The Regis McKenna Inc.
Professional Development Series

MARKETING TRANSFORMATION: THE PROCESS OF CONTINUING CHANGE THAT DRIVES MARKET LEADERSHIP

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The Regis McKenna Inc. Professional Development Series is designed to explore the application of significant concepts in the professions of marketing and communication in technology-based markets. This paper, the second in a series, explores the use of the adoption process in marketing technology-based products and services.

Foreword

The professions of marketing and communications have come under fire in recent years, particularly by those who see "public relations" as manipulation of the press and marketing as manipulation of customers and potential customers. While some of the criticism is deserved, much of it is not.

The disciplines of marketing and communications have excellent factual foundations. They are based on solid research on human behavior, both individuals and groups.

This Regis McKenna Professional Development Series is designed to revisit many of the factual bases for our work, and to update and translate classic marketing and communications work to modern terminology and practice.

This particular volume in the series deals with one of the areas where both marketing and communications knowledge and skills must be used in order to achieve success: the use of word-of-mouth to successfully market emerging products. It is one of the most visible points in our profession where neither the marketer nor the communicator can succeed without the other. It is also one of the most challenging and daunting tasks professionals in the field ever face. When done well, it provides results far beyond the norm, and provides a level of personal and professional satisfaction that more than compensates for the normal failures and frustrations of the profession.

Lee R. James
Portland, Oregon
March, 1989

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Marketing Transformation

To many entrepreneurs, a goal of building a $25 million company appears to be too small. Venture capitalists look for a company that can grow to at least $100 million, and go public. Yet the facts argue that achieving just a $25 million level of business is a major achievement. For perspective, the average sales per business firm in the United States in 1987 was $210,000[1].

Only six in every 1,000 businesses achieve revenues of $25 million. The other 994 either fail or peak at less than $25 million[2]. Lack of focus on marketing transformation is at the root of much of the failure.

The consulting business provides an excellent perspective on the attempts of many companies to achieve growth and leadership. There are few successes, relatively few failures, and a large number of firms that are neither wholly successful, nor wholly failures.

It is the "might have beens" that are the most disturbing. For many of these companies, a slightly better job of marketing management could have helped the company leap the $25 million barrier.

From this perspective, the most difficult thing for an entrepreneur to accomplish is *to* *build a long-term, distinctive position that results in a sustaining enterprise.*

Timing and luck always have a role in the determination of success. But the quintessence of building a long-term, distinctive and sustainable position is the ability to understand and act on the continuing need for *transformation–particularly marketing transformation.*

Transformation is not alchemy, nor does it require guild membership to understand and practice. Rather, marketing transformation is the continual redirection and renewal of the enterprise that occurs from strategic adaptation to the environment. Since the environment is in constant flux, marketing transformation must continue without end.

The changing environment is a constant source of clues. Interpreting environmental clues requires judgment, analytical skill and creativity. For many entrepreneurs, seeing the clues requires a perspective that is inconsistent with the need to focus on daily operations. Developing perspective is difficult for those whose consuming (and necessary) daily activities are concentrating on the latest order. So perspective is one of the most important qualities a counseler can contribute to entrepreneurs.

There remains the matter of will. For many managers, acting on fuzzy clues requires a leap of faith that is difficult to make, or that is resisted until change becomes inevitable. A continual, gradual transformation is less traumatic to the organization, provides higher returns and lower costs, and is preferable to the organizational earthquakes that affect some companies. The will to make continuing change occur is a prerequisite to breaking the $25 million barrier.

Dynamic Perception: Moving from tangibles to intangibles

Perhaps the best model to understand the need for marketing transformation–understanding changes in a dynamic environment and translating those changes into requirements for the organization to change–is the model of product perceptions.

Typically, when a new organization brings a new product (or service) to market, the initial consumers and users are intrigued with the tangible features of the product itself: its performance, its specifications, its size, color, shape, weight or even "footprint". Moreover, the entrepreneurial team that conceived, developed and first sold the product is–by definition–often consumed by these tangible aspects. Tangible aspects of the product–at the time of introduction–often become the only focus of the development team.

