The derived demand through advertising marketing essay

Introduction

Advertising plays an important role in economics. It affects on profits of any firm as well as on the consumption decision and as a result the utility of any consumer. This is why this topic attracts a lot of attention of the economists. This current assignment intends to contribute to the understanding of the role of advertising of Intel in economics and how Intel creates derived demand through advertising.

Intel manufacturer of semiconductor computer circuits in US. Intel was founded in 1968 as NM Electronics by Robert Noyce and Gordon Moore, inventors of the integrated circuit, to manufacture large-scale integrated (LSI) circuits (Mamta, 2003). In the early 1970s it introduced the most powerful semiconductor chips then known, which soon replaced the magnetic cores previously used in computer memories. IBM chose to use Intel's 8088 microprocessor (introduced 1978) in its first personal computer (the IBM PC), and Intel microprocessors became standard for all PC-type machines. Although other manufacturers eventually developed Intel-compatible microprocessors, Intel continued to power more than 75% of PCs at the beginning of the 21st century (fortune, CNNmoney. com, 1994).

Intel pushes the boundaries of innovation so our work can make people's lives more exciting, fulfilling, and manageable. And our work never stops. We never stop looking for the next leap ahead-in technology, education, culture, manufacturing, and social responsibility. And we never stop striving to deliver solutions with greater benefits for everyone. Intel creates amazing leaps in technology every day. Intel is driven to create bold advancements in technology that enable positive change and a better, more interesting world. Intel’s mission is to meet and exceed the expectations of our customers, employees, and shareholders. Learn more about these efforts below (Intel, 2009).

Advertising

Advertising defined as “ Mass paid communication, the ultimate purpose of which is to impart information, develop attitudes and induce behavior beneficial to advertiser” (Colley, 1961). By advertising we mean “ any expenditure which influences the shape or position of a firm’s demand curve and which enters the firm’s cost function” (Dorfman and Steiner, 1954).

Firms use advertising as a form of non price competition, which they use to boost their market share. Outcome from advertising can be customer loyalty, product differentiation. By advertising, the business will not only be informing the consumer of products existence and availability, but also deliberately attempting to persuade and entice the consumer to purchase the goods (Sloman and Sutcliffe, 2001). It is well know that the degree of consumer loyalty to some firm plays a significant role for profits collection of the firm. Consumer loyalty might be affected by advertisement. Firms are supposed to have diverse characteristics. Firms will compete by advertisement to build the prestige for their products. The modeling of advertising includes two main elements: (i) Specification of firm and their advertising possibilities and (ii) specification of consumers’ demand together with their reaction to advertising.

Derived Demand

Derived demand is the demand for the factor of production depends on the demand for the good which uses it (Sloman and Sutcliffe, 2001). The higher the market demand for the goods the higher will be its market price and hence higher will be the marginal revenue and the marginal revenue for product. Business to Business marketers face a derived demand within the value chain. The demand for products or services is not primary out of the needs and wants of end customers. It ultimately depends on the demand of companies later in the value chain and the demand for consumer goods at the end. Demand for certain products depends on the success of companies down in the value chain. Every activity upstream the value chain is initiated by derived demand; that is, the demand for products and services is derived from the demand for a customer’s products and services (Dwyer, 2002). Business to Business demand is derived demand because a business’s demand for goods and services comes either directly or indirectly from consumers’ demands

Intel creates derived demand through advertising

In the 1990s, one of the key subjects of worry to business managers was branding—how to promote, manage and profit from the brands[1]that identified their products and services to customers (Karen Vrotsos), the confidence that computer consumers place in the words “ Intel inside.” At the start of a new decade, as the world economy shifts dramatically in response to the rise of Internet technologies and an increasingly digital marketplace, brands continue to be seen as crucial. But businesses face a host of new challenges now in managing their brands on a global scale and in the new marketplace of the Internet.

In the industrial markets, demand for the goods is ultimately derived, in that it depends on the demand means that marketers need to pay attention to the markets served by their customers. Are these markets growing? If they are falling, could this mean a reduction in demand for their own goods and services?

Marketers of industrial products can play a proactive role in stimulating derived demand by advertising their product directly to final consumers. For example, the British glass manufacturer, Pilkington, sells the benefits of its high-technology glass to householders. The intention is that when people buy glass products they will ask for those which use Pilkington’s. Another example is Intel which markets its computer chips direct to consumers in the hope that, due to consumer demand, computer manufacturers will buy Intel chips rather than Motorola or non-branded chips (Kotler, Pfoertsch, 2006).

Since demand depends on the health of the customer’s business, it is liable to fluctuate more than is the case in consumer markets. However, demand is also more inelastic (because their cost is often a small proportion of the purchaser’s total cost) and for these reasons demand may be insensitive to the product’s price.

Effective marketing strategy is inextricably linked to the development of processes for the creation, production, and distribution of products that are focused on the customer’s perceived value (Goldman, Nagel, and Preiss, 1995). The decision to buy and the price that customers are willing to pay is dependent on their assessment of the value they will receive from one product relative to the known alternatives. The emergence of the information economy has contributed to the convergence of knowledge, goods and services into total product solutions that attempt to maximize customer perceived value and, hence, customer satisfaction. Customers have greater access to information about competitive products, which has led to an improved ability to articulate value expectations. Knowing what customers value and how the solutions a company provides meet those values is key to developing a viable marketing strategy (Greg Laird, 1997).

