CHAPTER ONE PART 2

The power of marketing – the law of supply and demand

The power of marketing – the law of supply and demand

Synopsis

Part 2 sets out to examine how the law of supply and demand will determine which of the three main business orientations an organization must adopt in order to succeed. In conjunction with the first part of this chapter it will establish why a marketing orientation is essential for the successful running of most businesses today.

Introduction

As a method of generating sales revenue, however, marketing is not the be-all and end-all of running a business. There are at least two other business philosophies which are capable of producing lots of revenue profitably under the right circumstances. Indeed, marketing can be said to be the least favoured option in that as a business concept it is the most difficult to put into practice, it requires special and scarce talent. It is also the most expensive way to operate. If a company does not have to adopt a marketing stance, then the 'best advice' is that it should not bother. The problem is, however, that the circumstances under which any alternative to marketing can be adopted, are getting fewer and further between. What are these alternatives, and under what circumstances would they prove more profitable than marketing? To address that question we have to start at the very basic link in the chain of business, the process from which profit is derived.

The basic link in the chain

Like all good ideas, the way that profit is derived is quite a simple concept, it is the practice that can prove hellishly difficult. The principle is to buy well, and to sell well, such that the total costs incurred by the company are more than covered by the income derived from what that company sells. When income is greater than expenditure, the company is profitable, when income does not cover expenditure the company is making a loss and under all normal circumstances it will eventually fail.

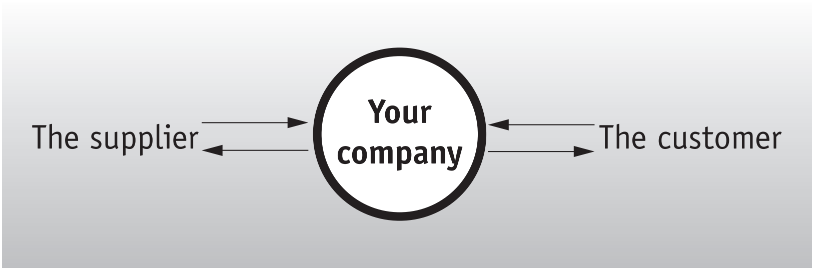


FIGURE 1.6: THE ESSENTIAL DYNAMIC

The essential dynamic therefore as shown in Figure 1.6 is but one link in a chain which stretches from the raw material producer to the eventual consumer. At this point it is worth taking short diversions down two tributaries:

- In business to business situations, i.e. where the customer is another company, it is the consumer markets at the end of the chain that initiate the demand from which the company will eventually derive its income (*there is only one exception to this rule that we know of, the defence industry*).
- At both interfaces between the company and its suppliers, and between the company and its customer, there is a struggle as each party tries to get the best possible deal for themselves.

The company is in turn, both a customer of its suppliers, and a supplier of its customers. (*To leap ahead for a moment, even before we have defined what marketing is, it can be seen from this that the customer can in no way be regarded as a passive element in this process. Therefore, the* *conventional view of marketing, 'what sellers do to buyers,' can be very misleading. The more useful view is that marketing is what sellers* ***and*** *buyers do between themselves.*)

Hard/sellers markets

If the business situation is as portrayed by Figure 1.6, there is not really a market. For a market to exist there has to be alternative suppliers and alternative customers.

This Figure 1.6 situation is therefore a monopoly, i.e. a 'hard' market. The supplier and the company are 'the only game in town'; the customer has no other source of supply and must pay the price demanded, or go without.

Where a few suppliers exist and there are many customers, the situation is hardly any better, this we call an oligopoly. An example of these types of business situations are to be found in the UK and EU telecomms industries. BT (British Telecoms) and Vodafone being the main carriers in the UK and each other EU country having rarely more than two other carriers additional to the former state monopoly. (*Throughout the world this is changing as more and more governments open up their mobile/wireless telephony to more and more competition, via the issuing of licences to companies other than their indigenous state telecoms.*) Another example is the UK utilities industries where formerly the ordinary person had to take their water, gas or electrical power from the one pertinent local supplier available, but can now shop around.

