

For managers, new ideas from current research

insights

from **MSI**

Retailing

New benefits of adding an old channel

As e-commerce has come into its own, researchers have raced to examine how adding the Internet as a sales channel enhances or cannibalizes sales in existing channels, such as physical stores or catalogs. But virtually no attention has been given to the effect that opening stores might have on retailers that previously sold only through catalogs and the Internet.

In general, opening up a new channel is likely to increase sales because it gives customers more opportunity to purchase products. It may also attract a whole new customer demographic—one that feels more comfortable with the new channel. Alternatively, new channel sales may simply

cannibalize sales from existing channels. Physical stores also have the drawback of making it easier for customers to make returns and exchanges.

Will retailers that open physical stores lose revenue due to increased returns? More generally, how will the addition of this channel affect the frequency and size of purchases, returns, exchanges, and customer acquisition?

To address those questions, Koen Pauwels and Scott Neslin of the Tuck School of Business at Dartmouth investigated the experiences of a retailer of durables and apparel that sold its products through catalogs and over the Internet. The retailer ventured into a new channel, opening bricks-and-mortar stores in 2000, 2001, and 2002. The authors observed the orders, returns, and exchanges of customers living within 50 miles of the new stores, along with the catalogs and e-mails those customers received. They report their findings in “Building with Bricks and Mortar: The Revenue Impact of Opening Physical Stores in a Multichannel Environment.”

The authors theorized that the new store channel was more likely to cannibalize sales from the catalog than the Internet because both the catalog and the store attract a similar sort of customer, namely, people who enjoy shopping, whereas the



How might the introduction of bricks-and-mortar stores affect revenues of catalog and Internet retailers?

i n s i d e

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This meta-analysis offers guidelines to managers aiming to optimize personal-selling expenditures.

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Internet attracts people more interested in simply completing a transaction quickly.

“Our prediction came as a surprise to several colleagues who believed that the similar way in which shopping information is presented on the Internet and in catalogs would make them close substitutes,” said Pauwels.

“But research clearly shows that certain shoppers prefer the Internet, while others enjoy browsing in both catalogs and physical stores.”

The authors hypothesized that overall, the store openings would have a beneficial effect on revenue, but because the presence of a physical store also makes returns easier, they hypothesized that the company would see increased returns. However,

Internet channel. As expected, returns shifted from the catalog to the store, and they increased, as did exchanges. However, the ancillary purchases that customers made when they came to the store to exchange products generated additional revenue for the retailer.

“Revenue positive” exchanges

“The biggest surprise was the positive revenue impact of adding physical stores on returns and exchanges,” said Pauwels. “High-service retailers such as the one we studied normally experience 25–30% rates of return, so there was a certain risk involved in opening a channel that was likely to increase returns even more. While we do indeed find that returns increase overall, we also observe

a much higher incidence of ‘revenue positive’ exchanges—consumers return an item, but buy a more expensive product during the same shopping trip.

Both the visual stimulation of the physical store and the selling skills of its personnel are likely responsible for the positive net impact on exchanges.”

The authors calculated that the addition of the store channel resulted in an additional \$7,243 per week in revenue for the retailer, and of that, \$659 was due to increased exchange revenues. Annually, the store channel increased revenues by 19.8% among customers contained in the firm’s customer database.

That increased revenue came almost entirely from the increased purchase frequency represented by customers’ use of the new channel. Size of customers’ purchases in the other two channels appeared to be unaffected by the new channel; the cannibalization that the catalog channel suffered was due to decreased purchase frequency, not decreased purchase size.

In analyzing the impact of marketing variables, the authors

found that direct mail promotions and media advertising contributed not only to sales through the new channel, but also to sales through the already established channels in the firm’s repertoire, thanks to the multiple interactions across channels.

As possible avenues for future research, the authors suggest investigation into the order of channel introductions and the effect of store location. Noting that even catalogers tend to have regional consumer loyalties, the authors ask, “Should the company locate stores in areas where it is strong in other channels, or weak?”

Other questions emerge as Web opportunities continue to evolve. Although Pauwels is fairly confident that the results of this study will be robust for some time, given the nature of consumer shopping behavior, he acknowledges that “today’s retail customers are mostly digital immigrants; the rising generation are digital natives, who may develop very different preferences and shopping habits.”

