paid subscribers a particular medium attracts.*

reach—*the total number of people exposed to an ad at least once in a period of time, usually four weeks.*

frequency—*the average number of times a person is exposed to an ad in a period of time.*

absolute cost—*the actual dollar outlay a business owner must make to place an ad in a particular medium for a specific period of time.*

relative cost—*the cost of an ad per potential customer reached.*

cost per thousand (CPM)—*the cost of an ad per 1,000 customers reached.*

	Sentinel	Democrat
Circulation	21,000	18,000
Percentage of readers that are potential customers (p.c.)	×25%	×37%
Potential customers reached	5,250	6,660
Absolute cost of ad	$1,200	$1,300
Relative cost of ad (CPM)	$\frac{\$1200}{5.250}$ = .22857 or $228.57 1,000 per p.c.	$\frac{\$1300}{6,600}$ = .19520 or $195.20 1,000 per p.c.

Although the *Sentinel* has a larger circulation and a lower absolute cost for running the ad, the *Democrat* will serve the small business owner better because it offers a lower cost per thousand potential customers (CPM) reached. It is important to note that this technique does not give a reliable comparison across media; it is a meaningful comparison only within a single medium. Differences among the format, presentation, and coverage of ads in different media are so vast that such comparisons are not meaningful.

Traditional Media Options

Figure 8.2 gives a breakdown of U.S. business advertising expenditures by medium. Choosing advertising media is no easy task because each has distinctive advantages, disadvantages, and cost. The "right" message in the "wrong" medium will miss its mark.

word-of-mouth advertising—*advertising in which satisfied customers recommend a business to friends, family members, and acquaintances.*

WORD-OF-MOUTH ADVERTISING AND ENDORSEMENTS. Perhaps the most effective and certainly the least expensive form of advertising is **word-of-mouth advertising** in which satisfied customers recommend a business to friends, family members, and acquaintances. Unsolicited testimonials are powerful because they carry so much weight among potential customers. The best way to generate positive word-of-mouth advertising is to provide the superior quality and service discussed in chapter 6. Providing that level of service and quality leads to loyal customers who become walking advertisements for the companies they believe in. Word-of-mouth advertising can make or break a business because *dissatisfied* customers also speak out against businesses that treat them poorly. To ensure that the word-of-mouth advertising a company generates is positive, business owners must actually do what they want their customers to say they do!

A Company Example

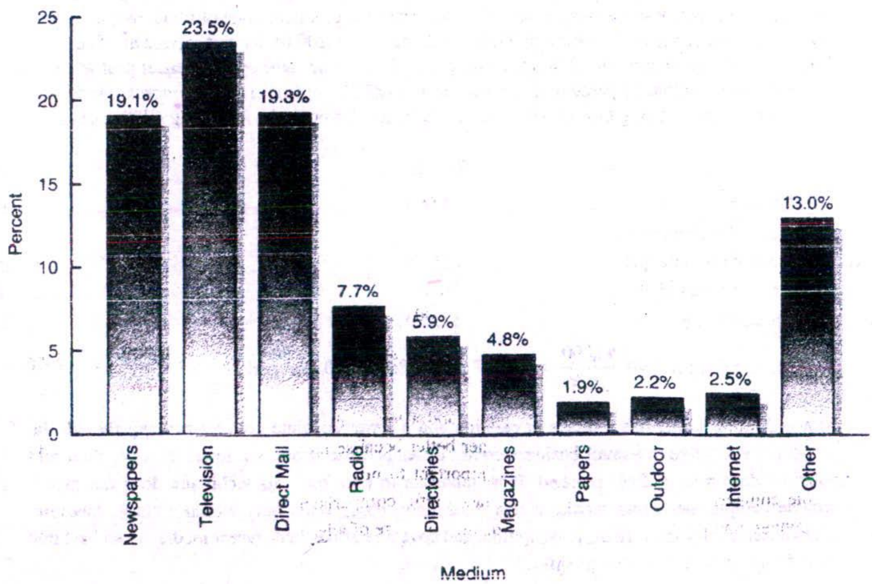
For instance, Fred Anderson, owner of ***Anderson's Landscape Construction****, a landscape planning and design service that targets upscale homes, relies totally on word-of-mouth advertising for his company's sales. Anderson counts on referrals from professional architects and from satisfied customers to generate new business. If a customer is unhappy about any aspect of a project his company has done, Anderson fixes it to the customer's satisfaction at no extra charge, which surprises some people.*[18]

A customer endorsement is an effective way of converting the power of word of mouth to an advertising message. The more recognized the person making the endorsement, the more potential customers will be influenced to buy. For example, Brad Johnson, quarterback for the Tampa Bay Buccaneers, has appeared on local Tampa Bay stations endorsing Fantastic Sams for haircuts. After their stunning win in Super Bowl XXXVII, the endorsement became even more meaningful to Tampa fans. Of course, unpaid and unsolicited endorsements are the most valuable. In a cynical world, many potential customers are turned off by what they believe is simply a paid statement from a person who may or may not have used the product.

The ultimate in word-of-mouth advertising is the holy grail of advertising, something experts call "buzz." Buzz occurs when a product is hot and everyone is talking about it.

FIGURE 8.2 Advertising Expenditures by Medium

Source: McCann-Erickson, Inc. *Statistical Abstract of the United States*, 2002, p. 772.



From the mood rings of the 1970s to the redesigned Volkswagen Beetle of the 1990s, buzz drives the sales of many products. The Internet has only magnified the power of buzz to influence a product's sales. Buzz on the Web has become a powerful force in influencing the popularity of a firm's products or services. What can business owners do to start a buzz about their companies or their products or services? Sometimes buzz starts on its own, leaving a business owner struggling to keep up with the fury it creates. More often than not, however, business owners can give it a nudge by creating interest, mystique, and curiosity in a product or service or by ensuring its scarcity. Ty Inc. has managed to keep collectors interested for years by "retiring" some of its Beanie Baby patterns every year to ensure that demand for them outstrips supply.

NEWSPAPERS. Traditionally, the local newspaper has been the medium that most advertisers rely on to get their messages across to customers. Although the number of newspapers in the United States has declined in recent years, this medium attracts nearly one-fifth of all advertising dollars nationwide.

Newspapers provide several *advantages* to the small business advertiser:

Selected geographical coverage. Newspapers are geared to a specific geographic region, and they reach potential customers across all demographic classes.

Flexibility. Newspaper advertisements can be changed readily on very short notice. The owner can select the size of the ad and its location in the paper.

Timeliness. Papers almost always have very short closing times, the publication deadline prior to which the advertising copy must be submitted.

Communication potential. Newspaper ads can convey a great deal of information by employing attractive graphics and copy.

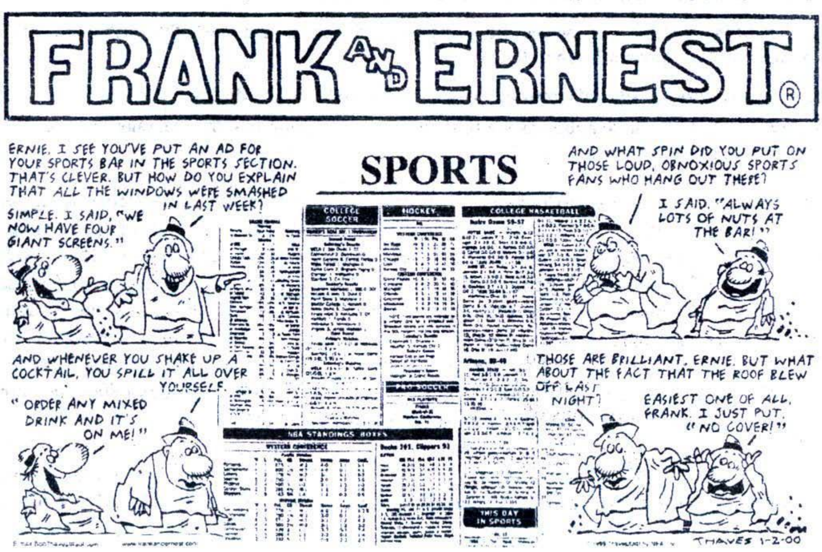
Low costs. Newspapers normally offer advertising space at low absolute cost and, because of their blanket coverage of a geographic area, at low relative cost as well.

Prompt responses. Newspaper ads typically produce relatively quick customer responses. A newspaper ad is likely to generate sales the very next day, and advertisers who use coupons can track the response to an ad.

Of course, newspaper advertisements also have *disadvantages*:

Wasted readership. Because newspapers reach such a variety of people, at least a portion of an ad's coverage will be wasted on those who are not potential customers.

Reproduction limitations. The quality of reproduction in newspapers is limited, especially when it is compared to that of magazines and direct mail.



Source: REPRINTED BY PERMISSION OF NEWSPAPER ENTERPRISE ASSOCIATION, INC.

Lack of prominence. One frequently cited drawback of newspapers is that they carry so many ads that a small company's message might be lost in the crowd. The typical newspaper is 62 percent advertising.

Declining readership. Newspaper circulation as a percentage of U.S. households has dropped from 98 percent in 1970 to 70 percent today. Newspaper ads would be least effective for small businesses targeting young people, who are least likely to read newspapers.

Short ad life. The typical newspaper is soon discarded and, as a result, an ad's life is extremely short. Business owners can increase the effectiveness of their ads by giving them greater continuity. Spot ads can produce results, but maintaining a steady flow of business requires some degree of continuity in advertising.

BUYING NEWSPAPER SPACE. Newspapers typically sell ad space by lines and columns or inches and columns. For instance, a 4-column × 100-line ad occupies four columns and 100 lines of space (14 lines are equal to 1 column inch). For this ad, the small business owner would pay the rate for 400 lines. Most papers offer discounts for bulk, long-term, and frequency contracts and for full-page ads. Advertising rates vary from one paper to another, depending on such factors as circulation and focus. A small business owner would do well to investigate the circulation statements, advertising rates, and reader profiles of the various newspapers available before selecting one.

RADIO. Newspapers offer blanket advertising coverage of a region, but radio permits advertisers to appeal to specific audiences over large geographic areas. By choosing the appropriate station, program, and time for an ad, a small company can reach virtually *any* target market.

Radio advertising offers several *advantages*:

Universal infiltration. Radio's nearly universal presence gives advertisements in this medium a major advantage. Virtually every home and car in the United States is equipped with a radio, which means that these advertising messages receive a tremendous amount of exposure in the target market. Radio reaches 94 percent of all consumers each week![19]

Market segmentation. Radio advertising is flexible and efficient because advertisers can choose stations directed toward a specific market within a broad geographic region. Radio stations design their formats to appeal to specific types of audiences, which makes an advertiser's job much easier.

Flexibility and timeliness. Radio commercials have short closing times and can be changed quickly.

Friendliness. Radio ads are more "active" than ads in printed media because they use the spoken word to influence customers. Vocal subtleties used in radio ads are impossible to convey through printed media. Table 8.3 offers a guide to producing effective radio copy.

Radio advertisements also have a number of *disadvantages*:

Poor listening. Radio's intrusiveness into the public life almost guarantees that customers will hear ads, but they may not listen to them.

Need for repetition. Radio ads must be broadcast repeatedly to be effective.

Limited message. Because radio ads are limited to one minute or less, the message must be brief and not overly complex.

BUYING RADIO TIME. The small business owner can zero in on a specific advertising target by using the appropriate radio station. Stations follow various formats—from rap to rhapsodies—to appeal to specific audiences. Radio advertising time usually sells in 15-second, 30-second, and 60-second increments, with the latter being the most common. Fixed spots are guaranteed to be broadcast at the times specified in the owner's contract with the station. Preemptible spots are cheaper than fixed spots, but the advertiser risks being preempted by an advertiser willing to pay the fixed rate for a time slot. Floating spots are the least expensive, but the advertiser has no control over broadcast times. Many stations offer package plans, using flexible combinations of fixed, preemptible, and floating spots.

Radio rates vary depending on the time of day they are broadcast and, like television, there are prime time slots known as drive-time spots. Although exact hours may differ from station to station, the following classifications are common (listed in descending order of cost):

TABLE 8.3
Guidelines for Effective Radio Copy

Source: Radio Basics, Radio Advertising Bureau.

- *Mention the business often.* This is the single most important and inflexible rule in radio advertising. Also make sure listeners know how to find your business. If the address is complicated, use landmarks.
- *Stress the benefit to the listener.* Don't say "Bryson's has new fall fashions." Say "Bryson's fall fashions make you look fabulous."
- *Use attention-getters.* Radio has a whole battery—music, sound effects, unusual voices. Crack the barrier with sound.
- *Zero in on your audience.* Know to whom you're selling. Radio's selectivity attracts the right audience. It's up to you to communicate in the right language.
- *Keep the copy simple and to the point.* Don't try to impress listeners with vocabulary. "To be or not to be" may be the best-known phrase in the language . . . and the longest word has just three letters.
- *Sell early and often.* Don't back into the selling message. At most, you've got 60 seconds. Make the most of them. Don't be subtle.
- *Write for the ear.* Write conversationally.
- *Prepare your copy.* Underline words you want to emphasize.
- *Triple space.* Type clean, legible copy. Make the announcer rehearse.
- *Use positive action words.* Use words such as now and today, particularly when you're writing copy for a sale. Radio has qualities of urgency and immediacy. Take advantage of them by including a time limit or the date the sale ends.
- *Put the listener in the picture.* Radio's theater of the mind means you don't have to talk about a new car. With sounds and music, you can put the listener behind the wheel.
- *Focus the spot on getting a response.* Make it clear what you want the listener to do. Don't try to get a mail response. Use phone numbers only, and repeat the number three times. End the spot with the phone number.
- *Don't stay with a loser.* Direct-response ads produce results right way—or not at all. Don't stick with a radio spot that is not generating sales. Change it.

Class AA: Morning drive time—6 A.M. to 10 A.M.
Class A: Evening drive time—4 P.M. to 7 P.M.
Class B: Home worker time—10 A.M. to 4 P.M.
Class C: Evening time—7 P.M. to Midnight
Class D: Nighttime—Midnight to 6 A.M.

Some stations may also have different rates for weekend time slots.

TELEVISION. In advertising dollars spent, television now ranks first in popularity of all media. Although the cost of national TV ads precludes their use by most small businesses, local spots can be an extremely effective means of broadcasting a small company's message. A 30-second commercial on network television may cost more than $500,000, but a 30-second spot on local cable television, which now is in 67 percent of all U.S. homes, may go for $200 or less.

