Chapter 7

**Researching demand for the business idea**

Car parking

Dan's parents weren't particularly green fingered and throughout his childhood they had always increased his pocket money if he mowed the front lawn and kept the plants tidy. Dan could command double pocket money: his parents' lawn was huge! It was so big, in fact, that Dan used to have a full five-a-side game of football on it with nine friends, with ease.

Dan loved his football and was delighted when his team, Brighton and Hove Albion, decided to move from their temporary home, the Withdean Stadium, to a new ground just outside the town.

The new ground was nearer to Dan's home but it wasn't the shorter journey to home games that pleased Dan; it had given him a business idea.

Tired of doing the lawn but not wanting to give up the income it generated for him, he tried to persuade his parents to cover it all in gravel. Where would the income come from? Charging football fans to park on it on match day!

Dan's parents told Dan that he could start his enterprise if he could prove that it would work. He waited for the first few games of the season to see how the traffic and parking situation was working out. Dan saw that the council had put double yellow lines on the local roads and car parks were often full by midday for a 3pm kick off. Encouraged, he went to an 'Albion internet forum' and asked if people thought that home and away fans would be interested in paying £5 for parking on his drive. The response was remarkable. Dan did one quick check that the council or the club weren't planning on extending their car parks and presented his findings to his parents. The gravel arrived the next day.

Discussion points

1. How did research help Dan develop his business idea?
2. What risks would Dan have faced if he hadn't conducted any research?
3. What other research might Dan have had to conduct if he wasn't a football fan himself?

Market research

A new Starting a business, or launching a new product in an established business, both involve significant up-

product front costs. These include:

* product development
* investment in equipment and premises to produce the product or provide the service
* spending on initial marketing.

Businesses try to ensure that these potentially expensive outlays carry the minimal possible risk. In order to do this they conduct market research, which is the process of finding out information about customers, competitors and market conditions. Gathering this information will allow them to be more confident that investing in the new idea will be profitable in the long term.

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**Market**

**research**

The table below shows how market research can reduce risk when developing a new business idea:

|  |  |
| --- | --- |
| Purpose - allows the entrepreneur to: | Procedure |
| • quantify potential demand | Using the results of market research, entrepreneurs can forecast future sales. This allows them to estimate future sales revenue and decide whether it will cover the costs of production. |
| • understand how much customers are willing to pay | An entrepreneur can assess whether the price that people want to pay will be sufficient to cover costs of production. |
| • understand customer behaviour | Entrepreneurs can work out how best to interact with the consumer. This will include finding out exactly who the product appeals to and why, so that they can sell it in the right places and advertise it and promote it in a way that will be effective with those people.  It may also highlight a customer craving for a product or service that is currently unavailable; this will give the entrepreneur an incentive to explore the possibility of meeting these customer needs. |
| • identify competitors and their unique selling points (USPs) | The entrepreneur can ensure that their own business idea is able to compete effectively with existing businesses by having a source of competitive advantage which makes it stand out from competitors. |
| • identify key features of the business environment | The entrepreneur can decide whether social, legal, economic, political and technological (SLEPT) factors are favourable to the successful launch of the new business idea. |
| Types of market research |  |

A lot of the questions that businesses may ask about the issues surrounding their new idea may have already been answered by other organisations. Interrogating these data sources is known as secondary or desk research. This name comes from the fact that the information is 'second hand' to the business that is using it. Researchers can simply review it from their desks in the office.

**Secondary**

**research**

When the business can't find answers to their questions from an existing source, they will carry out their own research, known as primary or field research. This name comes from the fact the information is found out 'in the field'. The researchers will be looking directly at the market and the information they collect is 'first hand' to the person doing it.

**Primary**

**research**

Market research is the process of gathering data in order to understand current and future customer needs and factors affecting the marketplace. This reduces the risks associated with developing a new business idea.

Primary market research is obtained 'first hand' by the business that is interested in the results.

It involves fieldwork and can be directly related to the needs of the individual business. Also known as field research.

Different approaches to primary research

Market research can also be categorised in another way, according to the type of data collected. If the outcomes of the research are numerical, such as quantities or percentages, it is known as quantitative research. This might generate estimates of future sales or preferred shopping habits and times, or the size, qualities, features and colours of an ideal product.

**Quantitative or qualitative**

Other kinds of data might require qualitative research. It could concern the psychology of the potential customers - their opinions or feelings about the product. This kind of data cannot be put into numbers. But it can reveal much about consumer attitudes and behaviour, their perceptions and their anxieties.

Quantitative market research - market research conducted where the results are numerical and can be analysed statistically.

Qualitative market research - market research conducted where the results are based on opinions and feelings.

Both primary and secondary research can be either quantitative or qualitative. Good market research will link qualitative and quantitative data to build a detailed picture of the customers' preferences.

Ways of conducting market research

Primary methods How they can be used

Questionnaire/survey Asking people a pre-planned set of open and closed questions to gather  
qualitative and quantitative data respectively.

Questionnaires can be used for postal or phone surveys, or in personal interviews. They must be very carefully designed and should be clear, relevant, logically sequenced and never personally intrusive. In general, closed-end questions give a choice of answers and provide quantitative data. Open-ended questions provide individual answers that yield qualitative information.

**Primary**

**research**

Secondary market research uses data that has been gathered previously by another organisation and is publicly available. Also known as desk research.

Comment: this could be very detailed, or could consist of asking a few friends or colleagues to answer two or three simple questions about an idea

Focus group Assembling people for a group discussion on a topic led by the researcher.

The nature of the research means the data is always qualitative and attempts to capture the perceptions, reactions and attitude of the group to a product, service or advertisement. For example, a group might be asked what they think of a planned advertisement or change in branding, or about their attitude to a competitor, in order to refine the business idea or plan a rival product that exploits their weaknesses. Comment: running a focus group really well requires specialist skills. Entrepreneurs may need to hire a market research company to do this so it can be an expensive strategy. Some small businesses may not be able to afford this type of market research, especially when starting up.

Observation Watching and studying the actions of potential customers, suppliers and

competitors. This can include:

* counting the footfall (including the type of person) walking past a prospective retail site in order to assess the suitability of the location
* observing how customers move around the store in order to learn how to position products for better sales
* studying the product range or pricing of a competitor to spot a potential gap in the market (see Chapter 8).
* gathering information on the shortfalls of another product or service,

in order to spot a gap in the market.

Comment: This can be quite quick and simple for an entrepreneur without specialist marketing skills. It is also generally cost-free.

|  |  |  |
| --- | --- | --- |
| Test  marketing | Test marketing | Launching a product in a small portion of the market (normally a limited geographical location) and evaluating the response to it. This may be done to avoid the costs of a 'national' launch before the product is proven. (See Chapter 10, page 60.)  Comment: an entrepreneur might do very small scale test marketing by, for example, asking friends to try a new recipe (for a bakery) or providing a free service in return for detailed feedback (e.g. Tamara, in Chapter 2, may have given her friends free massages in order to test out new techniques). |
|  | Secondary methods | How they can be used |
| Secondary  research | Market reports | Organisations such as Mintel and Key Note produce reports on trends in the market, which are available for purchase by businesses. They will inform about changes in consumer attitudes and how established businesses are responding to these changes. |
|  | Government data | National and local government provide details on the demographics of the population. For example it will be relatively easy to find out the age, gender or income distribution of people in a certain area. |
| Forecasting | Economic historic and forecast data | Trends in unemployment, economic growth, inflation and consumer spending are available from governmental and non-governmental sources. This data will be useful, particularly if sales of the product are dependent on strong consumer confidence. |

|  |  |
| --- | --- |
| Internet | Search engines make it easy to find out if there is any competition in the market that a business is considering entering. Furthermore, services like Google Maps allow researchers to plot the locations of competitors in a geographical area. |
| Trade publications | Lots of industries have specialist magazines that report on trends in the |

market. For example, The Grocer and Hotelier report on trends in the grocery and hospitality market respectively and will give insight to new businesses on customer needs and how they are currently being met.

Which method is best?

There is no simple answer to this question as it depends entirely on the situation. This is because primary and secondary research both have their own distinctive advantages and disadvantages. In reality many businesses find that a combination of methods works best, with primary research following some secondary research that can contribute useful background information. The entrepreneur needs to balance three key issues: cost, time and ease of data collection.

