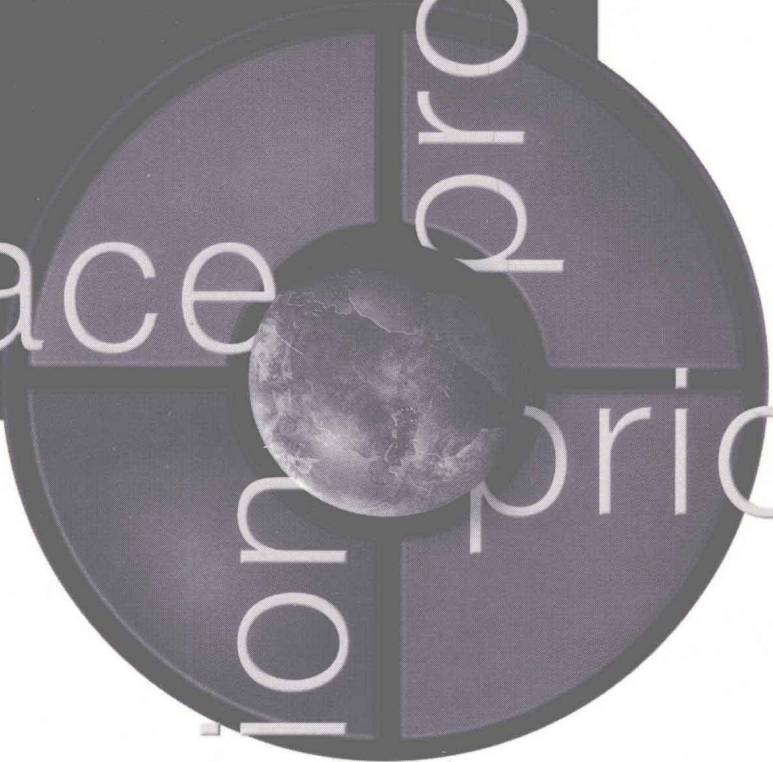


Applications in Basic Marketing

Clippings from the Popular
Business Press

2003-2004
Edition

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William D. Perreault, Jr.
E. Jerome McCarthy

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and

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APPLICATIONS IN BASIC MARKETING:

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Preface

This is the fourteenth annual edition of *Applications in Basic Marketing*. We developed this set of marketing "clippings" from popular business publications to accompany our texts—*Basic Marketing* and *Essentials of Marketing*. All of these clippings report interesting case studies and current issues that relate to topics covered in our texts and in the first marketing course. We will continue to publish a new edition of this book *every year*. That means that we can include the most current and interesting clippings. Each new copy of our texts will come shrink-wrapped with a free copy of the newest (annual) edition of this book. However, it can also be ordered from the publisher separately for use in other courses or with other texts.

Our objective is for this book to provide a flexible and helpful set of teaching and learning materials. We have included clippings (articles) on a wide variety of topics. The clippings deal with consumer products and business products, goods and services, new developments in marketing as well as traditional issues, and large well-known companies as well as new, small ones. They cover important issues related to marketing strategy planning for both domestic and global markets. The readings can be used for independent study, as a basis for class assignments, or as a focus of in-class discussions. Some instructors might want to assign all of the clippings, but we have provided an ample selection so that it is easy to focus on a subset which is especially relevant to specific learning/teaching objectives. A separate set of teaching notes discusses points related to each article. We have put special emphasis on selecting short, highly readable articles—ones which can be read and understood in 10 or 15 minutes—so that they can be used in combination with other readings and assignments for the course. For example, they might be used in combination with assignments from *Basic Marketing*, exercises from the *Learning Aid for Use with Basic Marketing*, or *The Marketing Game!* micro-computer strategy simulation.

All of the articles are reproduced here in basically the same style and format as they originally appeared. This gives the reader a better sense of the popular business publications from which they are drawn, and stimulates an interest in ongoing learning beyond the time frame for a specific course.

We have added this component to our complete set of **Professional Learning Units Systems** (our **P.L.U.S.**) to provide even more alternatives for effective teaching and learning in the first marketing course. It has been an interesting job to research and select the readings for this new book, and we hope that our readers find it of value in developing a better understanding of the opportunities and challenges of marketing in our contemporary society.

William D. Perreault, Jr. and E. Jerome McCarthy

Acknowledgments

We would like to thank all of the publications that have granted us permission to reprint the articles in this book. Similarly, we value and appreciate the work and skill of the many writers who prepared the original materials.

Lin Davis played an important role in this project. She helped us research thousands of different publications to sort down to the final set, and she also contributed many fine ideas on how best to organize the selections that appear here.

The ideas for this book evolved from and built on previous editions of *Readings and Cases in Basic Marketing*. John F. Grashof and Andrew A. Brogowicz were coauthors of that book. We gratefully recognize the expertise and creativity that they shared over the years on that project. Their fine ideas carry forward here and have had a profound effect on our thinking in selecting articles that will meet the needs of marketing instructors and students alike.

