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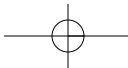
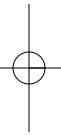
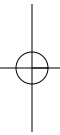
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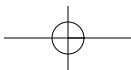
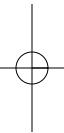
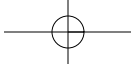
**PART  
ONE**

**STRATEGIC ANALYSIS**

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## CHAPTER TWO

# *External and Customer Analysis*

The purpose of an enterprise is to create and keep a customer.

—*Theodore Levitt*

Consumers are statistics. Customers are people.

—*Stanley Marcus*

Before you build a better mousetrap, it helps to know if there are any mice out there.

—*Mortimer B. Zuckerman*

**D**eveloping or adapting strategy in a dynamic market logically starts with external analysis, an analysis of the factors external to a business that can affect strategy. The first four chapters of Part One present concepts and methods useful in conducting an external analysis. The final chapter of Part One turns to internal analysis: the analysis of the firm's performance, strengths, weaknesses, problems, liabilities, and constraints.

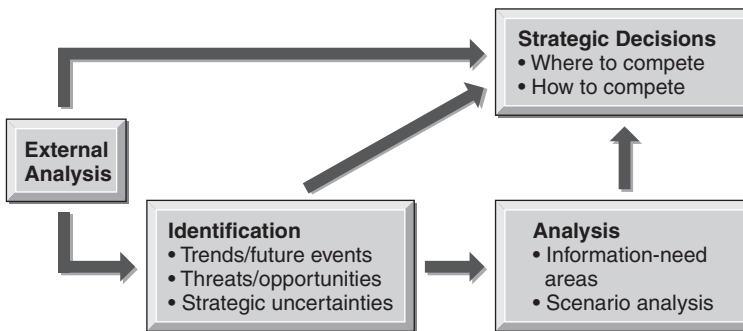
### **EXTERNAL ANALYSIS**

A successful external analysis needs to be directed and purposeful. There is always the danger that it will become an endless process resulting in an excessively descriptive report. In any business there is no end to the material that appears potentially relevant. Without discipline and direction, volumes of useless descriptive material can easily be generated.

#### **Affecting Strategic Decisions**

The external analysis process should not be an end in itself. Rather, it should be motivated throughout by a desire to affect strategy. As Figure 2.1 shows, an external analysis can impact strategy directly by suggesting strategic decision alternatives

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**Figure 2.1** The Role of External Analysis

or influencing a choice among them. More specifically, it should address questions such as:

- Should existing business areas be liquidated, milked, maintained, or targeted for investment?
- Should new business areas be entered?
- What are the value propositions? What should they be?
- What assets and competencies should be created, enhanced, or maintained?
- What strategies and programs should be implemented in functional areas? What should be the positioning strategy, segmentation strategy, distribution strategy, brand-building strategy, manufacturing strategy, and so on?

### Additional Analysis Objectives

Figure 2.1 also suggests that an external analysis can contribute to strategy indirectly by identifying:

- Significant trends and future events
- Threats and opportunities
- Strategic uncertainties that could affect strategy outcomes

A significant trend or event, such as concern about saturated fat or the emergence of a new competitor, can dramatically affect the evaluation of strategy options. A new technology, which can represent both a threat to an established firm and an opportunity to a prospective competitor, can signal new business arenas.

### Strategic Uncertainties

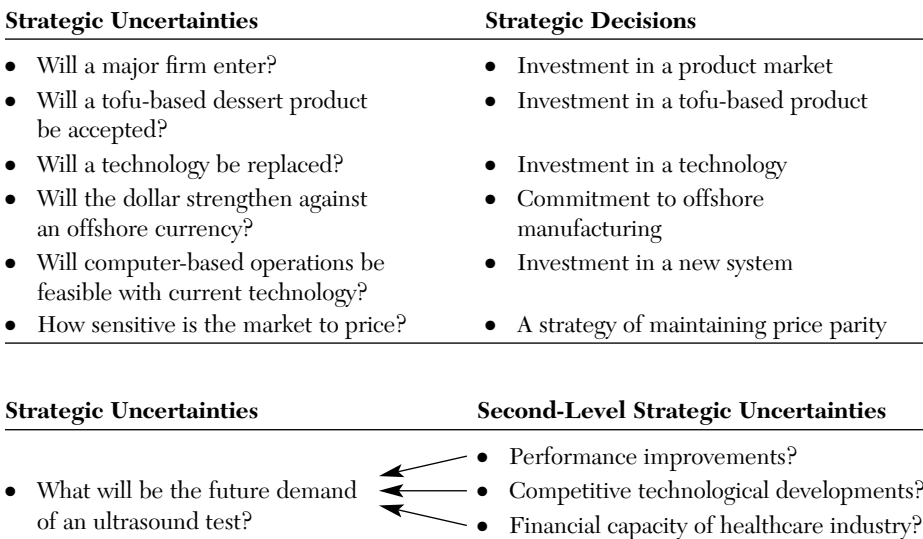
Strategic uncertainty is a particularly useful concept in conducting an external analysis. If you could know the answer to one question prior to making a strategic

commitment, what would that question be? If a property casualty insurance company were to consider whether to add earthquake insurance to its line, important strategy uncertainties might include the following:

- What will be the potential losses of a major earthquake?
- What will be the impact on the customer base of failing to offer coverage?
- Could coverage be provided in partnerships?