But as the product moves from the lab to development to prototyping to alpha and beta testing to introduction and then to distribution and use, a subtle yet powerful change occurs. Tangible aspects of the product inevitably decline in importance and intangible aspects surrounding the product begin to emerge. In the early days, the overwhelming emphasis on product tangibles can be diagrammed like this:

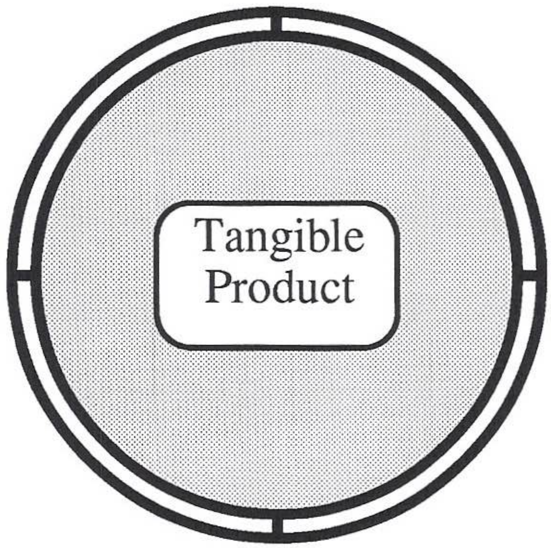

Figure 1

Typically, the product development team focuses on the inner portions of the circle: the tangibles.

But as the product begins to move into the market, and as the markets develop, a change occurs in perceptions of the product: intangibles assume an increasingly larger proportion of the perceived product. The comparison can be illustrated like this:

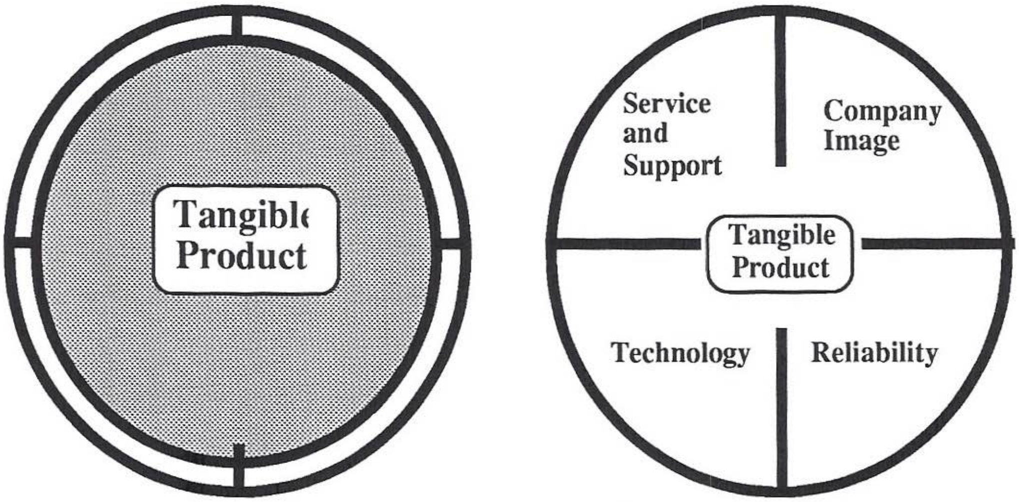

Figure 2

Customers begin with an appreciation of the tangible product, but they soon appreciate more the aspects of intangibles surrounding the product–service and support, the image of the company, the nature of the underlying technology, or the reputation the product begins to build for reliability.

Intangibles developed the copier market

One of the best examples of the power of intangibles is xerography. In the late 1950's, the Haloid Corporation (the predecessor of Xerox Corporation) developed the first dry copier, but ran short of funds for marketing. Haloid approached IBM with the notion that IBM handle distribution. The idea seemed to be a good one, in that IBM had the sales force and service organization that Haloid would otherwise have to establish.