We would also like to thank the many marketing professors and students whose input have helped shape the concept of this book. Their ideas—shared in personal conversations, in focus group interviews, and in responses to marketing research surveys—helped us to clearly define the needs that this book should meet.

Finally, we would like to thank the people at McGraw-Hill/Irwin, our publisher, who have helped turn this idea into a reality. We are grateful for their commitment to making these materials widely available.

W.D.P. and E.J.M.

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Marketing's Role in the Global Economy and in the Firm

What's Wrong With This Printer?

Believe it or not, it's too solid. So Hewlett-Packard spent \$1 billion to replace it with new machines that won't hold a person's weight. But they sell for less—and can squash rivals.

■ by Noshua Watson

The bet-the-company project that came to be known within Hewlett-Packard as the Big Bang started out with a whimper. And with grumbles and complaints that it shouldn't and couldn't be done. That was how the printer engineers who gathered for a kickoff meeting in Vancouver, Wash., three years ago reacted to the mandate laid down by their boss, Vyomesh Joshi. The mandate was to build a \$49 printer—one \$30 cheaper than HP's least expensive model at the time. Making a cheap printer was not itself an earthshaking proposition, but how Joshi intended to go about it certainly was. He didn't want just one low-end model; he wanted the engineers to conjure an entire new line of more than 50 consumer products—inkjet printers, digital cameras, "all in one" printer/fax/copier/scanners, and more. He wanted the engineers to ignore the models then being sold and start from scratch.

He wanted HP to be able to introduce the entire product line in one fell swoop. And he wanted to take it from concept to store shelves in less than three years—18 months faster than HP had ever accomplished a product launch.

The designers in the conference room that day, however, weren't in a history-making frame of mind. They were justifiably proud of the high-quality printers they'd been building, and if high quality meant higher prices, so what? Quality was what HP was known for.

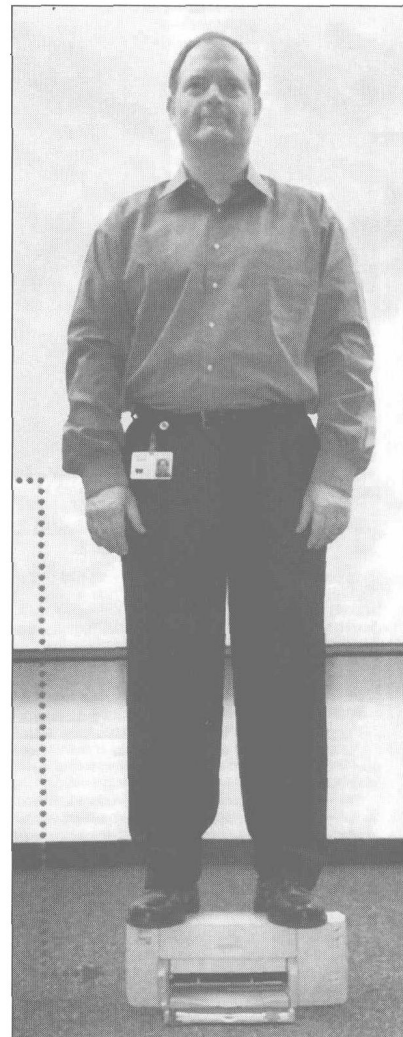
To explode their complacency and focus their attention on the real need to build a frugal machine, manager Tom Alexander finally grabbed an HP printer and set it on the conference room floor. Then he stood on it, all 200 pounds of him. The point behind his grandstanding? Customers aren't going to use printers as step stools, so don't add costs by building them strong enough to withstand

the weight of a grown man. Instead, design them to fit in the kitchen and print nice pictures.

Alexander's Stand helped open the way to a project that was audacity itself. Manufacturers often dream about reengineering an entire key product line, but few actually dare try. The risk is enormous not only because of the direct capital expense, but also because the market moves on. While the manufacturer is tied up getting the new line out the door, customers stray and competitors pounce.

With Joshi's Big Bang, the \$47-billion-a-year company (before its merger with Compaq) was betting more than \$1 billion: \$125 million for R&D, \$900 million for manufacturing, and \$200 million for marketing. More important, HP was gambling its crown jewel. Printers, ink, and related products accounted for 43% of HP's sales and 65% of HP's profits. If the new product line stalled or flopped when it debuted, it would sap HP's strength and very likely hammer the stock.

The gamble didn't scare Joshi, 48. The greater risk, he felt, was to maintain the status quo. HP had gained preeminence in the printer market by relying on the "waterfall" or "cascade" method of product development. Engineers would design a printer, put it on the market at a high price, and then gradually tweak the design to reduce the manufacturing cost. Meanwhile they'd also work on developing the next-generation machine. When the new generation eventually hit the shelves, HP would lower the prices on the old machines. The waterfall method worked: It put the emphasis where HP was strongest—on its superior engineering and allowed it to dominate the inkjet-printer market during the 1990s. But in late 1997, HP got a shock when competitor Lexmark introduced the first inkjet printer to sell for less than \$100. By mid-1999 Lexmark had doubled its market share



(Cont.)

to 14%, according to market researcher ARS. The price pressure was on.