'Hard markets' provide a vendor with the greatest freedom to manoeuvre. However, the monopoly (or ologopolistic) company in the 'market' will most often pursue profit maximization via the adoption of one (or a combination) of two available strategies, which in no particular order are:

- screwing down costs as far as possible, and
- 'jacking-up' prices as much as possible (i.e. an efficiency strategy re. Figure 1.3).

Freedom to manoeuvre in the first stratagem may be constrained by legislative imperatives, possibly including quality specifications.

On the second issue, monopolies/oligopolies will restrict their capacity so that 'supply' is always less than underlying demand. That way, price can be used as a tool to manage real demand (*i.e. a 'want' with the money to pay for it*). Price is raised to the point where demand falls off to meet the capacity available. There is no sense for a monopolist to invest in new plant and equipment so as to increase capacity. Such investment only makes sense if it leads to substantial reductions in the cost of production.

The key question for a business to address in a 'hard market' is:

How does the business produce more, efficiently?*

This approach to running the business is alternatively referred to as:

- production orientation if producing goods, or
- operations orientation if providing a service.

These companies have little if any intrinsic need for marketing, they have no competitors, and if the customer does not like what they are offering at the price demanded, there will be plenty more customers who may not be so inhibited.

Footnote: * (the comma can be before or after the word 'more' – it's true to both senses)

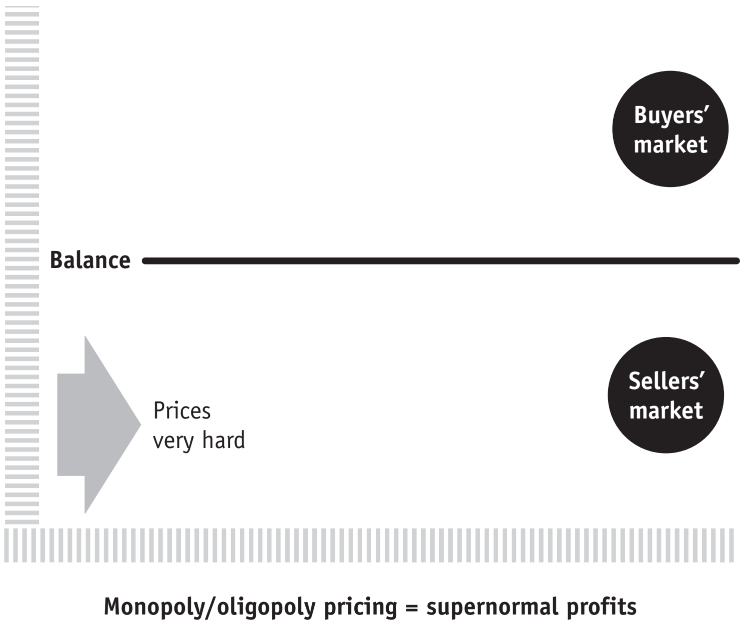


FIGURE 1.7: LAW OF SUPPLY AND DEMAND, PT1

Figure 1.7 shows this situation. Below the horizontal central axis, markets are under supplied, they are therefore sellers markets and there is no pressure on prices. Such companies are said to operate in 'hard markets', that is to say prices are hardened, because customers can do very little by way of getting a price concession.

What small amount of marketing may be exercised by oligopolies or monopolies is usually aimed at increasing traffic, particularly at slack times so as to increase the utilization of capacity.

An example of this would be BT promoting very cheap (late evening or very early morning) calls to friends and relations in Australia. The call traffic so generated will use exchange capacity that would otherwise be lying idle at that time of day in the UK.

Occasionally some oligopoly/monopoly companies may adopt a marketing orientation, but this is usually because they are subject to indirect competition, i.e. prospect customers are experiencing competitive demands on their limited resources of time and/or money. For example, what the customer (or prospect) spends on his/her mortgage, they are unable to spend on new gas appliances etc.