IBM hired Arthur D. Little, Inc. (ADL) to do a study of the market for dry copiers. ADL reported that the entire U.S. potential market was 5,000 machines. The study was used as one of the factors in IBM's decision to reject the Haloid offer.

So, with limited resources, Haloid brought the 914 Xerox copier to market. In the first two years, even though production was constrained, over 10,000 units were placed in use. Twice as many copiers than the predicted potential of the total market were sold. This story, and others like it, demonstrate the power and value of the tangible/ intangible product concept. ADL and IBM looked primarily at the tangible product. Haloid, on the other hand, concentrated more on intangibles. The 914 was sold in a unique way: on the basis of cost per copy. Or, in other words, on an intangible.

A customer could acquire a Xerox 914 for as little as $95 per month, which covered the machine and the first 2,000 copies per month. Additional use was billed on a cost per copy scale.

Customers bought double the projected total market forecast in the first two years primarily on the intangible aspects of the product.

This is but one of many examples of short-sided research that focused more on tangibles than intangibles. It has become a premise of the industry that research cannot uncover a market for a product that does not yet exist.

But this premise is wrong. The problem is not with research, *per se*, but with research that focuses exclusively on the tangible product factors. Good qualitative research, conducted by well-experienced professionals, often can elicit glimpses of markets based on intangible factors that might otherwise be ignored.

The Adoption Process

The concept of dynamic change in the perceptions of products is reinforced by the concept of the adoption process. In 1957, researchers at Iowa State College were able to track the diffusion of information and purchase patterns of a new product: hybrid seed corn.[3] They found that purchase and use (or adoption) behavior fell into understandable patterns. They found that five "segments" of an adoption population could be described. They noted the different characteristics of persons in these five groups, and hypothesized about the way word-of-mouth influences purchase behavior.

Five groups were identified as follows:

- Innovators--2.5% of the population
- Early Adopters--13.5%
- Early Majority--34%
- Late Adopters--34%, and
- Laggards--16%

The research demonstrated a number of elements of purchase behavior, including the dynamic nature of how products are purchased. Innovators, for example, are motivated by being first, while late adopters are primarily interested in a well-proved product. (See Appendix for descriptions of the various segments.)

The primary value of the research was the development of the idea of an "adoption process". New product acceptance could finally be understood and even diagramed.

And the diagrams could be correlated to cumulative unit purchases for a particular product:

The Adoption Process

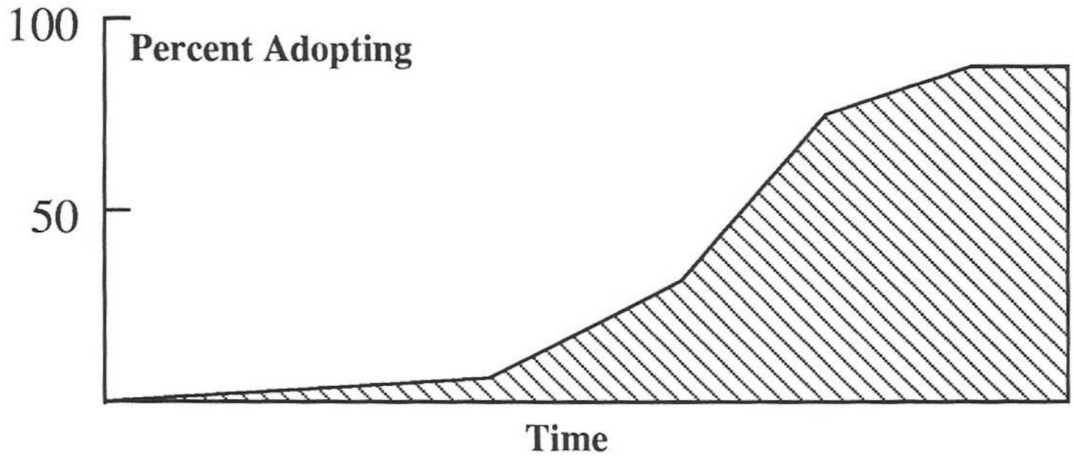

Figure 3.