Joshi predicted that HP's low-end printer business would slowly but surely erode unless HP abandoned the waterfall practice and went head-to-head with Lexmark on price. That meant the cost of making printers had to come down—way down.

When Joshi came to that conclusion in 1999, he was not yet in charge of the printing group, and CEO Carly Fiorina was new to the company, having come from Lucent just four months before. The head of the printing group, Carolyn Ticknor, then Joshi's boss, saw the urgency in his proposal and pushed for the massive capital investment. Other division heads objected—it was a risk they felt HP could not afford—but Joshi and Ticknor prevailed. Convinced that the imaging business would be a high-growth area and merited a billion-dollar investment, Fiorina overrode the objections, cut the check, and gave Joshi free rein.

Joshi's cost-cutting concept was this: He wanted his engineers to build 14 inkjet printers and seven all-in-ones using two new, cost-efficient platforms while he squeezed productivity from every link in the supply chain. The printer platforms consist of the main chassis and printer carriage on which the plastic casing and output trays rest. The Malibu mechanism was developed for high-performance, top-of-the-line models like the 7350 and the 5550 that start at \$150. But the key to the Big Bang's low-end strategy was the Crossbow platform, a design that taxed the Vancouver engineers' ingenuity.

In developing the Crossbow line, HP engineers had to count pennies for the first time. To make money on low-end printers, HP would have to make more than a million Crossbows a month. At that volume, each additional cent in unit manufacturing costs adds up quickly. For three months the engineers brought design after design to management only to be told that it wasn't cheap enough. And the heat was on: The old waterfall cycle had taken about four years. "We wanted to do it in less than three years," says Joshi, "because Lexmark was already there."

Finding the solution, the designers finally realized, depended on a kind of printer-engineer Zen. To clear their minds, they began to conceive of the printer not as a complex mechanism but rather as an empty box. It was perfectly light and inexpensive but would get heavier and costlier with every new feature. The object of the exercise was to think simply, adding only what the customer would absolute-

The engineers brought design after design to management only to be told that it wasn't cheap enough.

ly need. Suddenly bells and whistles like the ability to print on glossy paper or card stock seemed easy to live without.

But frugality had its limits. One of the fiercest debates broke out over the power switch. Technically there is no need for an on-off switch, since a PC can turn on a printer automatically, and installing a manual switch adds about \$1 per machine in cost. The engineers thought they had hit on easy savings until the marketing department got wind of it. The marketers argued that the average customer wouldn't understand how the printer could turn on and off without a power button and would become frustrated looking for it. The power switch stayed.

While the Vancouver engineers were perfecting the Crossbow mechanism and case designs, engineers in Corvallis, Ore., were racing to overhaul the most technologically complex part of the printer: the cartridge. "If a printer is a car, the cartridge is the engine and the gas tank," says Keith Bartlett, a cartridge group vice president. HP's intellectual-property stronghold in cartridges is formidable: Each cartridge is supported by nearly 100 patent applications, and in their own extension of Moore's law, HP's engineers have succeeded in doubling the number of ink drops per second every 18 months.

The little jewel boxes are also big money. For every printer on a store shelf, HP makes

ten to 20 cartridges. Some go in the printers, and the rest go to retail stores as replacements, where they sell for between \$20 and \$35 each. A customer spends more on cartridges over time than on the printer itself. Not surprisingly, cartridges and other supplies account for half of the imaging group's revenues and a higher percentage of its profits.

Because of the high volumes, savings on the manufacturing cost of the cartridges would be even more significant than savings on the printer itself. The cartridge engineers shaved off "nickels and dimes," says Bartlett, by using thinner plastic on the cartridge casings and covering the top with a paper label rather than a plastic cap.

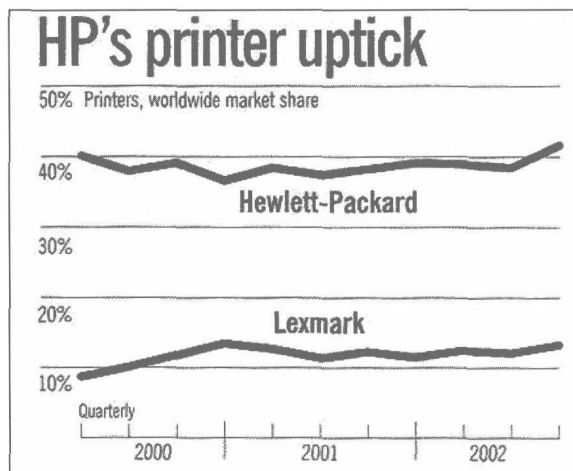
The biggest savings were to be found by altering the cartridge's engine head, the most important part of the inkjet system. The head consists of a silicon plate perforated by ink nozzles and glued to a piece of flexible plastic embedded with metal circuits. The flexible plastic wraps around the bottom of the cartridge, which skims back and forth above the paper's surface. When it's printing at full speed and top quality, the nozzles fire eight to ten million drops of ink a second.

