

Market Transformation Meets Resource Acquisition: The Mid-Market Approach

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ABSTRACT

Market transformation organizations have created valuable partnerships with manufacturers, distributors, and retailers in residential product markets. The product distribution channels that exist between manufacturers and retailers are complex and an important part of the market. The marketing, sales, and field resources these players can task toward efficiency often dwarfs the capability of publicly funded market transformation programs. The distribution networks are powerful, but the players resist long-term change based on short-term promotional efforts that disrupt business as usual. Some of our most dramatic program success has happened through the use of flexible cooperative funding pools that allow implementers to sit at the table with these players and create joint ventures that satisfy everyone's needs.

The authors label this network of relationships the “mid-market.” They argue that working with the mid-market represents more than just a slightly more efficient way to accomplish program objectives. Rather, the ability to leverage existing distribution systems can turn market transformation activities into powerful resource acquisition tools. This new paradigm requires significant change in the way programs are designed, implemented and funded.

The new generation of mid-market initiatives will look much more like business ventures and a lot less like “programs.” They will require program implementers to become reliable business partners *within* the market they wish to transform. Effective players will have to cultivate a long-term role for themselves within the network of relationships. This paper examines successful mid-market activities and programs currently under development to arrive at a new model for program design .

The Mid-Market: A Definition

As the energy efficiency program design pendulum swings back to an emphasis on direct acquisition of energy savings, we must examine which programs most efficiently accomplish this goal. We believe the next generation program designs should combine elements of both market transformation and traditional resource acquisition programs. Our experience reveals a robust “mid-market” infrastructure that program implementers can task toward their own efficiency goals. The concept of the “mid market” is a new one in the efficiency arena, and while it is reasonable to expect that our understanding of it will evolve as our experience grows, we offer the following definition to get the discussion started:

Mid-Market: the complex network of distribution relationships involved in the delivery of products and services. These can include the manufacturers' regional sales relationships and retailers' marketing relationships with suppliers. It does not include the production role of manufacturers, or conversely consumers.

The mid-market function is characterized by long-term relationships, common business interests and familiar frameworks.

Long-Term Relationships

The markets we work in as implementers of efficiency programs are incredibly competitive and decision-makers face tremendous pressure. As a result, business relationships with known partners are an important risk management technique. Decision-makers look to these relationships to provide repeatable results. They rely on their business partners for dependable information and are often more sensitive to the attitudes and activities of their peers than to analysis and data.

Common Business Interests

Mid-market business relationships are not only characterized by their stability and duration, but by the fact that participants have common interests in a market. Their relationships are strengthened because they share efforts to achieve success. Their relationships work because all partners bring value to the table and seek to establish long term relationships that leverage that value.

Familiar Frameworks

Business partners tend to look to familiar models, systems and approaches. Innovation and change occurs only within this framework. Alternative methods are not actively sought.

The Alliance's market transformation programs have enjoyed considerable success in applying mid-market techniques to create partnerships with manufacturers, distributors, and retailers in residential product markets. The marketing, sales, and field service resources that these partners can direct toward efficiency activities, with little added effort, dwarfs the comparable capability of a utility or government-funded program.

A Successful Mid-Market Initiative: Residential Lighting Co-op Program

The mid-market approach of leveraging existing relationships between retailers, distributors, and manufacturers can produce surprising results, as we have seen in expanding the cooperative marketing feature of the Alliance's ENERGY STAR CFL Program. In order to gain rural and small market participation in the Residential Lighting Co-op program, the Alliance employed a mid-market strategy. As in any mid-market approach, the program's

first goal was to define the mechanics of the target territory. To do this, we needed to uncover the buying and selling habits of the retail/wholesale markets.

In the Northwest, we identified four major distributors fulfilling the needs of the rural and small markets. It didn't take much investigation to realize the value of these four suppliers who are routinely in contact with hundreds of retailers. We approached each of the distributors with the goal of educating them on how the Alliance's program worked, what benefits could be reaped, and how they might fit into the future of the energy efficiency sales being driven by local utilities. Our experience with one of them, Jensen Distribution, Inc. of Spokane, Washington demonstrates the new challenges, and opportunities, presented by the mid-market approach.