Pauwels points out that this study’s data represent “only one side of the equation: we know the revenues, but not the retailer’s costs.” He and Neslin note that “there are obvious fixed costs in operating a store, and whether these outweigh the revenue benefits is a crucial area for future research.” But at least from the revenue side of the equation, it appears that adding a store channel is all to a retailer’s benefit. “Adding a channel—even an ‘old’ one—is definitely a way to grow a company,” the authors observe.

BY FRANCESCA FORREST



From “Building with Bricks and Mortar: The Revenue Impact of Opening Physical Stores in a Multichannel Environment” (MSI Report No. 08-101)

The introduction of the store channel had an overall positive effect on the retailer’s revenue.

exchanges should also increase and become more beneficial to the company, because the physical store makes it easy to find appealing alternatives to the returned item.

Because the study tracked several variables, the authors used a multivariate vector autoregression model to develop a multivariate baseline and then calculated the impact of adding the physical store channel. An adjusted baseline model was estimated to account for circumstantial changes (in this case, the retailer’s decision to cut down on the number of catalogs it sent to customers) unrelated to the addition of the store channel.

As the authors hypothesized, the introduction of the store channel had an overall positive effect on the retailer’s revenue. It did cannibalize purchase frequency from the catalog (the weekly percentage of customers buying from the catalog went from 1.90% to 1.54%) but had no significant effect on customer traffic in the

Metrics

How effective is personal selling?

Personal selling is a crucial marketing tool in many market sectors. In 2006, U.S. businesses spent \$800 billion on personal selling, almost three times the amount spent that year on advertising. Further, personal selling is generally known to have a stronger effect than advertising on sales per dollar spent. However, managers tasked with deciding how much money to allocate to a sales force have faced a striking absence of generalized, empirically derived quantitative guidance. Although the general effects of advertising expenditures on product sales have been quantified in a number of studies, no such studies have been undertaken to obtain generalizations regarding the effects of personal selling on sales.

A recent study by Sönke Albers of Christian-Albrechts University at Kiel and Murali K. Mantrala and Shrihari Sridhar, both of the University of Missouri, Columbia, provides managers with a starting point toward evaluating and determining appropriate levels of personal-selling spending. Based on a meta-analysis of empirical studies encompassing a variety of market settings, the authors provide quantitative generalizations about personal selling's effect on sales that managers can use to build accurate response models as well as to benchmark their decision making.

The meta-analysis examined the current-period elasticity of sales response to personal-selling efforts, i.e., the percentage increase or decrease in sales corresponding to a 1% change in personal selling effort.

Assessing the stock of knowledge

"There weren't enough studies of personal selling's effectiveness two decades ago to do this sort of meta-analysis, but now there are," says Mantrala. "With this study, we take stock of the knowledge that's out there and derive a benchmark estimate of personal-selling elasticity that managers can combine with previous generalizations about advertising and pricing elasticities to determine their optimal marketing mix.

"We analyzed elasticity for a couple of reasons," he explains. "Since it is based on percentages, you can compare many different studies that use different units of measure. And because elasticity has also been used extensively in similar studies of advertising and pricing, we can put our findings alongside others and make comparisons."

The researchers assembled a large dataset from 46 studies of personal selling's effects on sales outputs carried out during the past four decades. Those studies were conducted by scholars in a wide variety of disciplines—marketing, management, operations research, economics, and health economics—as well as by industry- and government-based researchers. The studies originated from the United States and Europe, and encompassed a range of research settings, models, data environments,

and estimation methods. The 46 papers provided a total of 3,193 personal-selling elasticity estimates.

To investigate the drivers of the elasticity estimate, 11 independent variables encompassing study market setting and research methodology characteristics were considered, and hypotheses regarding the effect that each variable would have on personal-selling elasticities were developed and tested.

Firms that use both personal selling and advertising should spend about twice as much on personal selling as on advertising.

Eight of the variables were found to have statistically significant effects on personal-selling elasticity estimates. Five corresponded to variations in the characteristics of the research methodologies used in the individual studies. For example, studies that omitted lagged effects, or carryover effects of sales efforts in previous periods, were found to yield inflated elasticity figures, as were studies that omitted promotion variables such as free samples, gifts, and temporary price reductions. Use of constant elasticity models, which constrain short-term elasticity so it is the same over the range of the response function, tended to underestimate elasticity. Moreover, studies that used yearly data estimated

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elasticities lower than studies using data gathered monthly or quarterly.