One of the more significant findings was the length of time required to move through the early stages of adoption. Note in the chart above that virtually one-half of the entire time (the horizontal axis) is used before more than one-third of the potential market adopts the product. *A key objective of marketing, today, is to find ways to accelerate the adoption process in order to compress the early stages of adoption.*

For our purposes, this research can be correlated with the concept of perceived product. The relationship between product tangibles and intangibles shifts dramatically as different stages of the adoption process are achieved.[4] This shift in customer emphasis from tangibles to intangibles can be demonstrated as:

Perceptions of the product change over the life cycle

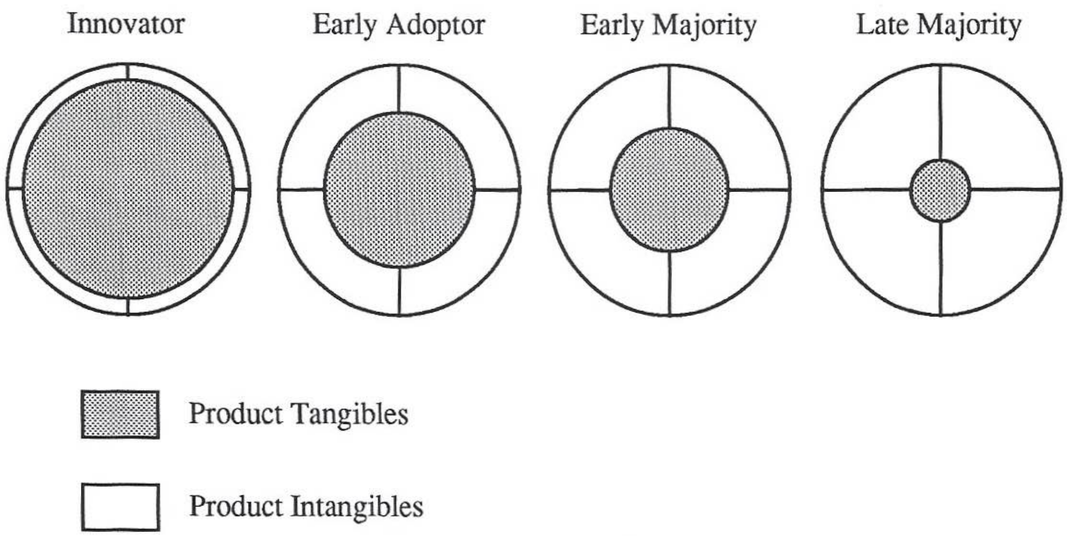

Figure 4

As products move through the adoption process, intangibles assume more importance. Often, pioneering new products lose their initial prominence because a new entrant is more successful in product positioning based on a more effective mix of intangibles. This can be the case even if the second product is not technically superior.

Apple was not the first microcomputer company, nor was the Apple II the first microcomputer. It was the first product to be called a personal computer, but much of the success of Apple, at a cost to MITS, Tandy and others, was the result of emphasis on intangibles.

Similarly, International Business Machines was not the first Mainframe computer company. A number of others were ahead of IBM (generally, Univac is credited as being the first moderately successful Mainframe company). But IBM was ultimately successful in dominating the Mainframe market. The main reason was an appropriate emphasis on intangibles in the early stages of market development. Univac and the others continued to compete mainly on the tangible aspects of the product, even though the situation had changed.

The power of the tangible/ intangible mix of the perceived product is so strong that it can be used to identify markets and product categories where pioneers can be superseded. A number of software categories exist, for example, where the major focus of the suppliers is tangibles. The distribution industry is also ripe for the effective marketing of intangibles.

Other technically-based industries are also vulnerable, particularly ones such as test and measurement where the major suppliers continue to focus primarily on the tangible aspects of performance, specifications and price/performance.