N.B. A 'PROSPECT' is a known member of the population toward whom the 'company' is targeting its sales efforts, but has yet not purchased.

As they are operating in hard and sellers markets, such companies will be inherently more profitable than those that are not so privileged.

Most oligopoly/monopoly situations are re-enforced by, if not actually established, in law. Such things as the old General Post Office monopoly for the distribution of letters, or the operation of the telephone system, or the Pilkington's Patent on the float glass method for producing window glass are just three from many examples. This legislation keeps competitors out of the 'frame', but when it is removed they swarm in like bees to the honey pot, to share in the potentially greater profitability.

Supply = demand, therefore sales orientation

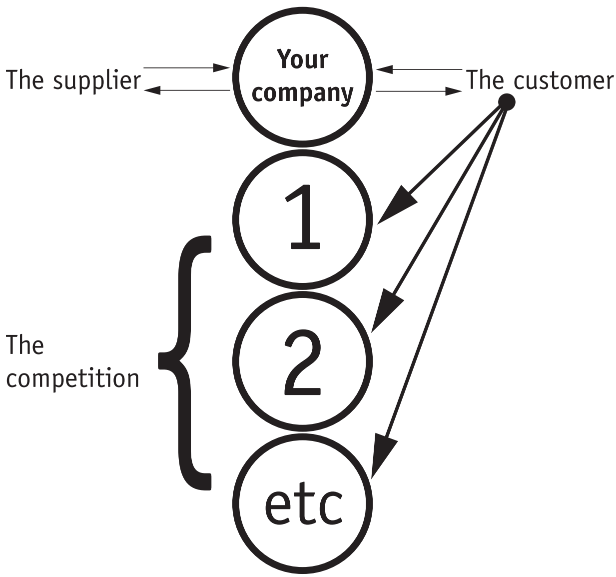


FIGURE 1.8: CREATING COMPETITION

Figures 1.8 and 1.9 show the situation. New companies entering the market increase supply. Prospects and customers can now canvas alternative suppliers, the effect is thus to create competition. Eventually this competition starts to soften prices.

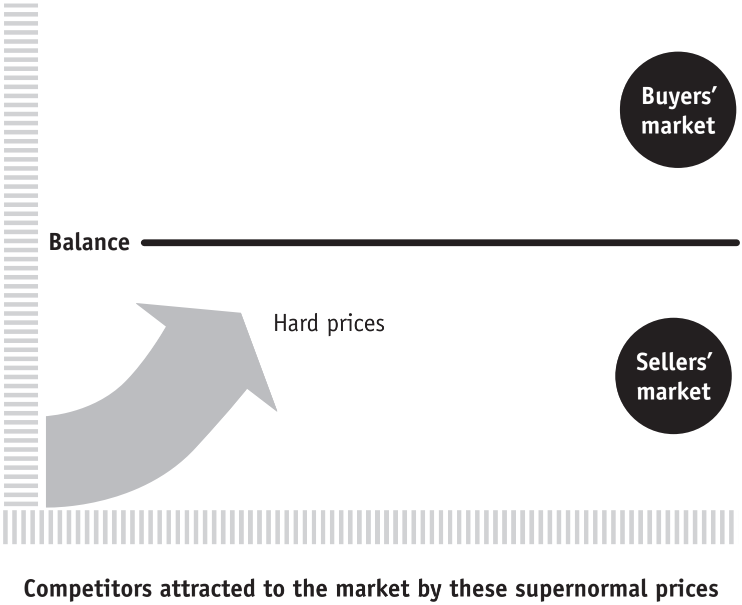


FIGURE 1.9: LAW OF SUPPLY AND DEMAND, PT 2

Whilst supply and demand are in a reasonable balance, however, there are alternatives to competing on price, the most popular of which is for the company to 'promote' its wares more effectively than the competition.