To provide managers with more accurate guidance on personal selling's effects, says Mantrala, researchers should build and use salesforce response models that allow for varying elasticity over the range of effort, include lagged effects and promotion variables, and employ absolute sales measures, and monthly or quarterly data. In settings where all of the above may not be possible, researchers should be able to judge the extent of the bias they introduce based on the quantitative generalizations obtained from the meta-analysis.

The remaining three variables impacting personal-selling elasticity pertained to specific market setting

greater personal-selling efficacy in Europe is a bit surprising but it could be due to their more collectivistic cultures which have been shown to be more receptive to personal selling than individualistic cultures.”

The year of data collection also had an effect; estimates of personal-selling elasticities from studies that used more recent data were lower than those conducted in earlier years.

“We attribute the estimated decline over the time range of the meta-analysis (of about .01 with each successive year) in elasticity estimates to increasing product complexity, longer sales cycles, and greater competition,” Mantrala says.

Focus efforts on new products

Managers can capitalize upon these findings by focusing personal-selling efforts toward new products rather than established products and, in the case of international firms, by concentrating

their personal-selling resources in European markets.

Additionally, after correcting for methodological biases, the authors found the weighted mean for personal-selling elasticity to be about .352. This is more than twice the modal elasticity of .15 found in meta-analyses of advertising elasticity. In other words, firms that employ both personal selling and advertising should spend about twice as much on personal selling as they spend on advertising.

Coupling the methodology bias-corrected estimate of .352 with past estimates of mean price elasticity from

other sources, the authors found that the efficient ratio of personal-selling expenditures to total revenues is about 12.5%, assuming prices are set optimally. “Relative to this benchmark, we found that many industries in 1998 to 1999 were under-spending on personal selling,” Mantrala says. Likewise, he noted, the mean ratio of .352 should be refined to account for specific market settings and idiosyncratic firm practices.

Personal selling remains a potent marketing instrument relative to other marketing instruments such as advertising. Companies lacking the data or skills to perform estimations of personal selling's impact on sales can now draw on the generalizations derived in this research to benchmark their decision making.

BY DEBORAH KREUZE



From “A Meta-analysis of Personal Selling Elasticities” (MSI Report No. 08-100)

Collectivistic cultures are more receptive to personal selling than individualistic cultures.

characteristics. On average, personal-selling elasticities for products in the early stages of their lifecycles were about .16 greater than those for late-stage products, and elasticities in Europe were .23 higher than in the United States.

Says Mantrala, “The higher elasticities for early-stage products aren't surprising, given the two-way communication inherent to personal selling. The salesperson can answer the customer's questions about the new product and provide reassurance. Customers are also more receptive to sales calls when the sales rep has something new to show them. The

Market segmentation

Customer loyalty and perceptions of status

In a marketplace flooded with promises of special pricing and white-glove treatment, customer loyalty doesn't come cheap.

Although “hard” benefits—frequent flier miles, free hotel stays, and other types of promotional currency—may stimulate repeat business, they also require a significant financial commitment. Even “soft” benefits such as discounts and preferential service can erode profit margins or drain hiring and training budgets. With marketing dollars stretched to the limit and customer churn rates rising, marketers face an increasingly delicate balancing act. How can they maximize the appeal of their loyalty programs without breaking the bank?

This dilemma may not be as unsolvable as it appears, according to Joseph C. Nunes of the University of Southern California and Xavier Drèze of the University of Pennsylvania. Their study of tiered loyalty programs—“Feeling Superior: The Impact of Loyalty Program Structure on Customers’ Perceptions of Status”—suggests an intriguing answer: The best way to fix financially shaky loyalty programs may be to remodel the top level.

All customers not equal?

The strategic advantages of tiering—segmenting customers based on their spending histories—captured the authors’ attention during their tenure as consultants for Southwest Airlines’ Rapid Rewards Program. “Southwest initially positioned itself as the airline where all customers are created equal,” said Nunes. “As high-ranked

customers on two legacy airlines, Xavier and I began reflecting on what aspects of our elite status were most meaningful to us as consumers.”

