



# CHAPTER 16

## Budgeting and controlling

### LEARNING OBJECTIVES

After studying this chapter you should be able to:

- understand why customer profitability is important
- define the concept of customer lifetime value (CLTV)
- understand why CLTV is important
- describe the key elements of the marketing control system
- list the most important measures for marketing performance
- understand the need for evaluation and control of marketing plans and their implementation
- explain how a marketing budget is established

### 16.1 INTRODUCTION

An organisation needs to budget in order to ensure that its expenditure does not exceed its planned revenue. Therefore, this chapter discusses how to use rational processes for developing budgets and allocating resources. Furthermore, the chapter will outline the need for a control system to oversee the marketing operations of the company.

### 16.2 BUDGETING

The classic quantification of a marketing plan appears in the form of budgets. Because these are so rigorously quantified, they are particularly important. They should represent a projection of actions and expected results, and they should be capable of accurate monitoring. Indeed, performance against budget is the main (regular) management review process.

The purpose of a marketing budget is to pull all the revenues and costs involved in marketing together into one comprehensive document. It is a managerial tool that balances what needs to be spent against what can be afforded and helps make choices about priorities. It is then used to monitor the performance. The marketing budget is usually the most powerful tool with which you think through the relationship between desired results and available means. Its starting point should be the marketing strategies and plans that have already been formulated in the marketing plan itself. In practice, the two will run in parallel and will interact. At the very least, the rigorous, highly quantified budgets may cause some of the more optimistic elements of the plans to be reconsidered.

Budgeting is also an organisational process that involves making forecasts based on the proposed marketing strategy and programmes. The forecasts are then used to construct a budgeted **profit-and-loss statement**. An important aspect of budgeting is deciding how to allocate all of the available money across all of the proposed programmes within the marketing plan.

**Profit-and-loss statement (operating statement, income statement)**

A financial statement that shows company sales, cost of goods sold, expenses and profits during a given period of time.

**Profitability analysis**

The calculation of sales revenues and costs for the purpose of calculating the profit performance of products, customers and/or distribution channels.

## Profitability analysis

Regardless of the organisational level, control involves some form of profitability analysis. In brief, **profitability analysis** requires that analysts determine the costs associated with specific marketing activities to find out the profitability of such units in different market segments, products, customer accounts and distribution channels (intermediaries).

Profitability is probably the single most important measure of performance, but it has limitations. These are that many objectives can best be measured in non-financial terms (maintaining market share); profit is a short-term measure and can be manipulated by taking actions that may prove counter-productive in the longer term (e.g. reducing R&D expenses); and profits can be affected by factors over which management has no control (the weather).

Analysts can use direct or full costing in determining the profitability of a product or market segment. In full costing, analysts assign both direct, or variable, and indirect costs to the unit of analysis. Indirect costs involve certain fixed joint costs that cannot be linked directly to a single unit of analysis. For example, office costs, general management and the management of the sales force are all indirect costs for a multi-product company. Those who use full costing argue that only by allocating all costs to a product or a market can they obtain an accurate picture of its value.

Direct costing involves the use of contribution accounting. Those favouring the contribution margin approach argue there is really no accurate way to assign indirect costs. Further, because indirect costs are mostly fixed, a product or market may make a contribution to profits even if it shows a loss. Thus, even though the company must eventually absorb its overhead costs, the contribution method clearly indicates what is gained by adding or dropping a product or a customer.

Contribution analysis is helpful in determining the yield derived from the application of additional resources (for instance, to certain sales territories). Contribution analysis attempts to determine the amount of output (revenues) that can be expected from a given set of inputs (costs). You should be familiar with break-even analysis, which is a type of contribution analysis, used to determine the amount of revenue necessary to cover both variable and fixed costs (see Chapter 12).

There are three ways of building a marketing budget that is based on a specific strategic market plan and the tactical marketing strategy designed to achieve the target level of performance:

- *Top-down budget*: a new marketing budget based on projected sales objectives is determined, using past marketing expenses as a percentage of sales.
- *Customer mix budget*: the cost of customer acquisition and retention and the combination of new and retained customers are used to derive a new marketing budget.
- *Bottom-up budget*: each element of the marketing effort is budgeted for specific tasks identified in the marketing plan.

As this book has a customer-oriented approach the customer mix budget will be discussed in the following.

## Customer mix budgets

Recognising the customer as the primary unit of focus, a market-based business will expand its focus to customers and markets, not just products or units sold. This is an important strategic distinction because there is a finite number of potential customers, but a larger range of products and services can be sold to each customer. And, as shown in Figure 16.1, a business's volume is its customer share in a market with a finite number of customers at any point in time, not the number of units sold:

$$\text{customer volume} = \text{market demand (from customers)} \times \text{market share (percentage)}.$$

Figure 16.1 presents an overall flow chart of how market-based net profits are derived. Customer volume, at the top of this diagram, is derived from a certain level of customer market demand and a business's share of that customer demand. Without a sufficient volume of customers, net profit will be impossible to obtain. Marketing strategies that affect customer volume include marketing strategies that:

- attract new customers to grow market share;
- grow the market demand by bringing more customers into a market;
- enter new markets to create new sources of customer volume.

Each of these customer-focused marketing strategies affects net profits, invested assets, cash flow and, as we will show later, shareholder value. Thus, a key component of profitability and financial performance is customer purchases and the collective customer volume produced.

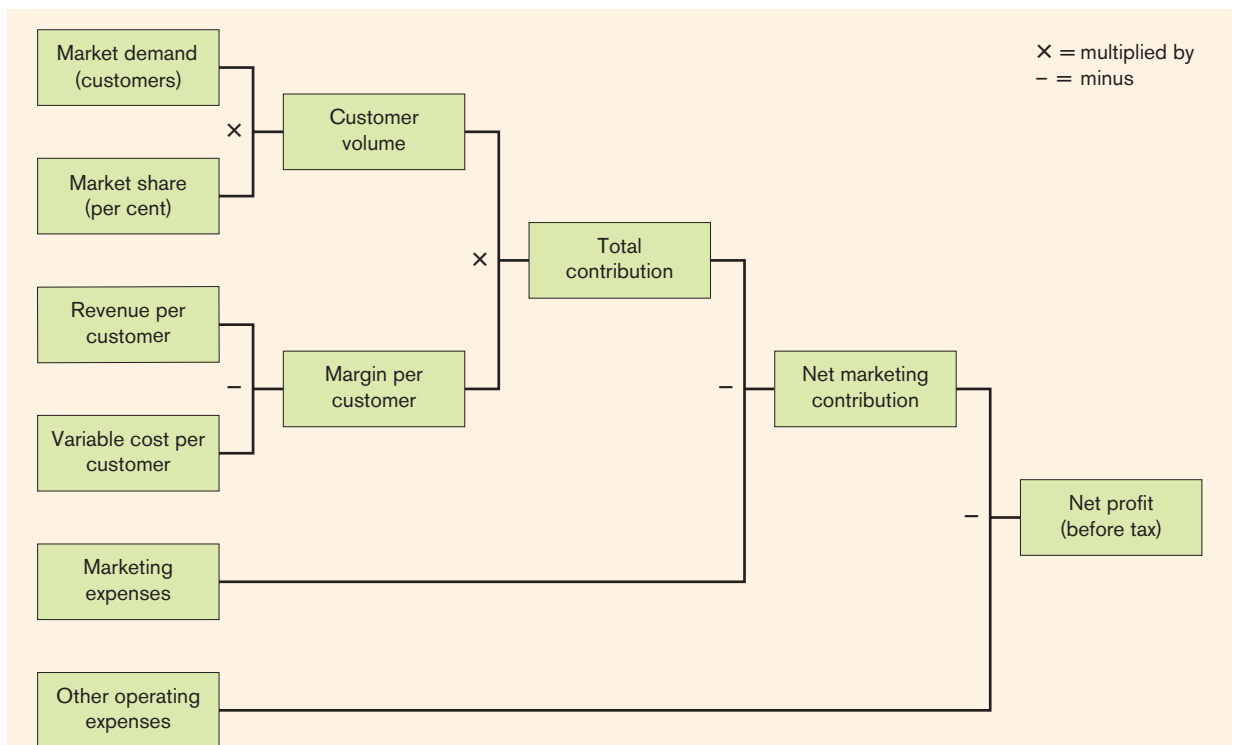


Figure 16.1

A customer-based model of marketing contribution and net profits (before tax)

Without customer purchases, there is no positive cash flow or potential for net profits or shareholder value.

In the following, the different components of Figure 16.1 will be discussed (Best, 2000). Customer-based budgeting recognises that companies are increasingly turning from traditional accounting methods, which identify costs according to various expense categories, to activity-based costing (ABC), which bases costs on the different tasks involved in performing a given activity.

## Margin per customer

When customers decide to purchase an assortment of products and services from a business, the result is a certain revenue per customer. And, of course, a corresponding set of variable costs that go into each purchase and sales transaction must be taken into account to determine the margin per customer:

$$\text{customer contribution margin} = \text{revenue per customer} - \text{variable cost per customer.}$$

This measure of customer profitability could be computed on a transaction basis (monthly or annually), or based on customer lifetime value (CLTV), which is discussed further in Section 16.3. The bottom line is that a business has to make a positive margin per customer or it will produce no profits and, therefore, no shareholder value. In many instances, new customers may produce a small or negative customer margin. Over time, we would expect a business to manage its marketing strategies so as to increase customer margin. If it does not, it has several alternatives to consider, one of which is to not continue to serve that customer as part of the business's marketing strategy. In general, marketing strategies designed to improve margin per customer can include marketing strategies that:

- grow revenue per customer by product line extensions;
- grow revenue per customer by adding services that enhance customer value;
- improve margin per customer with improved products and services for which the customer is willing to pay a premium price;
- develop more cost-efficient marketing systems that lower variable sales and transaction costs;
- eliminate customers that are not able to produce an acceptable level of customer margin.