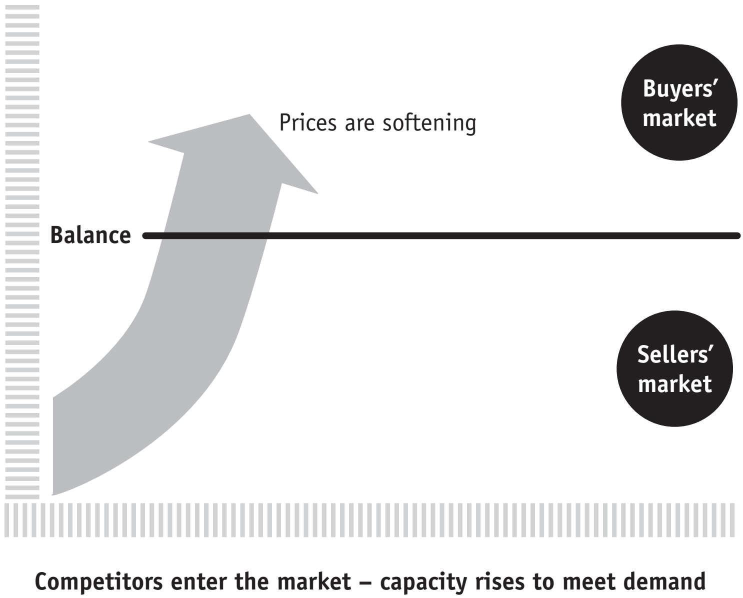


FIGURE 1.10: LAW OF SUPPLY AND DEMAND, PT 3

The key question for a business to address when there is a balance between supply and demand is:

How do we persuade prospects to purchase from us rather than our competitors?

The main aim for such promotion at this stage in the game is to persuade the prospect or customer to buy from the promoter in preference to anyone else. When this is the case we refer to the company as being 'sales oriented'.

Advertising is a child of sales orientation; it is not marketing per se though it is one of the tools of marketing as we will see. Advertising is only one of the many and varied elements of the promotional mix available to business. The job of promotion is to 'move the customer along the buying process' toward the promoter rather than the competition. In simple terms, promotion accomplishes its task via making a sales proposition to the prospect.

The Lever proposition last century, that 'Cleanliness is next to Godliness', persuaded the working class chapel goers of the North West to wash a little more often, especially on Sundays, and as a result a tremendous amount of Sunlight soap was sold. However, anyone could have claimed as much, and indeed the sales of soap so stimulated were not confined to 'Sunlight', but increased the whole market.

Oversupply brings the danger of commodity trading

As is illustrated in Figure 1.10, because markets are essentially an expression of human behaviour, like the various 'Gold Rush' episodes of the last century, the numbers of people (and through them businesses) drawn to a given commercial opportunity are not at first limited to the purchasing capacity of the market. Almost always more supply enters the newly identified opportunity than the market can bear, with the result that very soon the market is oversupplied with a vengeance and customers are spoilt for choice.

This excess of choice allows the customer to become an active arbiter within the market place. The customer shops around and directly or indirectly plays one supplier off against another.

At this point suppliers will need to compete in order to survive, and the natural tendency is for severe price competition to take place as more and more suppliers chase fewer and fewer buyers. Unless suppliers take a firm hold on the situation, price will become the focus of competition because buyers are out for a better deal, and they will try to simplify the task of buying so as to obtain the best price for:

- **a given** (common?) **specification**, and
- **a given** (common?) **availability**.