Small retailers, like their larger counterparts, prefer to work with as few vendors as possible because it saves time and money. Companies like Jensen offer small retailers this convenience. In addition to selling an assortment of products, Jensen also offers services such as advertising, store designing, price strategizing, and product planning. Jensen had been approached by the lighting program representatives in the past and had chosen not to participate. At that time the program was oriented toward two market segments: manufacturers and large volume retailers. There was a lack of attention to the role of the mid-market players. The program's first hurdle came during the initial meeting. Jensen did not believe they could participate because they thought the program was still directed toward manufacturers and big box retailers.

Jenson represents the first layer of the mid-market infrastructure. The key to gaining the participation of mid-market players like Jensen is flexibility, the willingness to discover their needs, and to find ways to work within their existing operational framework. Making this shift required the program managers to change their thinking, from trying to get people signed up for the program to finding ways to get more product flowing in the normal operations of the existing market. The first order of business was to get and hold Jensen's attention by telling them exactly what was "in it for them." Keeping in mind that distributors turn a profit only when they sell products, funding to increase sales was an essential element of the program. In Jensen's case, co-op funding was provided for various forms of advertising in addition to product incentives.

In order to bring as many potential interests to the table at once and to increase the opportunity for joint activities, the program representative also included a manufacturer's sales representative in the meeting. The program representative explained the program's primary goals and basic documentation needs. Acknowledging that the skill of selling belonged to the sales representative and to Jensen, the program representative asked what they needed to meet these goals and what documentation they felt they could provide. By asking open-ended questions, the program representative encouraged both the sales rep and Jensen to think creatively and both came up with very original ideas.

By bringing these three parties together, maintaining as their goal more products in the market, and meeting mid-market needs, the Alliance was able to build a very successful program. Each player had the opportunity to bring up ideas as well as concerns that the program representative could immediately address. As a result the group not only created some successful new promotions but the players provided documentation that exceeded the program requirements as a part of working out joint activities for a promotional partnership. It was imperative that the program representative be equally equipped to make participation

decisions, and this is a prime area where programs need to accommodate the style in which mid-market sales occur.

As a result of working as a mid-market partner alongside distributors like Jensen, the Alliance's Residential Lighting Co-op program was able to:

- sign several hundred new retailers as Energy Star Partners
- introduce these retailers to the benefits of selling CFL's
- prove that CFL's are a valuable addition to the lighting category
- gain prime location in-store displays
- increase consumer awareness and therefore product demand
- get quantity discounts from manufacturers
- leverage manufacturer co-op dollars
- acknowledge local utility sponsorship

In addition to these accomplishments, the program was able to show Jensen the value of efficiency programs. The company has begun aggressively pursuing program opportunities throughout the Northwest and California. This mid-market participant now moves millions of dollars of additional efficient lighting product and has the pursuit of energy efficient opportunities as part of their business plan. Their distribution of efficient products has continued even after the program intervention ended.

How much do other markets resemble this structure? This is a question of particular interest to the Alliance as we develop a comprehensive Commercial Buildings Initiative intended to address that market at multiple levels.

Efficiency Services and the Mid-Market Approach

The audience for innovation in the provision of efficiency services is much smaller than for efficiency products. However, we believe the relationship-driven dynamic of the mid-market is even stronger in markets where we provide these enhanced services. This audience is already in a "mature" market mode and is seeking to maintain the stability and predictability of capital investments and operations. In this market, new procedures and new vendors add complexity and risk, and many of the barriers that programs encounter in this market are, from the owner's point of view, important strategies for risk management that create stability and predictability.

The service industry in commercial building markets is a very competitive market serving commercial building owners and operators who may be the most risk adverse audience we have yet encountered. Building owners are very much in a business where they rely on proven procedures and relationships to achieve a modest but stable and reliable return on their investments. The market actors manage the increased complexity by relying on trusted relationships that provide certainty and reduce risk. The assumed business strategy of profit maximization often gives way to predictability and risk mitigation.

Commercial Buildings Research

The Alliance has not yet launched any major market transformation programs aimed at the commercial buildings market, but we sponsored some important market research delving into the operations of this market last year. The conclusions reached about the function and requirements of the commercial building market are remarkably similar to those drawn from our residential products mid-market experiences. The report, *New Commercial Office Buildings: Developing Strategic Market Transformation Initiatives for Energy Efficiency*, was produced for us by Rick Kunkle and Loren Lutzenhiser at Washington State University.