Television offers a number of distinct *advantages*:

Broad coverage. Television ads provide extensive coverage of a sizable region, and they reach a significant portion of the population. About 98 percent of the homes in the United States have a television, and the average household spends 7 hours and 12 minutes each day tuned in to television.[20]

Visual advantage. The primary benefit of television is its capacity to present an advertiser's product or service in a graphic, vivid manner with sight, sound, and action.

Flexibility. Television ads can be modified quickly to meet the rapidly changing conditions in the marketplace. Advertising on TV is the closest substitute for personal selling.

Design and production assistance. Few small business owners have the skills to prepare an effective television commercial. Although professional production firms might easily charge $50,000 for a commercial production, the television station from which a business owner purchases air time may be willing to offer design and production assistance very inexpensively.

Television advertising also has several *disadvantages*:

Brief exposure. Most television ads are on the screen for only a short time and require substantial repetition to achieve the desired effect.

Clutter. The typical person sees 1,500 advertising messages a day, and more ads are on the way. With so many ads beaming across the airwaves, a small business's advertising message could easily become lost in the shuffle.

zappers—*television viewers who flash from one channel to another, especially during commercials.*

"Zapping." **Zappers**, television viewers who flash from one channel to another, especially during commercials, pose a real threat to TV advertisers. Zapping means TV advertisers are not reaching the audiences they hope to reach. The remote control has transformed television viewers into channel surfers during commercial breaks.

Fragmented audience. As the number of channels available proliferates, the question of where to advertise becomes more difficult to answer. Network television has lost audience steadily over the past 20 years to cable television. About 96 percent of cable television households receive more than 30 channels.[21]

Costs. TV commercials can be expensive to create. A 30-second ad can cost several thousand dollars to develop, even before the owner purchases airtime. Table 8.4 offers some suggestions for developing creative television commercials.

infomercials—*full-length television commercials packed with information, testimonials, and a sales pitch.*

USING TELEVISION CREATIVELY. Although television ads are not affordable for every small business, many entrepreneurs have found creative ways to use the power of television advertising without spending a fortune. Two popular methods include creating infomercials and using home shopping networks. **Infomercials** (also called direct-response television), full-length television commercials packed with information, testimonials, and a sales pitch, are popular tools for selling everything from mops to computers. Producing and airing a half-hour infomercial can be expensive, often costing $50,000 or more, but entrepreneurs can save money by doing some of the work themselves and hiring freelance professionals for a share of the profits.

A Company Example

*After he launched **Smart Inventions**, Jon Nokes set out across the country to promote his latest product, the SmartMop, a unique mop from Finland with a self-wringing feature. In its first year, SmartMop generated $1.8 million in sales, but Nokes knew he could do much better if only he could let customers see the benefits of the SmartMop. Nokes worked with a production company to create a 28-minute infomercial for $60,000 to demonstrate the user-friendly mop. Consumer response to the infomercial amazed even Nokes. Whenever the infomercial aired, orders poured in—so fast, in fact, that Nokes had to invest in a larger manufacturing facility to keep up with demand. After a year of airing the infomercial, sales of the SuperMop had climbed to $44 million!*[22]

To become an infomercial star, a product should meet the following criteria:[23]

- Be unique and of good quality.
- Solve a common problem.
- Be easy to use and easy to demonstrate.
- Appeal to a mass audience.
- Have an aha! factor that makes customers think "What a great idea!"

TABLE 8.4
Guidelines for Creative TV Ads

Source: Adapted from How to Make a Creative Television Commercial, Television Bureau of Advertising, Inc.

- *Keep it simple.* Avoid confusing the viewer by sticking to a simple concept.
- *Have one basic idea.* The message should focus on a single, important benefit to the customer. Why should people buy from your business?
- *Make your point clear.* The customer benefit should be obvious and easy to understand.
- *Make it unique . . . different.* To be effective, a television ad must reach out and grab the viewer's attention. Take advantage of television's visual experience.
- *Get viewer attention.* Unless viewers watch the ad, its effect is lost.
- *Involve the viewer.* To be most effective, an ad should portray a situation to which the viewer can relate. Common, everyday experiences are easiest for people to identify with.
- *Use emotion.* The most effective ads evoke an emotion from the viewer—a laugh, a tear, or a pleasant memory.
- *Consider production values.* Television offers vivid sights, colors, motions, and sounds. Use them!
- *Prove the benefit.* Television allows an advertiser to prove a product's or service's customer benefit by actually demonstrating it.
- *Identify your company well and often.* Make sure your store's name, location, and product line stand out. The ad should portray your company's image.

Shopping networks such as QVC and the Home Shopping Network offer entrepreneurs another route to television. Time on these networks is free, but getting a product accepted is tough. One buyer for QVC says that the network subjects about 500 products to an extensive review every week, but that only 5 percent are selected to appear on television.[24] Shopping networks look for products that offer quality, have "demonstration appeal," and are typically priced between $15 and $40 (although there are exceptions). Landing a product on one of these networks may be a challenge, but entrepreneurs who do often sell thousands of units in a matter of minutes!

MAGAZINES. Another advertising medium available to the small business owner is magazines. Today, customers have more than 18,600 magazine titles from which to choose.[25] Magazines have a wide reach; nearly 9 out of 10 adults read an average of 7 different magazines per month. The average magazine attracts 6 hours and 3 minutes of total adult reading time, and studies show that the reader is exposed to 89 percent of the ads in the average copy.[26]

Magazines offer several *advantages* for advertisers:

Long life spans. Magazines have a long reading life because readers tend to keep them longer than other printed media. The result is that each magazine ad has a good chance of being seen several times.

Multiple readership. The average magazine has a readership of 3.9 adult readers, and each reader spends about 1 hour and 33 minutes with each copy. Many magazines have a high "passalong" rate—they are handed down from reader to reader.

Target marketing. By selecting the appropriate special interest periodical, small business owners can reach customers with a high degree of interest in their goods or services. Specialty magazines have proliferated in recent years, giving businesses the opportunity to advertise in magazines such as *Surfer Girl* or *Ferrets* that target specific audiences.

Ad quality. Magazine ads usually are of high quality, resulting in strong visual appeal. Photographs and drawings can be reproduced very effectively, and color ads are readily available.

Magazines also have several *disadvantages*:

Costs. Magazine advertising rates vary according to their circulation rates; the higher the circulation, the higher the rate. Thus, local magazines, whose rates are often comparable to newspaper rates, may be the best bargain for small businesses.

Long closing times. Another disadvantage of magazines is the relatively long closing times they require. For a weekly periodical, the closing date for an ad may be several weeks before the actual publication date, making it difficult for advertisers to respond quickly to changing market conditions.

Lack of prominence. Another disadvantage of magazine ads arises from their popularity as an advertising vehicle. The effectiveness of a single ad may be reduced because of a lack of prominence; 48.3 percent of the typical magazine content is devoted to advertising.[27] Proper ad positioning, therefore, is critical to an ad's success. Research shows that readers "tune out" right-hand pages and look mainly at left-hand pages.

DIRECT MAIL. Direct mail has long been a popular method of small business advertising and includes such tools as letters, postcards, catalogs, discount coupons, brochures, computer disks, and videotapes mailed to homes or businesses. The earliest known catalogs were printed by fifteenth-century printers. Today, direct-mail marketers sell virtually every kind of product imaginable from Christmas trees and lobsters to furniture and clothing (the most popular mail-order purchase). Responding to the convenience of "shopping at home," customers purchase more than $500 billion worth of goods and services through mail order each year!

Direct mail offers a number of distinct *advantages* to the small business owner:

Selectivity. The greatest strength of direct-mail advertising is its ability to target a specific audience to receive the message. Depending on mailing list quality, an owner can select an audience with virtually any set of characteristics. Small business owners can develop, rent, or purchase a mailing list of prospective residential, commercial, or industrial customers.

Flexibility. Another advantage of direct mail is its capacity to tailor the message to the target. The advertiser's presentation to the customer can be as simple or as elaborate as necessary. In addition, the advertiser controls the timing of the campaign; she can send the ad when it is most appropriate.

Reader attention. With direct mail, the advertiser's message does not have to compete with other ads for the reader's attention. People enjoy getting mail.

Rapid feedback. Direct-mail advertisements produce quick results. In most cases the ad will generate sales within three to four days after customers receive it.

Measurable results and testable strategies. Because they control their mailing lists, direct marketers can readily measure the results their ads produce. Also, direct mail allows advertisers to test different ad layouts, designs, and strategies (often within the same "run") to see which one "pulls" the greatest response. Table 8.5 offers guidelines for creating direct-mail ads that really work.

Effectiveness. The right message targeted at the right mailing list can make direct mail one of the most efficient forms of advertising. Direct mail to the right people produces results.

Direct-mail ads also suffer from several *disadvantages*:

Inaccurate mailing lists. The key to the success of the entire mailing is the accuracy of the customer list. A poor list is a waste of money.

Clutter. The average person in the United States receives over 600 pieces of direct mail each year. With that volume of direct mail, it can be difficult for an advertisement to get customers' attention.

High relative costs. Relative to the size of the audience reached, the cost of designing, producing, and mailing an advertisement via direct mail is high. But if the mailing is well planned and properly executed, it can produce a high percentage of returns, making direct mail one of the least expensive advertising methods in terms of results.

High throwaway rate. Often called junk mail, direct-mail ads become "junk" when an advertiser selects the wrong audience or broadcasts the wrong message. In fact, the typical direct-mail advertising campaign produces only a 2 percent response rate. To boost returns small business owners can supplement their traditional direct-mail pieces with toll-free (800) numbers and carefully timed follow-up phone calls.

"HIGH-TECH" DIRECT MAIL AND THE WORLD WIDE WEB. Sending out ads on computer diskettes and CDs is an excellent way to reach upscale households and businesses. Not only do computer-based ads give advertisers the power to create flashy, attention-grabbing designs, but they also hold the audience's attention.

Compact discs (CDs) offer advertisers the same benefits as computer disks with one extra—more space to do it in. Companies are using CDs with interactive ads to sell everything from cars to computers. The ads usually contain videos, computer games, quizzes, animation, music, graphics, and other features to engage more of their audiences' senses. In a world where U.S. households receive *4.5 million tons* of paper each year in the form of direct-mail ads, multimedia ads can offer a distinct advantage: They get noticed.

HOW TO USE DIRECT MAIL. The key to a direct mailing's success is the right mailing list. Even the best direct-mail ad will fail if sent to the "wrong" customers. Owners can develop lists themselves, using customer accounts, telephone books, city and trade directories, and other sources. Other sources for mailing lists include companies selling complementary but not competing products; professional organizations' membership lists; business or professional magazine's subscription lists; and mailing list brokers who sell lists for practically any need. Advertisers can locate list brokers through *The Direct Marketing List Source* from the Standard Rate and Data Service found in most public libraries.

THE WORLD WIDE WEB The past decade has witnessed the World Wide Web reshape the way companies conduct business and transform e-commerce into a major economic force. Just as the Web has become a common tool for conducting business, it also has become a popular medium for advertisers. Increasingly, small businesses are turning to the World Wide Web as a valuable way to reach their customers and to build an awareness of their products and services. For instance, when lingerie seller Victoria's Secret ran an ad during the Super Bowl to promote its first live lingerie fashion show broadcast over the Web, the response was phenomenal! More than 1.5 million people tuned in to Victoria's Secret Web site to watch the fashion show, proving the power of combining the Web with traditional advertising media. The Internet has proved to be the fastest-growing advertising medium in history. Using the time required for radio, television, and the Internet to reach 50 million users as a basis for comparing the three media, the Internet is the clear winner. Radio required 38 years to reach that milestone, and television took 13 years; the Internet, however, hit 50 million users in just five years!

The Web's multimedia capabilities makes it an ideal medium for companies to demonstrate their products and services with full motion, color, and sound and to get customers involved in

"Mail order means trend watching, meticulous planning, and devouring news and information on the industry, your niche, technology, politics, and the world—and that's just for starters," says one observer. "You'll have to deal with the laws of a vast federal bureaucracy and 50 states (plus a couple hundred countries if you go international), the intricacies of designing and mailing a catalog, and the fickle nature of a demanding public."
You'll also have to write copy that will get results. Try these proven techniques:
Promise readers your most important benefit in the headline or first paragraph.
Use short "action" words and paragraphs.
Make the copy look easy to read—lots of "white space."
Use eye-catching words such as *free, you, save, guarantee, new, profit, benefit, improve*, and others.
Consider using computerized "handwriting" somewhere on the page or envelope; it attracts attention.
Forget grammatical rules; write as if you were speaking to the reader.
Repeat the offer three or more times in various ways.
Back up claims and statements with proof and endorsements whenever possible.
Ask for the order or a response.
Ask questions such as "Would you like to lower your home's energy costs?" in the copy.
Use high-quality paper and envelopes (those with windows are best) because they stand a better chance of being opened and read. Brown envelopes that resemble government correspondence work well.
Envelopes that resemble bills almost always get opened.
Address the envelope to an individual, not "Occupant."
Use stamps if possible. They get more letters opened than metered postage.
Use a postscript (P.S.) always—they are the most often read part of a printed page. Make sure the P.S. contains a "hook" that will encourage the recipient to read on.
Make sure the order form is clear and easy to fill out; include a fax number for ordering, too.

TABLE 8.5

Guidelines for Creating Direct-Mail Ads That Really Work

Sources: Adapted from Kim T. Gordon, "Copy Right," *Business Start-Ups*, June 1998, pp. 18–19; Paul Hughes, "Profits Due," *Entrepreneur*, February 1994, pp. 74–78; "Why They Open Direct Mail," *Communication Briefings*, December 1993, p. 5; Ten Lammers, "The Elements of Perfect Pitch," *Inc.*, March 1992, pp. 53–55; "Special Delivery," *Small Business Reports*, February 1993, p. 6; Gloria Green and James W. Peltier, "How to Develop a Direct Mail Program," *Small Business Forum*, Winter 1993/1994, pp. 30–45; Susan Headden, "The Junk Mail Deluge," *U.S. News & World Report*, December 8, 1997, pp. 40–48.

the demonstrations. Businesses that normally use direct mail can bring the two-dimensional photos and product descriptions in their print catalogs to life, avoid the expense of mailing them, and attract new customers that traditional mailings might miss.