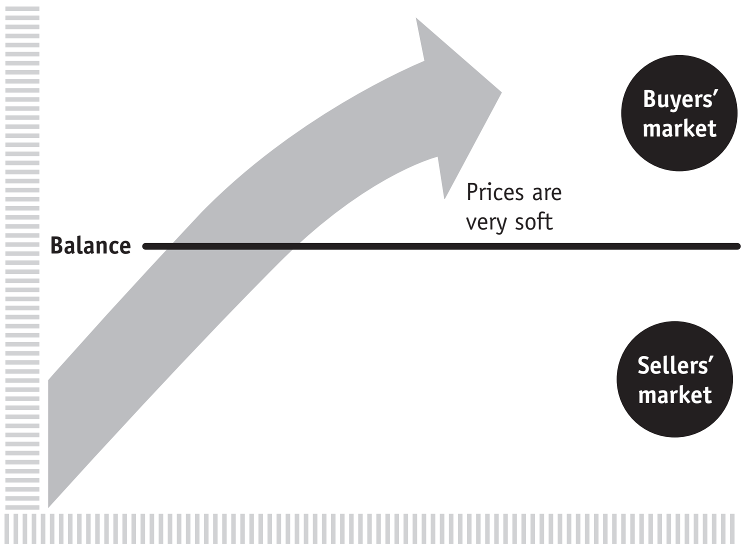
Specification and availability are made common in order for the buyer to be able to compare like with like.

In a buyers' market, prices are said to be soft because the buyer drives down the price with little if any regard for the suppliers' welfare.

These conditions are known as Commodity Trading. Unless companies adopt deliberate positive strategies to counteract these natural forces, all markets will tend toward this direction.

The consequences of this are shown in Figures 1.11 and 1.12.

The weakest companies will collapse as downward pressure on prices erode profit margins, capacity will be reduced, and as capacity falls dramatically below demand – it becomes a sellers' market once more.



The market is saturated and buyers are spoilt for choice

FIGURE 1.11: LAW OF SUPPLY AND DEMAND, PT 4

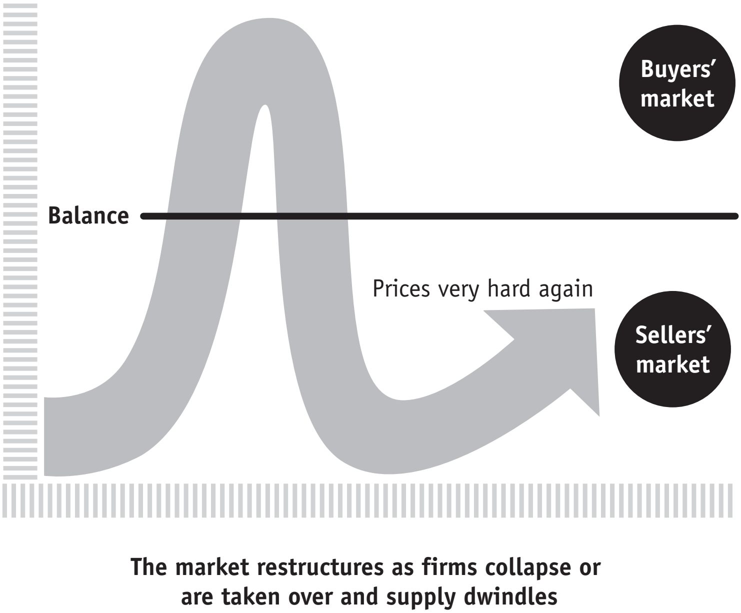


FIGURE 1.12: LAW OF SUPPLY AND DEMAND, PT 5

This is one of the basic business cycles, it is as old as commerce, and was noted by Adam Smith in his *Wealth of Nations*. The periodicity of the cycle depends upon the individual characteristics of the industry in question.

Surviving oversupply

There are basically only two ways to survive 'commodity trading' so as to be one of the few companies that enjoy the fruits of the hard markets to come.

The first, and most favoured is 'agglomeration', because traditionally this has been the most easy to adopt and to apply. Agglomeration is where companies come together, usually by acquisition, so that existing fat and/or muscle is used to obtain more fat and muscle; so as to ensure that companies end up with more power and endurance than the competition.

This process creates so called conglomerates. Some of the world's major commercial empires are thus formed. The most successful of these empires, like the Hanson Trust, are those which have adopted strategies to spread risk and areas of interest. These behemoths spread their range of acquired businesses across a number of counter-cyclical markets. This is to ensure that companies in the group that are going through the rough time of 'soft markets', can be supported by those in the group, which at that time, are enjoying the better profitability of 'hard markets'.