The more ink-shooting nozzles on the engine head, the better the printing speed and quality. But engine heads are cut from pricey silicon wafers. The HP engineers' challenge was to make the heads smaller, thus using less silicon, without sacrificing the number of nozzles. In the end they managed to shrink the engine head to half its original size and still squeeze 30% more nozzles onto it by making each nozzle narrower. (They also refined the ink.)

By early 2001 Joshi, now head of the imaging and printing group, was ready to move the new line into the plants. To guard its cartridge-making secrets, HP designs and manufactures the little boxes almost entirely

in-house, at a design and fabrication facility in Corvallis and high-volume manufacturing plants in Ireland, Singapore, and Puerto Rico. Printers, meanwhile, are farmed out to contract manufacturers in Southeast Asia, China, and Mexico.

HP's contract factory owners were in for a big surprise. After test runs were complete, Joshi wanted to increase production from zero to one million units a month within three months, ten times faster than any previous ramp-up for an HP product. To support the huge volume, HP's manufacturers would have to build factories, and do it faster than ever. Under the old system, engineers would design the production line in the U.S. to get out



(Cont.)

the kinks before sending the plant blueprints overseas. That process typically took about 18 months. But under the pressure of the Big Bang, Joshi gave them only one year. To speed up building the plants, engineers passed along tooling specifications to the factories before the printer designs were final. There wasn't a minute to lose, and everyone felt it. Paul Speer, who supervises the Vancouver engineers, recalls debating alternatives in his cubicle with two program managers when the fire alarm went off. Sent out into a rainstorm, Speer and his staffers huddled behind a passenger van in the parking lot to continue their discussion.

Building printers from just two platforms—the Malibu and the Crossbow—made the production line more efficient. Before the Big Bang, HP had built printers using multiple platforms, and the production line had to shut down and retool when switching from one platform to the other. Now several different models could be built from the Crossbow alone. The line could run continuously, splitting into smaller lines to finish off different products. The Crossbow printer's compact dimensions doubled the number that HP could pack on a shipping pallet, saving shipping costs. Even a 20-year veteran like Speer was awed by the millions of machines spilling from the production lines by early 2002. "I walked into a factory in Singapore and looked all the way down the line to the curvature of the earth," he claims. "All I could see were Crossbow printers."

Back home, HP's marketing department was preparing to sell this sea of Crossbows. The timing couldn't have been worse. HP's merger with Compaq had just been announced. The tech sector was in a slump. Still, the marketers knew they had to go all-out to make sure Big Bang wasn't a bust.

To support the huge volume, HP's suppliers would have to build new plants, and build them faster than ever.

After mailing one million direct-mail "magalogs" and outfitting three tractor-trailers with HP products and demos to tour the U.S., the company invited major retailers, including Circuit City, Office Max, and Best Buy, to Cupertino, Calif., for product demos. The retailers were hesitant to commit to buying the Big Bang line. HP was making a lot of demands: It wanted better displays, with all its new printers lined up together in a single aisle. At the same time, HP had disappointed many retailers by failing to keep them stocked with its old products. Without a guarantee that the new machines would be in the stores on time, the retailers wouldn't advertise the Big Bang printers in their Sunday circulars.

HP marketers promised to supply more than 8,000 stores by July 28, 2002. To make that date, the printers would have to be shipped from Asia in May or June at the latest. Most of the factories kept to the schedule, but by June it was apparent that thousands of printers weren't going to make it onto ships because of manufacturing problems in Singapore. Rather than jeopardize its relationships with retailers, HP paid a huge sum to transport tens of thousands of printers from Southeast Asia by air. By July 28, HP had put more than one million printers on store shelves.

Joshi had been waiting for that moment for

three years. Despite the economic slump in general—and the tech slump in particular—he was optimistic. "I was extremely confident," Joshi says. "I felt like a proud parent." In the next few months the market justified his pride. In a year when overall printer sales fell 10%, HP's printer sales increased by 3% between June and December. Shipments of color inkjet printers to stores grew by 18%. Joshi was particularly pleased by the results in the high-margin all-in-one

market: After the Big Bang, HP took 20 percentage points of market share—most of it from Lexmark—to grab nearly 70% of the market. In June, Joshi had promised Wall Street that his \$20 billion business would grow 10%, with 12% to 15% margins. In the fourth quarter his results made analysts purr—record revenues of \$5.6 billion, representing 12% year-over-year sales growth. His margins: 16.5%.

Joshi's lieutenants now brag that he wants a Big Bang every year. "We're improving our cost structure all over HP," says Larry Lesley, senior vice president in the imaging and printing group. "This isn't an endgame; it's an ongoing philosophy." Leveraging its new competitive advantage, HP plans to launch new products in June and to continue to make the existing Big Bang line faster and better. As John Solomon, printer category manager, summarizes the success of the new line, "It's much cheaper to make, much better in terms of image quality and speed, and it's half the size." But success does have its price: "Of course, you can no longer stand on it."