As shown in Figure 16.1, revenue per customer and variable cost per customer come together to produce a certain level of margin per customer. Because the customer is the primary unit of focus of market-based management, it is the business's responsibility to develop marketing strategies that systematically build customer volume and customer margin.

## Total contribution

Ultimately, whether tracking product revenues and variable product costs or tracking customer volume and margin per customer, the end result will be a total contribution produced by the marketing strategies that have been developed and implemented. Once again, both approaches are needed in managing different aspects of a business. However, those in marketing should be more concerned with a customer perspective and how to develop marketing strategies that affect both customers and the total contribution of the business:

$$\text{total contribution} = \text{customer volume} \times \text{customer margin.}$$

As shown in Figure 16.1, the total contribution produced by a marketing strategy is the product of the customer volume it produces and customer margin derived from customer purchases. The total contribution produced by a marketing strategy is an important component

in the profitability equation because from this point forward only expenses are introduced. Hence, building market-based strategies that increase total contribution is an important priority in developing marketing strategies that deliver profitable growth.

## Net marketing contribution

All marketing strategies require some level of marketing effort to achieve a certain level of market share. Expenses associated with sales effort, market communications, customer service and market management are required to implement a marketing strategy designed to obtain a certain customer volume. The cost of this marketing effort is shown in Figure 16.1 as marketing expenses and must be deducted from the total contribution to produce a *net marketing contribution*. This is the net contribution produced after the marketing expenses are deducted from the total contribution produced:

$$\text{net marketing contribution} = \text{total contribution} - \text{marketing expenses.}$$

In effect, this is how the marketing function contributes to the business's profits. If the marketing team develops a marketing strategy that fails and, therefore, produces a lower net marketing contribution, then that marketing strategy has, in effect, lowered the net profits of the business.

Marketing strategies are generally designed to affect total contribution, whether by increasing market demand, market share or revenue per customer, or by decreasing the variable cost per customer. The net marketing contribution equation should make it clear that such strategies are profitable only if the increase in total contribution exceeds the increase in marketing expenses required to produce that increase in total contribution. That is, for a marketing strategy to improve profits for the business, it has to improve net marketing contribution.

## Net profit (before tax)

Although marketing strategies contribute to net profits through net marketing contribution, net profit (before tax) is generally beyond the control of the marketing function or the marketing management team. Marketing strategies produce a certain level of net marketing contribution from which all other business expenses must be deducted before a net profit is realised, as illustrated in Figure 16.1. These operating expenses include fixed expenses, such as human resources management, research and development, and administrative expenses, and other operating expenses, such as utilities, rent and fees. In most instances, corporate overheads would also be allocated, which includes company expenses such as legal fees, corporate advertising and executive salaries:

$$\text{net profit (before tax)} = \text{net marketing expenses} - \text{other operating expenses.}$$

However, there are instances when a marketing strategy can affect other operating expenses. For example, a strategy to improve a product to attract more customers and build market share could involve research and development expenses to develop the new product.

Figure 16.1 is an illustration of the different budget element. Figure 16.2 illustrates the traditional marketing budget (per customer group) and its underlying determinants.

From Figure 16.2 the most important measures of marketing profitability may be defined as:

$$\text{contribution margin: \%} = \frac{\text{total contribution}}{\text{total revenue}} \times 100$$

$$\text{marketing contribution margin \%} = \frac{\text{total marketing contribution}}{\text{total revenue}} \times 100$$

$$\text{profit margin \%} = \frac{\text{net profit (before tax)}}{\text{total revenue}} \times 100$$

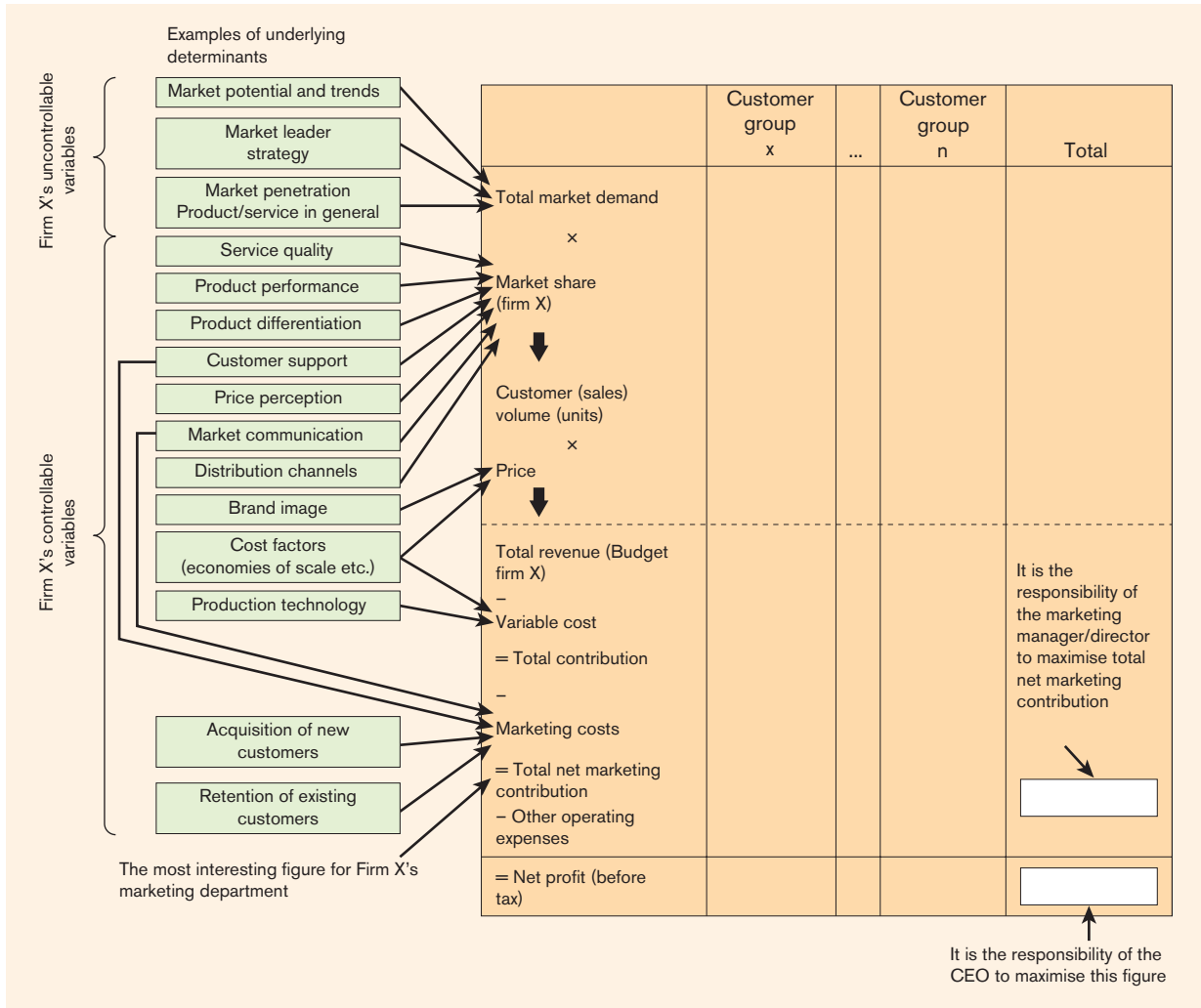


Figure 16.2 A marketing budget and its underlying determinants

If we had information about the size of assets (accounts receivable + inventory + cash + plant + equipment) we could also define:

$$\text{return on assets (ROA)} = \frac{\text{net profit (before tax)}}{\text{assets}}$$

ROA is similar to the well-known measure ROI (return on investment).

### 16.3 CUSTOMER PROFITABILITY AND CUSTOMER LIFETIME VALUE

Traditional accounting systems have viewed customers as sources of revenue. More and more firms, however, are beginning to use their accounting systems to view customers as assets, basing their decisions on customers as much as they would base their decisions on investments. Therefore we propose customer lifetime value (CLTV) to be the central unit of measurement for customer profitability. We define CLTV as the **net present value (NPV)** of the profit a firm stands to realise on the average new customer during a given number of years.

The transition from market share to customer share (share of disposable income) is a prevalent theme in the CRM debate about customer loyalty and lifetime value. One result of

**Net present value (NPV)**

Represents total present value (PV) of a time series of future cash flows

the debate is a growing understanding that a large market share is not equivalent to having loyal customers. What you have today can be gone tomorrow, if the customer is not locked in or dependent (Gupta and Mela, 2008).

Loyal customers should be viewed as an asset by the firm, and it should work to create relationships that will maintain their loyalty (Forbes, 2007).

Long-term contracts and repeat sales produce predictable sources of revenue. In fact, the worth of many businesses can be calculated by the size of the customer base, such as the number of subscribers of a mobile phone company. Customers are not viewed as prospects for a single sale or as targets for problem solving. Rather, they are partners in a relationship that produces long-term cash flows for the seller (Turner *et al.*, 2007).

Ask yourself this question: What is the overall length of the relationship (retention) and how much will the customer buy in his or her lifetime?

Retention rate is used to measure customer turnover. It shows how large a percentage of its customer portfolio the enterprise retains yearly. The **churn rate**, on the other hand, shows how large a percentage of its customer portfolio the enterprise loses every year.