*Strategic uncertainties* focus on specific unknown elements that will affect the outcome of strategic decisions. “Should earthquake coverage be added?” is a strategic decision, whereas “What are the potential losses from a major earthquake?” is a strategic uncertainty. Most strategic decisions will be driven by a set of these uncertainties.

Below are some examples of strategic uncertainties and the strategic decisions to which they might relate. A single strategic uncertainty can often lead to additional sources of strategic uncertainty. One common strategic uncertainty, as portrayed in Figure 2.2 at the bottom of this page, is what the future demand for a product (such as ultrasound diagnostic equipment) will be. Asking, “On what does that depend?” will usually generate additional strategic uncertainties. One uncertainty might address technological improvements, whereas another might consider the technological development and cost/benefit levels achieved by competitive technologies. Still another might look into the financial capacity of the healthcare industry to continue capital improvements. Each of these strategic uncertainties can, in turn, generate still another level of strategic uncertainties.



**Figure 2.2** Strategic Uncertainties

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### Analysis

There are three ways of handling uncertainty, as suggested by Figure 2.1. First, a strategic decision can be precipitated because the logic for a decision is compelling and/or because a delay would be costly or risky. Second, it may be worthwhile to attempt to reduce the uncertainty by information acquisition and analysis of an information-need area. The effort could range from a high-priority task force to a low-key monitoring effort. The level of resources expended will depend on the potential impact on strategy and its immediacy. Third, the uncertainty could be modeled by a scenario analysis.

A scenario is an alternative view of the future environment that is usually prompted by an alternative possible answer to a strategic uncertainty or by a prospective future event or trend. Is the current popularity of vitamin enhanced waters a fad or does it indicate a solid growth area? Such a question could be the basis for a positive and a negative scenario. Each could be associated with very different environmental profiles and strategy recommendations. In Chapter 5, information-need areas and scenario analysis will be covered in more detail.

A host of concepts and methods are introduced in this and the following three chapters. It would, of course, be unusual to employ all of them in any given context, and the strategist should resist any compulsion to do so. Rather, those that are most relevant to the situation at hand should be selected. Furthermore, some areas of analysis will be more fruitful than others and will merit more effort.

### External Analysis as a Creative Exercise

In part, external analysis is an exercise in creative thinking. In fact, there is often too little effort devoted to developing new strategic options and too much effort directed to solving operational problems of the day. The essence of creative thinking is considering different perspectives, and that is exactly what an external analysis does. The strategist is challenged to look at strategy from the perspectives of customer, competitor, market, and environment as well as from an internal perspective. Within each there are several subdimensions; in Figure 1.3, more than two dozen are identified. The hope is that by examining strategy from different viewpoints, options will be generated that would otherwise be missed.

### The Level of Analysis—Defining the Market

An external analysis of what? To conduct an external analysis, the market or submarket boundaries need to be specified. The scope of external analysis can involve an industry broadly defined (sporting goods), narrowly defined (high performance skis), or using a scope definition that falls in between such as:

- Ski clothing and equipment
- Skis and snowboards
- Downhill skis

The level of analysis will depend on the organizational unit and strategic decisions involved. A sporting goods company, such as Wilson, will be making resource decisions across sports and thus needs to be concerned with the whole industry. A ski equipment manufacturer may only be concerned with elements of sporting goods relating to skis, boots, and clothing. The maker of high-performance skis might be interested in only a subsegment of the ski industry. One approach to defining the market is to specify the business scope. The scope can be identified in terms of the product market and in terms of the competitors. Relevant, of course, are the future product market and competitors as well as the present ones.

There is always a trade-off to be made. A narrow scope specification will inhibit a business from identifying trends and opportunities that could lead to some attractive options and directions. Thus, a maker of downhill skis may want to include snowboards and cross-country skis because they represent business options or because they will impact the ski equipment business. On the other hand, depth of analysis might be sacrificed when the scope is excessively broad. A more focused analysis may generate more insight.

The analysis usually needs to be conducted at several levels. The downhill ski and snowboard industry might be the major focus of the analysis. However, an analysis of sporting goods might suggest and shed light on some substitute product pressures and market trends. Also, an analysis may be needed at the segment level (e.g., high-performance skis) because entry, investment, and strategy decisions are often made at that level. Furthermore, the key success factors could differ for different product markets within a market or industry. One approach is a layered analysis, with the primary level receiving the most depth of analysis. Another approach could be multiple analyses, perhaps consecutively conducted. The first analysis might stimulate an opportunity that would justify a second analysis on a submarket.

### **When Should an External Analysis Be Conducted?**

There is often a tendency to relegate the external analysis to an annual exercise. Each year, of course, it may not require the same depth as the initial effort. It may be more productive to focus on a part of the analysis in the years immediately following a major effort.

The annual planning cycle can provide a healthy stimulus to review and change strategies. However, a substantial risk exists in maintaining external analysis as an annual event. The need for strategic review and change is often continuous. Information sensing and analysis therefore also need to be continuous. The framework and concepts of external analysis can still play a key role in providing structure even when the analysis is continuous and addresses only a portion of the whole.