The report found that, “the new commercial office building market is a complex, multi-actor, multi-interest system that is changing and evolving. Building development is inherently risky due to a variety of uncontrollable market variables (economic cycles, capital costs, regulations, etc.). We believe that effective market transformation efforts to support energy efficiency in this market cannot be simple, but ought to attack the problem on multiple levels, in concert with the efforts of multiple market and non-market allies.” The authors stated that their “research found that energy efficiency has little value in the market place. From the perspective of the building industry, buildings are energy efficient. There is little interest in making buildings more energy efficient. Thus, for energy efficiency to diffuse in the market place, we believe that it must be embedded in complementary interests in the building industry.”

The authors believe that for market transformation to occur:

- Energy efficiency must have value in the market place (i.e. it must provide benefits and be relevant to market interests).
- The demand for energy efficiency must be institutionalized by specific market actors.
- The supply of energy efficiency must be incorporated into the standard routines of the industry.
- Mechanisms must be developed within the market place to institutionalize the supply and demand for more energy efficient buildings.

These conclusions are consistent with our growing body of experience as our product programs reach deeper into the market. Markets for efficient products move rapidly from innovation (product introduction) to risk mitigation (stable supply chain relationships). Markets for efficiency services are already characterized by risk mitigation strategies. Program designs must be oriented to these concerns. This shift in perspective will make programs more effective and brings with it the opportunity to leverage tremendous resources in the market.

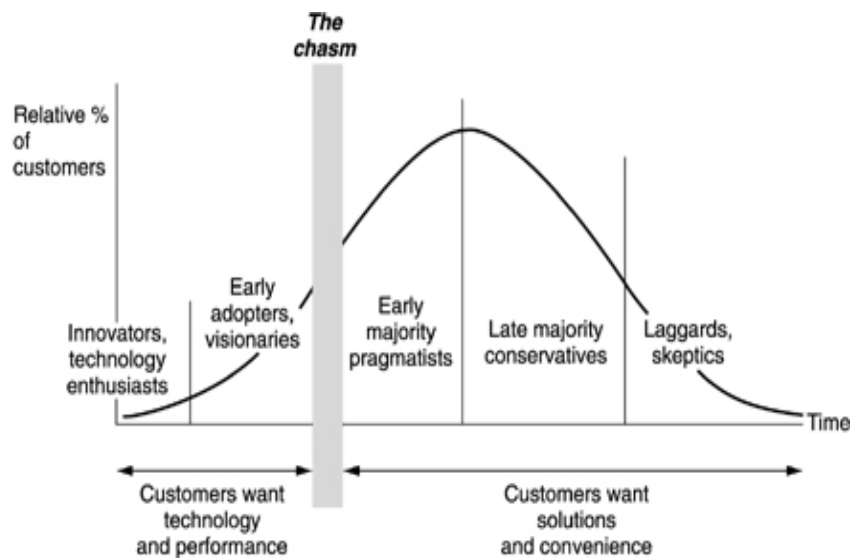
A Market Model for Efficiency Services

As we move away from introducing new products and towards attaining more widespread or deeper penetration for them in the market, the operation and key drivers in the market change in ways that make progress more difficult. The market participants move from being risk-takers (innovators or early adopters) to risk-averse (majority). The

relationships and motivations at work in the mid-market, especially at this stage, are resistant to change, and the market players do not respond to traditional program messages. Effective programs will thus need to become more responsive to the demands of the players in the trenches in the mid-market and as they do so, can experience dramatic success.

The difference between two important types of consumers, the “innovators and early adopters” and the “majority,” provides a useful framework for thinking about how to increase penetration of efficiency services in the commercial building industry. Early adopters are the market leaders. They are willing to implement new technologies before they become the industry standard. They have the highest tolerance for risk in their industry, although given the nature of commercial buildings even early adopters will still be fairly conservative.

The rest of the marketplace is often called the “majority.” This group can be segmented further but shares the common characteristics of being extremely peer-sensitive and far more risk-averse than the early adopters. Most of the commercial building industry fits this profile, and will adopt a new technology or practice only once it has proven to work for someone else.