Advantages

**Costs vs. accuracy**

Disadvantages

**Primary research**

* Is certainly up to date as it is conducted as required
* Can be exactly tailored to the needs of the business
* Can produce data which competitors do not have access to.
* Can be expensive to carry out
* Can be time consuming to carry out and interpret
* Some methods such as focus groups can require specialist skills
* Interviewer bias may be a problem

**Secondary research**

• Is available immediately and often relatively inexpensively (or free), compared to carrying out costly primary research from scratch.

* May be out of date
* Difficult to guarantee accuracy and reliability
* Some sources can be expensive to purchase (e.g. market reports)
* Data is not private so competitors can access it too.

Example

Sophie is considering setting up an upmarket restaurant. She is interested in the income level in the local area, so she can estimate how many people would have the disposable income to eat out regularly. This will help her to quantify demand. Sophie would like to conduct a survey of the incomes of all local residents, but it would be incredibly time consuming to do this for even a local area, even if people were willing to share the information. For this reason she may decide to use secondary research conducted by the local council. Although it may not be exactly what she is looking for, Sophie is willing to trade off accuracy against time needed.

If Sophie is satisfied that there are enough people in the local area with good incomes that will sustain a restaurant, she might carry out some primary research. This will help her to decide what pricing strategies might be most successful with the potential customers.

There would be little point in researching pricing strategies if secondary research showed there weren't enough customers. This shows why it is often best to use free or cheap secondary research first, to validate the basic idea before committing to the time and expense of doing primary research to test the idea fully.

Exam question practice

1. Explain two reasons why an entrepreneur would conduct market research before launching a new product. (6 marks)
2. Analyse two benefits of carrying out primary research to an entrepreneur planning to expand their business into a new location. (8 marks)



Surveys and questionnaires can gather information from a sample of potential consumers.

Sampling

Often it isn't possible to complete research which includes all potential customers. For example, at the beginning of this chapter you learned about Dan - he would have found it very difficult to contact all fans of Brighton and Hove Albion, as well as all away fans who may come to a match during the year. Dan used an internet forum as a way of accessing some of the fans in his target market and then made an assumption that their opinion was a fair reflection of all of the fans in the market. Dan used a sample (the fans who responded) to make judgements about the whole population (all fans).

Market research often involves sampling, particularly where quantitative primary research is required. Sampling is much quicker and easier than trying to collect data from a whole population. Surveys and questionnaires can gather information from a sample of potential consumers. The sample size must be large enough to reflect the variations in people's responses reasonably accurately. In general, the larger a sample, the more confident we can be that it will represent the whole population. An entrepreneur faces a trade-off between accuracy (larger is better) and cost/time (smaller is better) when deciding on the size of a sample.

**Surveys and questionnaires**

Potential bias

The people in the sample must be selected carefully, otherwise It may have a bias towards one particular group. Standing in a shopping place during working hours and asking passers-by for an interview will definitely produce a biased sample because it will include a larger percentage of retired and unemployed people than that existing in the population as a whole. This can be called a convenience sample as the researcher questions people who happen to be nearby. This might provide very unhelpful results if you wanted to know about customer preferences for an expensive new game. There are a number of techniques for selecting a sample which can help to avoid bias:

• A random sample could be made representative of the population by taking, say, every 100th name from the electoral register. This can be expensive: it might involve visiting people at their homes several times, before finding them in and willing to answer questions. It might also take a lot of time to travel to different locations.

**Random**

**samples**

Developing New Business Ideas for AS Level

* An alternative would be a quota sample. Using this method, a researcher ensures that responses from different groups of individuals accurately reflect the distribution of those groups in the population as a whole. So there would be representative groups distinguished according to age, gender, occupation and perhaps other factors too. The researcher would make sure to interview the required number of each group in order to get a certain percentage of each type of respondent in the sample.

**Sample types**

* Another alternative is stratified sampling, which means selecting from a particular segment of the population. For example, Sophie (page 41) might try to interview only people who looked relatively prosperous, since the less well off people in the neighbourhood probably couldn't afford her prices.

Sampling involves collecting data from a group of people who will be representative of the target market or the population as a whole.

Bias occurs when information collected from a sample does not accurately reflect variations in the total population. This is likely if the sample is small or inappropriately selected.

A random sample is one in which everyone has an equal chance of being selected.

A quota sample involves dividing the target market into groups according to their consumer characteristics; a percentage of the sample will be allocated to each group.

Stratified samples are similar to quota samples but select participants within the groups on a random basis, to gain greater accuracy.

A WATCH OUT!

Market research is often much more sophisticated than just doing questionnaires. In fact, very little market research is done this way. Instead, a lot of research is done using observation and focus groups because it gives a much deeper understanding of the customers and the market. Also it is often possible to observe people who wouldn't be willing to fill in a questionnaire.

Case study: Apple vs. Market Research

Steve Jobs' opinions about market research are well documented. In several separate interviews he dismissed the value of market research when developing new products at Apple.

"A lot of times, people don't know what they want until you show it to them."

"You can't just ask customers what they want then try to give that to them. By the time you get it built, they'll want something new."

When asked what market research went into the iPad, Mr Jobs replied: "None. It's not the consumers'job to know what they want."

Meanwhile, Vicky Rogers swears by the market research she conducted when setting up Really Lovely Camping Company in 2009. Vicky had been taken on holiday to Scotland by her boyfriend for their anniversary. She was initially sceptical when she found out her boyfriend had booked to go camping until she looked at the 'tent' they were staying in. The'tent' was actually a semi permanent geodesic fabric dome and had a log burner, a full size bed, a kitchen with a dishwasher and a 42 inch flat screen TV. Vicky quickly learned that this was 'glamping', not camping.

She returned from the holiday brimming with ideas. She was convinced that there was a market for glamping in the UK. She quickly began researching to see if there were other 'posh' glamping places in the UK by using the internet and looking at travel guides and brochures. Excited by what she didn't see, she began to research suitable sites where she could set up her own glamping

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experience in the Forest of Dean national park, around 50 miles away from her hometown, Worcester. Once she found a site she researched publications that were read by high income earners without children. These would become her target market so that she could advertise effectively.

Three years on the business is going from strength to strength. Looking back she says "market research gave me the confidence to go ahead with the business idea and give up my job." When asked what piece of research had been most useful, she answered without hesitation: "Finding out the level of competition, definitely. But I had no idea what media and promotion would influence my target market, so finding that out was really important too.

Questions

1. Does Steve Jobs' viewpoint suggest that Apple is product or market orientated? (See page 30, Chapter 5.J Explain your answer.
2. Do you think Vicky's trip to Scotland was market research? Explain your answer, outlining what method and type of research you think it was.
3. Identify two other methods of market research conducted by Vicky and state whether they were primary or secondary and qualitative or quantitative.
4. Explain why Vicky didn't think she needed to research future economic trends when setting up the Really Lovely Camping Company at a time when there were many people whose incomes were generally not growing.
5. Discuss the contrasting viewpoints regarding the usefulness of market research.

Do this

Create a market research plan for a business idea of your choice. Identify the research methods you would use and, for each, identify:

* The likely cost
* The resources you would need
* How you would use the data collected to help refine your business idea.

Chapter 8

**Volume or value?**

**Market**

**leaders**

**Is there a market for the business idea?**

iOS, Android, or Blackberry? or Windows?

Jamie left university in 2010 with a Computer Science degree and an idea.

Jamie was a talented Computer Scientist but awful in the kitchen. Like most students, Jamie spent very little time cooking because he didn't have any knowledge of recipes. His idea was to put his strength and his weakness together: create a smartphone app where you could tell it the ingredients you currently had in the house and it would provide a recipe that you could make with them.

Jamie initially thought that his primary target market would be other students. But he soon realised that there were probably thousands of people who had a fridge full of food but were not sure what they could make with it.

It was clear that this project would reguire many hours of development time. Jamie thought it might stop him from searching for a job. So he decided first to try working out how big the market might be for smartphone applications, and if there was potential scope for market growth in the future.

Discussion point

What information would you advise Jamie to try to find out about the smartphone applications market?

Market size

Market size can be measured in two ways:

* the value of all the items sold in the market in £s
* the volume of all the items sold in the market in 000s.

Measuring by one method is not necessarily better than another. For example, it is quite feasible for the size of the market to have grown in volume (more items have been sold) but at the same time, shrunk in value because the price of each item has fallen considerably in the market. An example of this is shown in the table below where market size has grown by volume but fallen by value:

Market for Average selling Market size (volume Market size (value

Blu-Ray DVDs price (£) of items sold, 000) of items sold, £000)

2010 20 100 2000

2011 15 110 1650

Market share

The market share of a business is their sales (£) as a percentage of the overall market. For example, in October 2010 the UK clothing market was estimated to be worth £25.2bn. Primark's sales were £2.57bn so it had a 10.2% share of the market.