That special feeling

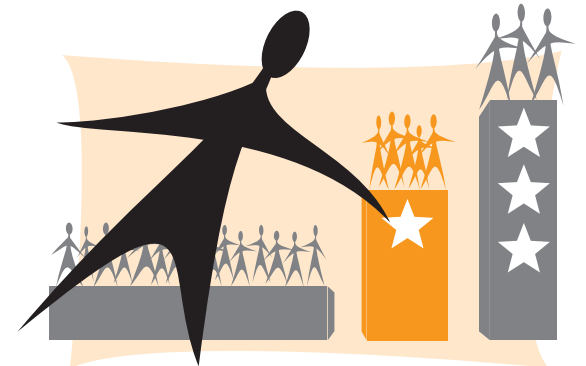
In the authors’ view, the potent allure of elite status transcends the perks and pampering it affords. Their study suggests that while consumers may appreciate convenience and preferential treatment, for many the psychological boost derived from those benefits is just as compelling. In other words it’s the feeling of being special—not the free cocktails—that provides the real kick.

That ego boost, according to the authors, springs from status comparisons. “You don’t have status in isolation,” said Drèze. “Rank in a hierarchy is comparative by nature—it exists only in relationship to other positions on that totem pole.”

Extensive social science research described by Nunes and Drèze explains that when people make social comparisons they typically look down at lower-ranked individuals to enhance their self-esteem. By providing ample opportunity to feel superior, elite status emphasizes the value of customer loyalty. Nunes noted that numerous studies as well as his own experience confirm the impact of such status comparisons. “The benefits associated with sitting in first class begin with boarding the plane before others and watching others walk by you with some degree of envy,” he remarked. “There’s a reason elite benefits are so visible; most elites like their status to be observed,

admired, and desired. It’s part of the benefit of being elite.”

The authors’ research suggests that it’s the relative nature of status that makes the structure of tiered loyalty programs so important. If elite customers’ sense of superiority depends on their position relative to others in the program hierarchy, then it’s logical to expect that changing the structure of that hierarchy will have a significant impact on their self-perceptions.



A buffer zone between top-ranked customers and the masses may help elite customers feel more secure about their status.

Nunes and Drèze proposed that changes in the hierarchy’s upper echelons would have the greatest influence on elite customers. Their contention is rooted in a basic principle of social comparison theory: People typically compare themselves to individuals with characteristics similar to their own.

“Being above other elites,” Drèze pointed out, “is different from being above the masses. Consequently we decided to test how changing

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the size and number of elite tiers affected top-ranked customers' sense of superiority."

As the study emphasizes, both the size and number of tiers help determine the central defining characteristic of elites: their exclusivity. Once being special becomes nothing special, the thrill of elite membership is gone. Programs that are insufficiently restrictive, then, will ultimately prove self-defeating. This link between perceived value and exclusivity informs the authors' initial premise: "The fewer people granted elite status, the more superior those people will feel."

A catch-22?

The flip side of this proposal seems to imply bad news for marketers. On the one hand, maximizing the company's pool of profitable customers who

increasing the number of elites dilutes their perception of status—which guided the authors' research into the specific effects of various structural changes on consumers' self-appraisals. To test the proposed benefits of adding a second elite tier, the researchers conducted several surveys of undergraduate, graduate, and executive business students at two major universities. In one study 30 executive MBA students were asked to imagine their spending histories entitled them to "Gold" status, an elite rank consisting of the top 5 percent of the hypothetical company's total customer base. Gold customers were then divided into two groups and presented with opposing scenarios. In the two-tier scenario, only Gold customers had special status; the other 95 percent constituted the bottom of the heap. The alternative three-tier scenario

included a secondary elite, or "Silver" tier comprising an additional top 10 percent of customers.

To gauge the Gold members' status perceptions, the researchers devised four 9-point

scales. Gold members used these scales to rate how special the program made them feel. Gold members also used the scales to rate their perception of the difficulty of earning their status, and the level of extra attention they felt was afforded by Gold status compared to other customers. The researchers used these measures to determine how superior the two different groups of Gold members felt in relation to lower-ranked customers.