External analysis deliberately commences with customer and competitor analyses because they can help define the relevant industry or industries. An industry can be defined in terms of the needs of a specific group of customers—those buying fresh cookies on the West Coast, for instance. Such an industry definition then forms the basis for the identification of competitors and the balance of external analysis. An industry such as the cookie industry can also be defined in terms of all its competitors. Because customers have such a direct relationship to a firm's operation, they are usually a rich source of relevant operational opportunities, threats, and uncertainties.

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### SEGMENTATION

- Who are the biggest customers? The most profitable? The most attractive potential customers? Do the customers fall into any logical groups based on needs, motivations, or characteristics?
- How could the market be segmented into groups that would require a unique business strategy?

### CUSTOMER MOTIVATIONS

- What elements of the product/service do customers value most?
- What are the customers' objectives? What are they really buying?
- How do segments differ in their motivation priorities?
- What changes are occurring in customer motivation? In customer priorities?

### UNMET NEEDS

- Why are some customers dissatisfied? Why are some changing brands or suppliers?
- What are the severity and incidence of consumer problems?
- What are unmet needs that customers can identify? Are there some of which consumers are unaware?
- Do these unmet needs represent leverage points for competitors or a new business model?

**Figure 2.3** Customer Analysis

## THE SCOPE OF CUSTOMER ANALYSIS

In most strategic market-planning contexts, the first logical step is to analyze the customers. Customer analysis can be usefully partitioned into an understanding of how the market segments, an analysis of customer motivations, and an exploration of unmet needs. Figure 2.3 presents a basic set of questions for each area of inquiry.

### SEGMENTATION

Segmentation is often the key to developing a sustainable competitive advantage. In a strategic context, *segmentation* means the identification of customer groups that respond differently from other groups to competitive offerings. A segmentation strategy couples the identified segments with a program to deliver an offering to those segments. Thus, the development of a successful segmentation strategy requires the conceptualization, development, and evaluation of a targeted competitive offering.

A segmentation strategy should be judged on three dimensions. First, can a competitive offering be developed and implemented that will be appealing to the target segment? Second, can the appeal of the offering and the subsequent relationship with the target segment be maintained over time despite competitive responses? Third, is the resulting business from the target segment worthwhile, given the investment required to develop and market an offering tailored to it? The concept behind a successful segmentation strategy is that within a reduced market space, it is possible



to create a dominant position that competitors will be unwilling or unable to attack successfully.

### How Should Segments Be Defined?

The task of identifying segments is difficult, in part, because in any given context there are literally hundreds of ways to divide up the market. Typically, the analysis will consider five, ten, or more segmentation variables. To avoid missing a useful way of defining segments, it is important to consider a wide range of variables. These variables need to be evaluated on the basis of their ability to identify segments for which different strategies are (or should be) pursued.

The most useful segment-defining variables for an offering are rarely obvious. Among the variables frequently used are those shown in Figure 2.4.

The first set of variables describes segments in terms of general characteristics unrelated to the product involved. Thus, a bakery might be concerned with geographically defined segments related to communities or even neighborhoods. A consulting company may specialize in the hospitality industry. A fast food firm in the United States may target Hispanics because this segment is projected to grow at a significant rate on its way to tripling its size by 2050.

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#### CUSTOMER CHARACTERISTICS

- Geographic
- Type of organization
- Size of firm
- Lifestyle
- Sex
- Age
- Occupation
- Small Southern communities as markets for discount stores
- Computer needs of restaurants versus manufacturing firms versus banks versus retailers
- Large hospital versus medium versus small
- Jaguar buyers tend to be more adventurous, less conservative than buyers of Mercedes-Benz and BMW
- Mothers of young children
- Cereals for children versus adults
- The paper copier needs of lawyers versus bankers versus dentists

#### PRODUCT-RELATED APPROACHES

- User type
  - Usage
  - Benefits sought
  - Price sensitivity
  - Competitor
  - Application
  - Brand loyalty
  - Appliance buyer—home builder, remodeler, homeowner
  - Concert—season ticket holders, occasional patrons, nonusers
  - Dessert eaters—those who are calorie-conscious versus those who are more concerned with convenience
  - Economy-sensitive Honda Civic buyer versus the luxury Mercedes-Benz buyer
  - Users of competing products
  - Professional users of chain saws versus homeowners
  - Those committed to Heinz ketchup versus price buyers
- 

**Figure 2.4** Examples of Approaches to Defining Segments

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Demographics are particularly powerful for defining segments, in part because a person's life stage affects his or her activities, interests, and brand loyalties. Another reason is that demographic trends are predictable. The U.S. population over 65 is expected to grow to 50 million in 2020, when more than 5 million people will be 85 or older. Gold Violin, recognizing this trend, has established itself as a source of products designed for the active elderly. Specialized items such as a talking watch, a bed-vibrating alarm clock, a doorknob turner, and a lighted hands-free magnifier (all with tasteful, attractive designs) are just some of the Gold Violin products that appeal to this long-ignored demographic segment.