"What's Wrong with This Printer?," *Fortune*, Feb 17, 2003, p. 120C-120H.
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Selling Cellphones with Mixed Messages

BY GABRIEL KAHN

In China, a special karaoke-enabled cellphone plays music and scrolls lyrics while you sing into the mouthpiece. A phone in South Korea allows you to download video clips and exchange them with friends. And in the U.S., there's a phone from Verizon Wireless that lets users play games.

These devices are all made by **Motorola Inc.**—and they also happen to be practically the same phone, known as the T720 in the U.S. and the V730 elsewhere. The thing that separates them is Motorola's multipronged sales strategy, which targets different markets with different phone features.

The mixed message reflects a new trend sweeping the \$60 billion cellphone industry. At the moment when technological standards for cellphones are becoming more universal, marketing campaigns for the phones are becoming more local. Giants such as Motorola of Schaumburg, Ill., **Siemens AG** of Germany and Sony Ericsson Mobile Communications Ltd., a venture of **Sony Corp.** of Japan and **Telefon AB L.M. Ericsson** of Sweden, once rolled out ads globally; now, they tailor their messages to different audiences.

Driving the change is the evolution of the cellphone itself, from phone to fashion item

and now to a vehicle for content, such as music, news or games. And content is extremely local.

"The industry is moving from a device-centric approach to an experience-centric approach, and that is making it a lot more local," says Brian Holmes, Motorola's Asia Pacific marketing manager.

So, for example, Motorola opted to play up the karaoke capability of the V730 in China. A special China ad campaign designed by **WPP Group PLC's** Ogilvy & Mather depicts a latter-stage Elvis impersonator crooning into a V730 mounted atop a microphone stand. The specially designed phone, which comes preloaded with two songs, was born of an alliance with Chinese cellular operator **China Unicom**.

Karaoke would seem a natural selling point for South Korea, too, where amateur singing is a popular pastime. But Motorola's research in South Korea showed that karaoke took a backseat to other functions, such as downloading video clips from soccer matches.

For people like Mr. Holmes, brought up in a design-based culture that emphasized sleeker cellphones, the shift to content means he has to move even faster than he did when he was following the latest fashion trends. "It means our product is radically changing by the minute," he says.

So is the research. "In the '90s, you could just have a focus group with a few phone owners, and the discussion was who had the smallest phone," says Pasi Jarvenpaa, **Nokia Corp.**'s Asia Pacific director of marketing for mobile phones. "The scope is now much broader and the answers a lot less obvious. We now look for a psychographic orientation,

such as people who are open to change."

The shift in cellphone marketing tactics also can be seen in the demise of ad campaigns that touted just technology—even as the phones themselves continue to become more sophisticated. Instead of throwing around acronyms for the latest messaging technologies, "now we put a lot of focus on what's on the street and what's in the stores," says Philip Vanhoutte, London-based vice president for marketing of Sony Ericsson.

That change in focus is forcing companies to rejigger more than just marketing. The cellular division of Siemens strengthened its marketing and research operations in Asia so that it can now feed back local consumer insights to headquarters in Germany while a new phone is still in the planning stage. More input upfront means less retooling later on, says Mark McCallum, vice president for product and marketing for mobile phones.

In both Europe and Asia, Siemens is targeting the same group for its C55 phone: the "social-centric set," a mostly teenage, female audience focused on friends and dating. But based on its research it has two distinct marketing plans. In Europe, it is promoting the phone's ability to record sounds and play them back or send them to friends. In Asia, it is shipping the same phones with special luminescent covers that glow in the dark, which emphasizes the phones' romantic or "puppy love" feature, says Mr. McCallum.

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FINALLY, COKE GETS IT RIGHT

The company is finding its footing in India after years of missteps

You might think selling in India would be a romp for beverage giant Coca-Cola Co. The country has a billion-plus consumers, a growing middle class, and the climate is hot, hot, hot. Look a little more closely, though, and this market is more minefield than mother lode. Sure, Coke's various beverages have more than half the market. But its flagship brand—Coca-Cola, the ur-soft drink—remains a distant third, with an estimated market share of 16.5%, far behind arch rival Pepsi-Cola's 23.5%. Almost as embarrassing, No. 2 is Thums Up, a sweeter local cola that Coke acquired in 1993, then proceeded to neglect. "The environment in India is challenging," says Alex von Behr, a Briton who is president of Coke India. "But we're learning how to crack it."

