Marketing Systems, Performance and Impediments to Product Differentiation

Vic Wright*

The structure of the agriculture sector in Australia appears to pose a fundamental constraint to 'product marketing' and 'value-adding' initiatives. A case is presented in this paper for the degree of search activity for differentiation and expansion opportunities to be related to measures of performance. Criteria are presented for the identification of the appropriate market level for an organisation to target within a vertical marketing system and these are then analysed with a view to identifying appropriate grounds for policy intervention by government to modify incentives in such systems. It is argued that grounds can exist for intervention because of increased consumer information even in markets which are contestable and that agribusiness provides many common examples.

1. Introduction

Marketing, as a business function, can be argued to be principally to do with enhanced information flows (Phillips). The benefit to consumers of these is, potentially, the production of output which is more aligned with their preferences. The benefit to producers is increased revenue which good producers will seek to ensure is not exceeded by increases in costs incurred in the process of better attending to consumer preferences, these costs including the cost of information gathering itself.

It is presumed, in the 'business marketing' literature, that the final consumers of the output of a society define its value. In the context of alternative ways of satisfying needs, wants or wishes, and their cost, marketers take it as given that the consumer is the appropriate arbiter of the value of specific products. While this is question-begging from a societal point of view, the origins of the perspective are easy to detect; the way to facilitate sales is to provide what buyers (think they) want (McColl-Kennedy *et al.*).

On the basis of this perspective, business marketers place much emphasis on identifying customer needs, and perceptions of the relevance to these needs of alternative products, and using this information to construct the output of organisations such as to optimise its attractiveness to consumers. 'Output' is composed of all organisational activity to which the consumer might be sensitive. Commonly referred to as the 'marketing mix', output is thus defined very broadly (McColl-Kennedy *et al.*).

The 'ideal' view of marketing management has it that no decisions are made by an organisation until consumer preferences are defined. This is rarely feasible, of course, and much more often, marketing mixes, with substantially pre-defined components, are modified at the margin to better appeal to consumer needs. It is clear that organisations who 'get close' to the consumer, who develop a good understanding of consumer needs, can perform exceptionally well as a result. The interest that farmers periodically show in business marketing is arguably based on the powerful logic that giving people what they want is likely to be more effective than trying to give them something they don't.

In this article, the objective is to propose a framework for analysis of the feasibility of adopting a consumer orientation, a business marketing perspective, and to argue that as a strategic management objective it has not been modelled well in any discipline. This casts doubts on the quality of strategic analysis in fresh food marketing, specifically, and raises questions on the interpretation of marketing principles in this context.

2. System Performance

In agribusiness quarters, agribusiness is defined as that 'vertical slice' of economies which undertakes the production and distribution of food and fibre. Within

* Department of Marketing and Management, University of New England. I thank the Editor for considerable guidance in preparing this paper. First presented as an Invited Paper at the Annual Conference of the Australian Agricultural and Resource Economics Society, Melbourne, 1996.

Review coordinated by the Editor.

the agribusiness system there may be a red meat subsystem, a wool subsystem and so on. In marketing syscircles, these are referred to as 'vertical marketing systems'. The idea is of a system, chain or channel, which contains all entities involved in the productive activity, from most basic input to finished retail product, contributing to the creation of a defined type of end product. Such systems intersect in practice which leads to different vested interests of different system members in particular products and systems.

'System performance' refers to the economic efficiency of such systems. Conventionally, this is viewed as having allocative and technical efficiency components, with the preferences of final customers lying at the core of allocative efficiency. This conventional approach is arguably incomplete. The partial, 'static' character reflects the difficulty economics has with entrepreneurship (Pasour). The problem is that customer preferences are defined as those reflected over the existing set of available goods and services. A better base for allocative efficiency would be one which took into account the tendency of system participants to search, or not, for both *unmet* preferences and better ways of meeting preferences.

While the system of most immediate interest is food and fibre systems, all products can be viewed as outputs of systems. Indeed, unless it is the case that a single organisation controls every relevant aspect of a product and its purchase context, to focus on individual entities in vertical marketing systems is intrinsically partial.