A Company Example

Charlie Hoeveler, CEO of **US Sports Camps, Inc.**, *a company that stages summer camps in a variety of sports on college campuses across the nation, has found the Web to be the ideal vehicle for promoting and managing the administrative details of the hundreds of camps the company runs. For years, US Sports Camps used direct-mail campaigns and ads in sports-oriented magazines to enroll youngsters in its camps. Today, the company touts its Web site (www.ecamps.com) with banner ads on Yahoo! and in all of its other promotional literature. The site, with its online registration form, has attracted hundreds of new customers and has boosted the company's international clientele 200 percent! The sports-specific bulletin boards on the Web site attract potential customers even in the off-season. Hoeveler, who says that he has "a perfect product for the Web," hopes eventually to "see 40 percent or 50 percent of sales come through the site."* [28]

Advertisements on the Web take five basic forms: banner ads, cookies, full-page ads, "push" technology ads, and e-mail ads. **Banner ads** are small, rectangular ads that reside on Web sites, much like roadside billboards, touting a company's product or service. When visitors to a site click on the banner ad, they go straight to the advertiser's home page. One measure of a banner ad's effectiveness is the number of impressions it produces. An **impression** occurs every time an ad appears on a Web page, whether or not the user clicks on the ad to explore it. Another common way of judging banner ads is the **click-through rate**, which is calculated by dividing the number of times customers actually click on the banner ad by the number of impressions for that ad. The cost of a banner ad to an advertiser depends on the number of users who actually click on it. The cost of creating a banner ad ranges from practically nothing for do-it-yourselfers to as much as $3,000 if the ad is designed by a professional and includes animation and high levels of interactivity.

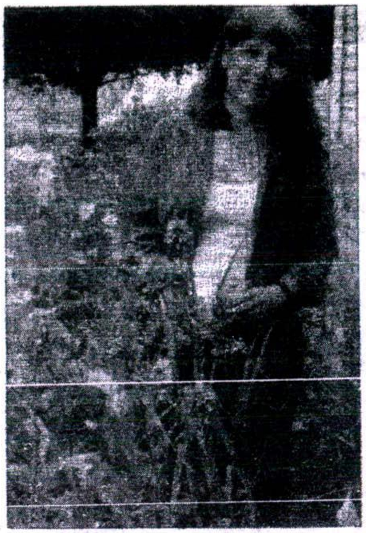
banner ads—*small, rectangular ads that reside on Web sites much like roadside billboards, touting a company's product or service.*

impression—*occurs every time an ad appears on a Web page, whether or not the user clicks on it.*

click-through rate—*a value calculated by dividing the number of times customers actually click on a banner ad by the number of impressions for that ad.*

Deborah Edlhuber, founder of Prairie Frontier, a small company selling wildflower and prairiegrass seed, drives traffic to her company's Web site with the help of a banner exchange program.

Courtesy of Praire Frontier, LLC.



Banner ads do not have to be expensive, however. Many small business owners increase the exposure their banner ads receive by joining a banner exchange program, which are similar to advertising cooperatives. In a banner exchange program, member companies can post their banners on each other's sites. These programs work best for companies selling complementary products or services. For instance, a small company selling gourmet food products over the Web might exchange banner ads with a company using the Web to sell fine wines or one selling upscale kitchen tools and appliances. Two of the largest banner exchange Web sites are Microsoft bCentral (formerly LinkExchange) and SmartClicks.

A Company Example

Deborah Edlhuber, owner of ***Prairie Frontier****, a small company selling wildflower and prairie-grass seed, uses a banner exchange program to drive traffic to her company's Web site. Through the exchange, Edlhuber places her banner ads she creates herself on several dozen gardening and photographic sites. Prairie Frontier's Web site now draws more than 1,700 hits a day, many of them from her banner exchange partners. "They definitely bring people to my site," says Edlhuber, "and I can track the click-throughs."*[29]

The primary disadvantage of banner ads is that Web users can easily ignore them. These ads have become such a part of the Web page landscape that frequent users may tend to ignore them. As this phenomena expands, Web designers search for the "best" page placement for banner ads, as well as any "bells and whistles" that will attract the browser and encourage them to click through. One newer form of Web advertising is more difficult to ignore. Known as an **interstitial or pop-up**, this is a separate window of advertising that pops open spontaneously, blocking the site behind it. It is designed to grab consumers' attention for the few nanoseconds it takes them to close the window. The danger, of course, is that the attention received is not necessarily positive. These ads are often perceived as an annoying intrusion. A slight variation on this is the "pop-under" ad that immediately goes behind the active screen but stays open until the browser window is closed.

interstitial or pop-up—*a separate window of advertising that pops open spontaneously, blocking the site behind it.*

Cookies are small programs that attach to users' computers when they visit certain Web sites. These programs track the locations users visit while in the site and use this electronic footprint to send pop-up ads that would be of interest to the user. For instance, a Web user who frequently visits garden sites might find ads for garden tools and seed companies popping up on her screen. Many sites that require users to register before they can enter are collecting information to create cookie files. Cookies cannot access a user's computer, read sensitive information such as credit card numbers or passwords, or send such data back to the company that created the cookie. Nor can they alter the files on a computer's hard drive. Cookies can, however, track users' Web browsing patterns, revealing which pages they view and how often they view them. Because cookies record users' Web use and habits transparently (and usually without users' express permission), their use has become somewhat controversial. Some companies use the information they glean from cookies to make inferences about customers' interests and then target ads at them based on those inferences.

cookies—*small programs that attach to users' computers when they visit certain Web sites and that track users' Web browsing patterns.*

Full-page ads are those that download to Web users' screens before they can access certain Web sites. They are common on popular game sites that attract a high volume of Web traffic. **Push technology ads** appear on users' screens when they download information such as news, sports, or entertainment from another site. For instance, a Web user downloading sports information might receive an ad for athletic shoes or T-shirts with the information. One advantage of Web advertising is its ability to track the results that an ad produces. Web technology allows advertisers to count the number of visitors to a site and to track the number of people who actually click on the ads placed there.

full-page ads—*ads that download to users' Web screens before they can access certain Web sites.*

push technology ads—*ads that appear on users' screens when they download information such as news, sports, or entertainment from another site.*

With more than 150 million users, e-mail is the most common application on the Internet, and e-mail advertising capitalizes on that popularity. **E-mail advertising**, in which companies

e-mail advertising—*advertising in which companies broadcast their advertising messages via e-mail.*

broadcast their advertising messages via e-mail, grew from just 3 percent of total Web advertising expenditures to 15 percent in 2003.[30] E-mail advertising takes two forms: permission e-mail and spam. As its name suggests, **permission e-mail** involves sending e-mail ads to customers with their permission; **spam** is unsolicited commercial e-mail. Approximately 20 percent of all e-mail in the United States is commercial, and it is split evenly between permission e-mail and spam.[31] Because most e-mail users see spam as a nuisance, they often view companies that use it ("spammers") in a negative light. Entrepreneurs would be wise to exclude spam from their Web advertising plans. However, permission e-mail can be an effective—and money-saving—advertising tool. Although a banner ad's response rate is just 1 to 5 percent, permission e-mail messages often produce response rates of 25 percent![32] The cost for traditional direct-mail campaigns ranges from $1 to $2 per piece compared to only $0.01 to $0.25 per piece for e-mail.[33]

permission e-mail—*commercial e-mail sent to customers with their consent.*

spam—*unsolicited commercial e-mail.*

For an online advertisement to be really effective consumers must want to receive the message. When customers request information, it is referred to as opt-in e-mail. The return communications should be personal and relevant and respect the reader.

Building an e-mail list simply requires attention to the basics of marketing. The goal is to have qualified potential buyers identify themselves to you by sharing their e-mail addresses. Successful marketers offer rewards to those willing to share their e-mail addresses. The reward may be a one-time discount, special offer, special report, entry in a sweepstakes, or drawing for a prize. Once a small company obtains potential customers' e-mail addresses, the next step is to send a message that is useful and of interest to them. The message must be geared to their interests and should show how your product or service will satisfy their needs or wants.[34]

Many companies have success with creative e-mail newsletters sent to customers.

A Company Example

For example, ***Paul Frederick****, a maker of fine men's shirts, sends a weekly e-mail newsletter to customers (with their permission) that covers everything from fashion do's and don'ts to the hottest new styles. The electronic newsletter contains links to the company's Web site, where customers can browse through the catalog, use the "Create Your Shirt" feature to design their own shirts, and take advantage of special deals for online customers. The combination of its e-mail advertising campaign and its user-friendly Web site gives Paul Frederick an edge over its rivals.*

Entrepreneurs can test e-mail promotions and online advertising messages to ensure maximum impact, just as is done with print material, only faster and at little cost. Too often, business owners simply assume that they know how to promote their products or services and never test various messages for effectiveness in producing new sales. Entrepreneurs can test a variety of messages using different product discounts to test the price sensitivity of the market, free gift offers, e-mail formats, or even a "hard" sell versus a "soft" sell. If you don't experiment, you will never gain additional knowledge of customers that allows for the implementation of successful e-mail marketing.[35]

OUTDOOR ADVERTISING. National advertisers have long used outdoor ads. This medium is proving to be popular among small firms (especially retailers) as well. Spending on outdoor ads is growing at a rate faster than that of most other media at nearly 10 percent a year. Very few small businesses rely solely on outdoor advertising; instead, they supplement other advertising media with billboards. With a creative outdoor campaign, a small company can make a big impact—even on a small budget.

Outdoor advertising offers certain *advantages* to the small business:

High exposure. Outdoor advertising offers a high-frequency exposure; studies suggest that the typical billboard reaches an adult 29 to 31 times each month. Most people tend to follow the same routes in their daily traveling, and billboards are there waiting for them when they pass by.

Broad reach. The nature of outdoor ads makes them effective devices for reaching a large number of potential customers within a specific area. Not only has the number of cars on the road increased, but the number of daily vehicle trips people take has also climbed. In addition, the people outdoor ads reach tend to be younger, wealthier, and better educated than the average person.

Flexibility. Advertisers can buy outdoor advertising units separately or in a number of packages. Through its variety of graphics, design, and unique features, outdoor advertising enables the small advertiser to match his message to the particular audience.

Cost efficiency. Outdoor advertising offers one of the lowest costs per thousand customers reached of all advertising media. Experts estimate the cost per thousand viewers (CPM) for outdoor ads is about $2, compared to $5 for drive-time radio spots, $9 for magazine ads, and $10 to $20 for newspaper ads and prime-time television spots.[36]

Outdoor ads also have several *disadvantages*:

Brief exposure. Because billboards are immobile, the reader is exposed to the advertiser's message for only a short time—typically no more than five seconds. As a result, the message must be short and to the point.

Limited ad recall. Because customers often are zooming past outdoor ads at high speed, they are exposed to an advertising message very briefly, which limits their ability to retain the message.

Legal restrictions. Outdoor billboards are subject to strict regulations and to a high degree of standardization. Many cities place limitations on the number and type of signs and billboards allowed along the roadside.

Lack of prominence. A clutter of billboards and signs along a heavily traveled route tends to reduce the effectiveness of a single ad that loses its prominence among the crowd of billboards.

USING OUTDOOR ADS. Until the 1990s, billboards were mostly hand-painted. Today, however, technology has changed the face of outdoor advertising dramatically. Computerized painting techniques render truer, crisper, and brighter colors and have improved the quality of outdoor ads significantly. Vinyl surfaces accept print-quality images and are extremely durable. Digital technology, three-dimensional effects, computerized lighting, and other advances allow companies to create animated, continuous motion ads that really capture viewers' attention at reasonable costs. Because the outdoor ad is stationary and the viewer is in motion, a small business owner must pay special attention to its design. An outdoor ad should:

- Identify the product and the company clearly and quickly.
- Use a simple background. The background should not compete with the message.
- Rely on large illustrations that jump out at the viewer.
- Include clear, legible type. All lowercase or a combination of uppercase and lowercase letters work best. Very bold or very thin typefaces become illegible at a distance.
- Use black-and-white designs. Research shows that black-and-white outdoor ads are more effective than color ads. If color is important to the message, pick color combinations that contrast both hue and brightness—for example, black on yellow.
- Emphasize simplicity; short copy and short words are best. Don't try to cram too much onto a billboard. One study found that ads with fewer than eight words were most effective, and those containing more than 10 words were least effective.
- Be located on the right-hand side of the highway.

One of the latest trends in outdoor advertising is "talking billboards." The text directs viewers to tune into a specific radio frequency, where they hear a short commercial. Those who tune in hear jokes, skits, and, of course, a commercial for the company and its products. Underwear maker Joe Boxer uses talking billboards with a great deal of success.[37]

Entrepreneurs are finding other creative ways to use outdoor advertising to get their messages across to customers. Tom Scott and Tom First, cofounders of Nantucket Nectars, send "mobile marketing squads" out in purple Winnebagos emblazoned with the company's logo to concerts, races, football games, and other events, where they hand out free samples of Nantucket Nectars' products.[38] Beach 'N Billboard, a small company in New Jersey, will imprint company logos and advertisements into the sand at the beach. Some companies now even advertise their products and services using stickers on pieces of fruit sold in grocery stores![39]

TRANSIT ADVERTISING. Transit advertising includes advertising signs inside and outside some 70,000 public transportation vehicles throughout the country's urban areas. The medium is likely to grow as more cities look to public transit systems to relieve transportation problems. Transit ads offer a number of *advantages*:

Wide coverage. Transit advertising offers advertisers mass exposure to a variety of customers. The message literally goes to where the people are. This medium also reaches people with a wide variety of demographic characteristics.

Repeat exposure. Transit ads provide repeated exposure to a message. The typical transit rider averages 24 rides per month and spends 61 minutes per day riding.

Low cost. Even small business owners with limited budgets can afford transit advertising. One study shows that transit advertising costs average only $0.30 per thousand.[40]

Flexibility. Transit ads come in a wide range of sizes, numbers, and duration. With transit ads, an owner can select an individual market or any combination of markets across the country.

Transit ads also have several *disadvantages*:

Generality. Even though a small business can choose the specific transit routes on which to advertise, it cannot target a particular segment of the market through transit advertising. The effectiveness of transit ads depends on the routes that public vehicles travel and on the people they reach, which, unfortunately, the advertiser cannot control.

Limited appeal. Unlike many media, transit ads are not beamed into the potential customer's residence or business. The result is that customers cannot keep them for future reference. Also, these ads do not reach with great frequency the upper-income, highly educated portion of the market.

Brief message. Transit ads do not permit the small advertiser to present a detailed description or a demonstration of the product or service for sale. Although inside ads have a relatively long exposure (the average ride lasts 22.5 minutes), outside ads must be brief and to the point.