Determining intangibles

In an existing business, with existing products, customers and competitors the process of determining the intangible factors that influence purchasing decisions is relatively simple. It means obtaining answers from customers (and other buying influences, the product's "infrastructure"[5]) to two basic questions:

1. What factors in the purchase and use of this product are important to you?, and

2. How does our product compare on these factors to other alternatives (including related but not directly competitive products)?

This type of research is easy to describe but difficult to do. In our experience, many research efforts fail to achieve adequate answers to the two questions.[6]

When it does, however, the results can be dramatic. In one recent case, interviews with 200 computer hardware customers and potential customers found that users valued the reputation of the supplier, the service and support of the company, the reliability of the product, and the availability of a number of existing software packages as the most important intangible attributes of the product. In fact, the tangible characteristics of the product ranked no higher than sixth in the customer's ranking.

However, this company had based the majority of its marketing and sales messages on tangible product attributes: performance, technology and architecture, and product features.

The research was commissioned only after a year of frustration and declining sales, and after two new competitors had made substantial early inroads into the company's customer base.

After the product perception research was completed and after the company's sales and marketing messages changed to reflect the results, revenues reversed their decline and climbed twenty-four percent the first year, gross margins tripled, and the market value of the company doubled. All of this occurred with only a slight increase in marketing expenditures, and with no *change in the tangible product*.

Not all cases are this positive, of course. But enough of them are to demonstrate the power of marketing product intangibles.

Simple in concept as this type of customer focused research is, it rarely appears in the literature of the technology industry. One exception is the ongoing research of the Gartner Group, Inc., who publish an annual Large Systems Survey. This research, for which six years of data are available, further supports the importance of intangibles:

Figure 5

Gartner Group, Inc. Large Systems Survey
Factors Affecting CPU Acquisitions:

	Research conducted in 4Q88	4Q87	4Q86	4Q85
Reliability	1.3	1.3	1.3	1.1
Performance	1.6	1.6	1.6	1.5
Service	1.9	2.0	1.7	1.3
Price	2.1	2.1	2.2	2.2
Upgradability	2.3	2.2	2.2	2.1
Reputation	2.5	2.3	2.2	1.7
Technology	2.8	2.6	2.6	2.4
Environmentals	3.3	3.2	3.3	2.8
Footprint	3.6	3.4	3.3	3.0

Key: 1=Most important, 5=Least important
Source: Gartner Group

Determining the product intangibles and converting the knowledge into messages and programs is easiest in an existing market where competition is strong, such as the example cited above.

The process also works in in emerging businesses and in turn-arounds, but the situations are different.

Assessing Intangibles in Turn-Arounds

Determining how customers view product intangibles is easy in turn-around situations. The usual problem is that many of the intangibles no longer relate primarily to the product. Instead, they concern the company's performance. Typically in turn-arounds, most of the intangible aspects surrounding the company turn negative.

For public companies, with highly publicized financial difficulties, the salesforce will often spend most of its time trying to answer intangible objections about the company's performance and longevity. In addition, most product advertising is wasted because tangible product claims are overwhelmed by intangible concerns. Here, the challenge is to find ways to reverse the perceived decline in non-product intangibles. Often, a refocus on product intangibles is the most effective way to accomplish this.

The most difficult task facing management of a turn-around is objectively determining the company's current perceptual strengths and weaknesses. Turn-arounds are characterized by attempting to effectively deal with past failures. Failure is an emotional issue. Consequently, determining current perceptions and the areas requiring improvement is something most difficult for existing employees and managers to accomplish. Experience, objective external support is almost always required.

Determining intangibles in emerging businesses

Determining intangibles in an emerging business is a special case within the disciplines of marketing and communication. In fact, it is one of the few areas where a substantial grounding in both marketing and in communications practices is required in order to both understand the marketing and the interwoven communications implications of the emerging businesses challenges.