The learning curve has been steep. In 1993—15 years after being thrown out by India's socialist government—Coke stormed back into the country with big plans to wrest control from Pepsi and the local beverage marketers that had risen up in its absence. Instead, the company spent years on the defensive after overestimating the size of the market, misreading consumers, and battling with the government. A semi-farical tussle in which Coke bottlers hoarded empty Pepsi bottles gave the company a black eye until the dispute was resolved last November. And Coke India has been hurt by a revolving door in the executive suite. In 10 years, it has had five expatriate heads. Pepsi, by contrast, last year appointed its third Indian chief executive in 14 years. The result: In 2000, Coke wrote down the value of its Indian bottling assets by \$405 million. It has suffered losses in India for years—although its execs won't reveal financial details.

Finally, Coke is starting to inject some fizz into its Indian operations. On Feb. 28, the company plans to sell 49% of its Indian bottler, Hindustan Coca-Cola Beverages, for \$41 million. The sale won't be the domestic stock listing that some in New Delhi had sought. Instead, the shares will be sold in a private placement with institutional investors and employees. But it puts to rest a thorny issue that had chilled relations with the government, which wanted Indians to have a substantial ownership stake in Coke's local operation. Better yet, Indians appear to be developing a taste for Coke products: The company's overall sales in India jumped 24%, to \$940 million, last year. "Coke lost a number of years over errors," says Jagdeep

Kapoor, chairman of Samsika Marketing Consultants in Bombay. "But at last, it seems to be getting its positioning right."

That will come as a great relief at Coke headquarters in Atlanta. India, with soft-drink consumption of just seven 8-ounce (250 milliliters) servings per capita annually, holds more potential for growth than just about any other market on earth. By contrast, neighboring Pakistan hoists an average of 14 servings per year; in China, it's 89; and in Mexico, the world's hottest soda market, it's nearly 1,500 servings. Determined to consolidate its position and boost growth, Coke this year cut prices on all of its beverages by an aggressive 15% to 25%, forcing Pepsi to follow suit. "India is the beverage battlefield for 2003," says Ronald S. McEachern, Pepsi's Asia chief.

Key to Coke's battle plans is operations chief Sanjeev Gupta. After being promoted from marketing director three years ago, the boyish, straight-talking Gupta persuaded his Coke bosses to change the way they do business. "He bravely stood up to Atlanta and told them their strategy in India was wrong," remembers a former Coke exec in New Delhi. Gupta's first step: revitalizing Thums Up, which led the market in 1993 with more than 60% of carbonated beverage sales but had slipped to just 15% by 1998. After Atlanta gave the green light to pushing local brands as much as Coca-Cola, the 41-year-old Gupta spent \$3.5 million to beef up advertising and distribution for Thums Up. Within a year, he built it into India's No. 2 soda.

Then Gupta—a veteran of marketing juggernaut Hindustan Lever Ltd.—persuaded Atlanta to revamp pricing and advertising for Coca-Cola. In 2001, he launched a new size, a 200-ml. bottle that sells for 10 cents and is aimed at rural areas and lower-income urban markets. This year he dropped the price of a 300-ml. bottle to 17 cents from 24 cents. The price cuts were key to boosting sales and the little bottle was a big hit. Gupta expects it to represent 50% of sales by volume this year.

In 2002, after years of lackluster ad campaigns, Gupta's team settled on an advertising strategy that caught the imagination of Indians. Breaking with Coke tradition, he hired a celebrity spokesman, Bolly-

LOCAL HERO Operations chief Gupta stood up to U.S. bosses and changed pricing, ads, and products to appeal to local tastes

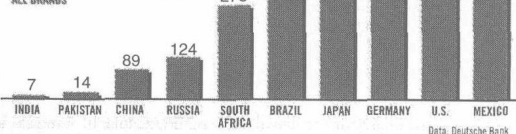
wood movie star Amir Khan. The campaign equates Coke with "thanda," the Hindi word for "cold," a commonly used term for a generic soft drink. "Coke had to break a lot of its rules for India," recalls Ashok Jain, the former head of Cadbury Schweppes PLC in India, who quit Schweppes after Coke bought it in 1999.

The company has been cutting costs, too. Although Coke owns 70% of its bottlers, many of them were outdated operations inherited from the Thums Up purchase. Over the past three years, it has shut down eight of them, which helped trim the payroll by 23%, to 5,000. Employee costs have fallen to 4.5% of revenues from 7% in 2002. Coke got rid of about 80 managers, including high-priced top execs, earning Gupta the moniker "Prince of Darkness." It saved 57% on import duties by using more local raw materials. And by upgrading its bottling technology and improving maintenance and training, Coke has improved plant efficiencies by 40%. Says Gupta: "We were saddled with chaotic operations, but that's all changed."

At the same time, Coke is branching out into other products. In 2001, it introduced Kinley bottled water, which has grown to a leading market share of 37% by building on Coke's

COKE IN INDIA: ROOM TO GROW

ANNUAL PER CAPITA CONSUMPTION OF SOFT DRINKS, 8-OUNCE SERVINGS, ALL BRANDS



(Cont.)

distribution network to reach far-flung villages. Key to Kinley's expansion have been ads depicting village life and military families that, given India's constant security concerns, have "built an emotional connect with the Indian consumer," says consultant Kapoor. Encouraged, Coke is now copying the success of its ready-to-drink coffee in Japan and test-marketing the concept in India.