To clarify the issue, compare the performance of the Australian red meat system with that of, say, the Australian system which provides recorded music. From the consumer's perspective, the former appears to show barely any interest in the changing needs of the consumer while the latter caters to our every whim and explores need-satisfying possibilities. (There have been two radical changes to domestic sound reproduction - audio-cassettes and compact discs - over the last three decades, each enhancing dramatically, for most consumers, the quality of reproduced music; the red meat system has created Trim Lamb and some butchers do a little value-adding.)

Incorporating measures of system 'pursuit of consumer satisfaction' in performance measures would be no mean feat. It seems, though, to be an important component, particularly when considering the matter of systems enhancing their consumer orientation.

The long-run performance capacity of a system can be argued to be bounded by its capacity to capture information about customer needs and new technologies of need satisfaction. (In this context, it has to be recognised that the very definition of systems in terms of what outputs the systems have, rather than needs they satisfy, is risky but this issue is beyond the scope of this paper.) The societal value of the output of a system is constrained by the validity of the information on which production (that is, resource allocation) decisions are based. In the absence of search activity to identify customer needs and preferences, there is little reason to expect that valid information about preferences will exist in a system. This is a common cause of market failure and can sometimes be rectified by government intervention.

3. System Output

Systems, as defined, present bundles of attributes to final customers. Systems present alternative (sets of) solutions to (sets of) problems. The problems are composed of two main types, need resolution and exchange. While all problems can be expressed in terms of need resolution, the distinction drawn is based on the derived nature of exchange needs. For example, food is sought to be acquired in anticipation of hunger; anticipated hunger is the trigger need and this leads to a consequential set of problems to do with acquisition of food. In marketing terms this translates into the Product component of the 'marketing mix' typically serving the 'need resolution' problem, while Price, Promotion and Distribution components relate to 'exchange' problems. This latter set of components is therefore usually more ephemeral in its importance to final customers than is Product although this does not imply any ordering in terms of absolute importance.

It is necessary in what follows to recognise that 'system output' and 'bundle' go beyond the economic notion of 'product'. A central distinction between economics and marketing is the separation in economics of consumer decision making about product from that about related transactions. In marketing this *a priori* 'partialing out' of either category of decision-making is seen as arcane and unhelpful. Relatedly, in this paper 'differentiation' refers to the modification of any element(s) of system output or bundle of product attributes.

The bundle of attributes to which final customers are exposed is the output of a sequence of productive activities in the system which is usually not transparent to the customers. Nor do most customers care who has done what. They may or may not identify particular attributes of the bundle as coming from a manufacturer or retailer, and they may be indifferent to many attributes and may *not* be able to source them even if they would prefer to.

For meaningful discussion of differentiation opportunities and expansion, it is important to appreciate that *realised* differentiation depends utterly on the customer. Differentiation means nothing except where the targeted customer perceives difference to have been achieved. Profit-generating differentiation may be realised only where customers perceive *relevant* difference. Relevant difference may occur over any attribute in the total bundle. The demand for a product may or may not be where difference is perceived; it may be exchange facilitating characteristics which are relevant.

Which attributes are relevant to customers is a major criterion for market segmentation. A market segment is comprised of people who, for whatever reason, prefer different combinations of attributes to other groups of people. These differences in preferences may be in terms of relative weighting of attributes within a given set or, in the case of interest here, attribute set composition. The former is characterised by preferences for different package sizes or retailer assistance in the shopping event, the latter by convenience in acquisition, or price or some other attribute being in or out of the considered attributes.

The attributes on which consumers ultimately predicate choice are 'determinant attributes' (Piggott and Wright). It should not be presumed that these are of high absolute importance to the customer. They may be of hardly any importance but the only attributes on which the customer can rationalise choice (Carpenter, Glazer and Nakamoto). Much will depend on the perceived proximity of competing bundles or attributes or attributes which *do* have absolute importance.

Amongst all of the attributes on which bundles might differ, determinant attributes will be those over which difference is perceived and which, for whatever reason, choice is based. One consequence of this is that the set of determinant attributes (for any given segment) might be able to be changed deliberately by marketers using tactics which attract consumer attention to attributes previously outside the set.