DIRECTORIES. Directories are an important advertising medium for reaching those customers who have already made purchase decisions. The directory simply helps these customers locate the specific product or service they have decided to buy. Directories include telephone books, industrial or trade guides, buyer guides, annuals, catalog files, and yearbooks that list various businesses and the products they sell.

Directories offer several *advantages* to advertisers:

Prime prospects. Directory listings reach customers who are prime prospects, because they have already decided to purchase an item. The directory just helps them find what they are looking for.

Long life. Directory listings usually have long lives. A typical directory may be published annually.

However, there are certain *disadvantages* to using directories:

Lack of flexibility. Listings and ads in many directories offer only a limited variety of design features. Business owners may not be as free to create unique ads as in other printed media.

Ad clutter. In many directories, ads from many companies are clustered together so closely that no single ad stands out from the rest.

Obsolescence. Because directories are commonly updated only annually, some of their listings become obsolete. This is a problem for a small firm that changes its name, location, or phone number.

When choosing a directory, the small business owner should evaluate several criteria:

- *Completeness.* Does the directory include enough listings that customers will use it?
- *Convenience.* Are the listings well organized and convenient? Are they cross-referenced?
- *Evidence of use.* To what extent do customers actually use the directory? What evidence of use does the publisher offer?
- *Age.* Is the directory well established and does it have a good reputation?
- *Circulation.* Do users pay for the directory or do they receive complimentary copies? Is there an audited circulation statement?

TRADE SHOWS. Trade shows provide manufacturers and distributors with a unique opportunity to advertise to a preselected audience of potential customers who are inclined to buy. Literally thousands of trade shows are sponsored each year, and carefully evaluating and selecting a few shows can produce profitable results for a business owner. A study by the Center for Exhibition Industry Research found that trade show success does *not* depend on how much an exhibitor spends; instead, success is a function of planning, preparation, and follow-up.[41]

Trade shows offer the following *advantages*:

A natural market. Trade shows bring together buyers and sellers in a setting where products can be explained, demonstrated, and handled. Comparative shopping is easy, and the buying process is more efficient.

Preselected audience. Trade exhibits attract potential customers with a specific interest in the goods or services being displayed. There is a high probability that these prospects will make a purchase.

New customer market. Trade shows offer exhibitors a prime opportunity to reach new customers and to contact people who are not accessible to sales representatives.

Cost advantage. As the cost of making a field sales call continues to escalate, more companies are realizing that trade shows are an economical method for making sales contacts and presentations.

There are, however, certain *disadvantages* associated with trade shows:

Increasing costs. The cost of exhibiting at trade shows is rising quickly. Registration fees, travel and setup costs, sales salaries, and other expenditures may be a barrier to some small firms.

Wasted effort. A poorly planned exhibit ultimately costs the small business more than its benefits are worth. Too many firms enter exhibits in trade shows without proper preparation, and they end up wasting their time, energy, and money on unproductive activities.

To avoid these disadvantages, business owners should:

- Establish objectives for the show. Do you want to generate 100 new sales leads, make new product presentations to 500 potential customers, or make $5,000 in sales?
- Communicate with key potential customers *before* the show; send them invitations or invite them to stop by your booth for a special gift.
- Make your display memorable. Be sure your exhibit shows your company and its products or services in the best light.
- Have knowledgeable salespeople staffing the booth. Research shows that the most important factor to trade show attendees is knowledgeable, friendly, professional people tending the exhibit.[42]
- Demonstrate your product or service; let customers see it in action.
- Learn to distinguish between serious customers and "tire-kickers."
- Distribute literature that clearly communicates the product or service sold.
- Project a professional image at all times.
- Follow up promptly on sales leads. The most common mistake trade show participants make is failing to follow up on the sales leads the show generated. If you are not going to follow up leads, why bother to attend the show in the first place?

SPECIALTY ADVERTISING. As advertisers have shifted their focus to "narrowcasting" their messages to target audiences and away from "broadcasting," specialty advertising has grown in popularity. Advertisers now spend more than $3 billion annually on specialty items. This category includes all customer gift items imprinted with the company's name, address, telephone number, and slogan. Specialty items are best used as reminder ads to supplement other forms of advertising and help to create goodwill among existing and potential customers.

Specialty advertising offers several *advantages*:

Reaching select audiences. Advertisers have the ability to reach specific audiences with well-planned specialty items.

A Company Example

For instance, ***Corhart Refractories Corporation*** *wanted to increase the number of steel executives reached at a trade show. The company mailed the executives invitations in a box containing a set of radio earphones. To get the radio (without which the earphones were useless), the executives had to stop by Corhart's booth. An overflow crowd stopped to get their radios, imprinted with Corhart's logo.*[43]

Personalized nature. By carefully choosing a specialty item, a business owner can "personalize" his advertisement. When choosing advertising specialties, a small business owner should use items that are unusual, related to the nature of the business, and meaningful to customers.

Versatility. The rich versatility of specialty advertising is limited only by the business owner's imagination. Advertisers print their logos on everything from pens and scarves to wallets and caps.

There are *disadvantages* to specialty advertising:

Potential for waste. Unless the owner chooses the appropriate specialty item, he will be wasting his time and money. The options are virtually infinite.

Costs. Some specialty items can be quite expensive. Plus, some owners have a tendency to give advertising materials to anyone—even to those who are not potential customers.

POINT-OF-PURCHASE ADS. In the last several years, in-store advertising has become more popular as a way of reaching the customer at a crucial moment—the point of purchase. Research suggests that consumers make 66 percent of all buying decisions at the point of sale.[44] Self-service stores are especially well suited for in-store ads because they remind people of the products as they walk the aisles. These in-store ads are not just blasé signs or glossy photographs of the product in use. Some businesses use in-store music interspersed with household hints and, of course, ads. Another ploy involves tiny devices that sense when a customer passes by and triggers a prerecorded sales message. Other machines emit scents—chocolate chip cookies or piña coladas—to appeal to passing customers' sense of smell.[45] Joe Boxer now sells its boxer shorts in pop-top aluminum cans from vending machines that use motion sensors to detect passing shoppers. When triggered, the machine talks to customers, with comments including, "Hey you! Hey you! Have you changed your underwear lately?"[46]

In sum, small business owners have an endless array of advertising tools, techniques, and media available to them. Even postage stamps, bathroom walls, sides of cows, and parking meters offer advertising space! Table 8.6 summarizes the different advertising media and their suitability for reaching particular customer groups.

PREPARING AN ADVERTISING BUDGET

Learning Objective

4. Discuss the four basic methods for preparing an advertising budget.

One of the most challenging decisions confronting a small business owner is how much to invest in advertising. The amount the owner wants to spend and the amount the firm can afford to spend on advertising usually differ significantly. There are four methods of determining an advertising budget: what is affordable; matching competitors; percentage of sales; and objective and task.

YOU Be the Consultant . . .

Fat Free But Not Famous—Yet

When she was in college, Candace Vanice was a french fry fanatic, but she worried about the fat content of fries cooked the traditional way. "I waited and waited for someone to create fat-free french fries, but no one did," recalls Vanice. "So, I got busy in my own kitchen. I explored a great number of approaches that did not work, but one recipe showed great promise." That recipe was based on her mother's recipe for crispy french toast, a dish Vanice had enjoyed while growing up. After much experimenting with seasonings, Vanice created french fries that tasted as good as the ones at fast-food restaurants but with one major advantage: They contained no fat!

In 1994, Vanice applied for and received a patent for her fat-free fries, and she launched a company, Marvel LLC, to market them. She quickly learned that breaking into the food business and getting a new product on grocers' shelves is no easy task. To gain widespread acceptance in supermarkets, a new product needs a food broker to push it. The problem 27-year-old Vanice faced was that both food brokers and supermarkets are reluctant to carry products that are not supported by big-time marketing and advertising campaigns. Vanice's company, like most fledgling start-ups, did not have the financial resources to launch an extensive advertising program.

Vanice had faith in her product, however, and believed that customers would flock to buy her fat-free fries once they tasted them. She contacted several supermarkets in her hometown of Kansas City and started handing out free samples. She also hired a sampling agency to give away free product samples in stores in the surrounding area. As Vanice and the sampling agency handed out fries, they collected customer feedback, asking people to fill out surveys about the fries. According to customers, her fries were an overwhelming hit! The only remaining question was how to raise the visibility of 8th Wonder Fat Free Fries enough to convince food brokers and supermarkets to carry them. That would be a challenge because Marvel LLC had practically no money for advertising.

1. Work with a team of your classmates to develop a creative advertising and promotional plan for Marvel LLC. What unique selling proposition should Vanice use?

2. How should Vanice use publicity to draw attention to her 8th Wonder Fat Free Fries?

3. According to one marketing expert, "A product can be copied or imitated, but a brand cannot." What can entrepreneurs such as Candace Vanice do to build brand name recognition when they do not have the advertising budgets large companies have?

Sources: Adapted from Don Debalak, "French Twist," *Business Start-Ups*, November 1999, pp. 78–81; Marvel LLC, www.fatfreefries.com; Sheryl Nance-Nash, "Making a Name for Your Brand," *Fortune*, July 20, 1998, pp. 156[L]–156[M].

TABLE 8.6

Advertising Media Comparison Chart

Media	Coverage	Special Characteristics
Newspapers	Selected geographic coverage. Entire city or metropolitan area with major newspapers. Single town with smaller, weekly papers.	Top advertising media; attracts about 23% of advertising expenditures.
Radio	Market area radio station serves. Stations' formats range from country and easy listening to rap and golden oldies.	Ability to reach almost any market by choosing proper station. The average household has 5.6 radios, and 95 percent of the cars in the United States have radios.
Television	Market area TV station serves; could be local (cable) or national (major network).	Powerful medium; especially effective at reaching younger, less educated audiences.
Magazines	Local magazines typically cover a particular city or region.	Magazines usually target specific audiences, from wealthy owners of country estates to low-income apartment dwellers.
Direct mail	Advertiser chooses the audience.	An effective advertising medium for small companies in virtually *any* business.
World Wide Web (WWW)	Anyone in the world who is wired to the WWW.	Reaches upscale, well-educated consumers anywhere in the world.
Outdoor advertising	Ranges from a neighborhood to an entire metropolitan area.	An excellent medium to supplement other forms of advertising.
Transit advertising	Urban areas.	Typically does not reach upper-income, well-educated audience.
Directories	Customers who have already made a purchase decision.	Many directories available; the key is picking the right ones.
Trade shows	Preselected audience.	Potential customers are inclined to buy.
Specialty advertising	Advertiser chooses the audience.	Allows advertiser to "narrowcast" message rather than broadcast it.
Special events and promotions	Advertiser chooses the audience.	Allow advertiser maximum flexibility and creativity in ads.
Point-of-purchase ads	Existing customers.	Two-thirds of buying decisions are made at the point of sale.

Under the what-is-affordable method, the owner sees advertising as a luxury. She views advertising completely as an expense, not as an investment that produces sales and profits in the future. Therefore, as the name implies, management spends whatever it can afford on advertising. Too often, the advertising budget is allocated funds after all other budget items have been financed. The result is an inadequate advertising budget. This method also fails to relate the advertising budget to the advertising objective.

Another approach is to match the advertising expenditures of the firm's competitors, either in a flat dollar amount or as a percentage of sales. This method assumes that a firm's advertising needs and strategies are the same as those of its competitors. Although competitors' actions can be helpful in establishing a floor for advertising expenditures, relying on this technique can lead to blind imitation instead of a budget suited to the small firm's circumstances.

Advantages	Disadvantages	Tips
Extensive coverage; low absolute and relative costs; timeliness.	Blanket coverage means some ads are wasted on those who are not potential customers; limited reproduction quality; significant ad clutter.	Research newspaper's reader profile; focus on placing ads in proper sections.
Universal infiltration; radio ads are more "active" than print ads, giving advertisers the ability to be more creative with ads.	Need to repeat ads for effectiveness; no visual possibilities; brief ads mean limited message potential.	Make sure station's listener profile matches company's target audience. Keep ad copy simple.
Visual advantage—advertiser can *show* customers product or service benefits; cable stations bring TV ads into price ranges that small businesses can afford.	Brief exposure to ads, often because of zapping; creating TV commercials can be expensive.	Consider infomercials. They may be obnoxious to many, but they work, if properly done. Try to evoke emotion in ads.
Long life spans for ads; most magazines have multiple readers; high ad quality.	Long closing times for ads require advance planning; ad clutter can reduce ads' effectiveness.	As in newspaper advertising, proper placement is the key. Left-hand pages are better.
Ability to select a specific audience and tailor a message to it; captures reader's attention, at least for a moment.	Will become junk mail if improperly targeted; high relative cost because of low response rates.	Plan direct-mail ads so that you can measure results; use catchy words—*free, save, new.*
Attractive audience profile; rapid growth of the WWW as a marketing tool; ability to use full-color, sound, animation, etc.	Audience may bypass ads without ever seeing them; advertising clutter is a problem and will grow as WWW use grows.	Make site interactive, if possible; games, puzzles, and contests can be effective draws.
Multiple exposures; a bargain because of its low relative cost.	Brief exposure requires limited messages; lack of prominence.	Keep ads short and simple; use clear, legible type.
Wide coverage and repeat exposure to ads; low relative cost.	Difficulty in reaching specific target audiences; brief exposure requires limited message.	Use contrasting colors and designs that give ads a two-dimensional appearance.
Target prime prospects; long ad life.	Danger of listing or directory becoming obsolete; ad clutter.	Design ad so that it stands out from the crowd.
Ample time for personal selling; ability to demonstrate products.	High cost of traveling to show, setting up, and staffing booth.	Make the most of sales time and follow up leads.
Ability to reach specific audience and to personalize the message.	Potential for waste and high costs.	Specialty items should prompt customer recall.
Reach some customers when all other attempts fail.	Require time to plan and coordinate; can be expensive.	Creativity is a must if a specialty promotion is to be successful.
Reach customer at a crucial moment: the point of purchase.	Require customers to come into the business first.	Capture the customer's attention first; then sell

The most commonly used method of establishing an advertising budget is the simple percentage-of-sales approach. This method relates advertising expenditures to actual sales results. Tying advertising expenditures to sales is generally preferred to relating them to profits because sales tend to fluctuate less than profits. One expert suggests a useful rule of thumb when establishing an advertising budget: 10 percent of projected sales the first year in business; 7 percent the second year; and at least 5 percent each year after that. Relying totally on such broad rules can be dangerous, however. They may not be representative of a small company's advertising needs.