The business which has the greatest market share is called the market leader. In markets with very few businesses you might need 40-50% to be the market leader, but when there are lots of small firms in the

market, the market leader can have a much smaller market share. For example the UK hairdressing market is made up mainly of thousands of individual salons with one or two national chains such as Toni and Guy, who will be market leaders but have a very small market share of hairdressing nationally.

Market growth

Market growth is an increase in market size, normally expressed as a percentage. Market growth indicates that demand for the product is increasing. Market growth can be rapid if the product is completely new and people want it but can be slow or static when the product is well established. Market growth will be negative when demand for the product is falling.

2011 -£185m 2010-£175m

Notice, after rapid growth, the market grows much more slowly from 2010

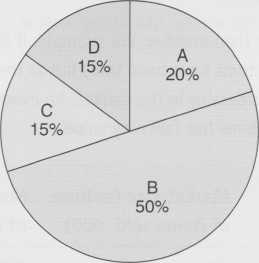
2009 -£170m

2008 - £40m

Businesses are sometimes falsely pre-occupied with market share when they should be looking at market growth. A business can have an increasing market share but actually be receiving less sales revenue if the market is experiencing negative growth. This is shown diagrammatically below:

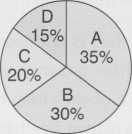
Market Share 2009

(market size = £20m)



Market Share 2011

(market size = £10m)



Over two years business A has grown its market share by 15% (mostly at the expense of business B) but in that time the market has halved in size. Therefore, despite an increase in market share, revenues have actually fallen. Business B has presumably reduced its commitment to this market (given its fall in size) and set up in a new one.

**Market share**

Market size is measured either by the total value or the total volume of goods sold in the market. Market share is shown by the percentage of the market that the individual business sells to. Market growth is an increase in the size of a market.

Show your understanding

1. Calculate the value of business A's market share in 2009 and in 2011. Using your answers explain which you think should be most important to a business: market share or market growth?
2. Co back to Jamie's idea in the opening case study. Research the market size for the different smart­phone ecosystems. Which smartphone operating system (iOS, Blackberry, Android, Windows) has the highest market share? Which one has the highest market growth? Which operating system would you recommend Jamie to develop his application for? Explain your answer.

Market segmentation

Green and Black

In 2005, Cadbury bought Green and Black's. Why would it want to do this? The takeover price to Cadbury is unknown but thought to be around £20 million. Green and Black's existed to sell organic, dark chocolate products - hence the name. It started using Fairtrade cocoa in the early 1990s. As well as having a strong ethical stance, the business developed an enviable reputation for the flavour and quality of its products.

Cadbury had always thought of itself as an ethical business. In the nineteenth century it had pioneered employee-friendly practices. But its chocolate products were always designed for the mass market, conventional in style and quality. It would be hard to find a UK resident who has not eaten its products. Green and Black's appealed to a different, smaller, market, people who wanted high quality chocolate sourced in environmentally friendly ways and offering fair prices to cocoa growers. They were prepared to pay premium prices. This was a market segment that Cadbury could not easily reach with its existing products and its well-known image.

Questions

1. What impact would the acquisition of Green and Black's have on Cadbury's market share?
2. What other benefits might Cadbury get from owning the company?

Personal tastes vary. They depend on individual preferences but they are also influenced by the kind of person you are. Market segmentation identifies different groups in society and studies their particular needs and wants.

**Consumer**

**groups**

Some products aim at a mass market - we all buy toothpaste. But even in that market, producers have identified a range of different needs. They produce differentiated products, e.g. toothpaste for sensitive teeth or with whitening qualities. A few products sell well in mass markets that run right across all sections of society - e.g. Coca Cola and unleaded petrol. But many markets for consumer products have segments that require different versions of the product to meet group needs precisely.

|  |  |
| --- | --- |
| Products for segmented markets: | Markets segmented by: |
| Package holidays, e.g. cheap beach holidays, safaris, exotic locations | Age, income |
| TV stations, e.g. ITV1, BBC4, Yesterday | Age, education, hobbies |
| blousing - starter homes, flats, houses | Income, location, family size |

Mass vs niche marketing

Market segmentation means that the market can be divided up into groups, each of which has distinctive customer preferences. Both products and marketing strategies can be differentiated to meet the requirements of each segment. Common groupings include age, gender, family status, income, interests, locations, culture, occupation, lifestyles etc.

Mass marketing happens when a business aims a product at the largest part of the market. For example, Cadbury sell their Dairy Milk brand to the mass market by appealing to a very broad audience, often in different market segments.

Niche marketing means deliberately targeting a small group of customers, within a larger market, who all share the same characteristics or needs. Cadbury sell their organic, Fair Trade sourced Green and Black's brand chocolate to a niche market consisting of people who are concerned about environmental and ethical standards. Both niche and mass marketing can bring benefits as well as risks to the business.

|  |  |  |  |
| --- | --- | --- | --- |
| Niche |  | Mass marketing | Niche marketing |
| markets | Benefits | • Large potential market could lead to large revenues | • Low levels of competition can lead to being able to charge a higher price, meaning increased revenue and profit |
|  |  |  | • Clear focus - can target particular customers (who are often easier to find and reach) |
|  | Risks | • Strong competition can drive the price down, resulting in lower profits | • Dependent on a small group of customers and vulnerable to changes in the market (all eggs in one basket) |
|  |  | • Branding and advertising to large and diverse groups can be expensive and difficult | • Likely to attract competition if successful |
|  | Niche markets often develop around subcultures. For example, people who like world music form a very distinctive subculture which has its own festivals, recordings and friendship groups. Together they form a subculture. There are many other examples - people who like to go fishing, or enact historical battles, or get involved in amateur dramatics. Before you decide that these are all a bit weird, have a think about the subcultures you yourself value or have experienced. | | |

Show your understanding

Mass marketing applies to a business that is aiming its product at the largest part of the market.

Niche marketing means deliberately targeting a small group of customers, within a larger market, who share the same characteristics or needs

Go back to Jamie's idea in the opening case study. Sketch images of typical customers for Jamie's smartphone app, identifying key segmentation information.

Is Jamie's smartphone app potentially a mass market or a niche market product? Explain your answer.

B&Q in China

Sales of DIY home improvement products topped £14bn in 2006. The market leader in this sector at this time was B&Q, which enjoyed around 24% market share, making their market share worth around £3.4bn.

B&Q executives were rightly proud of their company's performance in 2006. Their market share had increased from 19% in 1995 and the home improvement market had grown at an average rate of 7.8% for every year between 1997 and 2005, as customers were inspired by home improvement television shows like Changing Rooms and motivated by increasing property prices.

However, the boardroom was concerned that future company growth would be far harder to come by.

B&Q's increase in market share had been at the expense of Focus Do It All, Homebase and independent retailers but Wickes and a reinvigorated Homebase remained serious competitors in the retail sector whilst Travis Perkins was particularly strong in the wholesale sector. Significant increases in market share would be very expensive to achieve, requiring either costly takeovers, aggressive discounting or expensive marketing.

Furthermore, B&Q were concerned that the UK market would no longer continue to grow at such a rate. Changes in fashion were still expected but in terms of house decoration, the cycles of trend were far longer than those found in high street fashion.

By 2009 their fears were confirmed. The UK recession halted home improvement as disposable incomes fell and new housebuilding stopped almost entirely. The result was that the market shrank by around 15%. B&Q still enjoyed a healthy market share (still around 24%) but of a smaller market.

Nonetheless, B&Q executives were not overly worried because by 2005 they had opened altogether 48 B&Q branded stores in China. The Chinese home improvement market is estimated to be worth around £27bn; around twice as big as the UK's. Besides, growth in the Chinese home improvement market is around 15% per year.

The Water Saver

Having spent the summer in Africa volunteering, Lucy noticed how precious water is to African people. Inspired by this (and wondering if the West could carry on being so wasteful) Lucy designed a new shower-head that maintained a similar level of flow pressure whilst using 30% less water.

She tested her idea amongst her friends, using a prototype to verify that it worked before arranging for a manufacturer to take on production. As soon as she had a cost price (around £7) she approached B&Q with a view to stocking it in their stores. She worked out that the shower-head could save a family of four around £16 a year in water and demonstrated that it was easy to fit to existing showers. The B&Q product manager was impressed! Her positive reaction was confirmed when, later in the week, she called Lucy and agreed to stock the shower-head in the UK stores.