Finally, it has settled its long-standing dispute with Pepsi over bottles. Last November, Pepsi accused Coke of hoarding more

than 5 million of its bottles, which had ended up in Coke's hands from recyclers. Without them, Pepsi had difficulty meeting demand for its drinks. On Nov. 26, after Pepsi called the police and a court ordered Coke to return the bottles, the two companies agreed to regular exchanges.

The changes are paying Coke dividends. Execs at Coca-Cola India say the company is no longer losing money. "We have turned a corner," says N. Sridhar, Coke India's finance director. "This will release our energies to

concentrate on building market share." Now, Coke is planning on investing \$150 million more to expand its bottling and distribution network. That will make India Coke's second-largest Asian investment after China. The subcontinent hasn't become a mother lode for Coke yet. But the company sure is trying to make it one.

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COULD THIS BE THE NEXT DISNEY?

Electronic Arts makes one of every four videogames sold in the world (and that's before it took *The Sims* online). CEO Larry Probst says he's just getting started building "the greatest entertainment company ever."

By: Geoff Keighley

Until her boss showed up, Hecubah, queen of the undead, was having a pretty good day at work. It was the 1999 Electronic Entertainment Expo (known in the industry as E3), and the villainess of the chop-'em-up role-playing PC game *Nox* had young men flocking to the Electronic Arts (EAS) booth in Los Angeles's Convention Center. Some undoubtedly came to hear about EA's lineup of new videogames, but many stayed just to stare at the actress playing Hecubah—in devil horns, red contact lenses, and a dominatrix corset just a few threads shy of a misdemeanor rap.

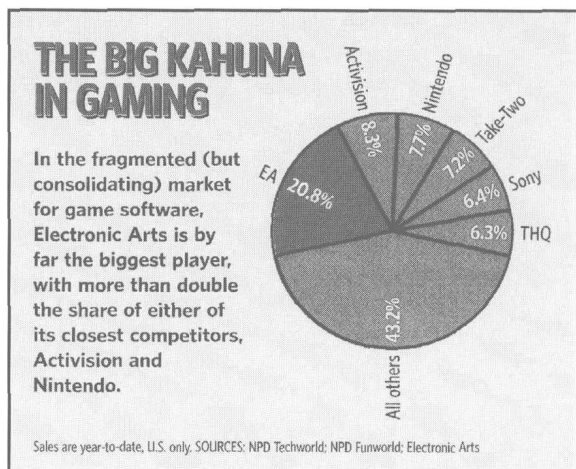
As the gamers milled and gawked, Larry Probst, CEO and chairman of Electronic Arts, pushed his way through. The sight of the queen stopped the 52-year-old executive in his tracks. Blanching, he turned to an assistant, and within seconds one of his minions had backed Hecubah into an inconspicuous corner while another raced off to get her some clothes. When the queen returned to work, she was wearing a skirt. "We want the focus at E3 to be on our products," Probst says about the incident, "not on scantily clad women."

Dressing the "booth babes," as they're inelegantly known at E3, may not be the most significant branding initiative of Probst's 18-year tenure at Electronic Arts, but it's a perfect metaphor for his vision of his company. In an industry that was born catering to adolescent male fantasies, Probst has turned EA into the runaway market leader by mining a largely PG audience. One of every four digital games sold worldwide this year carried the EA logo, despite the fact that the company has no product to compete with raunchy titles like the *Grand Theft Auto* series, unquestionably the hottest console franchise in the business. EA's gentler focus is evident in its lineup for the all-important 2002 holiday season. Of the 35 titles being rolled out, several are all-but-guaranteed blockbusters—*Harry Potter and the Chamber of Secrets*, *Lord of the Rings: The Two Towers*, *James Bond 007: NightFire*, *NBA Live 2003*, and the highly anticipated *The Sims Online*, the Web version of the best-selling PC game. The last, which goes live on Dec. 3, could bring EA as much as \$100 million a year. But not one is rated M, for a mature

audience. As Bing Gordon, a co-founder of EA and now its chief creative officer, puts it, "Management only wants to sell stuff that we'd be proud to have in our homes in front of our families."

If that brings to mind another media power built on wholesome entertainment, the resemblance is wholly intentional. "We've looked at Disney (DIS) as a model," Probst says. "It is the gold standard for us." Of course, it's almost absurd to compare a \$2 billion software maker with a \$25 billion diversified media giant. But that's what visions are made of. That, and the \$920 million of cash on EA's balance sheet—money Gordon hints could be used to expand into movies or music. In any event, Probst is clearly way beyond thinking of EA as merely a creator of software toys. "Our goal," he says with no hint of self-consciousness, "is to become the greatest entertainment company ever."