The objective-and-task method is the most difficult and least used technique for establishing an advertising budget. It also is the method most often recommended by advertising experts. With this method, an owner links advertising expenditures to specific objectives. Although the previous methods break down the total amount of funds allocated to advertising, the task

FIGURE 8.3 Advertising Planning Calendar

October

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
Advertising Budget for October: 9% of Sales = $2,275 Co-op Ads = $550 Total $2,825		October Advertising Expenditures: $2,845 Under/(Over) Budget: ($20) Remaining Balance: $6,400		1 WPCC Radio 5 Spots $125 Billboard $350	2 The Chronicle 140 lines $100	3
4	5	6	7	8	9 The Chronicle 140 lines $100	10
11	12	13 Meet w/ Leslie Re: November Ad Campaigns 2pm	14	15 Envelope "Stuffer" In Invoices Halloween Sale $175	16 The Chronicle 140 lines $100	17 WPCC Radio 5 Spots $100
18	19	20 WPCC Radio 5 Spots $125	21	22 Direct Mail Halloween Sale Promo "Preferred Customers" $120	23 The Chronicle 140 lines $100	24 WPCC Radio 5 Spots $100
25	26 WPCC Radio 5 Spots $125	27 WPCC Radio 5 Spots $125	28 WPCC Radio 5 Spots $125	29 WPCC Radio 5 Spots $125	30 The Chronicle Half-Page Spread Sale $300	31 Halloween WPCC Radio Live Remote Broadcast $425

method builds up the advertising funds by analyzing what it will cost to accomplish these objectives. For example, suppose that a manager wants to boost sales of a particular product 10 percent by attracting local college students. He may determine that a nearby rock radio station would be the best medium to use. Then he must decide on the number and frequency of the ads and estimate their costs.

A manager follows this same process for each advertising objective. A common problem with the method is the tendency for the manager to be overly ambitious in setting advertising objectives, which leads to unrealistically high advertising expenditures. The manager may be forced to alter objectives, or the plans to reach them, to bring the advertising budget back to a reasonable level. However, the plan can still be effective.

Most small companies find it useful to plan in advance their advertising expenditures on a weekly basis. This short-term planning ensures a more consistent advertising effort throughout the year. A calendar like the one pictured in Figure 8.3 can be one of the most valuable tools in planning a small company's advertising program. The calendar enables the owner to prepare for holidays and special events, to monitor actual and budgeted expenditures, and to ensure that ads are scheduled on the appropriate media at the proper times.

5. Explain practical methods for stretching a small business owner's advertising budget.

ADVERTISE BIG ON A SMALL BUDGET

The typical small business does not have the luxury of an unlimited advertising budget. Most cannot afford to hire a professional ad agency. This does not mean, however, that a small company should assume a second-class advertising posture. Most advertising experts say that, unless a small company spends more than $10,000 a year on advertising, it probably doesn't need an ad agency. For most, hiring freelance copywriters and artists on a per-project basis is a much better bargain. With a little creativity and a dose of ingenuity, small business owners can stretch their advertising dollars and make the most of what they spend. Three useful techniques to do this are cooperative advertising, shared advertising, and publicity.

cooperative advertising—*an arrangement in which a manufacturing company shares the cost of advertising with a small retailer if the retailer features its products in those ads.*

Cooperative Advertising

In **cooperative advertising**, a manufacturing company shares the cost of advertising with a small retailer if the retailer features its products in those ads. Both the manufacturer and the retailer get more advertising per dollar by sharing expenses.

David Lang, owner of a small lawn equipment store, purchases his inventory from 10 different manufacturers, nine of whom offer cooperative advertising programs. "Without [the manufacturers' help], we could only spend $20,000 a year [on advertising]," says Lang. "But now we can spend $40,000 because we're getting $20,000 back."[47]

Unlike Lang, who uses every dollar of cooperative advertising available to him, most small business owners fail to take advantage of manufacturers' cooperative advertising programs. Manufacturers, whose products cover the entire retail spectrum, make available an estimated $15 billion of co-op ad dollars each year; yet, more than two-thirds of it goes unused![48]

A Company Example

Barbara Malki, co-owner of **Cahaba Cycles**, *is now a believer in the power of cooperative advertising, although she admits that she has not always been. "Two years ago," she says, "I was leaving co-op money on the table. I'm more aggressive about it now. [Now] I . . . use every co-op dollar." Cahaba Cycles recoups about 10 percent of its annual advertising budget through cooperative advertising.*[49]

Shared Advertising

shared advertising—*an arrangement in which a group of similar businesses forms a syndicate to produce generic ads that allow the individual businesses to dub in local information.*

In **shared advertising**, a group of similar businesses forms a syndicate to produce generic ads that allow the individual businesses to dub in local information. The technique is especially useful for small businesses that sell relatively standardized products or services such as legal assistance, autos, and furniture. Because the small firms in the syndicate pool their funds, the result usually is higher-quality ads and significantly lower production costs.

Other cost-saving suggestions for advertising expenditures include the following:

Repeat ads that have been successful. In addition to reducing the cost of ad preparation, this may create a consistent image in a small firm's advertising program.

Use identical ads in different media. If a billboard has been an effective advertising tool, an owner should consider converting it to a newspaper or magazine ad or a direct-mail flyer.

Hire independent copywriters, graphic designers, photographers, and other media specialists. Many small businesses that cannot afford a full-time advertising staff buy their advertising services a la carte. They work directly with independent specialists and usually receive high-quality work that compares favorably to that of advertising agencies without paying a fee for overhead.

Concentrate advertising during times when customers are most likely to buy. Some small business owners make the mistake of spreading an already small advertising budget evenly—and thinly—over a 12-month period.

PUBLIC RELATIONS As we discussed earlier in this chapter, the press can be either a valuable friend or a fearsome foe to a any business, depending on how well the owner handles her firm's public relations. Too often, entrepreneurs take the attitude, "My business is too small to be concerned about public relations." However, wise small business managers recognize that investing time and money in public relations benefits both the community and the company. The community gains the support of a good business citizen, and the company earns a positive image in the marketplace.

Many small businesses rely on media attention to get noticed, and getting that attention takes a coordinated effort. Public relations doesn't just happen; an owner must work at getting her company noticed by the media. Although publicity may not be free, it definitely can lower the company's advertising expenditures and still keep its name before the public. Because small companies' advertising budgets are limited, public relations takes on significant importance.

A Company Example

Bob Mayberry, a car dealer in Monroe, North Carolina, recently bought a 1961 Ford squad car like the one used on the 1960s hit TV series The Andy Griffith Show. *Not only does the car lure potential customers onto his lot, but it also has gotten the dealership into several newspaper articles. "We have sold a lot of cars from it," says Mayberry.*[50]

One successful public relations technique is **cause marketing**, in which a small business sponsors and promotes fund-raising activities of nonprofit groups and charities while raising its own visibility in the community.

A Company Example

For example, during the Muscular Dystrophy Association's annual telethon, a local shop, Cookies Cook'n, donated over 100 pounds of cookies and brownies to feed telephone volunteers. Several giant cookies were auctioned off during the telethon, and the small cookie shop's name was mentioned frequently. ***Cookies Cook'n*** *got more television exposure for donating these cookies than it could have gotten spending its entire advertising budget on TV commercials.*[51]

cause marketing—*an arrangement in which a small business sponsors and promotes fund-raising activities of nonprofit groups and charities while raising its own visibility in the community.*

PRICING: A CREATIVE BLEND OF ART AND SCIENCE

Deciding how and where to advertise is not the only key to marketing success; small business owners also must determine prices for their goods and services that will draw customers and produce a profit. Unfortunately, too many small business owners set prices according to vague, poorly defined techniques or even hunches. Price is an important factor in the relationship with customers, and haphazard-pricing techniques can confuse and alienate customers and endanger a firm's profitability. Setting prices is not only one of the toughest decisions small business owners' face, but it also is one of the most important. Improper pricing has destroyed countless businesses when owners mistakenly thought their prices were sufficient to generate a profit.

Price is the monetary value of a product or service in the marketplace; it is a measure of what the customer must exchange in order to obtain various goods and services. As the media continuously reinforces, this is an era where shoppers seek value for their money. Price also is a signal of a product's or service's value to an individual, and different customers assign different values to the same goods and services. From an owner's viewpoint, price must be compatible with the customer's perception of value. "Pricing is not just a math problem," says one business writer. "It's a psychology test."[52] The psychology of pricing is an art much more than it is a science. Value often becomes what the customer perceives it to be. For example, price reflects this notion of perceived value nowhere better than that of the products of the Swiss watch industry. Rolex, Cartier, Patek Philippe, Chopard, Toric, Blanepain, and Corum are legendary brands of ultrapremium handmade watches selling from $10,000 to $50,000. Owning one of these watches is a mark of financial success, yet each is less accurate at keeping time than a $10 quartz-driven Timex.[53] A similar example of price insensitivity can be found in fountain pens. In recent years, Renaissance Pen Company has marketed pens made from gold and platinum and encrusted with diamonds selling for as much as $230,000. Or how about one that contains the crystallized DNA of Abraham Lincoln for only $1,650?[54] Value for these examples is not found in superior technical performance but rather in their scarcity and uniqueness. Although entrepreneurs must recognize the shallow depth of the market for such ultraluxury items, the ego-satisfying ownership of limited-edition watches, pens, cars, jewelry, and so on is the psychological force supporting this pricing strategy.

Two Potent Forces: Image and Competition

PRICE CONVEYS IMAGE. A company's pricing policies communicate important information about its overall image to customers. For example, the prices charged by a posh men's clothing store reflect a completely different image from those charged by a factory outlet. Customers look at prices to determine what type of store they are dealing with. High prices frequently convey the idea of quality, prestige, and uniqueness to the customer. Accordingly, when developing a marketing approach to pricing, a small business manager must establish prices that are compatible with what its customers expect and are willing to pay. Too often, small business owners *underprice* their goods and services, believing that low prices are the only way they can achieve a competitive advantage. One study by the Copernicus consulting firm found that only 15 percent to 35 percent of customers consider price to be the chief criterion when selecting a product or service.[55]

A common mistake small business owners make is failing to recognize the extra value, convenience, service, and quality they give their customers—all things many customers are willing to pay for. These companies fall into the trap of trying to compete solely on the basis of price when they lack the sales volume—and, hence, the lower costs—of their larger rivals. It is a recipe for failure. "People want quality," says one merchant selling upscale goods at upscale prices. "They want value. But if you lower prices, they think that you are lowering the value and lowering the quality."[56]

A Company Example

*Discounting the prices on its once popular Izod polo shirts nearly cost **Lacoste** its entire business. Demand for the shirts, which sported a unique crocodile logo, slumped as prices fell. Discounting had eroded the company's distinctive image. Today, the company is trying to rebuild its upscale image and the cachet of its shirts by charging premium prices. Sales have been climbing.*[57]

The secret to setting prices properly is based on understanding the firm's target market, the customer groups at which the small company is aiming its goods or services. Target market, business image, and price are closely related.

A Company Example

*For instance, **Crème de la Crème** child care centers charge a staggering $14,000 a year in tuition, compared to a national average tuition of $5,400, and parents are clamoring to enroll their children. (Some applicants have not even been conceived yet!) Despite its premium prices, Crème de la Crème had a six-month waiting list in only its first year. How did the company manage this spectacular record? The key is differentiating itself from other child care centers and marketing those differences to well-to-do parents who want only the best for their preschool children. A Crème de la Crème center features a 3,600-volume library, a math lab, television and dance studios, and a state-of-the-art computer lab. The company pays 40 percent above the norm for teachers, 90 percent of whom have college degrees, compared to just 31 percent nationwide. Specialized teachers handle important subjects such as music and foreign languages and keep the student–teacher ratio low. Twenty security monitors ensure students' safety as they play tennis, stage plays in an open-air theater, or frolic in well-equipped playgrounds.*[58]

COMPETITION AND PRICES. When setting prices, business owners should take into account their competitors' prices, but they should *not* automatically match or beat them. Two factors are vital to studying the effects of competition on the small firm's pricing policies: the location of the competitors and the nature of the competing goods. In most cases, unless a company can differentiate the quality and the quantity of extras it provides, it must match the prices charged by nearby competitors for identical items. For example, if a self-service station charges a nickel more per gallon for gasoline than does another self-service station across the street, customers will simply go across the street to buy. Without the advantage of a unique business image—quality of goods sold, value of services provided, convenient location, favorable credit terms—a small company must match local competitors' prices or lose sales. Although the prices that distant competitors charge are not nearly as critical to the small business as are those of local competitors, it can be helpful to know them and to use them as reference points. Before matching any competitor's prices, however, small business owners should consider the rival's motives. The competition may be establishing its price structure based on a unique set of criteria and a totally different strategy.

The nature of the competitors' goods also influences the small firm's pricing policies. The manager must recognize which products are substitutes for those he sells and then strive to keep his prices in line with them. For example, the local sandwich shop should consider the hamburger restaurant, the taco shop, and the roast beef shop as competitors because they all serve fast foods. Although none of them offers the identical menu of the sandwich shop, they're all competing for the same quick meal dollar. Of course, if a small business can differentiate its products or services by creating a distinctive image in the consumer's mind, it can charge prices higher than those of its competitors. Because competitors' prices can have a dramatic impact on a small company's own prices, entrepreneurs should make it a habit to monitor their rivals' prices, especially on identical items.

Generally, small business managers should avoid head-to-head price competition with other firms that can more easily achieve lower prices through lower cost structures. Most locally owned drugstores cannot compete with the prices of large national drug chains. However, many local drugstores operate successfully by using nonprice competition; these stores offer more personal service, free delivery, credit sales, and other extras that the chains have eliminated. Nonprice competition can be an effective strategy for a small business in the face of larger, more powerful enterprises, especially because there are many dangers in experimenting with price changes. For instance, price shifts cause fluctuations in sales volume that the small firm may not be able to tolerate. Also, frequent price changes may damage the company's image and its customer relations.

One of the most deadly games a small business can get into with competitors is a price war. Price wars can eradicate companies' profit margins and scar an entire industry for years. "Many entrepreneurs cut prices to the point of unprofitability just to compete," says one business writer. "In doing so, they open the door to catastrophe. Less revenue often translates into lower quality, poorer service, sloppier salesmanship, weaker customer loyalty, and financial disaster."[59] Price wars usually begin when one competitor thinks he can achieve higher volume instantaneously by lowering prices. Rather than sticking to their strategic guns, competitors believe they must follow suit.