When an enterprise operates with a churn rate of 20 per cent – retention rate of 80 per cent – it means that it replaces one customer in five each year. In other words, it completely replaces all of its customers over a five-year period. In this case, the period over which the enterprise can generate income from the customer will be only five years – the so-called CLTV.

**Retention rate** has great significance for the creation of value. Research has shown that when the enterprise increases the retention rate from e.g. 80 to 90 per cent, it can double CLTV. Longevity creates value.

#### Churn rate

Refers to the proportion (%) of contractual customers or subscribers who leave a supplier during a given time period. A churn rate of 20% means that a company's customers on average stay with the supplier for 5 years.

#### Retention rate

The percentage of customers who continue to purchase from the supplier in a subsequent year. Retention rate = 100% – churn rate (%). If churn rate is 20%, the retention rate is 80%.

#### Gross margin

The difference between net sales and cost of goods sold.

## Realising the full profit potential of a customer relationship

How much is a loyal customer worth in terms of profits? Reichheld (1994) analysed the profit per customer in different service businesses, categorised by the number of years that a customer had been with the firm. Reichheld found that the longer the customer remained with a firm in each of these industries, the more profitable they became to serve. Annual profits per customer, which have been indexed over a seven-year period for easier comparison, are summarised in Table 16.1. As shown in Table 16.1, it is more profitable to keep existing customers than acquire new ones. During the normal development of a customer relationship, the cost to market and sell to these customers gradually declines, and the potential for **gross margin** improvement increases.

The loyal customer rarely focuses on price alone but instead sees customer relationships in terms of value for money. In this way, the customer acts as an advocate for the enterprise and thus helps attract new customers.

**Table 16.1**

Calculation of CLTV for one mobile telephone customer

Period	Cash flow (\$)	Present value of \$1 (discount rate = 10%)	Net present value (NPV) of cash flow (\$)
0	-50	1.000	-50
1	15	0.909	+13.6
2	40	0.826	+33.0
3	50	0.751	+37.6
4	60	0.683	+41.0
5	70	0.621	+43.5
6	80	0.564	+45.1
7	90	0.513	+46.2
CLTV			+210

Let us assume that Table 16.1 illustrates an example with average profit per mobile telephone customer generated over a seven-year period. Acquiring a new customer produces a loss of US\$50 the first year. Consequently, the break-even of this customer is at the beginning of year 3. In this example, the average customer life is seven years, meaning that the churn rate is 14 per cent ( $1/7 \times 100\%$ ). Working backward, we can estimate the customer retention rate to be 86 per cent as in Table 16.1.

## Customer retention

To estimate the lifetime value of the customer at this rate of customer retention, we need to compute the net present value of the customer cash flow in Table 16.1. In this example we assume that the yearly cash flow is equal to the yearly net profit. The calculation of present value is shown in Table 16.1 using a discount rate of 10 per cent.

The payback time of the investment (\$50) in customer acquisition is a little more than two years. The CLTV per customer is \$210. If the firm has 10,000 mobile telephone customers, the total CLTV would be \$2.1 million.

If customer lifetime were only, say, four years, the customer value (net present value) would be considerably smaller. Thus, the higher rate of customer retention, the longer the average customer life expectancy and the greater the CLTV.

In Table 16.2 the CLTV calculation is a little more complex than in Table 16.1. Table 16.2 is based on an average of 1000 customers.

**Table 16.2** Calculating CLTV for an average of 1000 customers

	Year 1	Year 2	Year 3	Year 4	Year 5
<b>Revenue</b>					
Number of customers (left)	1,000	400	180	90	50
Retention rate	40%	45%	50%	55%	60%
Average annual sales per customer	\$150	\$150	\$150	\$150	\$150
Total revenue	\$150,000	\$60,000	\$27,000	\$13,500	\$7,425
<b>Costs</b>					
Cost percentage	50%	50%	50%	50%	50%
Total costs	\$75,000	\$30,000	\$13,500	\$6,750	\$3,713
<b>Profits</b>					
Gross profit	\$75,000	\$30,000	\$13,500	\$6,750	\$3,713
Discount rate	1.00	1.20	1.44	1.73	2.07
NPV profit	\$75,000	\$25,000	\$9,375	\$3,906	\$1,790
Cumulative NPV profit	\$75,000	\$100,000	\$109,375	\$113,28	\$115,072
CLTV (per customer)	\$75.00	\$100.00	\$109.38	\$113.28	\$115.07

Source: Adapted from Pitt, L. F., Ewing, M. T. and Berthon, P. (2000) Turning competitive advantages into customer equity, *Business Horizons*, 43(5): 11–18. Copyright © 2000 Elsevier. Reproduced with permission.



This spreadsheet might be typical of a firm marketing a magazine subscription. If we assume that the firm sells 1,000 new subscriptions in year 1 at \$150 each, then the calculation of net revenue and net costs at 50 per cent of revenue are both simple procedures. A further important issue is retention – in simple terms, how many customers at the beginning of a year are still subscribers at the year's end. Table 16.2 assumes a retention rate of 40 per cent at the end of year 1, then increases this gradually over the five-year period. Thus, 400 customers are still subscribers at the beginning of year 2, 180 at the beginning of year 3, and so forth. Naturally, the revenues and costs for a year are functions of the number of customers in the beginning of that year. Calculating gross profit is then a simple subtraction procedure.

As in all investments, the NPV for a customer five years from now is not worth what it is today. The discount rate we have chosen in Table 16.1 is 20 per cent – a discretionary figure, the choice of which will vary from firm to firm. Some may choose a premium bank rate, others an internal rate of return, still others some minimum rate of investment acceptability. The final calculation is a simple one: what is the CLTV of a customer who became a customer in year 1? The answer is the NPV of the cumulative gross profit for the year divided by the number of customers (1,000) in year 1. Thus, the CLTV of one of these customers in year 4 would be \$113.28; \$115.07 in year 5, and so on.

An obvious application of this spreadsheet is its use in calculating what can be done to increase CLTV. The decision maker can change variables such as price, costs, the discount rate, the number of years an individual will be a customer, and the retention rate to determine the effects these will have on CLTV. In more general terms, however, it is worth considering what can be done from a marketing strategy perspective to maximise CLTV.

In summary we can increase CLTV by increasing the lifetime, increasing sales to customers and cutting the costs of serving a customer.

## Increasing CLTV

### Increasing customer life

There have been some excellent recent examples of firms extending the life of a customer by adapting the marketing strategy. Kimberly-Clark, manufacturer of Huggies disposable diapers, was subject to the limitations imposed by the fact that the 'life' of a Huggie customer (the baby) averaged only 18 months, until the child became toilet-trained. Market research also revealed a considerable degree of guilt among parents. Mothers and fathers felt guilty that little Johnny or Mary was still in 'nappies', while simultaneously feeling guilty at pushing a small child who might not be ready for pants. So Kimberly-Clark introduced 'trainer-pants', which fit like real pants but are disposable and have all the absorbency of the conventional nappy. No more guilt for parents. More important, Huggies have increased customer life by about six months. Though this might not seem much in real terms, it is effectively a 33 per cent average increase in customer life.

While the Huggies strategy has extended customer life, an alternative strategy would be to ask how a customer's life could start earlier. The Danish toy company Lego made building blocks that were played with by children between the ages of four and eight, on average. But this was a customer life of only about four years. So the company embarked on strategies that both began the customer life earlier and extended it for longer. In 1969 it launched Duplo – essentially, bigger Lego blocks that can be played with by children as young as two – thus adding two years to customer life. In 1977 it launched Lego Technic, an intricate set of construction blocks and fittings for older children (Pitt *et al.*, 2000).

### Increasing retention rate

Current industry retention rates have a direct impact on long-term customer value. Where retention rates are 50 per cent or below, the average customer stays with the firm for two years or less. If a firm improves its retention rates from 50 per cent to 55 per cent, the average retention increases to 2.2 years from 2.0 years. In contrast, if average retention rates in an industry are

relatively high, of the order of 75 per cent or greater, then an increase of 5 per cent in customer retention has a far greater impact. For example, improving retention rates from 75 per cent to 80 per cent improves customer retention from four years to five years. Here, long-term customer value is substantially greater and the leverage effect is more significant. The key to estimating and increasing average retention rates is to examine switching costs in the industry. To the extent that 'natural' or inherent switching costs exist, firms can retain their customer base with relatively less effort. These situations include monopolies, long-term contracts, warranties tied to service and buying arrangements (e.g. a business has preferred rates with a hotel chain). Generally, higher switching costs will be related to higher retention rates. Industries that have higher switching costs will tend to have some or all of the following characteristics (Butcher *et al.*, 2001).

### ***Membership-based programmes***

Membership services, such as banks, telephone firms and credit card companies, have a formal tie or link with the customer. The customer must make an explicit decision to break the link and some effort is required to move to another firm. Further, from the provider's viewpoint, the formal link offers valuable customer information that may be used to enhance loyalty.

### ***Loyalty-based programmes***

A vast range of industries focus on customer retention and loyalty nowadays, from airline frequent flyer schemes to supermarket **loyalty card** programmes. Even Coca-Cola now has an established loyalty programme. Many companies reward customers simply by discounting or offering free products or services (airlines offering free flights, telephone companies discounting regular and frequent calls to friends and families). More and more firms are realising that all customers are not the same, and that more individualised strategies will be more effective at retaining them.

Loyalty is a function of both the customer's unwillingness to exit and his or her ability to exert a voice, so managers should focus on loyalty by reducing the tendency to exit and providing opportunities to voice any concerns or complaints.