If any gamemaker has a shot at realizing such ambitions, it's Electronic Arts. Based in Redwood City, Calif., the 3,800-employee company has more than twice the sales of Activision (ATVI), its biggest rival, and its expected revenues for this year are around \$2.3 billion, a 35 percent increase over 2001. The stock market seems to believe in EA's future: During the past 30 months—a period



(Cont.)

that left most tech stocks in smoking ruins—EA's shares are up more than 80 percent.

Mike Wallace, an analyst at UBS Securities, calls EA “the Microsoft (MSFT) of the gaming business,” in part because of its portfolio of seemingly indestructible franchises, such as Madden NFL Football, James Bond 007, and The Sims. These titles produce revenues year-in and year-out and give the company a breadth and stability that are the envy of the industry. That, in turn, has enabled EA to assemble a massive internal studio system—2,500 game developers in five countries—that produces games that are consistently considered the best in their categories. “In terms of overall lineup, no one else comes close to EA,” says John Davison, editorial director of Ziff Davis Media Game Group.

The man at the helm of this success story started his career a long way from Redwood City. A sales director for Clorox in St. Louis, Probst had never even thought about computer games until the early 1980s, when he first played Pong. In that primitive ricochet game, Probst says, he saw the future of entertainment.

Packing up his wife and two boys, Probst traded the Midwest for Silicon Valley in 1984 and joined Trip Hawkins, the former director of product marketing at Apple (AAPL) who had launched EA two years earlier. Back then Pac-Man was the most popular videogame and Electronic Arts's portfolio was limited to a handful of products for the Apple II and Atari computers. Hawkins hoped that Probst would bring the fledgling company some practical business smarts, and he did. As Don Valentine, the Sequoia Capital VC

who bankrolled EA, puts it, “Unlike Trip, who is far more evangelical and visionary, Larry was the down-to-earth businessman who really set EA on its course.”

Within months of arriving, Probst began to shake things up. At that time, game publishers distributed their titles to thousands of independently owned stores through a handful of big manufacturers' representatives. “I just didn't think that was very effective,” Probst recalls. He set out to bypass the distributors and sell directly to retailers, as he had done at Clorox. The benefits, he reasoned, were

too good to pass up: higher margins, better market intelligence, and, most important, he says, “the guarantee that your reps aren't also selling competitive product.”

The move was risky, expensive, and unprecedented. “Who are you to think you can change the rules of the industry?” demanded Valentine at the board meeting in which Probst outlined his proposal. But Probst promised that it would work, and EA began to put a sales network in place, one store at a time. The distributors howled, but at a board meeting six months later, Probst reported better orders. Today, EA deals directly with 20,000 retail

FOCUSING WHERE IT COUNTS

Electronic Arts makes games for every platform, but it has built its dominance by emphasizing titles for Sony's PlayStation 2 console and the PC. As well it should: PlayStation 2 titles make up 66 percent of console games sold and 38 percent of all games. The PC is the next-largest platform, with a 26 percent share, and it has the added benefit of stability: It isn't subject to the disruptive hardware upgrades that occur with consoles.

TOP-SELLING GAMES IN 2002, BY PLATFORM

PLAYSTATION 2

- 1 Grand Theft Auto 3 (Take-Two)
- 2 Madden NFL 2002 (EA)
- 3 Medal of Honor Frontline (EA)
- 4 Spider-Man: The Movie (Activision)
- 5 Final Fantasy X (Square EA)
- 6 NCAA Football 2003 (EA)

PC

- 1 WarCraft III: Reign of Chaos (Vivendi Universal)
- 2 The Sims (EA)
- 3 Medal of Honor Allied Assault (EA)
- 4 The Sims: Vacation Expansion Pack (EA)
- 5 Neverwinter Nights (Infogrames)
- 6 Star Wars Jedi Knight II: Jedi Outcast (LucasArts)

GAMECUBE

- 1 Super Mario Sunshine (Nintendo)
- 2 Super Smash Bros. Melee (Nintendo)
- 3 Sonic Adventure 2: Battle (Sega)
- 4 Resident Evil (Capcom)
- 5 Spider-Man: The Movie (Activision)
- 6 James Bond 007: Agent Under Fire (EA)

XBOX

- 1 Halo (Microsoft)
- 2 Spider-Man: The Movie (Activision)
- 3 Max Payne (Take-Two)
- 4 James Bond 007: Agent Under Fire (EA)
- 5 Elder Scrolls III: Morrowind (Bethesda)
- 6 WWE Raw (THQ)

Sales are year-to-date, U.S. only. SOURCE: NPD Group, courtesy of EA

outlets, even those that are part of a national chain—a unique strategy among gamemakers. Instead of shipping exclusively to Wal-Mart's (WMT) distribution centers, for example, EA also ships directly to individual Wal-Mart stores as often as three times a week. Ken Williams, former CEO of Sierra Entertainment, which published Leisure Suit Larry, calls EA's sales force “unrivaled and a huge competitive edge.”

In the late 1980s, EA stumbled upon another of its key competitive advantages: sports games. The beauty of