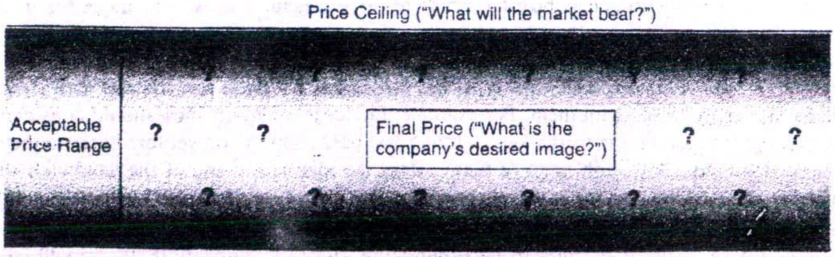
Entrepreneurs usually overestimate the power of price cuts, however. Sales volume rarely rises enough to offset the lower profit margins of a lower price. If you have a 25 percent gross profit margin, and you cut your price by 10 percent, you have to roughly triple your sales volume just to break even. In a price war, a company may cut its prices so severely that it is impossible to achieve the volume necessary to offset the lower profit margins. Even when price cuts work, their effects often are temporary. Customers lured by the lowest price usually have almost no loyalty to a business. The lesson: The best way to survive a price war is to stay out of it by emphasizing the unique features, benefits, and value your company offers its customers!

Setting prices with a customer orientation is more important than trying to choose the ideal price for a product. In fact, for most products there is an acceptable price range, not a single ideal price. This price range is the area between the price ceiling defined by customers in the market and the price floor established by the firm's cost structure. A manager's goal should be to position the firm's prices within this acceptable price range. The final price that business owners set depends on the desired image they want to create for the business in the customer's mind—discount, middle of the road, or prestige (see Figure 8.4).

Setting appropriate prices requires more than just choosing a number based solely on intuition. Rather, proper pricing policies require information, facts, and analysis. The factors that small business owners must consider when determining the final price for goods and services include the following:

- Product/service costs
- Market factors—supply and demand
- Sales volume
- Competitors' prices

FIGURE 8.4 What Determines Price?



- The company's competitive advantage
- Economic conditions
- Business location
- Seasonal fluctuations
- Psychological factors
- Credit terms and purchase discounts
- Customers' price sensitivity
- Desired image

Although business owners may not be able to charge the ideal price for a product or service, they should set the price high enough to cover costs and earn a reasonable profit but low enough to attract customers and generate an adequate sales volume. Furthermore, the right price today may be completely inappropriate tomorrow because of changing market and competitive conditions. For many businesses, the pricing decision has become more difficult because the World Wide Web gives customers access to incredible amounts of information about the prices of items ranging from cars to computers. Increasingly, customers are using the Web to find the lowest prices available.

PRICING STRATEGIES AND TACTICS

Learning Objective

4. Describe effective pricing techniques for introducing new products or services and for existing ones.

There is no limit to the number of variations in pricing strategies and tactics. This wide variety of options is exactly what allows the small business manager to be so creative. This section will examine some of the more commonly used tactics under a variety of conditions. Pricing always plays a critical role in a firm's overall strategy; pricing policies must be compatible with a company's total marketing plan.

Introducing a New Product

Most small business managers approach setting the price of a new product with a great deal of apprehension because they have no precedent on which to base their decision. If the new product's price is excessively high, it is in danger of failing because of low sales volume. However, if its price is too low, the product's sales revenue might not cover costs. When pricing any new product, the owner should try to satisfy three objectives:

1. *Getting the product accepted.* No matter how unusual a product is, its price must be acceptable to the firm's potential customers.
2. *Maintaining market share as competition grows.* If a new product is successful, competitors will enter the market, and the small company must work to expand or at least maintain its market share. Continuously reappraising the product's price in conjunction with special advertising and promotion techniques helps to retain a satisfactory market share.
3. *Earning a profit.* Obviously, a small firm must establish a price for the new product higher than its cost. Entrepreneurs should not introduce a new product at a price below cost because it is much easier to lower a price than to increase it once the product is on the market.

A Company Example

Linda Calder, owner of ***Calder & Calder Promotions****, a company that produces trade shows, knows how difficult it can be to raise prices. When she launched her company, Calder decided to set her price below the average price of competing trade show production companies because she thought that would give her a competitive edge. "My fee was so low . . . I sold out but did not make a profit," she says. Realizing her mistake, Calder raised prices in her second year, but her customers balked. Her sales fell by 50 percent.*[60]

Small business managers have three basic strategies to choose from when establishing a new product's price: a penetration pricing strategy, a skimming pricing strategy, and a sliding-down-the-demand-curve strategy.

MARKET PENETRATION. If a small business introduces a product into a highly competitive market in which a large number of similar products are competing for acceptance, the product must penetrate the market to be successful. To gain quick acceptance and extensive distribution in the mass market, the firm should introduce the product with a low price. In other words, it should set the price just above total unit cost to develop a wedge in the market and quickly achieve a high volume of sales. The resulting low profit margins may discourage other competitors from entering the market with similar products.

In most cases, a penetration pricing strategy is used to introduce relatively low-priced goods into a market with no elite segment and little opportunity for differentiation exists. The introduction is usually accompanied by heavy advertising and promotional techniques, special sales, and discounts. Entrepreneurs must recognize that penetration pricing is a long-range strategy; until customers accept the product, profits are likely to be small. If the strategy works and the product achieves mass market penetration, sales volume will increase, and the company will earn adequate profits. The objectives of the penetration strategy are to break into the market quickly, to generate a high sales volume as soon as possible, and to build market share. Many consumer products, such as soap, shampoo, and lightbulbs, are introduced through penetration pricing strategies.

SKIMMING. A skimming pricing strategy often is used when a company introduces a new product into a market with little or no competition. Sometimes the firm employs this tactic when introducing a product into a competitive market that contains an elite group that is able to pay a higher price. Here a firm uses a higher-than-normal price in an effort to quickly recover the initial developmental and promotional costs of the product. Start-up costs usually are substantial due to intensive promotional expenses and high initial production costs. The idea is to set a price well above the total unit cost and to promote the product heavily in order to appeal to the segment of the market that is not sensitive to price. Such a pricing tactic often reinforces the unique, prestigious image of a store and projects a quality picture of the product. Another advantage of this technique is that the owner can correct pricing mistakes quickly and easily. If the firm sets a price that is too low under a penetration strategy, raising the price can be very difficult. If a firm using a skimming strategy sets a price too high to generate sufficient volume, it can always lower the price. Successful skimming strategies require a company to differentiate its products or services from those of the competition, justifying the above-average price.

SLIDING DOWN THE DEMAND CURVE. One variation of the skimming price strategy is called sliding down the demand curve. Using this tactic, the small company introduces a product at a high price. Then technological advancements enable the firm to lower its costs quickly and to reduce the product's price before its competition can. By beating other businesses in a price decline, the small company discourages competitors and gradually, over time, becomes a high-volume producer. Computers are a prime example of a product introduced at a high price that quickly cascaded downward as companies forged important technological advances.

Sliding is a short-term pricing strategy that assumes that competition will eventually emerge. But even if no competition arises, the small business almost always lowers the product's price to attract a larger segment of the market. Yet, the initial high price contributes to a rapid return of start-up costs and generates a pool of funds to finance expansion and technological advances.

Pricing Established Goods and Services

Each of the following pricing tactics or techniques can become part of the toolbox of pricing tactics entrepreneurs can use to set prices of established goods and services.

odd pricing—*a pricing technique that sets prices that end in odd numbers to create the psychological impression of low prices.*

ODD PRICING. Although studies of consumer reactions to prices are mixed and generally inconclusive, many small business managers use the technique known as **odd pricing**. These managers prefer to establish prices that end in odd numbers (5, 7, 9) because they believe that merchandise selling for $12.95 appears to be much cheaper than the same item priced at $13.00. Psychological techniques such as odd pricing are designed to appeal to certain customer interests, but their effectiveness remains to be proven.

price lining—*a technique that sets the same price for products that have similar features and appear within the same line.*

PRICE LINING. **Price lining** is a technique that greatly simplifies the pricing function Under this system, the manager stocks merchandise in several different price ranges, or price lines. Each category of merchandise contains items that are similar in appearance, quality, cost, performance, or other features. For example, most music stores use price lines for their DVDs and CDs to make it easier for customers to select items and to simplify stock planning. Most lined products appear in sets of three—good, better, and best—at prices designed to satisfy different market segment needs and incomes.

LEADER PRICING. Leader pricing is a technique in which the small retailer marks down the customary price (i.e., the price consumers are accustomed to paying) of a popular item in an attempt to attract more customers. The company earns a much smaller profit on each unit because the markup is lower, but purchases of other merchandise by customers seeking the leader item often boost sales and profits. In other words, the incidental purchases that consumers make when shopping for the leader item boost sales revenue enough to offset a lower profit margin on the leader. Grocery stores frequently use leader pricing.

leader pricing—*a technique that involves marking down the normal price of a popular item in an attempt to attract more customers who make incidental purchases of other items at regular prices.*

GEOGRAPHICAL PRICING. Small businesses whose pricing decisions are greatly affected by the costs of shipping merchandise to customers across a wide range of geographical regions frequently employ one of the geographical pricing techniques. For these companies, freight expenses comprise a substantial portion of the cost of doing business and may cut deeply into already narrow profit margins. One type of geographical pricing is **zone pricing**, in which a small company sells its merchandise at different prices to customers located in different territories. For example, a manufacturer might sell at one price to customers east of the Mississippi and at another to those west of the Mississippi. The United States Postal Service's varying parcel post charges offer a good example of zone pricing. A small business must be able to show a legitimate basis (e.g., differences in selling or transporting costs) for the price discrimination or risk violating Section 2 of the Clayton Act.

zone pricing—*a technique that involves setting different prices for customers located in different territories because of different transportation costs.*

Another variation of geographic pricing is uniform **delivered pricing**, a technique in which a firm charges all of its customers the same price regardless of their location, even though the cost of selling or transporting merchandise varies. The firm calculates the proper freight charges for each region and combines them into a uniform fee. The result is that local customers subsidize the firm's charges for shipping merchandise to distant customers.

delivered pricing—*a technique in which a company charges all customers the same price regardless of their locations*

A final variation of geographical pricing is **FOB-Factory**, in which the small company sells its merchandise to customers on the condition that they pay all shipping costs. In this way, the company can set a uniform price for its product and let each customer cover the freight costs.

FOB-Factory—*a pricing method in which a company sells merchandise to customers on the condition that they pay all shipping costs.*

OPPORTUNISTIC PRICING. When products or services are in short supply, customers are willing to pay more for products they need. Some businesses use such circumstances to maximize short-term profits by engaging in price gouging. Many customers have little choice but to pay the higher prices. **Opportunistic pricing** may backfire, however, because customers know that unreasonably high prices mean that a company is exploiting them. For example, after the devastating Los Angeles earthquake, one convenience store jacked up prices on virtually every item, selling small bottles of water for $8 each. Neighborhood residents had no choice but to pay the higher prices. After the incident, many customers remembered the store's unfair prices and began to shop elsewhere. The convenience store's sales slipped and never recovered.

opportunistic pricing—*a pricing method that involves charging customers unreasonably high prices when goods or services are in short supply.*

DISCOUNTS. Many small business managers use **discounts or markdowns**—reductions from normal list prices—to move stale, outdated, damaged, or slow-moving merchandise. A seasonal discount is a price reduction designed to encourage shoppers to purchase merchandise before an upcoming season. For instance, many retail clothiers offer special sales on winter coats in midsummer. Some firms grant purchase discounts to special groups of customers, such as senior citizens or students, to establish a faithful clientele and to generate repeat business. For example, one small drugstore located near a state university offered a 10 percent student discount on all purchases and was quite successful in developing a large volume of student business.

discounts (markdowns)—*reductions from normal list prices.*

Multiple unit pricing is a promotional technique that offers customers discounts if they purchase in quantity. Many products, especially those with relatively low unit value, are sold using multiple unit pricing. For example, instead of selling an item for 50 cents, a small company might offer five for $2.

multiple unit pricing—*a technique offering customers discounts if they purchase in quantity.*

SUGGESTED RETAIL PRICES. Many manufacturers print suggested retail prices on their products or include them on invoices or in wholesale catalogs. Small business owners frequently follow these suggested retail prices because this eliminates the need to make a pricing decision. Nonetheless, following prices established by a distant manufacturer may create problems for the small firm. For example, a haberdasher may try to create a high-quality, exclusive image through a prestige pricing policy, but manufacturers may suggest discount outlet prices that are incompatible with the small firm's image. Another danger of accepting the manufacturer's suggested price is that it does not take into consideration the small firm's cost structure or competitive situation. A manufacturer cannot force a business to accept a suggested retail price or require a business to agree not to resell merchandise below a stated price because such practices violate the Sherman Antitrust Act and other legislation.

7-A. Explain the pricing methods and strategies for retailers.

PRICING STRATEGIES AND METHODS FOR RETAILERS

As customers have become more price conscious, retailers have changed their pricing strategies to emphasize value. This value/price relationship allows for a wide variety of highly creative pricing and marketing practices. As discussed previously, delivering high levels of recognized value in products and services is one key to retail customer loyalty.

Markup

markup (or markon)—*the difference between the cost of a product or service and its selling price.*

The basic premise of a successful business operation is selling a good or service for more than it costs. The difference between the cost of a product or service and its selling price is called **markup** (or **markon**). Markup can be expressed in dollars or as a percentage of either cost or selling price:

$$\text{Dollar markup} = \text{Retail price} - \text{Cost of merchandise}$$

$$\text{Percentage (of retail price) markup} = \frac{\text{dollar markup}}{\text{retail price}}$$

$$\text{Percentage (of cost) markup} = \frac{\text{dollar markup}}{\text{cost of unit}}$$

For example, if a man's shirt costs \$15, and the manager plans to sell it for \$25, markup would be as follows:

$$\text{Dollar markup} = \$25 - \$15 = \$10$$

$$\text{Percentage (of retail price) markup} = \frac{\$10}{\$25} = \$40\%$$

$$\text{Percentage (of cost) markup} = \frac{\$10}{\$15} = 66.67\%$$

Notice that the cost of merchandise used in computing markup includes not only the wholesale price of the merchandise but also any incidental costs (e.g., selling or transportation charges) that the retailer incurs and a profit minus any discounts (quantity, cash) that the wholesaler offers.