B&Q bought a number of Focus stores after the company went into administration in 2011, due to its recent losses.

Show your understanding

1. Calculate the value of the DIY home improvement market in 2009.
2. Calculate the value of B&Q's market share in 2009.
3. "B&Q's profits will have fallen in 2009." Discuss the accuracy of this statement.
4. Explain why B&Q needed to look abroad to achieve company growth.
5. Discuss whether Lucy should be worried about the recent negative market growth for DIY home improvement products.
6. Discuss whether Lucy should insist that her shower head be sold in Chinese branches of B&Q. Find out

Visit [http://neoformix.com/2011 /UKAuto.pna](http://neoformix.com/2011_/UKAuto.pna)

What does the graphic show in terms of market size for top ten cars? Find out about the market for cars as a whole over the same time period.

Using the graphic, how could you segment the UK car market?

Chapter 9

**Positioning the business idea**

Are you nuts?

In the mid-1990s internet connections were slow; pages with pictures took a long time to load and social networking and streaming video were distant phenomena. Magazines were still the media for older teens and early twenties to explore fashion, music, celebrity, sport and adulthood. Monthly copies of Just Seventeen, Bliss, More! (sold fortnightly) and Sugar for girls and FHM, Maxim and Loaded for men sold well on the shelves of newsagents.

By the mid-2000s the internet had gathered pace and seriously threatened the sales of the magazines as their monthly publication cycle struggled to keep pace with rapidly changing trends. They offered readers very little opportunity to interact instantly with the magazine content. Faced with a dynamic market, magazine publishers needed to position new products to meet the changing needs of customers and compete with internet sites that could update content constantly.

It didn't take long for publishers to position several new magazines in the market. Look!, Shout! and Heat launched as weekly magazines aimed at young women whilst More! also moved to a weekly publication. For men Nuts and Zoo launched as weekly 'lad mags'. The move to weekly publication was a clear attempt to position the magazines much closer to readers' changing customer needs by providing a much more up to date view on fashion and celebrity. It also facilitated a much faster response to reader input through social media.

Discussion point

Explain why it was necessary for the magazine publishers to position their new businesses ideas as 'weekly' products.

Market positioning

In many markets, a range of similar products is available and each will have distinguishing features. (Think about the car industry.) Businesses like to have differentiated products. It helps them to cater for a range of market segments: they can design each product in the range so that it fits the requirements of a target segment quite precisely. These requirements can be discovered by doing careful market research and Market using the information obtained to make the product really attractive to customers. This is all part of market

orientation orientation - being sensitive to customer preferences. (See page 30.)

Another important aspect of product differentiation is that it helps the business to compete. A distinctive product, perhaps with a memorable brand name, will have particular attractions for many customers. But no matter how carefully designed the product is, if it is competing with a very similar product from another business, it will be much harder to sell in quantity.

This is where market positioning comes in. Most businesses look for a gap in the market - a group of potential customers whose needs are not well covered by existing products. This is what the publishers of Nuts and Zoo were doing. They positioned their magazines in a part of the market where there would be relatively little competition.

X X

> X x x

X x X

\*X X x \* X X x

\* x x x: vx x v Atmosphere Romantic

x <xx X x

x X X X



**Market maps**

Differentiated products are designed so that they have distinctive features that are different from those of competing products. The product may have unique characteristics or it may be marketed in a different way from its competitors, so that it has a distinct image.

Market positioning refers to the way the product is perceived in comparison with competing products. Considering the positioning of the product helps the business to make decisions about the way its product range matches customer preferences or appeals to different market segments.

**Market mapping**

The best way to visualise the position of different products in the market is to use market mapping. There are two important aspects to consider when positioning a business idea.

* The business idea must be evaluated as to how well it will meet the customer needs that have been identified by market research. (See Chapters 7 and 8.) If it isn't going to meet current (or future) customer needs it is unlikely to be successful.
* Even if the product or service clearly meets the researched customer needs, it may be important that other businesses are not already doing that. Market mapping allows an entrepreneur to check whether this is the case.

A market map sets out the features of the market on a diagram and then plots where each product fits in according to the market research findings. Each axis can represent a feature of the product or the market, or any possible way of segmenting the market. Each end of the axis is a polar opposite. These might include:

**Feature**

**Segmentation**

High quality vs lower quality Mass vs niche market Modern vs traditional Aesthetic vs functional Luxury vs value

Male vs female Old vs young

Urban customers vs rural customers

High income customers vs low income customers

Figure 9.1 shows what a market map for restaurants in a big city might look like. The features considered are price and atmosphere, which will be an important element in customer choice.

*Figure 9.1 Which position?*

£ High

x

X

Atmosphere

Functional



x X X

X

The market map below shows the UK 14-24 year old magazine market in the mid 2000s (for the case study on page 51). It uses a feature on the vertical axis and market segments - male vs female - on the horizontal axis.

Figure 9.2: The UK market for magazines for age 14-24, mid-2000s Maxim Monthly

|  |  |
| --- | --- |
| x[[1]](#footnote-1) Loaded | Sugar \* x \* ^ |
| FHM | Bliss |
|  | More! |
|  | X |
| Males | Females |
| □ | f | |

Weekly

The three magazines in the top left corner of the map are positioned there because they are very focussed towards the male market. They are at the top of the map because they are all monthly magazines. More! is on the right hand side of the map because it meets the needs of females and is halfway between the top and the bottom of the map because it is fortnightly.

**Finding a gap in the market**

The market map allowed the publishers to check the level of potential competition and identify a gap in the market. There clearly were no products in the green areas for weekly magazines aimed at 14-24 year old males and females (either monthly, fortnightly or weekly). Positioning their products there would mean they would not face immediate competition.

Having used the market map to identify a gap and help position new products (e.g. Nuts and Zoo), the magazine publishers ultimately went ahead. They believed that customers had switched preferences, towards weekly magazines. However, the quote below is very useful for considering the main drawback with market mapping.

"There's a gap in the market but no market in the gap." (Peter Jones, Dragons' Den).

Market mapping can highlight gaps in the market but the reality is that there can be a gap in the market for a good reason. It may be that no business has 'filled the gap' because there are few customers who want that combination of features from the product. Or maybe a previous business has tried and failed. This could be the case for a unisex magazine: trying to meet the needs of both segments could mean that the product would not fully meet the needs of either and therefore it would be unpopular.

**A WATCH OUT!**

There is often a gap in the market for luxury or high quality products at a low price. This may happen because businesses find it impossible to offer luxury or high quality at a low price; alternatively offering it at a low price may actually take the luxury feel away from the product.

Repositioning the product

Sometimes a product loses its attractions for its target market. If the business is making a loss on it, the best strategy may be to discontinue production. But sometimes it can be repositioned successfully. Lucozade did this; as a nutritional product for people in poor health, it was failing. Repackaged and advertised differently, it sold very well as an energy drink for fitness enthusiasts.

By 2012, some brands in the magazine market had repositioned themselves or left the market altogether. Publishers found that the Sugar brand no longer met its customer needs and it was discontinued, whilst the Bliss brand was repositioned to the 'tweenies' (ages 12-15) market.

A market map is a tool that plots brands in the market according to how they meet customers' needs. It allows a business to position individual products effectively.

A gap in the market indicates that there is scope for a new product that is not currently being provided.

Repositioning means targeting a different segment of the market, one where its individual features are more in keeping with the needs of the customer.

Show your understanding

**Competing**

1. Complete an up to date version of the market map for magazines in the UK, using your own choice of axes.
2. Do you think there are any current gaps in the market, creating an opportunity for a new magazine brand? If so, justify your thoughts.
3. Are there any brands that could do with repositioning? If so, justify your thoughts.
4. Explain why businesses sometimes reposition brands rather than creating new ones.

Evaluating the competition - strengths and weaknesses [[2]](#footnote-2) •

A new business will engage in a SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis in order to evaluate their competitors before deciding where to position their brand. Essentially they will follow this process:

**SWOT**

Yes

Do competitors

have weaknesses > Yes that we can attack?

Do they have strengths  
that we can overcome  
or match?

Compete directly  
with them in the same  
area of the market

No

Compete with them  
by differentiating  
the product

Show your understanding

1. Explain the purpose of market mapping.
2. Analyse why it is important to find a gap in the market.
3. Explain the steps a business could take to avoid a competitor positioning a new product or brand in a similar area of the market to itself.
4. Evaluate the extent to which product differentiation is necessary when entering a new market.