Some practical illustrations of these issues in recent times can be seen in the airline industry. Most frequent flyer schemes attempt to reduce exit by offering air miles to customers, who are then presumably unwilling to leave because they do not wish to lose those miles (we might refer to this as the economies of loyalty). But for customers this is a false loyalty, as they might endure poor quality of service (normally a reason for exiting) merely to avoid losing the miles. Besides, frequent flyers who put in hundreds of thousands of miles annually are not likely to be motivated by the reward of even more flying.

### ***High degree of customer contact***

The opportunity to establish a relationship with the customer through personal knowledge and customisation to individual preferences will reduce risk and increase customer confidence in the firm. Professional service firms, hair stylists and financial services typically have either frequent contact and/or a long encounter when they meet their customers. The customer information gained during these encounters allows the firm to both meet and anticipate customer expectations.

### ***Ability to differentiate***

Services that are experience and/or credence based have a higher perceived risk (i.e. the cost of failure is high), and it is important to have a greater opportunity to be differentiated. Again, professional service firms, car repair services, delivery services and digital phone services can add customer value through offering various arrays of bundled services and/or better delivery of the core offering. Through effective differentiation these firms can improve retention rates.

### **Increasing sales to customers**

This is done by raising either the firm's share of the customer's purchases or the customer's referral rate (the number of times the customer refers others to the firm's products and services).

#### **Loyalty card**

Usually a plastic card which is issued by a company to a customer and is used to record the frequency of the customer's purchases and calculate resulting discounts, rewards or allowances.

If the firm can segment and target high volume or usage customers, the revenue generated is substantial. In a number of industries, including financial services, the revenue generated from the high volume customers accounts for 70 per cent or more of the firm’s business. Increasing the retention rates among these customers, or increasing their expenditure will be profitable. The key point is that the customer base must have varying spending rates and the high volume customers need to be identified. That is, the firm must be able to determine the average profitability per year by customer or segment.

**Cutting the costs of serving a customer**

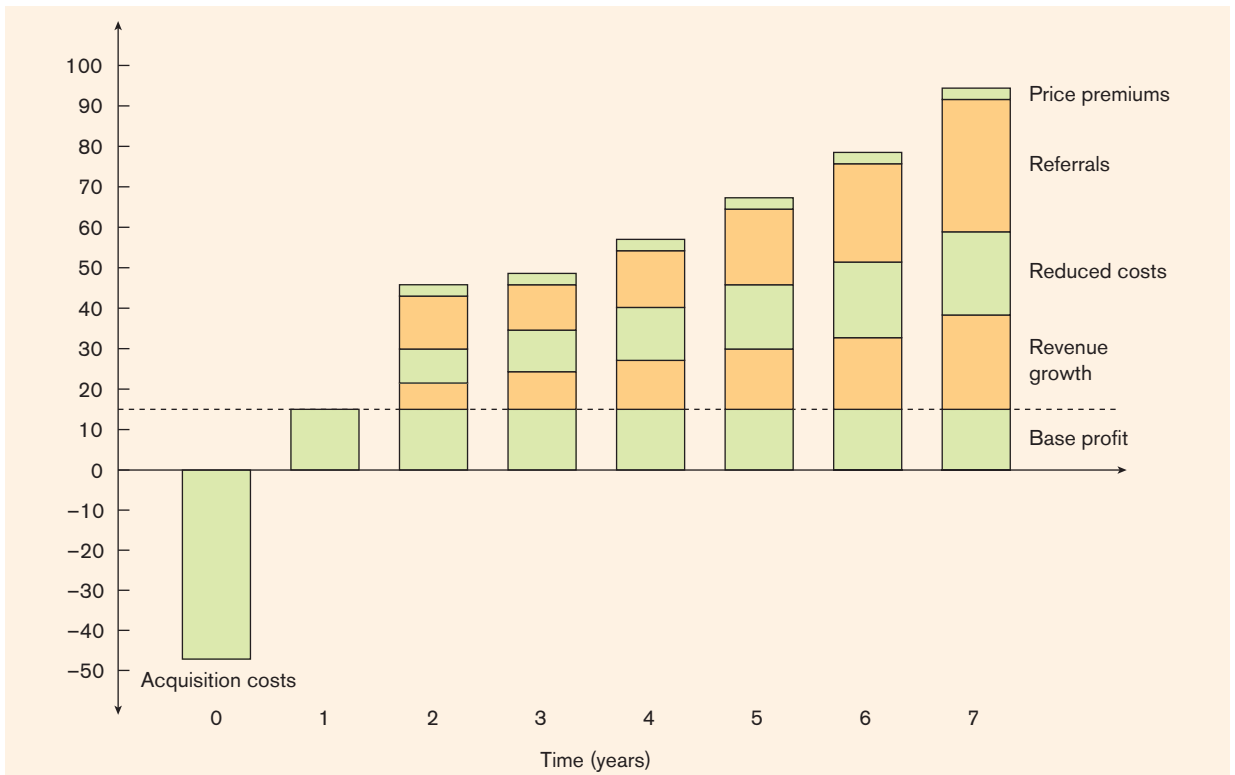
The more the costs of serving customers can be reduced, the greater the profit margin on those customers that can be realised in the future. In many environments, it is also possible to cut costs by getting the customer to perform some of the work involved in service delivery – what Downes and Mui (1998) call ‘outsourcing to the customer’. Surprisingly, customers often prefer this because it gives them greater control over the delivery process. When firms can develop systems to process customer transactions efficiently and effectively, servicing costs are also lower. This occurs with many financial services and business markets where large volumes of transactions are a characteristic of the industry.

The reasons why the profit per customer increases over time are schematically illustrated in Figure 16.3. The economic effect of customer loyalty can be attributed to the following factors: acquisition costs, revenue growth, reduced cost, referrals and price premiums.

The vertical axis in the figure is only an example (a mobile telephone customer), because the effects on profits of the various factors differ from industry to industry, firm to firm, and even customer to customer. However, the height of the sections gives some general indications of the relative importance of these factors. Every firm should, however, take the time and trouble to study its accounting and reporting system in order to make the necessary calculations of the influence on total profits per customer of these and possibly other profit

**Referrals**

Usually obtained by the salesperson asking current customers if they know of someone else, or another company, who might have a need for the salesperson’s product.



**Figure 16.3**

**Illustration of customer lifetime value**

Source: Adapted from Reichheld, F. F. (1994), Loyalty and the renaissance of marketing management, *Marketing Management*, 12(4): 17–25. Reproduced with permission from the American Marketing Association.

drivers. It is a time-consuming task, because in most firms the figures needed are not readily available – revenues and costs are usually registered on a per product basis and not usually on a per customer basis. These factors are discussed below.

## Acquisition costs

The active acquisition of new customers using sales and external marketing efforts is required in most businesses. As a rule of thumb, getting a new customer costs five to six times as much as the costs of normal service operations (sales calls, providing information about new goods or services, etc.) to keep an existing satisfied customer. In other words, it costs only 15–20 per cent of what has to be invested in getting a new customer to keep an existing customer. The economics of customer loyalty are very apparent. These figures of course vary from industry to industry, and situation to situation, but are nevertheless remarkable. In Figure 16.3 the acquisition cost per customer appears as a negative profit effect in the year before the customer relationship starts.

## Base profit

In many service industries the price paid by customers during the first year or even the first few years does not cover the costs of producing the service. This is the base profit in the figure. After some years, depending on the industry and other factors, the accumulated base profits have covered the initial marketing costs of getting the customer.

## Revenue growth

In most situations a long-standing customer will bring more business to the same service provider. Customers may decide to consolidate their purchases with a single supplier who provides high quality service.

This means that, on average, customers can be expected to contribute more to a firm's profit as the relationship grows. The annual revenue per customer increases over the years, thus contributing to growing profits.

## Reduced costs

As the service provider and the customer learn about each other, and they get experience with what to expect and how to perform, service processes will be smoother and take less time, and fewer mistakes that have to be corrected will be made. Thus, the average operating costs per customer will decrease, which in turn has a positive impact on profits.

## Referrals

Positive word-of-mouth recommendations are like free advertising, saving the firm from having to invest as much money in these activities.

Long-standing and satisfied customers will create positive word-of-mouth communication and recommend the supplier or service provider to friends, neighbours, business associates and others. The customer takes over the role of marketer without any additional costs to the firm. A large number of businesses, especially smaller ones, thrive on good referrals by satisfied customers. In this way new customers are brought in with lower than normal acquisition costs, which has an extra positive effect on profits.

With many services, particularly those that are primarily experience based (e.g. restaurants) or credence based (e.g. professional services, technical services such as car tuning), word of mouth may be quite important in generating new business. Services that are high risk, which would include professional services, would also tend to have high impact from word of mouth.

## Price premiums

New customers often benefit from introductory promotional discounts whereas long-term customers are more likely to pay regular (higher) prices. Moreover, when customers

trust suppliers they may be more willing to pay higher prices at peak periods or for express work.

The argument is that the customer trusts the firm, values the relationship, and is therefore less sensitive to price increases.

Of course, it is not always the case that old customers pay a premium price. Sometimes, long-lasting relationships have given the customer a bargaining position based on power or social relationships, which keeps prices down. If this happens, a negative profit-eroding effect occurs.

**EXHIBIT 16.1**

Simulation of firm X's customer value (cumulative sales for firm X over periods 1 to 10) with different retention rates



The assumptions for Table 16.3 are:

- Customer value is defined as accumulated sales for 100 customers of firm X from periods 1 to 10.
- Every customer makes one transaction per period.
- Every transaction is €100.
- The costs of the transaction are not considered.
- Firm X's ability to attract new customers is not considered.