For an emerging business, the base of customers is small, and many customers represent innovators and early adopters, buyers whose characteristics are not typical of the majority of the future market. Indeed, attempting to build a business based on innovators is often a course that leads to bankruptcy. Even if the company does not fail, relying on innovators leaves the majority of the market open to new competitors who focus more effectively on the intangibles important to other adoption segments. It is this phenomenon that results in pioneering firms doing all the early eduction and market development, only to find the lion's share of the market falling to a later entrant.

Building intangibles for emerging businesses remains a special art, particularly in markets where the majority of customers are still classified as innovators. In this situation, traditional research techniques usually do not provide adequate insight into potential intangibles. Instead, the entrepreneur is often wiser to embark on a course of creating intangibles rather than searching for them in the customer base.

Creating Intangibles in emerging businesses

Creating intangibles in an emerging market is–by definition–a creative marketing and a creative communications task. It is also a "steering" task, comparable to steering an ocean liner where feedback is limited and time is a critical variable. It requires the ability to think through what the customer needs are likely to be in the future, and to begin positioning the emerging product based on expected needs. Hence, it is both exhilerating and risky.

Often, first the company's first attempts at bringing a new product to market will seem unsuccessful. Sales will not appear to increase. The messages will appear to be too early, the channels used to send messages inappropriate, or the intangible messages will be received but not correlated to a product.

Each of these apparent "failures" is, however, often a normal part of the process of learning that a potential customer goes through.

The process concept of learning is an vital one with regard to marketing planning. In most product markets characterized by some customer risk (in other words, most markets where the price is higher than a few dollars for a disposable commodity), customers will require three to twelve positive exposures to messages–during the purchase cycle–about a new product before they purchase. At the same time, we know that the same message reaches a saturation point after it has been noted three times. The way in which these two apparently contradictory findings–the need for up to twelve exposures and the saturation at three exposures–are fused helps explain the extraordinary power of word-of-mouth communication in an emerging business.[7]

There are also some important caveats here. First, is there a purchase cycle? From the standpoint of perception, if there is no interest in purchasing, there is little chance that a message sent by mass communications channels will be received–instead, it will merely be dismissed as clutter.

Second, is the message relevant? Even in situations where a customer is disposed toward purchase, if the messages are not on-point, they are likely to be discarded.

The most likely way that information about an emerging product and category can be effectively communicated is through word-of-mouth.

Word-of-mouth has these advantages:

- The source is seen as credible, particularly in comparison with advertisements since the source is a person known to the recipient. Advertisements are known to be created by the advertiser. Today, even editorial endorsements have the "taint" of being created by "public relations" tactics and therefore have less credibility than word-of-mouth communication.

- Word-of-mouth often deals with awareness, interest, the source's trial experience and product benefits all at the same time. This can move the recipient rapidly through the stages of purchase decision making and often even creating a reason for purchasing, all in one "exposure".

- It appears to have a more permanent effect than most other communications channels

As a result, second only to the task of creating intangibles for an emerging product, category and company is the challenge of finding the most effective way to generate positive and relevant word-of-mouth.

But because word-of-mouth communication is out of the "senders" control, the requirements for developing essential messages, positions and reasons for purchasing is substantially different than it is for, say, advertising.

Advertising is as direct as standing across a small creek from the prospect, and signaling via messages of the advertiser's design, based on assumptions about the recipient's needs. Advertising is direct, controlled and immediate.

Word-of-mouth, on the other hand, is like swimming 40 miles underwater in a decaying swamp, with the mandate that the swim must be completed by a large group of other people under no control of the starting swimmer, via strokes that cannot be prescribed, and on a time schedule that cannot be forecast. And to add more reality to the metaphor, none of the swimmers can see each other.

With an advertising campaign, the marketer determines message, positioning and purchase reasons only weeks or at most months in advance. If a particular advertisement or campaign does not work, it can be pulled and redesigned.

With word-of-mouth communication, however, the initial positioning and messages–once started through the word-of-mouth channel(swamp?)–are completely outside the sender's control. They are also outside easy measurement. Consequently, they must be designed at the outset to survive the trials of time decay and the communications quality deterioration through a series of people who invariably have motives other than the marketer.