When Intel, the microprocessor manufacturer, began advertising[2]its products based on quality, consumers began to demand computers with Intel processors, enabling an increase in price and driving up stock value (pettis, 2000). Business Demand is derived demand – it ultimately derivers from the demand of consumer goods. Intel buys Silicon wafers because consumers buy PC’s and laptops with Intel memory chips. If consumer’s demand for laptops and PC’s drop’s, so will the demand for silicon wafers and all the other products used to make memory chips. Hence, business marketers sometimes promote their products to final consumers to increase their product demand. For example, Intel’s long running ‘ Intel Inside’ advertising campaign sells PC buyers on virtues of Intel microprocessors. The increased demand for Intel chips boosts demand for PC’s and laptops containing them, and both Intel and its business partners win.

Fig 1: Derived Demand

- Demand for Intel’s chips is derived demand.

– This derived demand is driven by consumer demand for products which contain Intel's chips.

- Demand for Intel's chips is more inelastic than elastic

– Changes in price for Intel's chips will not significantly impact, the short run, the quantity purchased by business customers.

- Demand for Intel's chips fluctuate more, and more quickly, than in consumer markets.

– small percentage raise in end user demand for products that contain Intel's chip may cause a significantly large percentage change in demand for Intel's chips.

Generally accepted that demand in business markets is tied ultimately to consumer demand (Blythe and Zimmerman, 2005; Hutt and Seph, 2004). Therefore, a business markets whose products become a visible part of final product (eg. Intel processor), might find the use of advertising in high consumer traffic areas helpful in meeting promotional objective. Intel, for example, may be able to drive up the demand for computers by placing its billboards near college campus that tend to purchase a lot of computer products. It may be able to influence demand by placing ads in mass transit. College students tend to purchase more computers. As these ads likely to drive up the demand for computers, the demand for Intel processors will go up (Lichtenthal, Yadav and Donthu, 2006).

By advertising Intel is trying to (i) shift the product demand curve to right: if the advertising brings the product to more people's attention and increase people's desire for products. (ii) Make demand curve less elastic: if the advertising creates greater brand loyalty peoples are led to believe that the competitor's brands are inferiors (Sloman and Sutcliffe, 2001).

Fig 2: The affect of advertising on the demand curve.

The figure above shows the original demand cure D1 with price at P1 and sales at Q1. D2 shows the curve after an advertising campaign. The rightward shift shows an increased quantity Q2 . If at the same time, the demand is made less elastic; the firm can also raise its price and still experience an increase in sales. Thus in the diagram, Price raised to P2 and sales will be Q3. The total gain in the revenue is showed by the shaded area. An advertising campaign is considered to be more successful is, the more the demand curve shifts to right the more it is less price elastic (Sloman and Sutcliffe, 2001).

Digital Henge located in Seoul brings to market a family of servers based on powerful Intel® Xeon™, Intel Itanium and Intel Pentium III processors. Digital Henge builds its products on Intel server products because of their exceptional performance, quality, reliability and price, as well as the comprehensive support that Intel provides to its reseller community through its own advertising. Now, the company's Intel-based servers are bringing exceptional levels of performance to its customers at a very affordable price, allowing Digital Henge to expand its business rapidly and become even more profitable than before (Choy 2003).

Business buyer demand is derived from final consumer demand

– Demand in many business markets is more inelastic, not affected as much in the short run by price changes

– Demand in many business markets fluctuates more, and more quickly.

Business customers for Intel's chips are more geographically concentrated

– (Dell in Texas, HP/Compaq[3]in California and Massachusetts, and clone manufacturers in Taiwan and China).

The demand for microprocessor chips is strongly linked to the demand for new PC's and other electronic products, so that when an economy goes into a downturn or recession, so we would expect the demand for microprocessor chips to decline likewise. The major producer of microprocessor chips in the world is Intel. They produce for a wide range of different industries; from agriculture, aerospace and electronic industries to consumer goods producers. The demand for microprocessor chip market during high demand for PC's and Laptops

Fig 3: Intel's Demand curve for Chips.

The higher the market demand for the Intel chips, the higher will be the market price, and hence the higher will be the marginal revenue and marginal revenue of product. This too determines the demand for the curve and shows how the demand for Intel chips is a derived demand. A change in price is represented by a moment along the demand curve for chips. A change in demand for the goods shifts the curve (Sloman and Sutcliffe, 2001).

The conditional demand for Advertising is based on constant full prices, thus sales. The market derived demand for advertising under competition indicates that advertising outlays for a brand or product would be higher the higher the wage rate of customers; the greater the effectiveness of advertising messages. Advertising is provided essentially in response to buyer's demand for knowledge about variety of available brands which in turn, are produced in response to prevailing consumer preferences, rather than as consequence of firms attempt to acquire monopoly power by changing this preferences.(Ehrlich and Fisher, 1982).

Conclusion

From an economic point of view, demand for Intel's chips can be considered a derived demand. As these microprocessor chips will be used in conjunction with other consumer products, e. g. laptops, and mobile phones, their demand depends on the sales of these products. In addition, as consumers and firms demand a certain level of intelligence to operate their mechanical and electronic devices. However, as Intel will not be the only microprocessor chip providers in the market, they will need to compete with other supply technologies as well as with technologies decreasing the amount of services needed by final products, i. e. energy saving technologies, high processor speed, smaller size etc… The set of technologies competing to power certain devices depends on several factors such as cost, reliability, noise, emissions, regulation and taxation. Therefore, the derived demand for microprocessor chips depends on their ability to compete with other technologies according to the factors evaluated by consumers. In order to gain advantage over their competitors Intel has used production & marketing tricks.