Competitive advantage

Once the competition has been evaluated, the new business (or the team developing the new product) can decide how it is going to gain competitive advantage. There are many ways of gaining a competitive edge which will help the business to succeed when competing with rivals. Price is important to competing successfully but adding value is also a key factor. All businesses do this to some extent, but the most successful will add more value.

**Adding value**

* Car manufacturers might design their brands to incorporate greater reliability.
* A beauty therapist might add value by getting some additional training, learning new ways of using beauty products effectively, or offering free styling advice.
* A theatre might add value by getting better known actors.

Adding value isn't costless but it can create a strong competitive advantage. It can make it possible to raise the price and still be perceived as offering good value for money.

Possible areas for gaining competitive advantage are shown in the diagram:

Lower

price

Uniqueness

Higher

quality

Innovative new

technology Successful high quality advertising and branding

Show your understanding

For the following products or services, evaluate the relevance of each source of competitive advantage to their success:

**Competitive**

**advantage**

Competitive advantage may be achieved using any factor that will help the business to succeed when competing with rivals. Price may be important but there are many other ways of making a product competitive. Innovation, reputation and reliability can all be important.

Added value is the difference between the price that is charged and the total cost of the inputs needed to create the product. It applies to services as well as to manufactured goods. It may come from improving the product itself, or from improving the way markets perceive the product.

* iPhone
* Netflix or LoveFilm
* Alton Towers
* Dyson vacuum cleaners

Fashion matters

Robyn graduated with a degree in Fashion design in 2010. Whilst studying and after she graduated she worked as a retail assistant at FI&M, where she closely studied what customers like and their buying habits. Robyn now believes that with this experience in high street fashion retail and her knowledge of fashion design she is ready to set up her own fashion boutique.

The boutique will sell clothes designed by Robyn. She acknowledges that she will never achieve the low prices of the main high street brands, so will not be competing on price but does see the high street (Top Shop, River Island etc.) and online brands (ASOS.com etc.) as direct competition. She plans to gain competitive advantage by producing unique pieces to avoid what she describes as "the horror moment you get when you realise someone is wearing the same dress or shirt as you."

Robyn believes that she has found a gap in the market for a unisex shop, targeting customers aged between 17 and 28.

Questions

1. Describe how Robyn is planning to differentiate herself from the high street brands.
2. Explain two other methods that Robyn could use to gain competitive advantage.
3. Draw two market maps (with appropriate axes) to assist you in evaluating the extent to which Robyn has found a gap in the market, competing against the high street and online brands.
4. Discuss the usefulness of market mapping to Robyn as she attempts to position her brand.

Find out

Conduct some market research in a local town nearby and add any independent shops to the market map for fashion brands that you have drawn for Robyn. Would Robyn's store be positioned in a gap in the market in your town?

Chapter 10

**What really works? Opportunity cost, test marketing and product trial**

Taking decisions

Jim owned and ran a greengrocers shop in the High Street of a small town. Everyone said it was the best place for fruit and veg, anywhere in the town. Prices were quite high compared to the supermarket but the quality was excellent and Jim stocked everything you could possibly want. You could get all the things you needed for a new recipe and all the everyday greengroceries as well.

About two years after opening the shop, Jim rented the premises next door and knocked the walls down. That gave him a large open space to expand the greengrocery business and set up a small coffee area where customers could sit and eat delicious pastries or a light lunch. Sales revenue continued to climb.

After three more years, Jim found that he could make more money from the coffee shop than from the greengroceries. He saw that he had a choice. If he cut down the greengrocery space by half, he could put many more tables and chairs in for the coffee shop. That would increase the sales revenue from the coffee shop but might not make too much of a difference to the sales revenue from selling fruit and vegetables. He lay awake worrying about this. He just could not tell whether the gains from the one would be greater or less than the loss from the other.

In the end, Jim expanded the coffee shop and continued to sell fruit and vegetables from a smaller space. He stocked somewhat fewer items. He isn't saying how much his overall sales revenue increased but a few years later, he opened a second outlet in the big town ten miles away. The format was the same as his first outlet, so he must have made the right decision.

Questions

1. The greengrocery business was always successful. Why was Jim running a risk when he expanded the coffee shop?
2. How could Jim gather evidence that might help him to take the decision?

Choosing Jim's dilemma is a very familiar one. Every time we have a choice, we have to weigh up the pros and cons,

between We evaluate the alternatives. We have to do this because we never have enough resources to do everything

alternatives we might want to do - resources are scarce, when compared to what we might want to do.

This means that every decision we make means going without some alternative.

* As a consumer you could be deciding between going to the cinema or buying a book like the one you are reading now, one that could be useful in helping you to understand your course on New Business Ideas.
* For Jim, the decision was between expanding one side of the business at the expense of the other. Many businesses have to decide whether to concentrate on existing products or launch new ones that may capture customers from a different market or market segment.
* For a government, the decision might be about spending more on military hardware. The alternative might be to spend more on welfare benefits for disabled people.

In each of these cases, the choice that is made will have an opportunity cost. That is what we are

foregoing as a result of our choice. Jim was worried about foregoing some of his income from sales of

greengroceries, when he expanded the coffee shop. You have taken a decision to study; the opportunity cost of studying is the income you might be earning if you can work. Governments are worrying all the time about spending priorities and the opportunity cost of their expenditures.

Trade-offs

Where there is a choice, there is an opportunity cost. Having one thing, or following one course of action, means not having something else. Choosing between the cinema ticket and the text book is like this. But often, the choice is rather different - it is between more of A and less of B, or more of B and less of A. This definitely applied to Jim's decision - he was never going to shut down either side of his business. This means there is a trade-off between one choice and the other, or others.

**Opportunity**

**cost**

The opportunity cost of a decision is the value which is expected to flow from the next best alternative decision. When making a choice between possible alternatives, the opportunity cost of any spending decision is made clear.

Trade-offs occur when two things cannot be fully achieved. Having more of one thing may mean having less of the other.

Tata

Tata is a huge Indian conglomerate, a business that makes many different products. It owns JLR (Jaguar Land Rover) as well as much of the UK steel industry. In 2010 it launched the Nano car, designed specifically for the Indian market. To sell well there, the price had to be low - it started at around £1750. Obviously it is basic compared to cars sold in western markets, but it is affordable in India, at least for some people.

Many people, including the Tata management, thought the Nano would sweep the market. In the event, sales were disappointing. No one wanted to buy the world's cheapest car. In the post mortem some commentators said that Tata had made some bad decisions:

* The advertising emphasised the low price. Some said Tata had put too much effort into cost savings and not enough into sex appeal.

**Style vs. price**

* Others said that the senior managers at Tata had taken their eyes off the ball. They were so excited about taking over JLR that they put all their energy into making that work, and overlooked the need to monitor the development of the Nano.
* Better market research could have alerted the Tata management to the difficulties it would face in the market. More emphasis might have been put on the efficiency of the air conditioning (an important factor in India), or other product features.

Questions

1. What was the opportunity cost of focusing solely on keeping the price of the Nano down to the absolute minimum?
2. What evidence is there that Tata faced a trade-off between getting the Nano right and ensuring that the takeover of JLR was a success?

Could Tata have known in advance that the decision to take over Jaguar Land Rover would make it difficult to give full attention to promoting the Nano? Perhaps in the long run both ventures will prove to be a success. At the time of writing, sales of the Nano are picking up, especially to women and people living in



What do you think?

the smaller Indian cities. Demand for JLR vehicles is so high that they are expanding capacity and taking on more employees at their UK factories.

Very often, businesses have to decide between developing one product rather than another. In business and in everyday life, every decision involves weighing up two (or possibly more) alternatives. Almost always, a decision to do one thing means foregoing something else.

Test marketing

Taking decisions in business is difficult. Often they have to be taken using incomplete information. Estimates may be somewhat different from the reality as it turns out. One way to reduce the risks of launching a new product is to try it out by test marketing in a limited area. In this way, it may be possible to find out whether the product will be profitable. It creates an opportunity to see how the product sells without risking the huge investment required to set up full-scale production of the new product.

Should Tata have test marketed the Nano, trying it out, say in just one Indian province? Would this have revealed design shortcomings, which could have been rectified before the main product launch? This approach would probably have been far too expensive for a complex product like a car. But it is much more feasible with everyday consumer products, and it can work well for food products.

**Reducing**

**risks**

New products will be tried out on focus groups, with people who volunteer to taste the product and comment on it. If they approve of the flavour, texture and so on, the product will then be launched on a small scale in a particular area.