Another demographic play is represented by the Toyota Scion, a small car with a funky design (tall, angular, and boxy) aimed at Generation Y, the so-called echo boomers. The average age of a Toyota buyer is 48, the company's inexpensive entries are considered boring, and Scion is an effort to become relevant and interesting to a key target segment. To create a buzz around Scion so that it would appeal to the next generation of drivers, Toyota targeted the 15 percent of the echo-boomer target market seen as "leaders and influencers"—those who encourage their peers to gravitate to a new style, whether it be in music, sports, or cars.<sup>1</sup>

The second category of segment variables includes those that are related to the product. One of the most frequently employed is usage. A bakery may follow a very different strategy in serving restaurants that rely heavily on bakery products than in serving those that use fewer such products. A manufacturer of lawn equipment may design a special line for a large customer such as Wal-Mart, but sell through distributors using another brand name for other outlets. Four other useful segment variables are benefits, price sensitivity, loyalty, and applications.

### **Benefits**

If there is a most useful segmentation variable, it would be benefits sought from a product, because the selection of benefits can determine a total business strategy. In gourmet frozen dinners/entrées, for example, the market can be divided into buyers who are calorie-conscious, those who focus on nutrition and health, those interested in taste, and the price-conscious buyers. Each segment implies a very different strategy.

The athletic shoe industry segments into serious athletes (small in number but influential), weekend warriors, and casual wearers using athletic shoes for street wear. Recognizing that the casual wearer segment is 80 percent of the market and does not really need performance, several shoe firms have employed a style-focused strategy as an alternative to the performance strategy adopted by such firms as Nike.

### **Price Sensitivity**

The benefit dimension representing the trade-off between low price and high quality is both useful and pervasive; hence it is appropriate to consider it separately. In many product classes, there is a well-defined breakdown between those customers concerned first about price and others who are willing to pay extra for higher quality and features. General merchandise stores, for example, form a well-defined hierarchy from discounters to prestige department stores. Automobiles span the spectrum

## THE MALE SHOPPER<sup>2</sup>

The male shopper has been long ignored. A segmentation scheme provides insight into how males differ and suggests strategies for appealing to very different segments.

**The Metrosexual.** An affluent urban sophisticate, aged 20 to 40, who loves to buy and looks for trendy, prestigious, and high-quality products. Into men's grooming, expensive haircuts. Think Polo Ralph Lauren, Beiersdorf, and Banana Republic.

**The Retrosexual.** Traditional male behavior, into football and NASCAR, rejects feminism, nostalgic for the way things were, prefers below-casual clothing, not into moisturizers for men. Think Levi's, Nike, Old Spice, Burger King, and Target.

**The Modern Man.** Between "metro" and "retro," this shopper shares their interests but does not go overboard. A sophisticated consumer in his twenties or thirties, he is comfortable with women but does not shop with them. Think Gap, Macy's, and fast casual restaurants.

**The Dad.** Good income. Involved in the family shopping. Efficient shopper. More functional clothing. Think Nordstrom's, McDonald's, and Amazon.

**The Maturiteen.** More savvy, responsible, and pragmatic than earlier generations of teens. A technology master adept at online research and buying. Sony, Adidas, Old Navy, Circuit City, and Internet sites of all types do well.

from the Honda Civic to the Buick Lucerne to the Lexus 460. Airline service is partitioned into first class, business class, and economy class. In each case the segment dictates the strategy.

## Loyalty

Brand loyalty, an important consideration in allocating resources, can be structured using a loyalty matrix as shown in Figure 2.5. Each cell represents a very different strategic priority and can justify a very different program. Generally, it is too easy to take the loyal customer for granted. However, a perspective of total profits over the life of a customer makes the value of an increase in loyalty more vivid. Thus, the highest priority is to retain the existing loyal customer base and, if possible, increase their commitment intensity and perhaps encourage them to talk to others.

		Low Loyalty	Moderate Loyalty	Loyal
Customer		Medium	High	Highest
Noncustomer		Low to Medium	High	Zero

**Figure 2.5** The Brand Loyalty Matrix: Priorities

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The key is often to reward the loyal customer by living up to expectations consistently, providing an ongoing relationship, and offering extras that surprise and delight.

The loyalty matrix suggests that the moderate loyals, including those of competitors, should also have high priority because they represent one route to increase the size of the loyal segment. Using the matrix involves estimating the size of each of the six cells, identifying the customers in each group, and designing programs that will influence their brand choice and loyalty level. The brand loyal noncustomer is a low priority because the cost to attract is usually prohibitive unless a competitor misstep provides an opportunity. The nonloyal group will have a reduced long-term value because they will be easily enticed by a price deal.

### Applications

Some products and services, particularly industrial products, can best be segmented by use or application. A laptop computer may be needed by some for use while traveling, whereas others may use it at the office. One segment may use a computer primarily for Internet access while others may use it for editing documents or for data analysis. Some might use a four-wheel drive for light industrial hauling and others may be buying primarily for recreation.