The second stratagem, and the only one open to the smaller company when entering 'soft markets', is to focus the business on the needs of the customer, by asking the third type of seminal question:

What do our (potential) customers want, and are willing to pay for at a price, that allows us to supply at a profit?

This is commonly known as a MARKETING ORIENTATION.

The marketing concept introduced

Thus, instead of the business offering the market what it wants to produce, it produces what the customer wants to buy! An apparently simple concept, but like most good ideas is often more easy to preach than to practise. The key issue at the heart of a 'marketing orientation' is what can be called the 'competitive edge', in other words, what makes the company's offering so different from that of the opposition? A sales orientation makes propositions to the market based on the company's perspective. Whereas the marketer will base the proposition on a competitive edge that is valuable to the customer. (Formally known as the 'Competitive Differential Advantage' – CDA.)

To illustrate via the use of a consumer good, – say, frozen peas:

The '**sales-oriented**' company would make propositions that their peas were bigger (or smaller), greener, fresher, withstood freezing longer, etc than the competition. They may even go on to offer special deals such as: This week's special offer: *buy two packs and get one free*; *collect the packets to get a special premium 'gift'*; (or if business to business) *free delivery etc*. The list can be as long and as ingenious as the mind is fertile.

The '**marketing oriented**' company will first ask the prospective customer (i.e. prospect) what they wished to use the peas for, and then base their product and offering on satisfying the needs thus revealed.

So that for business to business:

- The restaurateur will be offered petit-pois to delight the most jaded pallet (because he/she is buying customer satisfaction for their restaurant, not peas).
- The hospital dietician will be offered peas that meet the nutritional requirements of the nursing regime.
- The local education authority will be offered peas for school dinners that will retain texture for up to three hours to allow for central cooking and subsequent distribution and when the kids get to them – are guaranteed bullet proof.

And for consumers:

- The mothers of families will be offered:
  - economy packs for the freezer,
  - peas mixed with diced carrots for attractive meals,
  - sugar-snaps for that intimate 'tête-à-tête' meal with hubby, after a long week, when the kids are in bed.
- Those on their own, such as pensioners, and the like will be offered:
  - single portion packs,
  - perhaps products suitable for the microwave.

This approach, tailoring the competitive edge to the needs of the prospect, is primarily aimed at defending price by creating a differential which is not only attractive to the customer, but also inhibits the potential customer's ability to compare like with like when shopping around. It really works well, when the prospect believes that the value of the perceived differential is worth any extra price (or whatever else they may have to forego) in order to acquire the offering.

The critical issue for a marketing orientation is:

To know what the prospect/customer wants, and what price they are willing to pay for it.

However, **not** only is this difficult in itself, but in addition, the three questions below are NOT mutually exclusive for the marketer:

- How do we produce/operate more efficiently?
- How do we persuade people to buy from us?
- What do people want, that they are willing to pay for?

In order to be successful, the marketer will see these central questions as being critically interdependent, in that:

- no matter how good the competitive differential, if customers are not made aware of:
  - its existence,
  - how and where it can be obtained, and
  - for how much money (*raising this awareness being in the realm of sales activity*) they will not be able to buy, and no matter how good the sales, if the costs of production/operation are not under control, the company can, and often will, bleed to death.

So far this argument has established that, for optimum business results, a company should adopt the business orientation appropriate for the stage of the supply and demand cycle applying to its market at that time.

If supply and demand were the only consideration, companies without the muscle necessary to dominate their market, should be flexible enough to stay in step with, though perhaps slightly ahead of, their markets supply and demand cycle. However, as we shall see in Chapter 6, there are forces in addition to 'supply and demand' that ensure that nowadays most companies have little option other than to adopt a marketing orientation if they wish to do more than just 'scrape by'.