Test marketing means that the new product will be marketed and sold within a small area to see how potential customers react to it. This market needs to have similar features to the ultimate target market. It is quite an expensive way to discover whether the product will sell, but it may be a lot cheaper than a full-scale launch of a product for which there is little demand.

Island Analyses

This is a company that organises test marketing on the islands of Jersey, Guernsey or the Isle of Man. The idea is that these islands are isolated from the rest of the UK and advertising within the islands will be easier, cheaper and more efficient than on the mainland. Also, in Guernsey in particular, the age, social and occupational structures of the population closely resemble those of the UK market as a whole. So test marketing done there is likely to provide conclusions that would apply to the wider market.

**Test**

**marketing**

Island Analyses reckons these factors mean that it can offer reasonably priced services that will give valuable information about the likely impact of the new product in the wider market.

Show your understanding

1. Why would food products be particularly suitable for test marketing?
2. What other kinds of products might be suitable for test marketing?
3. What disadvantages does test marketing have?

Test marketing can be used before production begins, sometimes even before the product development stage is complete. The idea is that both the product and the marketing strategy can be evaluated by small groups of customers, in the context of a normal retailing situation and without the customers realising that this is happening. You may have been in a department store or supermarket where someone is standing by a table with delicate nibbles or drinks, inviting you to help yourself and comment on the product you have been offered. At the end of the day conclusions will be drawn on the customer reaction to the product. The conclusions may be used to adapt the product to make it more attractive.

Product trial

Test marketing is just one way of achieving product trial - making sure that people actually try the unfamiliar product to see if they like it. If they do, then the possibility of repeat purchases will greatly increase the chances of the product's succeeding.

Getting consumers to try a new product can be difficult, especially if it is competing with many popular existing products. Often in the launch phase, large sums of money will be spent on advertising to make people aware of the new product's existence. But if the advertising suggests that the product is truly wonderful, and it turns out to be just another version of an existing product, the advertising may backfire. This will mean disappointing levels of repeat purchase.

Product trial refers to the way customers will buy something once to see if they like it.

**Repeat**

**purchases**

Repeat purchases occur when the customer decides to buy the product on a regular basis.

Sometimes new products start out being quite expensive. If they are really innovative and attractive as well, they will face little competition and the business can charge a high price and still sell the product. But when potential competing businesses see the success of the product, they will come along with me-too versions. This happened with bagless vacuum cleaners and liquid laundry detergents.

To ensure that a new product gets repeat purchases, it has to be highly competitive. It must:

* be something people do want
* offer good value for money, in terms of quality if not price
* be marketed in ways that ensure widespread recognition
* be displayed where people will notice it.

Yorkie

The chocolate bar that came out in 1975 and is still selling well must be a good example of a repeat purchase. It is worth looking at the development process it went through. It was Rowntree's answer to Cadbury's Dairy Milk (selling since 1905).

Cadbury had reduced the thickness of the Dairy Milk bar, because of rising sugar and cocoa prices. Market research showed that customers did not like this. Rowntree set to work to find an answer to a range of consumer needs that the research had identified and produced edible samples, packaging and advertising material for four new products:

* a chocolate bar with nuts and port wine flavour and advertising associations from the 1900s
* a thick bar with countryside associations
* a box of milk chocolate pieces and a continental image
* a chunky milk chocolate bar with masculine associations, called 'Rations'.

More market research followed; all four concepts were tested on four groups of consumers. They liked the last one, but not the name, which was changed to Yorkie, possibly because it was to be made in York.

Questions

1. Explain why a focus group was an appropriate way to review the four proposed products.
2. How would you explain the success of the Yorkie bar?

Find out

Over the next three weeks, look out for new products in adverts, on display, in the news or come across by word of mouth. What makes you think that the product might or might not succeed? Compare your findings with those of others in your group.

Stakeholders

Wherever there are decisions to be made, there will be trade-offs and the interests of different groups of people will be affected. Each decision will impact upon a stakeholder group in a different way. Stakeholders include all those people who are directly affected by business decisions.

**Impact on people**

Stakeholder groups include customers, employees, shareholders, suppliers and the wider community, all of which are affected by the actions of the business.

The effects of decisions on stakeholders can be seen in many everyday situations.

* When Honda decided to expand its car factory in Swindon, the employees and the local community were cheered by the offer of more jobs.
* A new product that turns out to be unprofitable usually means that some customers have been disappointed, and the shareholders might be too.
* A business that strives to improve efficiency and makes some employees redundant, but makes a bigger profit in consequence, will please the shareholders but anger the employees.

Think

Which stakeholders will feel the impact, and how, if the business improves customer service?

Chapter 11

**Looking at the economy**

Two businesses - different stories

Travel agents have had a tough time. Competition from direct on-line booking has reduced their profits over a long period. On top of that, recession conditions and falling or very slow growing incomes mean some people are cutting back on holidays abroad. Thomas Cook, one of the UK's oldest travel businesses, made a fairly modest loss of £269 million in the first half of 2011 but that rose in 2012 to £713 million. The business operates worldwide but even so, that is a very serious loss.

Jaguar Land Rover, on the other hand, was doing well in 2012. Tata Motors, its Indian parent company, announced that it would raise spending on new products from an annual £1.5 billion to £2 billion. It planned to replace its Range Rover top-of-the-range model and build a new engine plant in Wolverhampton. Sales in China had increased by 75% over the previous year and the company planned to increase the level of shift working in its UK factories. After-tax profits doubled.

Both these businesses were operating against a background of generally difficult trading conditions in the UK economy as a whole.

Questions

1. List three possible reasons why Thomas Cook was in difficulty.
2. How might the business deal with the rising losses? Outline two possibilities.
3. Why were things rather different at JLR?

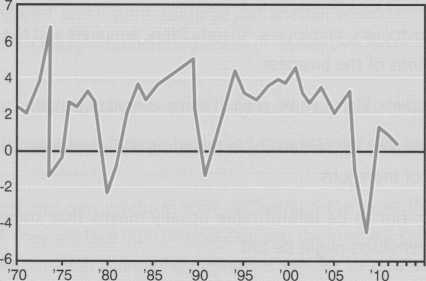
The economic cycle

The business environment is quite dynamic. Things are always happening - demand changes, costs and prices change. Governments change too - and not just at election time. New policies may be introduced. Change is normal. Businesses have to keep a sharp eye on the changes that might affect

**The national economy**

them and adapt as fast as they can.

*Figure 11.1: Real GDP growth, annual % change*



Source: ONS; NB 'Real' means that inflation has been allowed for; 2012 = estimate

One key question recurs, is the economy growing and by how much? In general a growing economy means growing demand for many businesses. A few businesses do better when the economy isn't growing (remember Domino's in Chapter 6?) Either way entrepreneurs need to know what is going on, and be aware of the economic cycle.

Figure 11.1 shows how and when Cross Domestic Product (GDP) has grown (or not) since 1970.

* Why so long ago? Because the graph shows how the economy fluctuates, in cycles.
* Why GDP? This just means the sum total of all production in the economy. The statisticians add up all the output, all the income and all the spending - which are three different ways of measuring the same thing. The percentage change in GDP is a measure of economic growth.

**A WATCH OUT!**

These cycles are referred to in three ways - but they all mean the same thing. The business cycle, the economic cycle and the trade cycle are just different ways of describing the fluctuations. Here we are using the term economic cycle, but if you get asked about the business cycle in an exam, remember, the two are no different.

**The economic cycle**

The economic cycle is the sequence of depression, recovery, boom and recession which creates significant fluctuations in demand for many products. Also known as the business cycle or the trade cycle.

Cross domestic product (GDP) is a measure of the size of the economy and gives the money value of all output. It is also used as a measure of national income and total expenditure in the economy. GDP or incomes in real terms refer to data that has had the effects of inflation removed.

Economic growth means an increase in the total output of the economy. If it is rising, the standard of living should improve. Many businesses will experience rising demand for their products.

Booms and recessions

Looking at Figure 11.1, you can see that most of the time the, the economy is growing by between 2% and 4% each year. This is a happy story - most years, for most people, there has been a little more income to spend or save. Standards of living have risen. But every so often - in 1974,1980,1989 and 2008 - there has been an abrupt change in which economic growth slowed and went below zero, i.e. negative, so that the economy actually shrank. Those downturns were recessions - output fell but only for a short time. If output falls for longer, there is a depression - as happened in the 1930s. To see what the phases of the economic cycle are actually like, look at the table.