Christiansen et al. argue that an application focus is more likely to lead to successful new products and marketing programs than other segmentation schemes.<sup>3</sup> They illustrate by telling the story of a milkshake seller that found that many consumers bought the product in the morning in order to help them kill time while driving to work and provide energy to tide them over to lunch. Being efficient to buy and capable of being consumed with only one hand was therefore critical. Such an insight leads to ideas like making the shake thicker (so it takes longer to consume), making the purchase even more efficient with buyer cards, and adding fruit to make it more interesting in the context of a boring commute. The basic concept is that ideas for products and marketing programs are more likely to come from a deep understanding of how the product is used than by understanding the customer. The success of Arm & Hammer in extending its business can be credited to a focus on applications involving deodorizing (carpets, kitty litter, clothes, underarms, and refrigerators).

### Multiple Segments versus a Focus Strategy

Two distinct segmentation strategies are possible. The first focuses on a single segment, which can be much smaller than the market as a whole. Wal-Mart, now the largest U.S. retailer, started by concentrating on cities with populations under 25,000 in eleven south central states—a segment totally neglected by its competition, the large discount chains. This rural geographic focus strategy was directly responsible for several significant SCAs, including an efficient and responsive warehouse supply system, a low-cost, motivated workforce, relatively inexpensive retail space, and a lean and mean, hands-on management style. Union Bank, California's fifth largest bank, makes no effort to serve individuals and thus provides a service operation tailored to business accounts that is more committed and comprehensive than those of its competitors. An alternative to a focusing strategy is to involve multiple segments.

General Motors provides the classic example. In the 1920s the firm positioned the Chevrolet for price-conscious buyers, the Cadillac for the high end, and the Oldsmobile, Pontiac, and Buick for well-defined segments in between. A granulated potato company has developed different strategies for reaching fast-food chains, hospitals and nursing homes, and schools and colleges.

In many industries aggressive firms are moving toward multiple-segment strategies. Campbell Soup, for example, makes its nacho cheese soup spicier for customers in Texas and California and offers a Creole soup for southern markets and a red-bean soup for Hispanic markets. In New York, Campbell uses promotions linking Swanson frozen dinners with the New York Giants football team, and in the Sierra Nevada mountains, skiers are treated to hot soup samples. Developing multiple strategies is costly and often must be justified by an enhanced aggregate impact.

There can be important synergies between segment offerings. For example, in the alpine ski industry, the image developed by high-performance skis is important to sales at the recreational-ski end of the business. Thus, a manufacturer that is weak at the high end will have difficulty at the low end. Conversely, a successful high-end firm will want to exploit that success by having entries in the other segments. A key success factor in the general aviation industry is a broad product line, ranging from fixed-gear, single-engine piston aircraft to turboprop planes, because customers tend to trade up and will switch to a different firm if the product line has major gaps.

## CUSTOMER MOTIVATIONS

After identifying customer segments, the next step is to consider their motivations: What lies behind their purchase decisions? And how does that differ by segment? It is helpful to list the segments and the motivation priorities of each, as shown in Figure 2.6 for air travelers.

Internet retailers have learned that there are distinct shopper segments, and each has a very different set of driving motivations.<sup>4</sup>

- **Newbie shoppers**—need a simple interface, as well as a lot of hand-holding and reassurance.
- **Reluctant shoppers**—need information, reassurance, and access to live customer support.
- **Frugal shoppers**—need to be convinced that the price is good and they don't have to search elsewhere.
- **Strategic shoppers**—need access to the opinions of peers or experts, and choices in configuring the products they buy.

Segment	Motivation
Business	Reliable service, convenient schedules, easy-to-use airports, frequent-flyer programs, and comfortable service
Vacationers	Price, feasible schedules

**Figure 2.6** Customer Motivation Grid: Air Travelers

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- **Enthusiastic shoppers**—need community tools to share their experiences, as well as engaging tools to view the merchandise and personalized recommendations.
- **Convenience shoppers**—(the largest group) want efficient navigation, a lot of information from customers and experts, and superior customer service.

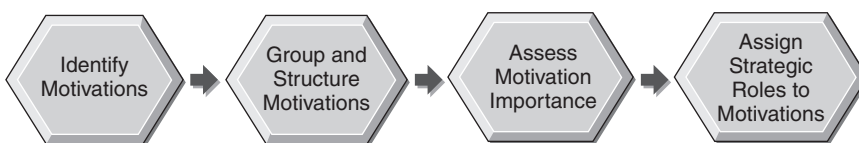
Some motivations will help to define strategy. A truck, for example, might be designed and positioned with respect to power. Before making such a strategic commitment, it is crucial to know where power fits in the motivation set. Other motivations may not define a strategy or differentiate a business, but represent a dimension for which parity performance must be obtained or the battle will be lost. If the prime motivation for buyers of gourmet frozen-food dinners is taste, a viable firm must be able to deliver at least acceptable taste.

### Determining Motivations

As Figure 2.7 suggests, consumer motivation analysis starts with the task of identifying motivations for a given segment. Although a group of managers can identify motivations, a more valid list is usually obtained by getting customers to discuss the product or service in a systematic way. Why is it being used? What is the objective? What is associated with a good or bad use experience? For a motivation such as car safety, respondents might be asked why safety is important. Such probes might result in the identification of more basic motives, such as the desire to feel calm and secure rather than anxious.