Table 16.3 shows that if firm X can increase its retention rate from 50 per cent to 60 per cent the customer value (here defined as cumulative sales from periods 1 to 10) will increase 24 per cent, whereas an increase from 80 per cent to 90 per cent will increase cumulative sales by 46 per cent. Hence, the higher the retention rate, the higher the increase in customer value.

**Table 16.3** Firm X's customer value under varying retention rates

Retention rate (repeat buying rate)	Number of customers left in each buying period										Number of transactions	Customer value: cumulative sales from periods 1 to 10	Growth of cumulative sales (%)
	1	2	3	4	5	6	7	8	9	10			
50%	100	50	25	13	7	4	2	1	0	0	202	20,200	24% 30% 38% 46%
60%	100	60	36	22	13	8	5	3	2	1	250	25,000	
70%	100	70	49	34	24	17	12	8	6	4	324	32,400	
80%	100	80	64	51	41	33	26	21	17	14	447	44,700	
90%	100	90	81	73	66	59	53	48	43	39	652	65,200	

## 16.4 CONTROLLING THE MARKETING PROGRAMME

The final, but often neglected, stage of marketing planning is the control process. Not only is control important to evaluate how we have performed, but it completes the circle of planning by providing the feedback necessary for the start of the next planning cycle. Unfortunately, control is often viewed by the people of an organisation as being negative. If individuals fear that the control process will be used not only to judge their performance, but as a basis for punishing them, then it will be feared and reviled.

The evaluation and control of marketing probably represents one of the weakest areas of marketing practice in many companies. Even the organisations that are otherwise strong in their strategic marketing planning have poor control and evaluation procedures for their global marketing. There are a number of possible reasons for this. First of all, there is no such thing as a standard system of **marketing control**.

The function of the organisational structure is to provide a framework in which objectives can be met. However, a set of instruments and processes is needed to influence the behaviour and performance of organisation members to meet the goals. The critical issue is the same as with organisational structures: what is the ideal amount of control? On the one hand, headquarters needs information to ensure that marketing activities contribute maximum benefit to the overall organisation. On the other hand, controls should not be construed as a code of law.

The key question is to determine how to establish a control mechanism capable of early identification of emerging problems. Considered here are various criteria appropriate for the evaluation process, control styles, feedback and corrective action. These concepts are important for all businesses, but in the international arena they are vital.

### Design of a control system

In designing a control system, management must consider the costs of establishing and maintaining it and trade them off against the benefits to be gained. Any control system will require investment in a management structure and in systems design.

The design of the control system can be divided into two groups which depend on the object of control:

- output control (typically based on financial measures);
- behavioural controls (typically based on non-financial measures).

Output control may consist of expenditure control, which involves regular monitoring of expenditure figures, comparison of these with budget targets, and taking decisions to cut or increase expenditure where any variance is believed to be harmful. Measures of output are accumulated at regular intervals and typically forwarded from the foreign subsidiary to headquarters, where they are evaluated and criticised based on comparison with the plan or budget.

Behavioural controls require the exercise of influence over behaviour. This influence can be achieved, for example, by providing sales manuals to subsidiary personnel or by fitting new employees into the corporate culture. Behavioural controls often require an extensive **socialisation process**, and informal, personal interaction is central to the process. Substantial resources must be spent to train the individual to share the corporate culture; that is, the way things are done at the company.

To build a common vision and values, managers at the Japanese company Matsushita spend a substantial amount of their first months in what the company calls cultural and spiritual training. They study the company credo, the 'Seven Spirits of Matsushita', and the philosophy of the founder, Kanosuke Matsushita.

However, there remains a strong tradition of using output (financial) criteria. A fixation with output criteria leads companies to ignore the less tangible behavioural (non-financial)

#### Marketing control

A system of methods, procedures and devices used to ensure compliance with marketing policies and strategies.

#### Socialisation process

The process by which a society transmits its values, norms and roles to its members.

measures, although these are the real drivers of corporate success. However, there is a weakness in the behavioural performance measures. To date there has been little success in developing explicit links from behaviour to output criteria. Furthermore, companies and managers are still judged on financial criteria (profit contribution). Until a clear link is established, it is likely that behavioural criteria will continue to be treated with a degree of scepticism.

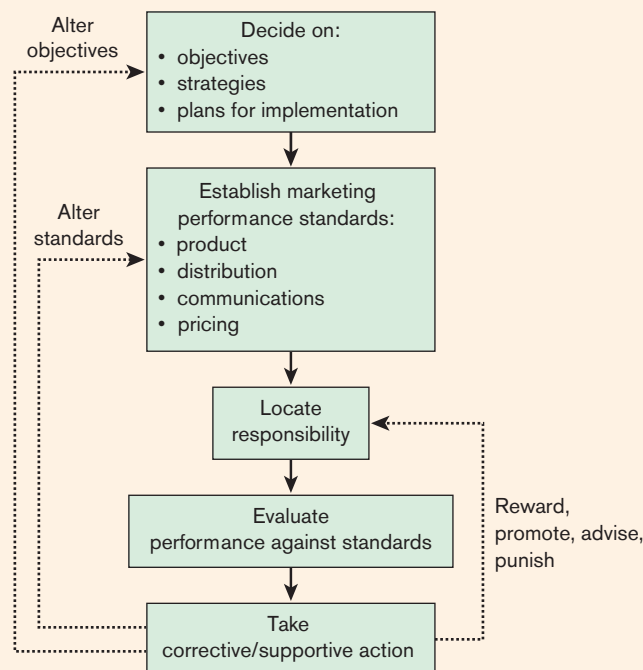
We will now develop a marketing control system based primarily on output controls. Marketing control is an essential element of the marketing planning process because it provides a review of how well marketing objectives have been achieved. A framework for controlling marketing activities is given in Figure 16.4.

The marketing control system begins with the company setting some marketing activities in motion (plans for implementation). This may be the result of certain objectives and strategies, each of which must be achieved within a given budget. Hence budgetary control is essential.

The next step in the control process is to establish specific performance standards which will need to be achieved for each area of activity if overall and sub-objectives are to be achieved. For example, in order to achieve a specified sales objective, a specific target of performance for each sales area may be required. In turn, this may require a specific standard of performance from each of the salespeople in the region with respect to, for example, number of calls, conversion rates and, of course, order value.

The next step is to locate responsibility. In some cases responsibility ultimately falls on one person (e.g. the brand manager); in others it is shared (e.g. the sales manager and the sales force). It is important to consider this issue, since corrective or supportive action may need to focus on those responsible for the success of the marketing activity.

In order to be successful, the people involved and affected by the control process should be consulted in both the design and implementation stages of marketing control. Above all, they



**Figure 16.4**

The marketing control system

Source: Hollensen, S. (2001) *Global Marketing: A Market Responsive Approach*, 2nd edn, Financial Times-Prentice Hall, Harlow, p. 600. Reproduced with permission.

will need to be convinced that the purpose of control is to improve their own levels of success and that of the company. Subordinates need to be involved in setting and agreeing their own standards of performance, preferably through a system of management by objectives.

Performance is then evaluated against these standards, which relies on an efficient information system. A judgement has to be made about the degree of success and failure achieved and what corrective or supportive action is to be taken. This can take various forms:

- Failure which is attributed to the poor performance of individuals may result in the giving of advice regarding future attitudes and actions, training and/or punishment (e.g. criticism, lower pay, demotion, termination of employment). Success, on the other hand, should be rewarded with praise, promotion and/or higher pay.
- Failure which is attributed to unrealistic marketing objectives and performance may cause management to lower objectives or lower marketing standards (Figure 16.4). Success which is thought to reflect unambitious objectives and standards may cause them to be raised in the next period.

Many firms assume that corrective action needs to be taken only when results are less than those required or when budgets and costs are being exceeded. In fact, both negative (underachievement) and positive (overachievement) deviations may require corrective action. For example, failure to spend the amount budgeted for, say, salesforce expenses may indicate that the initial sum allocated was excessive and needs to be reassessed, and/or that the salesforce is not as active as it might be.

It is also necessary to determine such things as the frequency of measurement (e.g. daily, weekly, monthly or annually). More frequent and more detailed measurement usually means more cost. We need to be careful to ensure that the costs of measurement and the control process itself do not exceed the value of such measurements and do not overly interfere with the activities of those being measured.

The impact of the environment must also be taken into account when designing a control system. The control system should measure only factors over which the organisation has control. Rewards make little sense if they are based on factors that may be relevant for overall corporate performance, but over which no influence can be exerted (e.g. price controls). Neglecting the factor of individual performance capability would send the wrong signals and severely impair the motivation of personnel.

Control systems should harmonise with local regulations and customs. In some cases, however, corporate behavioural controls have to be exercised against local customs even though overall operations may be affected negatively. This type of situation occurs, for example, when a subsidiary operates in markets where unauthorised facilitating payments are a common business practice.

## Feedforward control

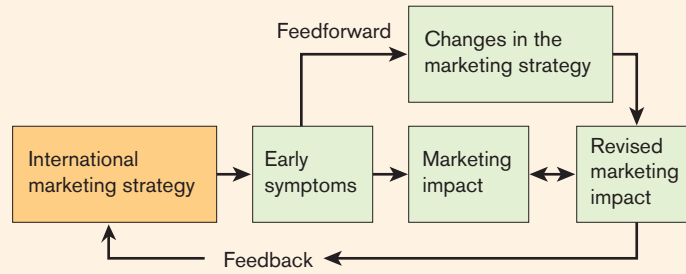
Much of the information provided by the firm's marketing control system is feedback on what has been accomplished in both financial (profits) and non-financial (customer satisfaction, market share) terms. As such, the control process is remedial in its outlook. It can be argued that control systems should be forward looking and preventive, and that the control process should start at the same time as the planning process. Such a form of control is feedforward control (Figure 16.5).