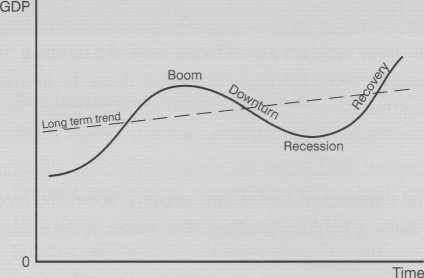
|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Depression | Recovery | Boom | Recession |
| Unemployment | High | High but falling | Low | Rising |
| Inflation | Low | Stable | Accelerating | Falling |
| Confidence | Very low | Rising | High | Falling |
| Investment | Very little | Growing slowly | Growing faster | Falling |

Recessions usually have more than one cause. In 1974 and 1980, huge oil price rises were very much part of the story. When people and businesses have to pay much more for petrol, they are left with less money to spend on other things, so many businesses find it harder to sell their products. In 1989 and 2008 the economy had been allowed to expand fast and in an unsustainable way. In keeping cyclical movements to a minimum, government policies can help or hinder. But economies do have a tendency to expand and contract all on their own. Figure 11.2 shows the phases of the economic cycle and the long term trend rate of economic growth as standards of living gradually rise.

**Causes of recession**

The economic cycle plays a big part in determining the levels of unemployment and inflation. This will become clearer later.

What was wrong in 2012?

Well, quite a lot. In 2007-08, the credit crunch, a banking crisis in which the banks all lost confidence, meant that they stopped lending to each other. This caused a fall in spending generally because loans became very hard to get. The economy was in any case sliding slowly towards recession. Business confidence took a big hit: few businesses wanted to invest significantly in new production facilities. So spending fell further. As unemployment rose, many people found their incomes falling and so spent less. The economy got into a vicious downward spiral.

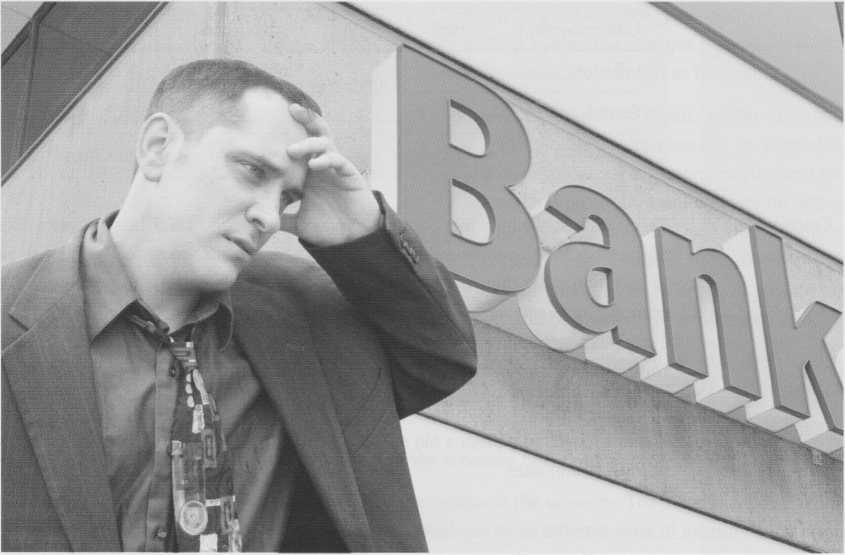
**Current**

**trends**

*Figure 11.2: The economic cycle*

Find out

By the time you read this, the economy will have moved on. Find out what has happened since 2012 to GDP, inflation and unemployment. How would you describe the current level of business confidence? Have you come across businesses that are planning to invest and expand? Do you know why they believe they could succeed?



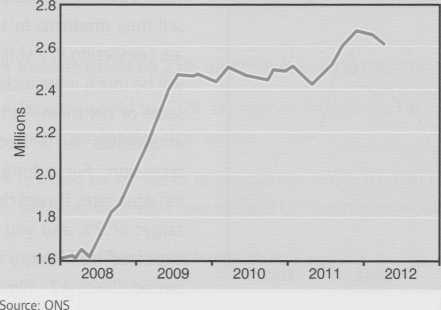
*The banking crisis led to fewer loans, less spending and greater unemployment.*

Between 2000 and 2008, the number of unemployed people hovered between 1.5 and

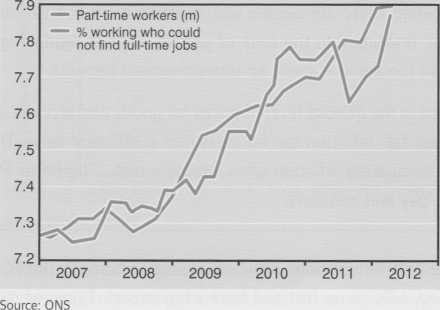
1. 7 million, mostly about 5.5% of the labour force, which was more than most people would want but not too serious. Figure
2. 3 shows how unemployment rocketed in 2008-9. Actually it could have been worse. Many employers tried to avoid making people redundant and kept on as many people as they could. They offered shorter hours or part-time work and some people accepted a pay cut rather than lose their jobs (see Figures 11.4 and 11.5). This meant that employers could be ready and able to expand as soon as demand improved.

**The data**

*Figure 11.3: Unemployment, 2008-2012*



*Figure 11.4: Part-time working*

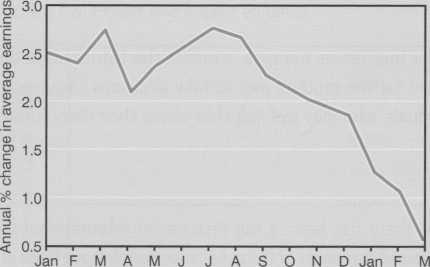


**A WATCH OUT!**

The axes do not start at zero. Remember to look for this when you are trying to interpret the data.

Remember that if earnings increase by less than the rate of inflation, real incomes are falling.

Figure 11.5: Average earnings



2011 2012

Source: ONS

Unfortunately, in 2012, although there had been short periods of relative buoyancy in the economy, the turnaround had not yet begun. This story is very typical of recession conditions. 2.6 million is about 8.2% of the work force. In addition, there may be many people who would like to work but do not qualify for unemployment benefits and have given up looking.

**Recession**

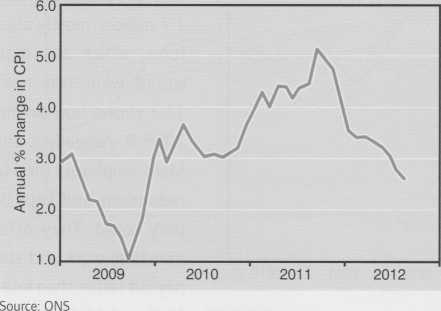
**continued**

**Unemployment**

The smaller increase in unemployment, in 2011, suggested the start of what is called a double-dip recession. A possible reason for this could be the painful expenditure cuts, which governments all over Europe were using as a way of reducing their large deficits. The difficulty is that in a recession, part of the large deficit comes from paying increased unemployment benefits while receiving less in tax revenue because incomes for many people are falling. There is more in this in Chapter 12.

In a booming economy, demand is growing fast. Businesses can put up prices and still sell their products. In a recession, businesses are competing in a shrinking market and they will be much more inclined to keep prices the same or cut them. So inflation automatically accelerates in a boom and slows in a recession. For a long period up to 2007, inflation rates stayed close to the government target of 2% and you might therefore have expected inflation to fall below that in the period 2008-12. Figure 11.6 shows what actually happened.

*Figure 11.6: Inflation*



**Inflation**

Unemployment occurs when there are people who want to work but cannot find a job. High unemployment is wasteful: resources, in the form of people, are not producing anything and the government has to increase the amount spent on unemployment benefits.

Inflation is a sustained rise in the general level of prices for goods and services. If incomes stay the same, purchasing power will fall. Inflation can be measured in different ways. The Consumer Price Index (CPI) is used when comparing inflation rates internationally. The Retail Price Index (RPI) is used as a basis for setting pay and pensions.

The economic cycle is not the only influence on inflation. Rising commodity prices are a big factor. When oil prices rise, petrol and energy bills go up fast and have a big impact. Prices of minerals like copper and some food prices may also rise (or fall). Prices go up when VAT rises. When inflation rose in the period 2009-11, all of these figured amongst the suggested causes. To explain this, we have to take a look at global trends.

**Rising prices**

Inflation causes problems for businesses because it makes the future more uncertain. It is harder to estimate likely future demand for the product and to take decisions about possible expansion. It also creates uncertainty for individuals, who may feel less clear about their likely future standard of living.