A subsequent survey asked 49 students to describe their reactions to variations in the size of the Silver tier. An additional 104 students were then surveyed to assess the impact of adding a third ("Bronze") tier. As the authors predicted, the addition of a Silver tier boosted Gold members' perception of status. Furthermore, these positive effects diminished when the size of

the Silver tier expanded. Adding a third ("Bronze") tier, however, had no impact on Gold customers' sense of superiority.

Additional studies explored the effects of other variations in program design, including the addition of a super-elite (Platinum) tier. While the previous studies had tested participants' reaction within a static hierarchy, this later study examined how altering an established hierarchy in midstream affects self-perceptions. The results further confirmed that a subordinate elite tier helps insulate top-ranked members from structural changes that might have otherwise challenged their sense of superiority.

One aspect of the authors' findings illustrates how the right program structure may also help win a bigger share of customers' wallets. Nunes explained that several of their surveys measured respondents' purchase intentions along with their status perceptions. "We found that the more special a firm's program made members feel, the more inclined they felt to buy from that firm again."

For marketers striving to mine greater value from their most profitable customers, the authors' results support the idea that well-designed loyalty programs offer a sustainable competitive advantage. By fostering and protecting elite customers' sense of superiority through the strategic use of tiering, companies can create a win-win value proposition. The customers' payoff increases, motivating greater loyalty—without costing the firms an extra dime.

BY ELLEN PERSIO



From "Feeling Superior: The Impact of Loyalty Program Structure on Customers' Perceptions of Status" (MSI Report 08-102)

By providing ample opportunity to feel superior, elite status emphasizes the value of customer loyalty.

are given elite status promises the best return on its investment in loyalty. On the other, the more new elite members its program gains, the more disenfranchised its existing members are likely to feel. The potential backlash from these disaffected members appears to pose a catch-22. By increasing the number of customers with status and thus the appeal of their loyalty programs to attract more customers, marketers might actually be dooming those programs to failure.

The authors propose an ingeniously simple antidote: Add a second elite tier to the customer hierarchy. By creating a buffer zone between top-ranked customers and the masses, this strategy should help elite customers feel more secure about their status.

The results of a series of studies confirmed their initial premise—

Marketing's role in the firm

Reclaiming marketing's influence

As companies focus more on understanding the constantly changing needs of customers, traditional marketing functions have been absorbed by other departments or pushed lower in the corporate hierarchy. Marketing is seen as a process or activity, rather than an organizational area. Dispersed marketing activities may lead in some cases to a lack of coordination and loss of close customer relationships. And boards of directors see marketing more as a cost and less as an investment. What is the role of a strong marketing department in a firm? How can marginalized marketers regain their former role of prominence in the firm?

In a recent study, Peter C. Verhoef and Peter S. H. Leeflang, both of the University of Groningen, examine and explain the state of marketing influence within the firm. They suggest possible ways to reestablish its influential role. Their findings may confirm marketers' sense that their traditional role is in jeopardy, but, according to Verhoef, "there is hope that marketers can regain their influence through accountability and innovativeness."

Why the decline?

In their working paper, "Getting Marketing Back in the Boardroom: Understanding the Drivers of Marketing's Influence within the Firm," they first posit the potential reasons for marketing's decline, such as the lack of accountability. "In many firms, marketers have a difficult time justifying their expertise in terms of direct return on investment," says Verhoef. "Many marketers do not measure the effect of

their actions because they are unable or unwilling to do so or because they do not use appropriate methods." Other factors that might affect marketing are whether the CEO has a marketing background and whether the firm participates in a business-to-business or business-to-consumer market.

The researchers began their study by interviewing 25 marketing and finance executives from leading Dutch firms and asking open-ended questions. Their goal was to determine the "state of feelings about marketing," according to Verhoef. Using the results of the interviews, they structured an e-mail survey of 296 top marketing and finance executives from medium-sized Dutch firms with at least one Dutch office. They asked the executives their opinions on a range of statements related to their perceptions of marketing, top management respect for marketing, the influence of the marketing department on decision making, and how that influence is dispersed throughout the company. Their goal was to determine the influence of the marketing departments in the participants' firms.

The survey results point to several important findings indicating that marketing is losing ground within firms. The researchers determined that the marketers' decision-making power is limited to advertising, relationship management including satisfaction measurement and

improvement, and product targeting and positioning. In the participating firms, pricing and distribution are now handled by other departments.