Customers can be accessed with group or individual interviews. Griffin and Hauser of the MIT Quality Function Deployment (QFD) program compared the two approaches in a study of food-carrying devices.<sup>5</sup> They found that individual interviews were more cost-effective and that the group processes did not generate enough extra information to warrant the added expense. They also explored the number of interviews needed to gain a complete list of motivations and concluded that twenty to thirty will cover 90 to 95 percent of the motivations.

The number of motivations can be in the hundreds, so the next task is to cluster them into groups and subgroups. Affinity charts developed by a managerial team are commonly used. Each team member is given a set of motives on cards. One member puts a motive on the table or pins it to a wall, and the others add similar cards to the pile until there is a consensus that the piles represent reasonable groupings. An alternative is to use customers or groups of customers to sort the motives into piles. The customers are then asked to select one card from each pile that best represents



**Figure 2.7** Customer Motivation Analysis

## BUYER HOT BUTTONS

Motivations can be categorized as important or unimportant, yet the dynamics of the market may be better captured by identifying current buyer hot buttons. Hot buttons are motivations whose salience and impact on markets are significant and growing. What are buyers talking about? What are stimulating changes in buying decisions and use patterns?

In consumer retail food products, for example, hot buttons include:

- Freshness and naturalness. Grocery stores have responded with salad bars, packaged precut vegetables, and efforts to upgrade the quality and selection of their fresh produce.
- Healthy eating. Low fat, particularly saturated and trans fat, is a prime driver, but concern about sodium, sugar, and processed foods is also growing and affecting product offerings in most food categories.
- Ethnic eating. A growing interest in ethnic flavors and cooking such as Asian, Mediterranean, and Caribbean cuisines has led to an explosion of new offerings. Brands usually start in ethnic neighborhoods, move into natural-food and gourmet stores, and finally reach the mainstream markets.
- Gourmet eating. The success of Williams-Sonoma and similar retailers reflects the growth of gourmet cooking and has led to the introduction of a broader array of interesting cooking aids and devices.
- Meal solutions. The desire for meal solutions has led to groups of products being bundled together as a meal and to a host of carryout prepared foods offered by both grocery stores and restaurants.
- Low-carb foods. The influence of low-carb diets has created a demand for reduced-carb food variants in both grocery stores and restaurants.

their motives. Although managers gain buy-in and learning by going through the process themselves, Griffin and Hauser report that in the twenty applications at one firm, the managers considered customer-based approaches better representations than their own.

Another task of customer motivation analysis is to determine the relative importance of the motivations. Again, the management team can address this issue. Alternatively, customers can be asked to assess the importance of the motivations directly or perhaps through trade-off questions. If an engineer had to sacrifice response time or accuracy in an oscilloscope, which would it be? Or, how would an airline passenger trade off convenient departure time with price? The trade-off question asks customers to make difficult judgments about attributes. Another approach is to see which judgments are associated with actual purchase decisions. Such an approach revealed that mothers often selected snack food based on what “the child likes” and what was “juicy” instead of qualities they had said were important (nourishing, easy to eat).

A fourth task is to identify the motivations that will play a role in defining the value proposition of the business. The selection of motivations central to strategy will depend

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not only on customer motivations, but on other factors as well, such as competitors' strategies that emerge in the competitor analysis. Another factor is how feasible and practical the resulting strategy is for the business. Internal analysis will be involved in making that determination, as will an analysis of the strategy's implementation.

#### Qualitative Research

Qualitative research is a powerful tool in understanding customer motivation. It can involve focus-group sessions, in-depth interviews, customer case studies, or ethnographic research (to be described shortly). The concept is to search for the real motivations that do not emerge from structured lists. For instance, buyers of sports utility vehicles might really be expressing their youth or a youthful attitude. The perception that a product is too expensive might really reflect a financing gap. Getting inside the customer can provide strategic insights that do not emerge any other way.

Although a representative cross-section of customers is usually sought, special attention to some is often merited. Very loyal customers are often best able to articulate the bonds that the firm is capable of establishing. Lost customers (those who have defected) are often particularly good at graphically communicating problems with the product or service. New customers or customers who have recently increased their usage may suggest new applications. Organizational buyers using multiple vendors may have a good perspective of the firm relative to the competition.

#### Changing Customer Priorities

It is particularly critical to gain insight into changes in customers' priorities. In the high-tech area, customer priorities often evolve from needing help in selecting and installing the right equipment to wanting performance to looking for low cost. In the coffee business, customer tastes and habits have evolved from buying coffee at grocery stores to drinking coffee at gourmet cafés to buying their own whole-bean gourmet coffees. Assuming that customer priorities are not changing can be risky. It is essential to ask whether a significant and growing segment has developed priorities that are different from the basic business model.

#### The Customer as Active Partner

Customers are increasingly becoming active partners in their relationship with the firm and brand rather than passive targets of product development and advertising. The trend is illustrated by patients taking control of medical issues, the control of media shifting as audiences move to DVRs such as TiVo, and the power-enhancing access to information and fellow customers provided by the Internet. To harness this change, managers should:<sup>6</sup>

- **Encourage active dialogue.** Contact with customers must now be considered a dialogue of equals. The interaction of Schwab with its customers (both online and offline) shows how active dialogues can create a strong relationship.
- **Mobilize customer communities.** The Internet facilitates stronger and more widespread online customer communities. The challenge is to organize



and create the context for the communities so that they become an extension of the brand experience and a source of customer input into the product and its use.