Globalisation

Over the past twenty years, there has been a big increase in international trade. Cheap imports of manufactured products have raised standards of living because people have been able to buy more with the amount they could earn. Export opportunities have increased too. World markets have become increasingly integrated. This means that countries that trade with one another become interdependent. They depend on one another for supplies of the products they want and for markets for the products they produce.

Globalisation also means that individual economies become more vulnerable to events elsewhere. Wars and civil disturbances can disrupt supplies of oil but can also mean that a previously useful market for other countries' exports is closed off. Falling demand in the economy of a trading partner, for any reason, can be very bad for exporters.

Globalisation refers to the way in which all the world's economies have become more closely integrated. There is more trade in products and services. There is foreign investment and many businesses are active in more than one country.

The impact of exchange rates

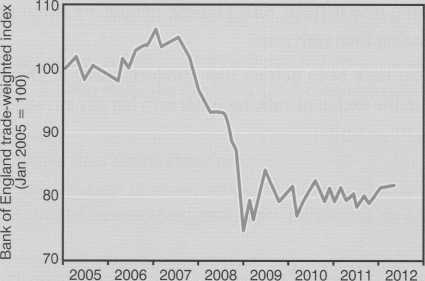
Understanding the UK economy is impossible without including the exchange rate in the story. Figure 11.7 shows that the pound fell by a total of 25% between 2006 and the end of 2008. This meant that if nothing else changed:

* Imports would be 25% dearer in late 2008 than they had been in 2006.'
* Exports would be 25% cheaper in foreign markets. Foreign buyers would find UK products much more competitive than before.

**Imports and exports**

* It would be far easier to compete in 2009-10 than it had been in 2006. Exporters would be able to sell more in foreign markets and UK businesses would find it easier to compete with imports.

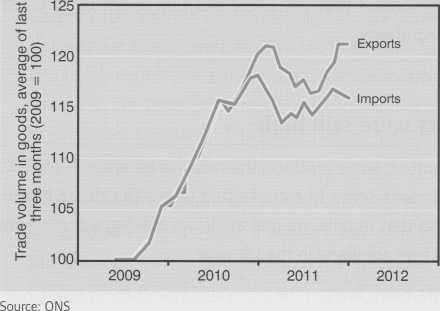
*Figure 11.7: The UK exchange rate*



Source: Bank of England

Of course, it takes businesses and consumers a little while to adapt to new exchange rates. But Figure 11.8 shows that in the two years after the dramatic fall in the UK exchange rate, exports rose by 20%. Flowever, imports really did not change very much. All that can be said is that they rose by a bit less than exports.

*Figure 11.8: Export and import volumes*



An exchange rate is the rate at which one currency is exchanged for another. Usually exchange rates change continuously, but by small amounts. An economy that is struggling to compete is likely to find its exchange rate falling.

Evidence

1. Some businesses are expanding - JLR are one example but other car companies like Flonda in Swindon have announced big new investments. UK-produced vehicles are selling well because they are cheaper than imported competitors. But this is probably not the major factor for JLR -

image18they are benefiting from the huge increase in demand for luxury products in China. They have, quite simply, found a big new market. Rich Chinese people are often more concerned with

**Competitive­**

**ness**

Figure 11.7 uses the exchange rate index to measure the change in the currencies of the UK's main trading partners as a group. The value of 100 was given for the base year, 2009, so it is easy to see the percentage change. You do not need a deep understanding of this process but you must be able to interpret the figures correctly, i.e. spot the percentage change.

status, quality and branding than with price.

2. Some manufacturers that have been getting their products made in China are rethinking their strategies. The change in the exchange rate, together with big pay increases in China, have made this a rather less competitive option.

Discussion points

1. To what extent can the car companies' new plans be explained by the change in the exchange rate?
2. Why might it make sense for a manufacturer of trainers to make them in the UK instead of an emerging economy like China?
3. Discuss whether or not consumers in the UK might buy more UK-made clothes if they were 25% cheaper.
4. 'Drink up' is a small independent retailer selling interesting but inexpensive wines. It sells locally as well as online. How will the owners of the business feel about a fall in the pound? What consequences will it have?
5. Think of two small businesses that you know and that might be affected by exchange rate changes. Explain how and why.

Explaining why imports were still high

* Globalisation involved importing some products that used to be made in the UK. If cheap labour made it possible to cut prices, it made sense to manufacture where the cheap labour was. Because of this, some UK factories closed so that in time, no one at all was making suitable substitute products in the UK. For example, very few toys are made in the UK now.
* Some UK businesses, like Burberry, were still making substitutes for imports, but designing them to sell as luxury items, with prices more than 25% above the old import prices.
* Using the example of the trainer manufacturer above, it might take some time to organise all the production facilities they would need if they were to relocate their manufacturing operations back to

the UK.

• Many UK exports require imported inputs - components, or raw materials. When exports rise, some imports will rise too.

High imports meant that many UK businesses were still having difficulty competing with products from abroad. Holidays in the UK were still often expensive and risky in terms of weather.

At the time of writing, the eurozone crisis and austerity policies generally (designed to cut government deficits) are leading to weak demand. This makes it very hard to sell exports to the countries concerned (see the case study below). More than half the UK's exports go to the EU. So exports are not as high as might have been expected.

The exchange rate and inflation

When import prices rise, inflation rises. Many of the products we buy are imported, so if we are measuring inflation, we have to include imports. Some of the inflation mentioned above can be blamed on the fall in the exchange rate. When the Bank of England needs to explain to the public why inflation has been guite high, this is given as an important reason. A lower exchange rate means you have to pay more for what you import.

**Import prices**

Imports are not just things brought to us by sea or by air. They include many services. The vast numbers of tourists who come to London are buying UK exports. When we holiday abroad we are buying imports.

If rates of pay are rising, costs will rise and products will cost more. This will push up the rate of inflation, but it will also make the economy concerned less competitive.

Show your understanding

You are about to go on holiday in France and have £100 spending money to exchange for euros. If the euro goes down against the pound, how will this affect your spending power?

Would an exporter of scotch whisky want the pound to be high or low? Say why.

Postscript - Greece and the euro

One reason for the low level of business confidence in 2012 was the eurozone crisis. The Creek government's borrowing had reached levels at which lenders felt very doubtful that it would ever be possible for them to be paid back. Greece had a huge external deficit (imports far exceeded exports) because many businesses had gradually lost competitiveness within the eurozone. So Greece could not sell enough exports to pay for its imports. Loss of export markets meant falling demand for Greek products. So incomes were falling, tax revenue was falling and the bill for unemployment benefit was rising. There was a plan to rescue Greece, largely with money from Germany. But there were very strict conditions attached to this bail out - involving huge cuts in government spending. The Greek voters decided to reject these austerity conditions and the German voters said OK, no bail-out.

In this kind of situation, a fall in the exchange rate can restore competitiveness. The effect on the standard of living is tough; however a few years hard work can put the economy back on its feet. But Greece was a small country in the eurozone. The euro wasn't going to fall just because of Greece - It was held up by the strength of other member economies.

**Next?**

Question

What happened next? If you don't know, find out.

1. if the business is large, it could temporarily reduce its price or engage in other promotional activities, in order to retain customers. This might last until the business with the new product gives up because it has been unable to compete on price or reputation

   customers may have long term contracts (as with mobile phone networks and health clubs), meaning that it is difficult for the new brand to gain customers quickly

   where the customer has already invested in the market. For example it will be hard to persuade people to swap to another manufacturer of digital cameras if they already have lots of lenses from a different brand that will be incompatible with the new brand. [↑](#footnote-ref-1)
2. The market mapping technique can illustrate areas where there are existing products attempting to meet customers' needs. Common sense would suggest that it would be wise to avoid this area of the market, especially if there is more than one competing product in that space.

   However, it is entirely realistic for a new entrant into the market to deliberately position a new product in an area of the market map where there is already a brand. It will do this if it believes the competitor has a weakness. Or maybe it has strengths that can be overcome.

   A product may have several weaknesses that would lead to a rival positioning their product in the same part of the market. These could include:

   high price

   low quality

   poor availability. This could include not being easily found by consumers in the places they expect,

   e. the lack of a convenient outlet or an online service

   slowness to respond to changing customer needs, perhaps due to outdated technology in the product or in production

   poor promotion leading to weak branding and brand loyalty.

   Equally, however, an existing product may have some significant strengths that will put new competitors off from positioning their idea in a similar segment of the market. These could include:

   a loyal customer base [↑](#footnote-ref-2)