The notion of determinant attributes as the focus of customer attention is central to the strategic planning issue, at what level in the vertical marketing system is the market for a given firm; and who is the customer at this level? This issue is central to the meaning, and management implications, of a 'customer orientation' to each specific organisation in a marketing system. It is also central to the operation of the system overall in terms of the predisposition of the system to seek out and meet final customer preferences (reflecting incentives in the system) and the ways in which this might be enhanced (reflecting the origins of structural characteristics of the system).

In the marketing literature, the focus is on segmentation and targeting issues *at a given market level.* Implicitly, it is commonly assumed that the appropriate level of the market being dealt with is apparent. (Another common implicit assumption is that the bundle of attributes, the marketing mix, is under a high degree of control; this compounds the mistake of assuming the market level is apparent.) The fallacy in this approach is that, in the absence of complete unilateral control over a system, *choice* of market level is not free. Rather, it is a function of the role of the individual organisation in the creation of the bundles of attributes put before customers at successive market levels and the returns to the organisation this brings. Successive market levels are treated as individual identifiable markets in what follows.

4. Identification of Relevant Market Level

The value of the output of a marketing system is bounded by the final consumer satisfaction it creates. Everything that occurs (in an efficient system) is derived from this. Generally, an organisation should view as ideal the serving of final consumers at all levels. At each level, organisation output is valued directly and information is most reliable. There are no 'side games' nor artefactual incentives that prevent this outcome.

There are four factors which can be argued to be critical, jointly, in identifying the market level an organisation can usefully view as its 'market' and the impediments to differentiation faced by the organisation in a market sub-system. These are: the contribution of the individual organisation to the presence or otherwise of determinant attributes in bundles at any market level; the responsiveness of customers to variation in attribute quantity or quality; the control of the organisation over attribute quality or quantity; and the efficiency of transmission of customer response to the originator of attribute variation.

Since determinant attributes are the focus of customer choice-making attention, an organisation with no role in providing these at any given market level can not usefully view that market level as a target. There is no capacity for the organisation to influence customer behaviour. The customers of the organisation must be at some market level vertically closer to the organisation in the system to be recognised and appreciated. (It may be that an organisation will find this situation totally unpalatable and respond strategically to modify the system but this is considered later.)

When a relevant market level has been identified, a logical issue is the responsiveness of customers to variations in the attributes contributed by the organisation. Customers may use very fine or coarse categories to judge attribute quality, there may or may not be clear and stable segments in the market, elasticities may be continuous and positive but too small to warrant investment in attribute modification or customers may be too fickle, seemingly unlikely to exhibit durable responses. In the context of the economics of modifying attributes, these kinds of considerations can provoke an organisation either not to differentiate or to define its market level as being vertically closer to it than the one just discussed. An incentive for the latter response would be that the costs of the greater elaborateness associated with reaching the more distant market seem unlikely to be income earning or that the market one level closer, where the organisation (logically inevitably) contributes a larger proportion of determinant attributes, displays more attractive responsiveness.

Given customer responsiveness, there is no benefit to knowing it if relevant product attributes cannot be varied deliberately to play on this responsiveness. Again, the response of an organisation would logically be to not differentiate or to move their focus to a vertically closer market, in this case one where they offer a determinant attribute to which customers are usefully responsive and over which the organisation has control.

With respect to attribute control and customer responsiveness, it is pertinent to bear in mind that attributes achieve determinant status or acceptance in the context of customer needs. At various market levels (apart from the final market), production processes and economics of system members produce attributes which may have relevance to final customer needs. Attributes can be added by successive system members and the same attribute can be added by different members in different ways (for example, meat tenderness as a result of beast production practices, slaughter technique or post-purchase ageing, and wool cleanliness as a result of farm management or picking the trash out by hand some time after shearing). The set of determinant or acceptable attributes at different market levels can thus vary considerably.

The above factors imply that the market level to be targeted needs to be one where the organisation contributes, controlledly, to the set of determinant attributes and this contribution evokes a response from customers which is valuable to the organisation.

There is a further consideration: the efficiency of transmission of customer response. The customer in question may not be the immediate customer of an organisation but one who is at least one market removed. 'Efficiency' may be too narrow a notion here. As well as transmission problems driven by market structure and conduct characteristics, response transmission relative to the cost of attribute modification is pertinent. That is, if costs are quite stable but output prices are not, and customer responsiveness is stable in sign but proportional to price, the profitability of differentiation may not always be positive. Relatedly, prompt supply response by competitors can lead to free-riding on the organisation bearing the initial cost of attribute modification (as in the case of red meat promotion or the promotion of microwave ovens by the first brand to introduce them into a market).