**Feedforward control** continuously evaluates plans, monitoring the environment to detect changes that would call for objectives and strategies to be revised. Feedforward control monitors variables other than performance; variables that may change before performance itself changes. The result is that deviations can be controlled before their full impact has been felt. Such a system is proactive in that it anticipates environmental change, whereas other control systems are more reactive in that they deal with changes after they occur. Examples of early symptoms (early performance indicators) are presented in Table 16.4.

### Feedforward control

The active anticipation and prevention of problems, rather than passive reaction.





**Figure 16.5**

**Adjustment of the marketing strategy**

Source: Samli, A. C., Still, R. and Hill, J. S. (1993) *International Marketing: Planning and Practice*, Macmillan, London, p. 425. Reproduced with permission from A. Coskun Samli, the estate of Richard R. Still and John S. Hill.

Feedforward control focuses on information that is prognostic: it tries to discover problems waiting to occur. Formal processes of feedforward control can be incorporated into the business marketer’s total control programme to enhance its effectiveness considerably. Utilisation of a feedforward approach would help ensure that planning and control are treated as concurrent activities.

**Key areas for control in marketing**

Kotler (2000) distinguishes four types of marketing control, each involving different approaches, different purposes and a different allocation of responsibilities. These are shown in Table 16.5. Here we will focus on annual plan control and profit control, since they are the most obvious areas of concern to firms with limited resources (e.g. SMEs).

**Annual plan control**

The purpose of annual plan control is to determine the extent to which marketing efforts over the year have been successful. This control will centre on measuring and evaluating sales in relation to sales goals, market share analysis and expense analysis.

Sales performance is a key element in the annual plan control. Sales control consists of a hierarchy of standards on different organisational control levels. These are interlinked, as shown in Figure 16.6.

We can see from the diagram that any variances in achieving sales targets at the corporate level are the result of variances in the performance of individual salespeople at the operational level. At every level of sales control, variances must be studied with a view to determining their causes. In general, variances may be due to a combination of variances in volume and/or price.

**Table 16.4**

Some key early performance indicators

Early performance indicators	Market implication
Sudden drop in quantities demanded.	Problem in marketing strategy or its implementation.
Sharp increase or decrease in sales volume.	Product gaining acceptance or being rejected quickly.
Customer complaints.	Product not debugged properly.
A notable decrease in competitors' business.	Product gaining acceptance quickly or market conditions deteriorating.
Large volumes of returned merchandise.	Problems in basic product design.
Excessive requests for parts or reported repairs.	Problems in basic product design, low standards.

Source: Samli, A. C., Still, R. and Hill, J. S. (1993) *International Marketing: Planning and Practice*, Macmillan, New York. Reproduced with permission of A. Coskun Samli, the estate of Richard R. Still and John S. Hill.

**Table 16.5** Types of marketing control

Type of control	Prime responsibility	Purpose of control	Examples of techniques/approaches
<b>Strategic control</b>	<ul style="list-style-type: none"> <li>• Senior management</li> <li>• Middle management</li> </ul>	<ul style="list-style-type: none"> <li>• To see if planned results are being achieved</li> </ul>	<ul style="list-style-type: none"> <li>• Marketing effectiveness ratings</li> <li>• Marketing audit</li> </ul>
<b>Efficiency control</b>	<ul style="list-style-type: none"> <li>• Line and staff management</li> <li>• Marketing controller</li> </ul>	<ul style="list-style-type: none"> <li>• To examine ways of improving the efficiency of marketing</li> </ul>	<ul style="list-style-type: none"> <li>• Salesforce efficiency</li> <li>• Advertising efficiency</li> <li>• Distribution efficiency</li> </ul>
<b>Annual plan control</b>	<ul style="list-style-type: none"> <li>• Senior management</li> <li>• Middle management</li> </ul>	<ul style="list-style-type: none"> <li>• To see if planned results are being achieved.</li> </ul>	<ul style="list-style-type: none"> <li>• Sales analysis</li> <li>• Market share analysis</li> <li>• Marketing expenses to sales ratio</li> <li>• Customer tracking</li> </ul>
<b>Profit control (budget control)</b>	<ul style="list-style-type: none"> <li>• Marketing controller</li> </ul>	<ul style="list-style-type: none"> <li>• To examine where the company is making and losing money</li> </ul>	<ul style="list-style-type: none"> <li>• Profitability by e.g. product, customer group or trade channel</li> </ul>

Source: Kotler, P. (2000) *Marketing Management: Millennium Edition*, 10th ed., Prentice Hall, Upper Saddle River, NJ. Copyright © 2000 Pearson Education, Inc. Reproduced with permission.

### Global profit control

In addition to the previously discussed control elements, all international marketers must be concerned to control their profit. The budgetary period is normally one year because budgets are tied to the accounting systems of the company.

Table 16.6 presents an example of a global marketing budget for a manufacturer of consumer goods. Included in the budget are those marketing variables which can be controlled and changed by the sales and marketing functions (departments) in the home country and in



**Figure 16.6** The hierarchy of sales and control

Source: Hollensen, S. (2001) *Global Marketing: A Market Responsive Approach*, 2nd ed., Financial Times-Prentice Hall, Harlow, p. 605. Reproduced with permission.

the export market. In Table 16.6 the only variable that cannot be controlled by the international sales and marketing departments is variable costs.

The global marketing budget system (as presented in Table 16.6) is used for the following (main) purposes:

- allocation of marketing resources among countries/markets to maximise profits. In Table 16.6 it is the responsibility of the global marketing director to maximise the total contribution 2 for the whole world;
- evaluation of country/market performance. In Table 16.6 it is the responsibility of export managers or country managers to maximise contribution 2 for each of their countries.

Please note that besides the marketing variables presented in Table 16.6, the global marketing budget normally contains inventory costs for finished goods. As the production

**Table 16.6** An example of an international marketing budget

International marketing	Europe				America				Asia/Pacific				Other markets		Total world $\Sigma$	
	UK		Germany		France		USA		Japan		Korea		B	A	B	A
	B	A	B	A	B	A	B	A	B	A	B	A	B	A	B	A
Budget year = _____																
Net sales (gross sales less trade discounts, allowances, etc.)																
÷ Variable costs																
= Contribution1																
÷ Marketing costs																
Sales costs (salaries commissions for agents, incentives, travelling, training, conferences)																
Consumer marketing costs (TV commercials, radio, print, sales promotion)																
Trade marketing costs (fairs, exhibitions, in-store promotions, contributions for retailer campaigns)																
= Total contribution 2 (marketing contribution)																

B = budget figures; A = actual.

*Note:* On a short-term (one-year) basis, the export managers or country managers are responsible for maximising the actual figures for each country and minimising their deviation from budget figures. The international marketing manager/director is responsible for maximising the actual figure for the total world and minimising its deviation from the budget figure. Cooperation is required between the country managers and the international marketing manager/director to coordinate and allocate the total marketing resources in an optimum way. Sometimes certain inventory costs and product development costs may also be included in the total marketing budget (see main text).

*Source:* Adapted from Hollensen, S. (2001) *Global Marketing: A Market Responsive Approach*, 2nd ed., Financial Times-Prentice Hall, Harlow, p. 605. Reproduced with permission.

runs of these goods are normally based on input from the sales and marketing department, the inventory of unsold goods will also be the responsibility of the international marketing manager or director.

Furthermore, the global marketing budget may also contain customer-specific or country-specific product development costs, if certain new products are preconditions for selling in certain markets.

In contrast to budgets, long-range plans extend over periods from two years up to ten years, and their content is more qualitative and judgemental in nature than that of budgets. For SMEs shorter periods (such as two years) are the norm because of the perceived uncertainty of diverse foreign environments.

### Overall economic value with successful implementation of CRM

The CRM process creates value by working with the customer to improve performance and business processes (see Figure 16.7). For example, the firm may negotiate with the customer's team to implement a new inventory system. If the relationship reduces costs and can yield a price reduction for the customer, revenues may increase as a result of increasing market share for the firm. Revenues may also increase as a result of better in-stock availability at the end of

$EVA = \text{Net profit} - (\text{Total assets} \times \text{Cost of capital})$

Where the 'cost of capital' is a weighed average cost (in %) of the debt claims used to finance the invested capital (total assets). With all else equal, a smaller invested capital balance (smaller total assets) results in a higher EVA. Similarly, other things being equal, higher net profit also results in a higher EVA.

In other words, a positive EVA reflects economic profit to owners of the firm, because it reflects returns greater than the opportunity cost of invested capital.