Once a business owner has a financial plan, including sales estimates and anticipated expenses, she can compute the firm's initial markup. The initial markup is the *average* markup required on all merchandise to cover the cost of the items, all incidental expenses, and a reasonable profit:

$$\text{Initial dollar markup} = \frac{\text{operating expenses} + \text{reductions} + \text{profits}}{\text{net sales} + \text{reductions}}$$

where operating expenses are the cost of doing business, such as rent, utilities, and depreciation; and reductions include employee and customer discounts, markdowns, special sales, and the cost of stockouts.

For example, if a small retailer forecasts sales of \$380,000, expenses of \$140,000, and \$24,000 in reductions, and she expects a profit of \$38,000, the initial markup percentage will be:

$$\text{Initial markup percentage} = \frac{140{,}000 + 24{,}000 + 38{,}000}{380{,}000 + 24{,}000} = 50\%$$

This retailer, thus, knows that an average markup of 50 percent is required to cover costs and generate an adequate profit.

Some businesses employ a standard markup on all of their merchandise. This technique, which is usually used in retail stores carrying related products, applies a standard percentage markup to all merchandise. Most stores find it much more practical to use a flexible markup, which assigns various markup percentages to different types of products. Because of the wide range of prices and types of merchandise they sell, department stores frequently rely on a flexible markup. It would be impractical for them to use a standard markup on all items because they have such a divergent cost and volume range. For instance, the markup percentage for socks is not likely to be suitable as a markup for washing machines.

Once an owner determines the desired markup percentage, she can compute the appropriate retail price. Knowing that the markup of a particular item represents 40 percent of the retail price

$$\begin{aligned}\text{Cost} &= \text{retail price} - \text{markup}\\ &= 100\% - 40\%\\ &= 60\% \text{ of retail price}\end{aligned}$$

And assuming that the cost of the item is \$18.00, the retailer can rearrange the percentage (of retail price) markup formula:

$$\text{Retail price} = \frac{\text{dollar cost}}{\text{percentage cost}}$$

Solving for retail price, the retailer computes a price of the following:

$$\text{Retail price} = \frac{\$18.00}{0.60} = \$30.00$$

Thus, the owner establishes a retail price of \$30.00 for the item using a 40 percent markup.

Finally, retailers must verify that the retail price they have calculated is consistent with their planned initial markup percentage. Will it cover costs and generate the desired profit? Is it congruent with the firm's overall price image? Is the final price in line with the company's strategy? Is it within an acceptable price range? How does it compare to the prices charged by competitors? And, perhaps most important, are the customers willing and able to pay this price?

Follow-the-Leader Pricing

Some small companies make no effort to be price leaders in their immediate geographic areas and simply follow the prices that their competitors establish. Entrepreneurs wisely monitor their competitors' pricing policies and individual prices by reviewing their advertisements or by hiring part-time or full-time comparison shoppers. But then these retailers use this information to establish a "me too" pricing policy, which eradicates any opportunity to create a special price image for their businesses. Although many retailers must match competitors' prices on identical items, maintaining a follow-the-leader pricing policy may not be healthy for a small business because it robs the company of the opportunity to create a distinctive image in its customers' eyes.

Below-Market Pricing

Some small businesses choose to create a discount image in the market by offering goods at below-market prices. By setting prices below those of their competitors, these firms hope to attract a sufficient level of volume to offset the lower profit margins. Many retailers using a below-market pricing strategy eliminate most of the extra services that their above-market-pricing competitors offer. For instance, these businesses trim operating costs by cutting out services like delivery, installation, credit granting, and sales assistance. Below-market pricing strategies can be risky for small companies because they require them to constantly achieve high sales volume to remain competitive.

Adjustable or Dynamic Pricing

For most of the history of business, price was set through face-to-face bargaining. A merchant knew his customers and their price sensitivity and bargaining skills. The result was that the final price for identical merchandise or services could vary significantly. In the mass marketing era of the latter half of the twentieth century when individual identity became blurred, the trend became to have an established "fixed" price for the goods or service.

dynamic pricing—*price is set by the interaction of buyer and seller at the point of purchase.*

With the Internet, the marketplace is beginning to see the reemergence of adjustable or **dynamic pricing**. Computer software is blending the disciplines of microeconomics, mathematics, and psychology into programs capable of analyzing a customer's price sensitivity based on that potential customer's previous purchasing behaviors. The airline and hospitality industries have been employing adjustable pricing for some time. For this reason, people on the same flight may have paid different prices for their tickets. Software firms such as ProfitLogic, Optivo, Enduse.com., Zillant, and KhL Metrics all employ a blending of consumer data with sophisticated mathematical models to help retailers set prices in ways they believe will maximize profits.[61]

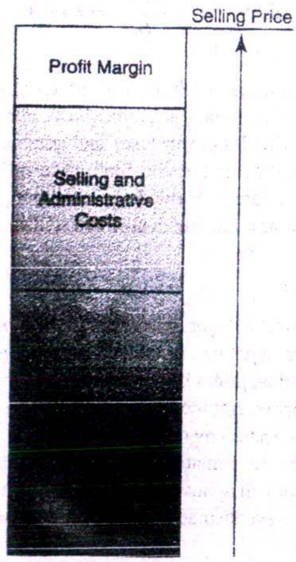
PRICING CONCEPTS FOR MANUFACTURERS

7-B. Explain the pricing methods and strategies for manufacturers.

For manufacturers, the pricing decision requires the support of accurate, timely accounting records. The most commonly used pricing technique for manufacturers is cost-plus pricing. Using this method, the manufacturer establishes a price composed of direct materials, direct labor, factory overhead, selling and administrative costs, plus the desired profit margin. Figure 8.5 illustrates the cost-plus pricing components.

The main advantage of the cost-plus pricing method is its simplicity. Given the proper cost accounting data, computing a product's final selling price is relatively easy. Also, because he adds a profit onto the top of the firm's costs, the manufacturer is guaranteed the desired profit margin. This process, however, does not encourage the manufacturer to use his resources efficiently. Even if the company fails to employ its resources in the most effective manner, it will

FIGURE 8.5 Cost-Plus Pricing Components



still earn a reasonable profit, and thus, there is no motivation to conserve resources in the manufacturing process. Finally, because manufacturers' cost structures vary so greatly, cost-plus pricing fails to consider the competition sufficiently. Despite its drawbacks, the cost-plus method of establishing prices remains prominent in many industries such as construction and printing.

Direct Costing and Price Formulation

One requisite for a successful pricing policy in manufacturing is a reliable cost accounting system that can generate timely reports to determine the costs of processing raw materials into finished goods. The traditional method of product costing is called **absorption costing**, because all manufacturing and overhead costs are absorbed into the finished product's total cost. Absorption costing includes direct materials, direct labor, plus a portion of fixed and variable factory overhead in each unit manufactured. Full absorption financial statements are used in published annual reports and in tax reports and are very useful in performing financial analysis. However, full-absorption statements are of little help to the manufacturer when determining prices or the impact of price changes.

absorption costing—*the traditional method of product costing in which all manufacturing and overhead costs are absorbed into the product's total cost.*

A more useful technique for managerial decision making is **variable (or direct) costing**, in which the cost of the products manufactured includes only those costs that vary directly with the quantity produced. In other words, variable costing encompasses direct materials, direct labor, and factory overhead costs that vary with the level of the firm's output of finished goods. Those factory overhead costs that are fixed (rent, depreciation, insurance) are *not* included in the costs of finished items. Instead, they are considered to be expenses of the period.

variable (direct) costing—*a method of product costing that includes in the product's cost only those costs that vary directly with the quantity produced.*

The manufacturer's goal when establishing prices is to discover the cost combination of selling price and sales volume that covers the variable costs of producing a product and contributes toward covering fixed costs and earning a profit. The problem with using full-absorption costing for this is that it clouds the true relationships among price, volume, and costs by including fixed expenses in unit cost. Using a direct-costing basis yields a constant unit cost for the product no matter what volume of production. The result is a clearer picture of the price–volume–costs relationship.

The starting point for establishing product prices is the direct-cost income statement. As Table 8.7 indicates, the direct-cost statement yields the same net income as does the full-absorption income statement. The only difference between the two statements is the format. The full-absorption statement allocates costs such as advertising, rent, and utilities according to the activity that caused them, but the direct-cost income statement separates expenses into fixed and variable. Fixed expenses remain constant regardless of the production level, but variable expenses fluctuate according to production volume.

When variable costs are subtracted from total revenues, the result is the manufacturer's contribution margin—the amount remaining that contributes to covering fixed expenses and earning a profit. Expressing this contribution margin as a percentage of total revenue yields the firm's contribution percentage. Computing the contribution percentage is a critical step in establishing prices through the direct-costing method. This manufacturer's contribution percentage is 36.5 percent ($288,000 ÷ 790,000).

Computing the Break-Even Selling Price

The manufacturer's contribution percentage tells what portion of total revenues remains after covering variable costs to contribute toward meeting fixed expenses and earning a profit. This manufacturer's contribution percentage is 36.5 percent, which means that variable costs absorb 63.5 percent of total revenues. In other words, variable costs should be 63.5 percent ($1.00 - 0.365 = 0.635$) of the product's selling price. Suppose that this manufacturer's variable costs include the following:

Material	$2.08/unit
Direct labor	$4.12/unit
Variable factory overhead	$0.78/unit
Total variable cost	$6.98/unit

The minimum price at which the manufacturer would sell the item for is $6.98. Any price below this would not cover variable costs. To compute the break-even selling price for this product, use the following equation:

$$\text{Break-even selling price} = \frac{\text{profit (variable cost per unit} \times \text{quantity produced)} + \text{total fixed cost}}{\text{quantity produced}}$$

TABLE 8.7

Full-Absorption Versus Direct-Cost Income Statement

Full-Absorption Income Statement		
Sales Revenue		$790,000
Cost of Goods Sold		
Materials	250,500	
Direct Labor	190,200	
Factory Overhead	120,200	560,900
Gross Profit		$229,100
Operating Expenses		
General and Administrative	66,100	
Selling	112,000	
Other	11,000	
Total Operating Expenses		189,100
Net Income (before taxes)		$ 40,000
Direct-Cost Income Statement		
Sales Revenue (100%)		$790,000
Variable Costs		
Materials	250,500	
Direct Labor	190,200	
Variable Factory Overhead	13,200	
Variable Selling Expenses	48,100	
Total Variable Costs (63.54%)		502,000
Contribution Margin (36.46%)		288,000
Fixed Costs		
Fixed Factory Overhead	107,000	
Fixed Selling Expenses	63,900	
General and Administrative	66,100	
Other Fixed Expenses	11,000	
Total Fixed Expenses (31.39%)		248,000
Net Income (before taxes) (5.06%)		$ 40,000

To break even, the manufacturer assumes $0 profit. Suppose that his plans are to produce 50,000 units of the product and that fixed costs will be $110,000. The break-even selling price is as follows:

$$\text{Break-even selling price} = \frac{\$0 + (\$6.98 \times 50{,}000 \text{ units}) + \$110{,}000}{50{,}000 \text{ units}}$$
$$= \frac{\$459{,}000}{50{,}000 \text{ units}}$$
$$= \$9.18/\text{unit}$$

Thus, $2.20 ($9.18/unit − $6.98/unit) of the $9.18 break-even price contributes to meeting fixed production costs. But suppose the manufacturer wants to earn a $50,000 profit. Then the selling price is:

$$\text{Selling price} = \frac{\$50{,}000 + (\$6.98/\text{units} \times 50{,}000 \text{ units}) + \$110{,}000}{50{,}000 \text{ units}}$$
$$= \frac{\$509{,}000}{50{,}000 \text{ units}}$$
$$= \$10.18/\text{unit}$$

Now the manufacturer must decide whether customers will purchase 50,000 units at $10.18. If not, he must decide either to produce a different, more profitable product or to lower the selling price. Any price above $9.18 will generate some profit, although less than that desired. In the short run, the manufacturer could sell the product for less than \$9.18 if competitive factors so dictated, but not below \$6.98 because this would not cover the variable cost of production.

Because the manufacturer's capacity in the short run is fixed, pricing decisions should be aimed at employing these resources most efficiently. The fixed costs of operating the plant cannot be avoided, and the variable costs can be eliminated only if the firm ceases offering the product. Therefore, the selling price must be at least equal to the variable costs (per unit) of making the product. Any price above this amount contributes to covering fixed costs and providing a reasonable profit.

Of course, over the long run, the manufacturer cannot sell below total costs and continue to survive. So, selling price must cover total product cost—both fixed and variable—and generate a reasonable profit.

PRICING STRATEGIES AND METHODS FOR SERVICE FIRMS

7-C. Explain the pricing methods and strategies for service firms.

A service firm must establish a price based on the materials used to provide the service, the labor employed, an allowance for overhead, and a profit. As in the manufacturing operation, a service firm must have a reliable, accurate accounting system to keep a tally of the total costs of providing the service. Most service firms base their prices on an hourly rate, usually the actual number of hours required to perform the service. Some companies, however, base their fees on a standard number of hours, determined by the average number of hours needed to perform the service. For most firms, labor and materials comprise the largest portion of the cost of the service. To establish a reasonable, profitable price for service, a small business owner must know the cost of materials, direct labor, and overhead for each unit of service. Using these basic cost data and a desired profit margin, an owner of a small service firm can determine the appropriate price for the service.

Consider a simple example for pricing a common service—television repair. Ned's T.V. Repair Shop uses the direct-costing method to prepare an income statement for exercising managerial control (see Table 8.8). Ned estimates that he and his employees spent about 12,800 hours in the actual production of television service. So total cost per productive hour for Ned's T.V. Repair Shop comes to the following:

$$\frac{\$172{,}000}{12{,}800 \text{ hours}} = \$13.44/\text{hour}$$

Now Ned must add in an amount for his desired profit. He expects a net operating profit of 18 percent on sales. To compute the final price he uses this equation:

$$\begin{aligned}\text{Price per hour} &= \text{total cost per productive hour} \times \frac{1.00}{(1.00 - \text{Net profit target as \% of sales})}\\ &= \$13.44 \times 1.219\\ &= \$16.38/\text{hour}\end{aligned}$$

A price of \$16.38 per hour will cover Ned's costs and generate the desired profit. The wise service shop owner computes his cost per production hour at regular intervals throughout the year. Rapidly

TABLE 8.8

Direct-Cost Income Statement, Ned's T.V. Repair Shop

Sales Revenue		\$199,000
Variable Expenses		
Labor	\$52,000	
Materials	40,500	
Variable Factory Overhead	11,500	
Total Variable Expenses		104,000
Fixed Expenses		
Rent	\$ 2,500	
Salaries	38,500	
Fixed Overhead	27,000	
Total Fixed Expenses		68,000
Net Income		\$27,000

rising labor costs and material prices dictate that the service firm's price per hour be computed even more frequently. As in the case of the retailer and the manufacturer, Ned must evaluate the pricing policies of competitors and decide whether his price is consistent with his firm's image.