- **Manage customer diversity.** Particularly in technology products there will be a wide range of sophistication among customers, and the challenge will be to deal with multiple levels. The more sophisticated group will be the most active partners.
- **Co-creating personalized experiences.** An online florist might let customers design the type and arrangement of flowers and vases, rather than merely providing a menu of choices. Co-creating experiences go beyond customization in tailoring the offering to the needs of individuals.

Interacting with the customer on the Internet requires skills in listening, engaging, and leading. Each has challenges. Often there is information overload. There is a mention of McDonald's on the Internet every 5 seconds or so. Software to summarize content can play a role if integrated into an information system. Engaging can be difficult because it will depend on where the firm has permission to enter the space and there can be risks of a misstatement or inflaming an issue if it is engaged. However, clearly identified firm spokespeople can be effective. Leading usually requires getting in front of the Internet discussion with products or programs.

## UNMET NEEDS

An unmet need is a customer need that is not being met by the existing product offerings. OfficeMax, for example, found that people, especially women professionals, wanted a cubical workplace with color, patterns, and textures. The result was four product lines that promised to enliven and personalize cubicle environments delivered under the tagline "Life Is Beautiful, Work Can Be Too." An unmet need provided not only a route to a successful offering but a way to enhance a brand relationship.

Unmet needs are strategically important because they represent opportunities for firms to increase their market share, break into a market, or create and own new markets. They can also represent threats to established firms in that they can be a lever that enables competitors to disrupt an established position. Ariat, for example, broke into the market for equestrian footwear by providing high-performance athletic footwear to riders who were not well served by traditional riding boots. Driven by the belief that riders are athletes, Ariat developed a brand and product line that was responsive to an unmet need.

Sometimes customers may not be aware of their unmet needs because they are so accustomed to the implicit limitations of existing equipment. Who could have conceived of a need for an electric lightbulb or a tractor before technology made them possible? Unmet needs that are not obvious may be more difficult to identify, but they can also represent a greater opportunity for an aggressive business because there will be little pressure on established firms to be responsive. The key is to stretch the technology or apply new technologies in order to expose unmet needs.

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## Using Customers to Identify Unmet Needs

Customers are a prime source of unmet needs. The trick is to access them, to get customers to detect and communicate unmet needs. What product-use experience

### USER-DEVELOPED PRODUCTS

For an internal application, IBM designed and built the first printed circuit card insertion machine of a particular type to be used in commercial production.<sup>7</sup> After building and testing the design in-house, IBM sent engineering drawings of its design to a local machine builder, along with an order for eight units. The machine builder completed this and subsequent orders and applied to IBM for permission to build essentially the same machine for sale on the open market. IBM agreed, and as a result the machine builder became a major force in the component insertion equipment business.

In the early 1970s, store owners and sales personnel in southern California began to notice that youngsters were fixing up their bicycles to look like motorcycles, complete with imitation tailpipes and chopper-type handlebars. Sporting crash helmets and Honda motorcycle T-shirts, the youngsters raced fancy 20-inchers on dirt tracks. Obviously onto a good thing, the manufacturers came out with a whole new line of motorcross models. California users refined this concept into the mountain bike. Manufacturers were guided by the California customers to develop new refinements, including the 21-speed gear shift that doesn't require removing one's hands from the bars. Mountain bike firms are still watching their West Coast customers.

problems have emerged? What is frustrating? How does it compare with other product experiences? Are there problems with the total-use system in which the product is embedded? How can the product be improved? This kind of research helped Dow come up with Spiffits, a line of premoistened, disposable cleaning towels that addressed the need for a towel already moistened with a cleaning compound.

A structured approach, termed *problem research*, develops a list of potential problems with the product or service. The problems are then prioritized by asking a group of 100 to 200 respondents to rate each problem as to whether (1) the problem is important, (2) the problem occurs frequently, and (3) a solution exists. A problem score is obtained by combining these ratings. A dog-food problem research study found that buyers felt dog food smelled bad, cost too much, and was not available in different sizes for different dogs. Subsequently, products responsive to these criticisms emerged. Another study led an airline to modify its cabins to provide more leg room.

Eic von Hippel, a researcher at MIT who studies customers as sources of service innovations, suggests that lead users provide a particularly fertile ground for discovering unmet needs and new product concepts.<sup>8</sup> Lead users are users who:

- Face needs that will be general in the marketplace, but face them months or years before the bulk of the marketplace. A person who is very into health foods and nutrition would be a lead user with respect to health foods, if we assume that there is a trend toward health foods.

- Are positioned to benefit significantly by obtaining a solution to those needs. Lead users of office automation would be firms that today would benefit significantly from technological advancement.