From *Crossing the Chasm* (1999)

Within this framework, efficiency services can be considered an “innovation.” Early adopters expect innovation to revolutionize their business, to give them a competitive edge, or define their image. Currently, many programs look to “early adopters” as the target segment. However, promoters of efficiency services will need to develop strategies for “crossing the chasm” between the early adopters and the majority, two very different kinds of consumers. (Moore, 1999) While early adopters are eager to apply innovative technologies and will be more willing to pay for them, the majority is more concerned with improving existing operations through tried and true methods. The majority of the building industry is extremely peer-sensitive and risk-averse. The successful example of early adopters will not be enough to convince them of the value of efficiency services. Instead, strategies that utilize familiar relationships and leverage common business interests will succeed.

Designing Initiatives for the Mid-Market

Our experience and our research indicate that designing initiatives for the mid-market requires a conceptual shift from acting *on* a market to participating *in* the market. This shift to a mid-market paradigm makes new demands on program implementers and is applicable to all attempts to deepen market penetration, in products as well as services. It requires that we learn more about the inner workings of our target markets than was previously necessary, in order to align our programs with their operations. It also requires a long-term commitment to those markets lasting beyond the traditional one or two year perspective.

While every market is different, the following are some common mid-market dynamics that are valuable to efficiency efforts.

Long-Term Relationships

These industry relationships have the ability to influence both their long and short-term decisions. Often what appear to be short-term decisions are actually seasonal decisions, one of many successive deals or promotions with known partners. Quite often we find that mid-market players have known one another for many, many years and operate on a level beyond business. It can be difficult, if not impossible, to reach a one of them without an inside connection. A program implementer must make a long-term commitment to develop relationships with mid-market players and garner their trust. The effort has its rewards, however, working within these relationships is a powerful market transformation tool.

Value Added Services

To remain competitive, distributors provide added value to their customers. These services include cost-effective consumer-oriented advertising programs, dealer-oriented merchandising programs, professional point of sale capabilities, flexible buying programs, pool ordering opportunities, seasonal dating programs, storefront design and retail profit management systems. It is obvious that distributors are intimate partners with their customers. These customers typically number in the hundreds or thousands. By building solid relationships with distributors, implementers can leverage these services to their efficiency goals.

Field Service Staff

In the same way that decision-makers rely on relationships, management in product distribution firms rely on dependable field service staff. They employ many people in this capacity, and allow them to operate semi-independently. Field service personnel are the link between vendors and distributors. They fulfill an important role in maintaining customer satisfaction by bringing distributors first-hand information on their vendor's needs as well as general market trends. Field service staff have on-the-ground knowledge that is valuable to efficiency program implementers, and they are the key to disseminating product information.

Co-Op Packages

Co-operative activities are the most useful tools program implementers can use. Within the industry, co-op is typically a requirement of a sale and the use of the co-op funds is usually determined by the buyer and not the seller. This frees the seller to pursue additional sales and leaves the retailer to do what he does best, and that is to promote additional sales of the manufacturer's product at the consumer level. Co-op opportunities, to be most successful should not be overly defined and 'packaged', as this stifles creativity. Sit down at the table with nothing more than a thorough understanding of program goals, what the client must have in the form of documentation and an open mind. One party must not feel that they are putting more on the table than the other party. Each activity performed, whether research, field service, in-house marketing, advertising or even creating a sales pitch has a dollar value. By being flexible and willing to appreciate the vast difference between energy efficiency programs and a profit driven market, decision-makers are open and interested in beneficial co-op opportunities. These relationships are built one solid deal at a time.

Future Alliance Mid-Market Program Designs

New resource acquisition programs should leverage the mid-market infrastructure to increase their effectiveness. As we work smarter and more effectively in these markets, the distinction between market transformation and resource acquisition approaches will blur. Resource acquisition programs that utilize the mid-market will be closely knit with the workings of the market players, much like some current market transformation programs.

The Alliance is considering several new cross cutting and target market programs, each utilizing a different mid-market venture approach to accomplish our goals. As we try to extend past successes and ensure their persistence beyond consumer product promotions, our partners in the market will require a higher level of commitment to the partnership. Rather than continuing to try to impose our values and goals on our partners' businesses, we will need to bring our interests to the table as a long-term business partner and look towards creating successful business ventures together. Two such future Alliance projects are profiled below. Key aspects of each include:

- Taking a business venture approach
- Developing a stable long-term partnership
- Identifying and committing to common business objectives
- Creating business partnership roles that fill market gaps on a medium to long term basis
- Partnering marketing efforts within existing mechanisms

Small Commercial HVAC

The Alliance has launched a pilot program to take advantage of three current market conditions: 1) Small HVAC systems are not currently optimized for energy efficiency. 2) HVAC service contractors already have maintenance contracts with building owners, yet many of them are not properly trained or equipped to address energy efficiency. 3) New

diagnostic tools can simplify the process of diagnosing energy efficiency problems in packaged units, but have not yet been widely adopted by the HVAC service contractors. This program is designed as an ongoing venture providing a platform of services to fill the technical gaps in the market that service providers face, while also assisting them in credibly marketing a branded set of enhanced services to their existing customer base.