It is for this reason that the initial positioning and message development effort in an emerging company is so critical: the risk of failure is so high, coupled with the need for a "hardened" yet buoyant position and set of messages that will work continually.

The content of word-of-mouth communication for an emerging product–once underway–can be enhanced and mildly diverted by the product marketer. But because it is essentially an *underground communications medium*, the content of word-of-mouth cannot be substantially changed or improved, once launched. Hence the need to be correct at the start, to assure that the power of word-of-mouth will not turn negative and then increasingly build negative perceptions.

The risk of negative word-of-mouth is always present, particularly for companies where products may not be completely debugged at introduction. Negative word-of-mouth is substantially stronger, and works substantially faster than positive word-of-mouth. Using a word-of-mouth based strategy for a new product that does not meet expectations will provide rapid and permanent failure.

For all of its difficulties and risks, word-of-mouth has powerfully vital attribute: it provides a method for reinforcement that is substantially better than any other medium. There is substantial research on the learning process that says, in essence, that the identical message is only effective the first three times it is received. After three exposures, the recipient becomes saturated with the particular message and interest declines rapidly.[8] It is this finding behind the use of changing messages in advertising, behind the campaign concept.

Word-of-mouth provides continually changing messages to maintain and even enhance learning. Word-of-mouth involves multiple sources (the people who talk about products) with, by definition, multiple messages. People who are the sources of word-of-mouth customize the message to fit their circumstances and experience.

The value of this customization is that it avoids saturation by providing different messages about the same product, avoiding the saturation point of the same message, and stimulating and reinforcing continuing progress through the learning process. It is for this reason that word-of-mouth has such a powerful effect in quickly stimulating purchase behavior.

The infrastructure concept and infrastructure communications recognize this unique characteristic of word-of-mouth and are designed to keep different messages flowing.

Product introductions that recognize this stimulating word-of-mouth effect focus on effective, customized communications to different segments of the infrastructure primarily to assure that word-of-mouth reinforcement communications keep moving, keep evolving and keep on target. Such product introductions recognize the requirement for multiple messages to multiple segments, they understand and plan based on the infrastructure concept, for changing but consistent messages, and they appreciate the fact that word-of-mouth is outside the marketer's control.

Building business mythology

We now come to the issue of messages and positioning in order to effectively leverage word-of-mouth communication in the most positive way. Here, much of the evidence is anecdotal. What appears to be most effective is the combination of a simple, emotional, and easy to understand positioning coupled with message elements that evolve based on the experiences of the person telling the story.

Word-of-mouth is essentially story telling. Positioning is the story's consistent theme. The story, therefore, must be so solid that it can be retold by hundreds and thousands of untrained storytellers. The story-teller's direct experience with the product enhances and elaborates on the basic story line, adding variation and interest, which can and will vary based on the story-teller's experience.

The most effective and permanent word-of-mouth marketing efforts involve stories that not only survive retelling, but that improve with further recitation. They become the guideposts for modern business experience. They take on the form and function of mythology in modern times.

And like myths, they become stories that survive and even improve with age.

Footnotes:

[1]"The Rise and Rise of America's Small Firms", The Economist, January 21, 1989, page 67.

[2]Cavanagh, Richard E., and Clifford, Donald K., Jr., The Winning Performance: How America's High-Growth Midsize Companies Succeed. Bantam Books, Inc. New York. 1985.

[3]North Central Rural Sociology Committee, Subcommittee for the Study of the Diffusion of Farm Practices. The Diffusion Process. Ames: Agriculture Extension Service, Iowa State College, Special Report No. 18, 1957, and Foundation for Research on Human Behavior, The Adoption of New Products: Process and Influence, Ann Arbor, Michigan, 1959

4 The relationship between tangibles/ intangibles and the adoption process is not a proven one. Yet anecdotal evidence, and the clear logic of adoption behavior would tend to favor this conclusion.