Where a marketer in an organisation perceives little prospect of customer satisfaction increases, due to efforts by the marketer, which generate 'equitable' and sufficient returns, incentives to differentiate will be slight.

5. System Complications

While this attention to the identification of relevant vertical markets, and incentives for differentiation, seems to be a useful framework, the diversity of sets of determinant attributes that might exist across the variety of market segments at any given market level must not be ignored. It is possible for a marketer to find it useful to target a number of different market levels. This somewhat schizophrenic existence might sound odd but it is precisely the situation in which brand-name producers of products, who also make brandless or 'generic' forms of the same products, find themselves. (This arises because they can 'play the brand marketing game' to final customers who value brand-based cues, but must contract with generic label owners to sell product where the final customers have no brand-based attributes in their set of determinant attributes.)

Another factor to recall is the possible instability of final product characteristics. These can change with changing technologies changing consumer preferences (and competencies), changing competitive behaviour and changing shopping contexts (for example, shopping in-store compared to shopping in a mail-order catalogue in which brand-to-brand competition is non-existent, or buying fresh meat in a supermarket or specialist butcher shop). Instability here can imply shifts in relevant market levels as well as market segment changes. Instability is only a matter for concern to the extent that it is unpredictable.

A further factor is that the analysis of appropriate market levels by an organisation is strategic in kind and could provoke search activity for a strategy which changes the system. This could involve vertical integration, one way or another, to modify control and incentives in the system. It could involve re-targeting on buyer groups to move the organisation to more comfortable markets. It could involve reconsideration of the business of the organisation, useful strategic alliances, and so on. It could involve collusion with like businesses or with other members in the vertical system.

6. Impediments to Differentiation and Expansion

One incentive for strategic intervention would be the perception that the system, *qua* system, is under-performing; that is, system outputs are insufficiently driven by consumer preferences or, to return to earlier points, the system is insufficiently active in pursuing the identification of consumer preferences. Various programs launched by the Australian Meat and Livestock Corporation (AMLC), such as Ausmeat, seem to be precisely such strategic interventions.

The societal value of the output of a system is constrained by the extent of active search undertaken by 'the system' to identify consumer preferences. Value can be enhanced by greater exploitation of this potential. Organisations can only operate as part of the 'system'. The interest in identifying consumer preferences depends largely on the position of the organisation in the system. Some systems may have characteristics that prevent attributes of importance to consumers from being assembled and passed on to consumers. This is not achieving the 'potential' of the system.

A prevailing concern in economics is to have industries maintain contestability so that societally dysfunctional conduct is minimised. Where this seems to have been achieved, it could be argued that it is achieved at the cost of little or no interest in product differentiation; e.g. competition determines 'the way the incentives fall'. This may be too firm a position to take. Desirable levels of contestability can be achieved in ways which impede, quite incidentally, the active pursuit of higher levels of customer satisfaction. Perfect competition is an instance and one where an argument could be mounted that 'imperfection', to some degree, leads to better overall system performance.

Whether impediments to differentiation are worthy of concern is an issue which can be addressed using the present framework. Consideration of the factors which influence the magnitude of incentives for differentiation indicates the relative desirability of intervention or not, by any possible intervener, in the functioning of the system.

Weak, or not, transmission of responses to differentiation is the issue. Recall that contestability is assumed. Factors that can impede transmission include reduced interest in specific product category determinant attributes by resellers who offer assortments of product categories (and whose interest is likely to be in determinant attributes with respect to choice of resellers by customers) and information problems where, for instance, the characteristics of products acquired from producers are not known with certainty. Price averaging and loss leading activity across product categories can break the link between successive markets in the case of the former, and Mullen (1995) has suggested the latter as a cause for transmission problems of premia for Elite lamb to farmers who supply at auction. Farrell and Tozer also discuss this issue (this *Review*).