Because the energy consumption of individual packaged units is low (although collectively, as a population, it is quite large), the O&M services similar to commissioning have not even begun to emerge for these systems. The program will develop and test an optimization service that HVAC service contractors can participate with to profitably expand the scope to their current service business.

The program will include diagnostic tools, technical training, sales training, and marketing assistance. The venture is designed to introduce and support these tools to the maintenance service industry as a complete branded “platform”. The program will provide a range of ongoing technical and marketing support services to HVAC contractors that will spur the expansion of services and support their success in offering optimization services to their customers.

We are researching the most favorable partnering arrangements with service contractors, and will develop a brand identity for the platform that can be used to market the enhanced services to customers. Dealers and their technicians will receive the service tools and be trained in their use, along with sales training to aid in using the diagnostic results to sell enhanced levels of service and repairs to customers. Participating dealers will have recurring training available on a periodic basis, and a menu of additional service training for technicians will be offered through the program. Technicians will have a technical hotline available for support in the field.

A regional program will market the importance and availability of enhanced HVAC services through promotional activities targeted directly to owner groups. These will include presentations to trade groups, mailings, and direct contacts with important owners. The program will develop a referral system to direct owners to participating dealers for service.

Independent Grocery

The Alliance’s *Market Assessment of the Independently Owned Retail Food Sector in the Pacific Northwest*, produced for us by Quantum Consulting, indicates that larger national chains have been significantly more successful at implementing energy efficient technologies than independently owned grocery stores. According to the market research, independently owned grocery stores lack economies of scale, access to technical expertise, a network of outside resources and ready access to capital. Yet they represent well over half of the grocery market and are worth pursuing.

The Alliance is considering a program that will provide independently owned grocery stores with access to the same resources that have made the large chain stores successful at implementing energy efficient technologies. Additionally, the project provides an excellent opportunity for independents to stay cost-competitive with larger national chains through energy efficiency opportunities.

The program would partner with key wholesalers in the Pacific Northwest, that have strong relationships and existing financial agreements with over 495 retailers. Each wholesaler has field staff that interact with retailers regularly and could easily market energy

efficiency services. Finally, these wholesalers could provide the economies of scale, access to technical expertise, and network of outside resources needed by independent grocers implementing energy-efficiency measures.

The program would support a new role within the wholesaler's organization expanding their service platform – a Resource Conservation Manager. The RCM would be available to multiple store sites, funded at first in a joint venture with the Alliance and increasingly by a subscriber fee, equipment markups and/or shared savings from the retailers allowing the business leg to develop and become self-sustaining.

Lasting change in the market sector will result because this program develops a self-sustaining business opportunity within the wholesaler's organization. The business offering is a natural extension of the work that wholesalers already do and provides a valuable and widely needed service for independently owned grocers. The program overcomes the barriers and development costs associated with starting up a new business line, reducing wholesaler's risk and putting the systems in place that will be needed for ongoing success.

Conclusions

Working through existing distribution networks in markets as different as residential lighting and commercial buildings, we hope to accomplish and exceed our program goals. Successfully impacting and leveraging the linkages that make markets function at the distribution level is what we define as the “mid-market” approach. It requires market transformation organizations, utilities and Alliance programs to work *with* rather than *upon* the actors and relationships in each market. The mid-market approach requires that we become a reliable business partner in each market we wish to transform. We must cultivate a role for ourselves within the network of business relationships. Doing anything less looks to our potential partners like a one-time opportunity which, while it may be a worthwhile short-term diversion, will not alter long-term business practices. As implementers then, our challenge is to make a long-term commitment to the markets on which we all depend. This will require not only a shift in our thinking, but a corresponding change in the way our programs are managed and funded. If we are successful, the next generation of market transformation initiatives will look much more like business ventures and a lot less like “programs.”

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