5 Of all of the many insights developed over the years by Regis McKenna, the concept of an "infrastructure" for technology marketing and communications may evolve to the the most long-lasting. The idea of an infrastructure is so powerful that it has already become part of the vocabulary and practices of the industry.

[6] The main reason for failure is not the questions, but the background, experience and perspective of the researcher. Product perception research requires a sensitivity to customer needs–both met and unmet–that usually cannot be either understood or demonstrated without general management experience. Further, this research is the kind of listening, questioning and probing that is almost always better done by those not directly associated with the product or supplier, because the commendable virtues of product pride and product knowledge are disadvantages to effective listening for and understanding intangibles. Consequently, while not difficult, this type of research rarely provides useful results.

7 The concept of effective frequency is usually credited to Alvin A. Achenbaum, espoused in an address entitled "Effective Exposure: A New Way of Evaluating Media", at the Association of National Advertisers workshop, February 3, 1977.

[8]The concept of satiation comes from L. Jakobovits, "Semantic Satiation and Cognitive Dynamics", American Psychological Association Meeting Paper, September, 1966.

Appendix

(Abstracted from North Central Rural Sociology Committee, Subcommittee for the Study of the Diffusion of Farm Practices. The Diffusion Process. Ames: Agriculture Extension Service, Iowa State College, Special Report No. 18, 1957.)

"Innovators:

They have larger than average farms, are well educated and usually come from well established families. They usually have a relatively high net worth and–probably more important–a large amount of risk capital. They can afford and do take calculated risks on new products. They are respected for being successful, but ordinarily do not enjoy the highest prestige in the community. Because innovators adopt new ideas so much sooner than the average farmer, they are sometimes ridiculed by their conservative neighbors. This neighborhood group pressure is largely ignored by the innovators, however. The innovations are watched by their neighbors, but they are not followed immediately in new practices.

The activities of innovators often transcend local community boundaries. Rural innovators frequently belong to formal organizations at the county, regional, state, or national level. In addition, they are likely to have many informal contacts outside the community: they may visit with others many miles away who are also trying a new technique or product, or who are technical experts.

Early Adopters

They are younger than the average farmer, but not necessarily younger than the innovators. They also have a higher average eduction, and participate more in the formal activities of the community through such organizations as churches, the PTA, and farm organizations. They participate more than the average in agricultural cooperatives and in government agency programs in the community (such as Extension Service or Soil Conservation). In fact, there is some evidence that this group furnishes a disproportionate amount of the formal leadership (elected officers) in the community. The early adopters are also respected as good sources of new farm information by their neighbors.

Early Majority

The early majority are slightly above average in age, education, and farming experience. They have medium high social and economic status. They are less active in formal groups than innovators or early adopters, but more active than those who adopt later. In many cases, they are not formal leaders in the community organizations, but they are active members in these organizations. They also attend Extension meetings and farm demonstrations.

The people in this category are most likely to be informal rather than elected leaders. They have a following insofar as people respect their opinions, their "high morality and sound judgment." They are "just like their following, only more so." They must be sure an idea will work before they adopt it. If the informal leader fails two or three times, his following looks elsewhere for information and guidance. Because the informal leader has more limited resources than the early adopters and innovators, he cannot afford to make poor decisions: the social and economic costs are too high.

These people tend to associate mainly in their own community. When people in the community are asked to name neighbors and farmers with whom they talk over ideas, these early majority are named disproportionally frequently. On their parts, they value highly the opinions their neighbors and friends hold about them, for this is their main source of status and prestige. The early majority may look to the early adopters for their new farm information.

Late majority

Those in this group have less education and are older than the average farmer. While they participate less actively in formal groups, they probably form the bulk of the membership in these formal organizations. Individually they belong to fewer organizations, are less active in organizational work, and take fewer leadership roles than earlier adopters. They do not participate in as many activities outside the community as do people who adopt earlier.

Laggards

They have the least education and are the oldest. They participate least in formal organizations, cooperatives, and government agency programs. They have the smallest farms and the least capital. Many are suspicious of county Extension agents and agricultural salesmen."