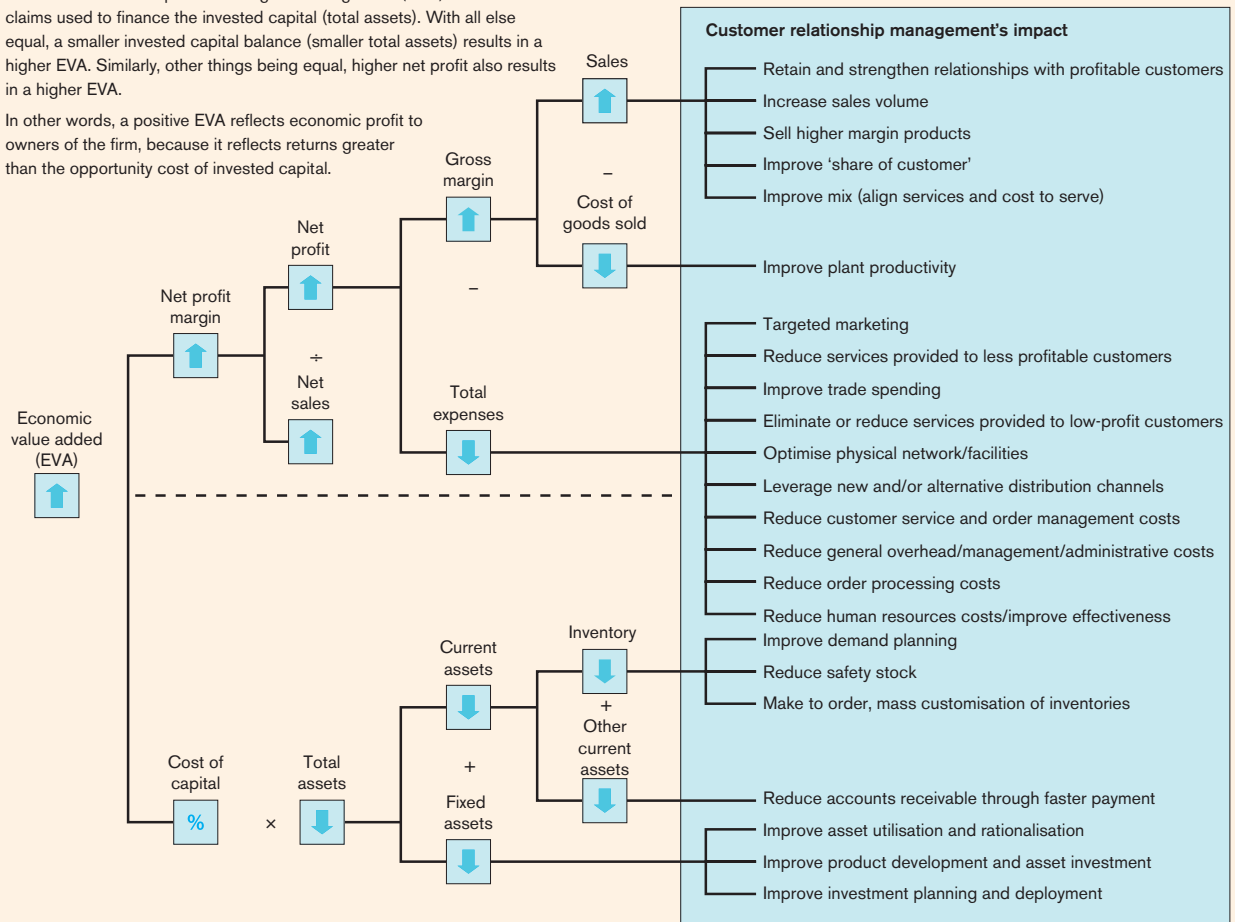


Figure 16.7

How customer relationship management affects economic value added (EVA)

Source: Adapted from Lambert, D. M. and Pohlen, T. L. (2001) Supply chain metrics, *The International Journal of Logistics Management*, 12(1): 10. Reproduced with permission from The Supply Chain Management Institute ([www.scm-institute.org](http://www.scm-institute.org)).

the supply chain. The cost of goods sold may decrease through better scheduling of material requirements and more efficient utilisation of plant capacity and labour.

The cost-of-goods sold may be reduced through the leveraging of larger buys with a smaller group of suppliers. Other costs may increase due to reduced order processing and forecasting costs. Inventory carrying costs decrease as point-of-sale data are used to schedule shipments instead of forecasting requirements and maintaining safety stock. Better capacity utilisation and collaborative planning and forecasting of requirements may reduce the need for customer-specific assets. In the end, the process improvements obtained through successful implementation of CRM can be translated into increased shareholder value through the use of an **economic value added (EVA)** model (Figure 16.7). By comparing net profit margin with cost of capital in Figure 16.7 the result would be a higher EVA.

EVA (economic value added) was popularised by the consulting firm of Stern and Steward (see further description in Steward, 1990).

EVA may be defined in the following way:

$$\text{EVA} = \text{Net profit} - (\text{Total assets} \times \text{Cost of capital}).$$

'Cost of capital' is a weighted average cost (in percentage terms) of the debt claims used to finance the invested capital (total assets). With all else equal, a smaller invested capital balance (smaller total assets) results in a higher EVA. Similarly, other things being equal, higher net profit also results in a higher EVA.

In other words, a positive EVA reflects economic profit to owners of the firm, because it reflects returns greater than the opportunity cost of invested capital.

#### Economic value added (EVA)

$\text{EVA} = \text{Net profit} - (\text{Total assets} \times \text{Cost of capital})$ . A smaller invested capital balance (smaller total assets) results in a higher EVA. Similarly, higher net profit also results in a higher EVA.

## 16.5 SUMMARY

Marketing strategies directly affect customers and sales revenue. However, they also affect margins, total contribution and marketing costs. These effects, in turn, lead to the total net marketing contribution. Because operating (manufacturing) costs and overhead costs are beyond the control of marketing managers, net marketing contribution plays the most important role for the marketing department, to determine the profit impact of a marketing strategy.

Traditional accounting systems have viewed customers as sources of revenue. More and more firms are beginning to use their accounting systems to view customers as assets, basing their decisions on customers as much as they would base their decisions on investments. Therefore, we propose *customer lifetime value* (CLTV) to be the central unit of measurement for customer equity. We define CLTV as the net present value (NPV) of the profit a firm stands to realise on the average new customer during a given number of years.

As marketing plans are being implemented, they have to be monitored and controlled. Control is the process of ensuring that global marketing activities are carried out as intended. It involves monitoring aspects of performance and taking corrective action where necessary. The global marketing control system consists of deciding marketing objectives, setting performance standards, locating responsibility, evaluating performance against standards, and taking corrective or supportive action.

In a conventional control system, managers wait until the end of the planning period to take corrective action. In a feedforward control system, corrective action is taken during the planning period by tracking early performance indicators and steering the organisation back to its desired objectives if they are not being achieved.

The most obvious areas of control relate to the control of the annual marketing plan and the control of profitability. The purpose of the global marketing budget is mainly to allocate marketing resources across countries to maximise the worldwide total marketing contribution. The process improvements obtained through successful implementation of CRM can be translated into increased shareholder value through the use of an economic value added (EVA) model.

## CASE STUDY 16.1

### Jordan

#### Developing an international marketing control and budget system for toothbrushes

Jordan is a family-owned international manufacturer of manual and mechanical oral hygiene products, household and painting tools, based in Oslo, Norway.

Jordan is among the 10 largest manufacturers of toothbrushes in the world, employing 780 people, including 180 in Norway. In 2007 the Jordan Group had net sales of €130 million, of which 45 per cent originated from toothbrushes. Net profit (EBIT) was €5 million.

Jordan-branded toothbrushes can be found in more than 100 countries on 5 continents. Jordan is the leading toothbrush in more European countries than any other brand.

The group's operations comprise the Norwegian parent company Jordan AS and four foreign subsidiaries. Jordan AS manufactures and sells oral care and household cleaning products. In addition, the company markets and distributes painting tools manufactured by its subsidiary, Anza AB.

- **Anza AB** produces and markets painting tools, and has become even more significant to the group after the acquisition of Britain's Hamilton Acorn in 2001. The company's head office is in Sweden.
- **Jordan (Far East) Ltd** is responsible for group sales in the Asia-Pacific region, with its head office in Malaysia.
- **Wisdom Toothbrushes Ltd** manufactures and markets toothbrushes in the UK, and has its head office in England.
- **Peri-dent Ltd** is one of the world's leading developers and manufacturers of dental floss, with its head office in Scotland.

#### History

**1837:** Wilhelm Jordan, Danish combmaker moved to Christiania (Oslo) and opened his workshop in the city centre. Soon afterwards he discovered that the town needed a brush factory. He hired the best local and foreign craftsmen, and the brushmaking business started to prosper.

**1879:** Wilhelm's son Fredrik Jordan took over the enterprise. The factory was modernised, and the variety of brushes became wider and wider.

**1911–16:** The founder's grandson Hjalmar Jordan, after taking the lead of the company, discovered the



Jordan manual toothbrushes

Source: Courtesy of Jordan AS

necessity of corporate changes. He bought two local competitors and moved the factory to bigger premises. At that time the product catalogue contained several thousand articles.

**1927:** Hjalmar Jordan, during his travels, found a new business opportunity: the toothbrush. Jordan became the first toothbrush manufacturer in Norway, by building a new factory only for toothbrush production. One thing was clear from the very beginning: Jordan's commitment to the best quality produced in the most sanitary conditions. The toothbrushes were sold under the 'Pronto' brand name.

**1937:** On its 100th anniversary, the company employed 144 people, produced 225,000 toothbrushes per year and had a turnover of NOK13 million. Jordan controlled the major part of the Norwegian market.

**1940–50:** Jordan remained stable after the war, and made further investments in new production technologies.

**1958:** Jordan entered the first export markets: Denmark, England, West Germany, Sweden and Finland. At the same time new methods of product presentation

were introduced: toothbrushes were packed individually in a transparent plastic container.

**1960–68:** The product assortment was rationalised, and focus was put on toothbrushes and oral care products. Manufacturing of dental sticks started. Exports expanded, partnerships were formed, and by the end of the 1960s Jordan sold 25 million toothbrushes per year.

**1969:** Since this year, just like the export label, the domestic toothbrushes have been named 'Jordan'. New production site opened in Flisa, Norway.

**1970:** Jordan entered the paintbrush market by acquiring Anza in Sweden. In 1976 total turnover exceeded NOK100 million. The company moved to today's location. In 1973 the revolutionary spoon-shaped toothbrush was developed in association with dental experts. This brush (predecessor of today's Jordan Classic) set the direction for Jordan for the coming decades.