Transmission problems may concern producers but their greater importance springs from the fact that they impede innovation which would enhance consumer satisfaction. That is, the incentives governing intervening markets work to the disadvantage of consumers, relative to what might be. This is the hallmark of a marketing system which is performing less than ideally in the pursuit of higher levels of consumer satisfaction and potential.

Transmission problems are much more pronounced where the 'core product' is produced in near-perfectly competitive industries. Here, non-price information often is of low value and price is itself taken rather than set and influenced by broad market aggregates as well as differentiation aspects. The idealistic wish to enhance organisation performance by better satisfying consumers is empty at the level of the individual producer. The industry-level or system consequence of this is a tendency to poor performance. This may create grounds for intervention. That is, the paradox of perfectly elastic demand faced by individual producers accompanied by less elastic industry-level demand is argued to be problematic for consumers as well as producers.

Intervention which seeks to reduce the contestability implicit in the industry's structure is indefensible. What is required is intervention to enable the mitigation of the impoverishment of system performance that the industry structure implies. This would usefully be legislation which enables the majority of an industry to decide to tax the industry for the purpose of undertaking consumer- and other market-level research, to force the introduction of product description, to fund product development and to oversee the adoption of product innovation (including promotion, where appropriate). These amount to interventions with the purpose of imitating the imperfectly competitive context. That is, activities which have the effect of making it possible at least for the aggregate demand curve to be 'managed'. In the fresh food domain, the AMLC has attempted to introduce a number of consumer-driven innovations (Trim Lamb and Right Meat). The International Wool Secretariat operates in similar ways in the fibre domain. There are many other examples in agri-business.

In contrast to the constraining effects on marketing system development that intervention in product markets implies, intervention in the information flow is much less likely to offend pro-competition preferences. It is also justified in market failure terms. Producers who seek to be utterly free may even benefit from such intervention!

The societal justification for this intervention is the inability of the marketing system to pursue resource allocation efficiency. Industry may benefit by preventing or ameliorating the decline in real prices that is occurring. The declining relevance of primary producers to final consumers exists wherever competing marketing systems are more active in their pursuit of enhanced consumer satisfaction, and may be partially reversed by 'planned' intervention in information systems.

7. Conclusion

Intervention in agricultural marketing systems has long been sought by producers. The sources of this wish have been utterly selfish, reflecting a desire to enjoy the psychic income arising from the independence of the small producer while avoiding, or minimising, the loss of income which awaits the producer of homogeneous goods. Producers also see an unequal distribution of power in the marketing channel.

The economist's enthusiasm for perfectly competitive industry structures makes him/her the natural enemy of producers who, like any of us, would like to sense that they exercise some control over the outcome of their labours. Governments have listened to this plea in the past.

This paper argues that allocative efficiency requires a little more than the economist usually proposes and that this is impeded by the absence of incentives to differentiate, a cause of which is perfect or near-perfect competitive structures. Further, it is argued that a socially preferred situation would exist if interventions were to (continue to) be introduced which would imitate the information flow characteristic of 'less' competitive structures. This would increase the possibility of consumer orientation of channel systems without contestability being imperilled. A market failure would be effectively overcome.

References

CARPENTER, G.S., GLAZER, R. and NAKAMOTO, K. (1994), 'Meaningful brands from meaningless differentiation: the dependence on irrelevant attributes', *Journal of Marketing Research* 31(3), 339-50.

McCOLL-KENNEDY, J.R., KIEL, G.C., LUSCH, R.F. and LUSCH, V. (1994), *Marketing: Concepts and Strategies*, 2nd ed., Thomas Nelson Australia, South Melbourne.

MULLEN, J.D. (1995), 'The influence of fat and weight on the price of lamb in the Homebush livestock and wholesale markets', *Review of Marketing and Agricultural Economics* 63(1), 64-76.

PASOUR, E.C. (1993), 'The work agenda in agricultural economics: why a shift in emphasis is warranted', *American Journal of Agricultural Economics* 75, 60-68.

PHILLIPS, J. (1968), 'A revised approach to marketing', *Review of Marketing and Agricultural Economics* 36(1), 28-36.

PIGGOTT, N.E. and WRIGHT, V.E. (1992), 'From consumer choice process to aggregate analysis: marketing insights for models of meat demand', *Australian Journal of Agricultural Economics* 36(3), 233-248.