Of course, the price of \$16.38 per hour assumes that each job requires the same amount of materials. If this is not a valid assumption, Ned must recalculate the price per hour *without* including the cost of materials:

$$\text{Cost per productive hour} = \frac{\$172{,}000 - 40{,}500}{12{,}800 \text{ hours}}$$
$$= \$10.27/\text{hour}$$

Adding in the desired 18 percent net operating profit on sales:

$$\text{Price per hour} = \$10.27/\text{hour} \times \frac{1.00}{(1.00 - 0.18)}$$
$$= \$10.27/\text{hour} \times 1.219$$
$$= \$12.52/\text{hour}$$

Under these conditions Ned would charge \$12.52 per hour plus the actual cost of materials used and any markup on the cost of material. A repair job that takes four hours to complete would have the following price:

Cost of service (4 hours × \$12.52/hour)	\$50.08
Cost of materials	\$21.00
Markup on material (10%)	\$2.10
Total price	\$73.18

8. Describe the impact of credit on pricing.

THE IMPACT OF CREDIT ON PRICING

Consumers crave convenience when they shop, and one of the most common conveniences they demand is the ability to purchase goods and services on credit. Small businesses that fail to offer customers credit lose sales to competitors that do. Yet, companies that do sell on credit incur additional expenses for offering this convenience. Small companies have three options for selling to customers on credit: credit cards, installment credit, and trade credit.

Credit Cards

Credit cards have become a popular method of payment among customers. Approximately 70 percent of the adult U.S. population uses credit cards to make purchases, and the typical U.S. household has 10 credit cards.[62] The number of credit cards in circulation in the United States exceeds 1 billion, an average of about four cards per person! The average customer uses a credit card 5.5 times per month to charge an average of \$547.[63] Customers use credit cards to pay for \$28 out of every \$100 spent on consumable goods and services.[64] One study found that accepting credit cards increases the probability, speed, and magnitude of customer spending. In addition, surveys show that customers rate businesses offering credit options higher on key performance measures such as reputation, reliability, and service.[65] In short, accepting credit cards broadens a small company's customer base and closes sales it would normally lose if customers had to pay in cash.

The convenience of credit cards is not free to business owners, however. Companies must pay to use the system, typically 1 to 6 percent of the total credit card charges, which they must factor into the prices of their products or services. They also pay a transaction fee of 5 to 25 cents per charge. Given customer expectations, small businesses cannot drop major cards, even when the big card companies raise the fees that merchants must pay. Fees operate on a multi-step process. On a \$100 Visa or MasterCard purchase, a processing bank buys the credit card slip from the retailer for \$97.44. Then that bank sells the slip to the bank that issued the card for about \$98.80. The remaining \$1.20 discount is called the interchange fee, which is what the processing bank passes along to the issuing bank. Before it can accept credit cards, a business must obtain merchant status from either a bank or an independent sales organization (ISO).

YOU Be the Consultant . . .

Pricing Web Services

Kerry Pinella, a recent business graduate of a small private college, started her career working for a large multinational computer software maker as a sales representative. After two years in sales, Kerry applied for a position on a development team that was working on software applications for the World Wide Web. Kerry thrived on the team atmosphere and learned the technical aspects of the new assignment very quickly. Not only did her team bring their project in on budget, but it also completed it slightly ahead of schedule. Team members give much of the credit for the project's success to Kerry's unofficial role as team leader. Her work ethic and relentless pursuit of quality inspired other team members.

After Kerry's team completed their project, however, Kerry had a hard time recapturing the thrill and excitement of developing the World Wide Web software. Subsequent projects simply could not measure up to the "magic" of that first assignment. After talking with several of the members of that software team, Kerry discovered that they felt the same way. Before long, Kerry and two of her former team members left the company to launch their own computer consulting company, Web Consultants. Having worked on the forefront of the Web's commercialization, Kerry and her partners saw the potential it had for revolutionizing business. Their company would specialize in developing, designing, and maintaining Web sites for clients. In their first year of business, Web Consultants accepted jobs from virtually anybody who wanted a Web site. Although they experienced some "growing pains," Web Consultants quickly earned a reputation for producing quality work on time and was more selective in the jobs it bid on.

Halfway into their second year of operation, the partners planned a weekend retreat at a nearby resort so they could get away, review their progress, and plan for the future. As they reviewed their latest financial statements, one of the questions that kept popping up dealt with pricing. Were Web Consultants' pricing policies appropriate? Its sales were growing twice as fast as the industry average, and the company's bid-winning ratio was well above that of practically all of its competitors. For the current year, sales were up, but Web Consultants' net profits were virtually the same as they had been in their first year.

Pulling the records from a computer database for each job they had completed since founding the company, the partners and their employees had spent 22,450 hours developing projects for their clients at a total cost of $951,207. "We were shooting for a net profit of 25 percent on sales," Kerry reminded her partners, "but we so far, our net profit margin is just 7.7 percent, only one-third of our target."

"Maybe we could increase our profits if we increased our sales," offered one partner.

The partners began to wonder if their price of $45 per hour was appropriate. Admittedly, they had been so busy completing projects for clients that they had not kept up with what their competitors were charging. Nor had they been as diligent in analyzing their financial statements as they should have been.

As Kerry closed the cover on her laptop computer, she looked at her partners and asked, "What should Web Consultants' hourly price be?"

1. Help Kerry answer the question she has posed.

2. What factors should Kerry and her partners consider when determining Web Consultants' final price?

3. Is the company's current price too low? If so, what signals could have alerted Kerry and her partners?

More small businesses also are equipping their stores to handle debit card transactions, which act as electronic checks, automatically deducting the purchase amount from a customer's checking account. The equipment is easy to install and to set up, and the cost to the company is negligible. The payoff can be big, however, in the form of increased sales. "How can you possibly lose when you're offering customers another avenue for purchasing merchandise?" says Mark Knauff, who recently installed a debit card terminal in his guitar shop.[66]

Installment Credit

Small companies that sell big-ticket consumer durables—such as major appliances, cars, and boats—frequently rely on installment credit. Because very few customers can purchase such items in a single lump-sum payment, small businesses finance them over an extended time. The time horizon may range from just a few months up to 30 or more years. Most companies require customers to make an initial down payment for the merchandise and then finance the balance for the life of the loan. The customer repays the loan principal plus interest on the loan. One advantage of installment loans for a small business is that the owner retains a security interest as collateral on the loan. If a customer defaults on the loan, the owner still holds the title to the merchandise. Because installment credit absorbs a small company's cash, many rely on financial institutions such as banks and credit unions to provide installment credit. When a firm has the financial strength to "carry its own paper," the interest income from the installment loan contract often yields more than the initial profit on the sale of the product. For some businesses, such as furniture stores, this has traditionally been a major source of income.

Trade Credit

Companies that sell small-ticket items frequently offer their customers trade credit—that is, they create customer charge accounts. The typical small business bills its credit customers each month. To speed collections, some offer cash discounts if customers pay their balances early; others impose penalties on late payers. Before deciding to use trade credit as a competitive weapon, the small business owner must make sure that the firm's cash position is strong enough to support the additional pressure.

CHAPTER SUMMARY

1. Describe the basis of a marketing communications plan.

- What is to be achieved with the message?
- Knowledge of the firm's targeted market to ensure that the message is properly focused.
- Build the message on the firm's unique selling proposition.

2. Describe the advantages and disadvantages of the various advertising media.

- Advertising.
- Publicity and public relations.
- Hybrid forms of promotion and advertising.
- Personal selling.

3. Describe the advantages and disadvantages of the various advertising media.

- The medium used to transmit an advertising message influences the consumer's perception—and reception—of it.
- Media options include newspapers, radio, television, magazines, direct mail, the World Wide Web, outdoor advertising, transit advertising, directories, trade shows, special events and promotions, and point-of-purchase ads.

4. Discuss four basic methods for preparing an advertising budget.

- Establishing an advertising budget presents a real challenge to the small business owner.
- Here are four basic methods: what is affordable; matching competitors; percentage of sales; objective and task.

5. Explain practical methods for stretching the small business owner's advertising budget.

- Despite their limited advertising budgets, small businesses do not have to take a second-class approach to advertising. Three techniques that can stretch a small company's advertising dollars are cooperative advertising, shared advertising, and publicity.

6. Describe effective pricing techniques for introducing new goods or services and for existing ones.

- Pricing a new product is often difficult for the small business manager, but it should accomplish three objectives: getting the product accepted; maintaining market share as the competition grows; and earning a profit. Generally, there are three major pricing strategies used to introduce new products into the market: penetration, skimming, and sliding down the demand curve.
- Pricing techniques for existing products and services include odd pricing, price lining, leader pricing, geographical pricing, opportunistic pricing, discounts, and suggested retail pricing.

7. Explain the pricing methods and strategies for retailers, manufacturers, and service firms.

- Pricing for the retailer means pricing to move merchandise. Markup is the difference between the cost of a product or service and its selling price. Most retailers compute their markup as a percentage of retail price, but some retailers put a standard markup on all their merchandise; more frequently, they use a flexible markup.

- A manufacturer's pricing decision depends on the support of accurate cost accounting records. The most common technique is cost-plus pricing, in which the manufacturer charges a price that covers the cost of producing a product plus a reasonable profit. Every manufacturer should calculate a product's break-even price, the price that produces neither a profit nor a loss.
- Service firms often suffer from the effects of vague, unfounded pricing procedures and frequently charge the going rate without any idea of their costs. A service firm must set a price based on the cost of materials used, labor involved, overhead, and a profit. The proper price reflects the total cost of providing a unit of service.

8. Describe the impact of credit on pricing.

- Offering consumer credit enhances a small company's reputation and increases the probability, speed, and magnitude of customers' purchases. Small firms offer three types of consumer credit: credit cards, installment credit, and trade credit (charge accounts).

DISCUSSION QUESTIONS

1. What are the four elements of promotion? How do they support one another?
2. Briefly outline the steps in creating an advertising plan. What principles should the small business owner follow when creating an effective advertisement?
3. What factors should a small business manager consider when selecting advertising media?
4. Create a table to summarize the advantages and disadvantages of the following advertising media:

Newspapers	Direct mail
Radio	Outdoor advertising
Television	Transit advertising
Magazines	Directories
Specialty advertising	Trade shows
World Wide Web	Sponsorships and promotions

5. What are fixed spots, preemptible spots, and floating spots in radio advertising?
6. Describe the characteristics of an effective outdoor advertisement.
7. Describe the common methods of establishing an advertising budget. Which method is most often used? Which technique is most often recommended? Why?
8. How does pricing affect a small firm's image?
9. What competitive factors must the small firm consider when establishing prices?
10. Describe the strategies a small business could use in setting the price of a new product. What objectives should the strategy seek to achieve?
11. Define the following pricing techniques: odd pricing, price lining, leader pricing, geographical pricing, and discounts.
12. Why do many small businesses use the manufacturer's suggested retail price? What are the disadvantages of this technique?
13. What is a markup? How is it used to determine individual price?
14. What is a standard markup? A flexible markup?
15. What is cost-plus pricing? Why do so many manufacturers use it? What are the disadvantages of using it?
16. Explain the difference between full-absorption costing and direct costing. How does absorption costing help a manufacturer determine a reasonable price?
17. Explain the technique for a small service firm setting an hourly price.
18. What benefits does a small business get by offering customers credit? What costs does it incur?

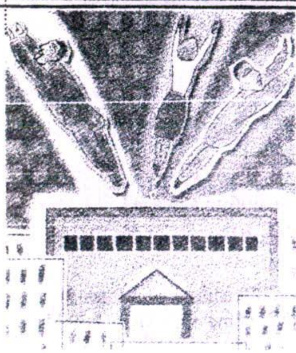
THE BUSINESS DISC

Launch *The Business Disc* and return to the section where Harry describes the basics of pricing. If you have passed that point in the program, you can easily return to it. From the "Go To" menu, select "Events from PART 1 - B," and click on "Harry on Pricing." If you haven't reached that point, continue from where you left off. **Note: If you skip ahead you will not be able to set your price**. Explain Harry's "formula" for setting the price for a product or service. What is a company's break-even point? Explain the factors that influence the price your company can charge for its products or services. If you have not done so already, complete the "Set Your Price Form" on *The Business Disc*. Now that you have read Chapter 8, do you want to change the prices you established? Explain.

BUSINESS PLAN PRO

Business PlanPro

Upon completion of this chapter you will likely need to modify some of the marketing sections in your business plan to provide the reader additional details regarding the advertising, promotion and pricing of your products or services.



1. Contact a small retailer, manufacturer, and a service firm and interview each one about his or her advertising program.

   a. Are there specific advertising objectives?

   b. What media does the owner employ? Why?

   c. How does the manager evaluate an ad's effectiveness?

   d. What assistance does the manager receive in designing ads?

2. Contact several small business owners and determine how they establish their advertising budgets. Why do they use the method they do?

3. Collect two or three advertisements for local small businesses and evaluate them on a scale of 1 (low) to 10 (high) using the following criteria: attention-getting, distinctive, interesting, brevity, personal appeal, credibility, USP focused, convincing, motivating, and effectiveness. How would you change the ads to make them more effective?

4. Browse through a magazine and find two ads that use sex to sell a good or service—one that you consider effective and one that you consider offensive. Compare your ads and reasoning with those of your classmates. What implications does your discussion have for advertisers?

5. Interview a successful small retailer and ask the following questions: Does the retailer seek a specific image through its prices? What type of outlet would you consider the retailer to be? What role do its competitors play in the business owner's pricing? Does the owner use specific pricing techniques such as odd pricing, price lining, leader pricing or geographical pricing? How are discounts calculated? What markup percentage does the firm use? How are prices derived? What are the firm's cost structures?

6. Select an industry that has several competing small firms in your area. Contact these firms and compare their approaches to determining prices. Do prices on identical or similar items differ? Why?

7. Use the Web to research the use of cookies in online advertising. What benefits do cookies offer Web users? Web advertisers? What ethical concerns do you have concerning cookies? Explain. Should marketers be able to use cookies?