They also found that marketers' accountability and innovativeness affect the amount of influence they have within their companies. The marketing department's close cooperation with the finance department fosters top management respect, but can lead to negative perceptions of marketing itself, as many of its responsibilities will be shared, hence the department loses some influence within the firm.

Marketers' influence was limited to advertising, relationship management, and product targeting and positioning; they had little influence on pricing and distribution decisions.

No need for strong department?

The study results also show that since there is no direct link between the influence of the marketing department and the performance of marketing-oriented firms, there may be no need for a strong marketing department. But, as Verhoef points out, "the outcome will be a lack of coordination of marketing activities. And vital customer relationships will be lost. While this doesn't have a role in the department's overall influence

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within the firm, connections with customers are beneficial.”

Back in the boardroom

How can the marketing department “get back in the boardroom”? According to Verhoef, “Marketing departments must become more accountable. Although it can be difficult to establish a link between certain marketing activities and measures of performance, it is vital marketers become more analytical so they can determine how they deliver and how they contribute to the overall productivity of the firm.”

“Marketers must also acquire the skills to become more innovative,” says Verhoef. “They must either become more creative themselves or hire people who are able to focus on customer preferences.” They should focus on new product or service development and find new solutions in order to regain their influence.

“Although our research highlights a weakened position for the marketing department,” comments Verhoef, “we believe that marketers should aim to regain their influence. They must continue to be the customer’s advocate.” So, by becoming more accountable and innovative, marketers can ensure the future of their influential role in the firm.

BY JANE GEBHART



From “Getting Marketing Back in the Boardroom: Understanding the Drivers of Marketing’s Influence within the Firm” (MSI Report No. 08-104)

shorttakes

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Social justice and consumer perceptions of fairness

In a recent paper, Gary Gebhardt argues that a social justice framework offers a more robust understanding than widely used equity theory to predict customers’ perceptions of fairness. He suggests that the social justice framework may help marketers more accurately predict the effects of marketing actions on consumer’s perceptions of a provider, customer satisfaction, and future behavioral intentions.

In contrast to equity theory, social justice theory provides a more expansive conceptualization of the antecedents related to perceived fairness. For example, it suggests that consumers’ perceptions of fairness and satisfaction are not only influenced by the inputs and outputs of a transaction—known as distributive justice—but also by the decision or allocation process—known as procedural justice. To determine distributive justice, a person would compare his or her inputs and outputs to someone else’s. To determine procedural justice, people compare their treatment to how other people are treated. Thus, it seems that customers compare themselves to other customers to ascertain fairness—rather than to their product or service provider, as is often assumed in marketing research.

Four experimental studies support Gebhardt’s notion that the choice of referent others, perceived distributive justice, and perceived procedural justice all affect customer’s perceptions of fairness.

“Using the social justice framework,” he writes, “managers are better equipped to plan and implement actions that are likely to increase customers’ perceptions of fairness, customer satisfaction, customer lifetime value, and, ultimately, firm profitability.”

From “Social Justice in Marketing: Fairness, Satisfaction and Customer Lifetime Value” (MSI Special Report No. 08-201)

A new approach to predicting market penetration

With increasing globalization and rapid introduction and obsolescence of new products, predicting the market penetration of new products is ever more important. Moreover, good recordkeeping has generated a wealth of new product penetration histories. However, until now, the literature has not shown how to integrate these rich data with the history of an evolving product to predict its future market penetration.

In a recent report, authors Ashish Sood, Gareth James, and Gerard Tellis use functional data analysis to develop a new model—functional regression—for predicting the market penetration of a new product. They demonstrate its superior performance over the widely used Bass model, using data about market penetration from 21 products across 70 countries, for a total of 760 categories (product x country combinations).

They find that their method can be used to make more accurate predictions on eight aspects of the future trajectory of an existing or new product with only a few years of observation. One could also make predictions for the evolution of a new product without any data based on the previously observed principal components of the historical curves of similar products. In addition, functional regression can easily include additional explanatory variables, such as pricing and advertising, to help managers explain, predict, and control the future penetration of a new product.

From “Functional Data Analysis: A New Approach for Predicting Market Penetration of New Products” (MSI Special Report No. 08-200)

Insights from MSI
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