An effective and efficient way to access customers is to use the Internet to engage them in a dialogue. Dell, for example, has a Web site labeled Ideastorm where customers can post ideas and observe and “vote” on the ideas of others. They also see the reaction of Dell, which can include responses such as “under review” or “partially implemented.” Among the suggestions was to have backlit keyboards, to support free software like Linux, and to design quieter computers. Starbucks with its MyStarbucksidea site is among many firms that are attempting to do something similar. A risk with customer-driven idea sites is that there can be a surge around an idea that is impractical or unwise and the company would then be defensive. But it has the potential of leveraging many perspectives to generate ideas that can result in real energy and innovation.

A less direct way is to create communities of customers and let them converse with each other. The conversation will illuminate problems and unmet needs. P&G, for example, has the engagement platform, BeingGirl, where preteen and teen girls can discuss coming of age issues with each other. It is an effective forum to spread awareness and knowledge about P&G feminine hygiene products and programs. Intuit’s site, developed to allow tax professionals to answer each other’s questions, provides insights into the kinds of questions being posed, which in turn informs Intuit’s TurboTax refinement efforts.

### **Ethnographic Research**

Ethnographic or anthropological research involves directly observing customers in as many contexts as possible. By accurately observing not only what is done involving the target or service but *why* it is being done, companies can achieve a deeper level of understanding of the customer’s needs and motivations and generate actionable insights. For example, the financial data company Thomson Corporation regularly studies from 25 to 50 customers, examining their behavior from three minutes prior to using their data as well as three minutes afterward.<sup>9</sup> One such study, which found that analysts were inputting the data into a spreadsheet, led to a new service. Although this research approach has been around for nearly a century, it has taken on new life in the last few years not only in packaged goods firms such as P&G but also in business-to-business firms such as Intel and GE.

Ethnographic research is particularly good at identifying breakthrough innovations. Customers usually cannot verbalize such innovations because they are used to the current offerings. Henry Ford famously observed that had he asked customers what they wanted, they would have said faster horses. By watching people buy and use in the context of their lives or their businesses, however, experienced and talented anthropologists (or executives, in the case of P&G) can generate insights that go beyond what customers could talk about.

Ethnographic research works.<sup>10</sup> After one study observed the difficulty people had in cleaning the bathroom, P&G developed Magic Reach, a device with a long handle

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and swivel head. Visits to contactors and home renovators resulted in the development of the OXO hammer (with a fiberglass core to cut vibration and a rubber bumper on top to avoid leaving marks when removing nails) as part of a line of professional-grade tools. Sirius followed 45 people for a week, studying music listened to, magazines read, and TV shows watched and then developed a portable satellite-radio player that can load up to 50 hours of music for later playback. Black & Decker's observation that electric drill users ran out of power led to the detachable battery pack. Intel's research in the Third World led it to develop a cheap PC that could run on truck batteries in 100-degree temperatures. GE found through ethnographic research that buyers of plastic fiber for fire-retardant jackets were more concerned with performance than price. That led to a completely different business model in GE's efforts to enter the field.

Ethnographic research can also be used to improve existing products or services. Marriott had a multifunctional team of seven people (including a designer and an architect) spend six weeks visiting twelve cities, hanging out with guests at hotel lobbies, cafés, and bars.<sup>11</sup> They learned that hotels were not doing well at service for small groups of business travelers. As a result, lobbies and adjacent areas were redesigned to be more suitable for transacting business, with brighter lights and "social zones" with a mix of small tables, larger tables, and semiprivate spaces.

### The Ideal Experience

The conceptualization of an ideal experience can also help to identify unmet needs. A major publisher of directories polled its customers, asking each to describe its ideal experience with the firm. The publisher found that its very large customers (the top 4 percent who were generating 45 percent of its business) wanted a single contact point to resolve problems, customized products, consultation on using the service, and help in tracking results. In contrast, smaller customers wanted a simple ordering process and to be left alone. These responses provided insights into improving service while cutting costs.<sup>12</sup>

#### KEY LEARNINGS

- External analysis should influence strategy by identifying opportunities, threats, trends, and strategic uncertainties. The ultimate goal is to improve strategic choices—decisions as to where and how to compete.
- Segmentation (identifying customer groups that can support different competitive strategies) can be based on a variety of customer characteristics, such as benefits sought, customer loyalty, and applications.
- Customer motivation analysis can provide insights into what assets and competencies are needed to compete, as well as indicate possible SCAs.
- Unmet needs that represent opportunities (or threats) can be identified by asking customers, by accessing lead users, by ethnographic research, and by interacting with customers.

## FOR DISCUSSION

1. Why do a strategic analysis? What are the objectives? What, in your view, are the three keys to making a strategic analysis helpful and important? Is there a downside to conducting a full-blown strategic analysis?
2. Consider the buyer “hot buttons” described on page 33. What are the implications for Betty Crocker? What new business areas might be considered, given each hot button? Answer the same questions for a grocery store chain such as Safeway.
3. Consider the segments in the male shopper insert on page 29. Describe each further. What car would they drive? What kind of vacation would they take? What shirt brand would they buy?
4. What is a customer buying at Nordstrom? At Banana Republic? At Zara?
5. Pick a company or brand/business on which to focus, such as cereals. What are the major segments? What are the customer motivations by segments? What are the unmet needs?

## NOTES

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