**1983:** The Colgate-Palmolive Company introduced a new type of toothbrush, which Jordan was asked to produce. A long-lasting relationship started based on the acknowledgement of Jordan's expertise.

**1987:** Freshly elected as 'Company of the Year 1986' in Norway, Jordan celebrated its 150th anniversary.

**1988:** Jordan opened its factory in Holland; Sanodent specialised in private label products. Peri-dent in Scotland was created as a joint venture and started to produce the total volume of Jordan dental flosses.

**1992:** Launch of Jordan Magic, the world's first colour-changing toothbrush.

**1993:** Launch of Jordan ActiveTip.

**1995:** Launch of Jordan Sport and Jordan Amigo.

**1997:** Launch of the Philips-Jordan electrical toothbrush.

**1998:** Jordan acquired Wisdom, England's leading toothbrush manufacturer (total sales in 1997: \$16 million)

**2000:** Jordan consolidates its Norwegian toothbrush production at Flisa and discontinues production in Oslo.

**2003:** All toothbrush production is moved out of Norway to Wisdom in England.

**2006:** Jordan's interdental product programme is extended with a range of plastic dental sticks.

In addition to the Jordan-owned subsidiaries in Sweden, England, Scotland and Malaysia, Jordan toothbrushes are produced under licence in five countries: India, Nigeria, Syria, Malaysia and Indonesia.

### The global toothbrush market

Table 16.7 shows the three general toothbrush market segments.

The main impetus to global growth was the phenomenal development of low-priced, mass-market



The Dental Floss Miracle (from the interdental programme)

Source: Courtesy of Jordan AS

**Table 16.7** Toothbrush market segments, 2006

Three toothbrush segments in the world market	Examples of brands	Typical retail consumer prices (€)
1 Manual toothbrushes	Jordan	3
2 Power toothbrush market, which can be divided into two sub-segments:		
(a) Battery-powered toothbrushes	P&G SpinBrush	7–8
(b) Electric toothbrushes (with rechargeable batteries)	Braun Oral-B	20

battery-operated toothbrushes, particularly in the US but also worldwide. This was triggered in the US by the acquisition of Dr John's Spinbrush by consumer products giant Procter & Gamble in late 2000. The global market for power toothbrushes amounted to just 55 million units in 2007, but this was a significant improvement on the level of 12.5 million units recorded in 1998.

Definitely the biggest buzz in the oral care category these days has been generated by battery-powered toothbrushes. According to Colgate-Palmolive, battery-powered brushes accounted for just 4 per cent of the toothbrush segment in 1999. Yet by the end of 2006, sales of these products accounted for 40 per cent of toothbrush sales in the EU-countries. The increasing popularity of power toothbrushes can also be seen in increasing sales figures for replaceable heads. All this means that manual toothbrushes have experienced a fallen market share in the total toothbrush market, whereas power toothbrushes have increased their market share.

### The German toothbrush market

Although 99 per cent of Germans over 14 years already brush their teeth at least once a day, there is still scope for growth in toothbrushes. Dentists still tend to claim that more people could replace their toothbrush more often, with replacement being recommended at least once every three months.

Table 16.8 shows the general development in the German toothbrush market. As illustrated the power toothbrushes segment is divided into two sub-segments: battery and electric toothbrushes. Each of these segments is then divided into two segments.

#### German market for manual toothbrushes

Despite a negative attitude towards private label toothpaste, the share of private label toothbrushes is relatively high. Private label brands have adapted to consumer preferences and are now offering products with flexible

**Table 16.8** Retail sales of toothbrushes by type: value (€m) 2003–2006

	2003	2004	2005	2006
Manual toothbrushes	199.9	187.5	177.8	175.0
Power toothbrushes	53.1	103.1	120.5	124.4
• Battery toothbrushes	15.7	34.1	43.0	47.0
– Battery toothbrush units	5.4	11.9	15.8	17.2
– Battery toothbrush replacement heads	10.3	22.2	27.2	29.8
• Electric toothbrushes	37.5	69.0	77.5	77.4
– Electric toothbrush units	18.1	35.8	41.7	39.5
– Electric toothbrush replacement heads	19.4	33.2	35.8	37.9
Manual and power toothbrushes	253.1	290.6	298.3	299.4

Sources: Adapted from trade press (Lebensmittelzeitung, Lebensmittel Report), company research and reports, trade interviews, Euromonitor International (www.euromonitor.com) estimates.



**Table 16.9** Replacement of manual toothbrushes 2006 (Germany)

Per cent of users changing their manual toothbrush	2006
Once a week	1.2
Once a month	27.4
Every three months	48.3
Every six months	16.8
Less than every six months	4.4
Never (don't need a manual toothbrush)	1.5
No reply	0.4
Total	100.0

Sources: Adapted from trade press and Euromonitor International ([www.euromonitor.com](http://www.euromonitor.com)) estimates.

toothbrush heads, X-shaped bristles or coloured indicators. As a result private label share has increased from 19 per cent in 2004 to 23 per cent in 2006.

While consumers at the high end of the market are still willing to pay up to €3.50 per brush, users of mid-range priced brushes are increasingly turning to private label products. Most of the main mass outlets, such as Schlecker, Aldi and DM, now include private label toothbrushes in their product ranges. As a result of growth in private labels and increased competition among brands, the average unit price of manual toothbrushes is stable at €3.0 in 2006.

The size of the market is determined by how often people are changing their toothbrush. Table 16.9 shows how often they do it.

#### Falling sales of child-specific manual toothbrushes

Value sales of children's brushes have decreased in line with the general decline of manual brushes. Parents

hoping to improve their children's dental care are more likely to spend money on power brushes specifically designed for children, such as Colgate Motion Bzzz. For children, the shape, packaging and marketing of the toothbrushes is more important than the function. Consequently, children's brushes have become very colourful, often in the shape of popular cartoon characters or toys. Manufacturers of manual brushes are trying to attract children and their parents with features such as anti-slip grips or special toothbrushes for the different stages of dental development. This has led to higher average prices for child-specific brushes.

#### Competition in manual toothbrushes

Together, the four largest companies accounted for 70 per cent of value sales of manual toothbrushes in 2006. GlaxoSmithKline leads the way, with a 32 per cent share, due to the success of its Dr Best brand. Dr Best brushes are associated with a high level of expertise,



Toothbrushing – a family event

Source: Courtesy of Jordan AS

captured in a wide range of specialised toothbrushes. Oral-B, Procter & Gamble and Gaba follow, with 14 per cent, 12 per cent and 11 per cent shares in 2006. Gaba managed to increase its value share between 2004 and 2006, while other company shares remained stable or fell during the same time period. Elmex, Aronal and Meridol, the main Gaba brands, have a high level of recognition among German consumers, and are known as forerunners in medical research.

Private label products are very successful, with a 23 per cent value share in 2006, up by 4.5 percentage points compared to 2003. The success of private label products in this sub-sector lies in the consumer perception of toothbrushes as secondary to toothpaste in terms of importance. While German consumers are likely to spend money on a 'quality' toothpaste, a private label toothbrush is perceived to do the same job as a similar branded product. This is especially the case with new private label brands, which keep up with branded labels in terms of new product development and innovations.

#### Power brushes change oral care

As early as the 1970s, Oral-B produced and sold electrical toothbrushes in Germany and other European countries, but it was not until 1998/9 that power brushes really took off. In 2000, the introduction of the first battery-operated toothbrushes gave the market new impetus, and their lower prices made them more affordable.

From 2000 onwards, power brushes made a real impact on oral hygiene, influencing other sub-sectors such as manual toothbrushes and toothpaste. In 2006, sales of power brushes and replacement heads amounted to €124.4 million.

Some models of battery brushes have to be replaced at regular intervals, while electric brushes have to be recharged. This means the number of replacement heads per sold unit is higher for electric brushes as new battery brushes come with a new head.

#### Switching between models

Consumers are expected to switch between brands and makes. Apart from the regular replacement of disposable battery toothbrushes, consumers are expected to switch from battery brushes to electric brushes. According to industry sources, many consumers use

the cheaper battery brushes as an initial 'trial brush' before committing to the price of a more expensive electrical brush that might display additional benefits, such as different speed settings or gum protection against too much pressure. Likewise, users of electric toothbrushes are likely to upgrade their toothbrushes in line with new product developments.

## QUESTIONS

Until now Jordan's market share in the total German toothbrush market was below 2 per cent, with high regional differences. In Norway the market share is around 60 per cent, in Denmark 25 per cent, in Sweden 20 per cent and in Poland it has risen to about 15 per cent.

Jordan's management in Norway is not satisfied with this market share in such a non-distant market as Germany. Therefore, you are contacted by the marketing director to help her with some suggestions for developing the marketing plan for Germany.

- 1 Discuss if it would be a good idea for Jordan to enter the German power toothbrush market with a new product? If yes, how should such a decision be implemented?
- 2 Outline a marketing plan for Jordan's existing product line (manual toothbrushes) in Germany.
- 3 Make a proposal for Jordan's marketing control and budget system – if possible, outline the specific Jordan marketing budget for the German market. Use the following for your marketing budget:

Financial calculation for a typical Jordan manual toothbrush (per unit):

Retail price	€4
Ex works price	€1.5
Variable costs	<u>€1.0</u>
Contribution margin	€0.5
Contribution margin	33%

(Please note that these figures are not official Jordan figures.)

## SOURCES

Jordan AS ([www.jordan.no](http://www.jordan.no)); Euromonitor International ([www.euromonitor.com](http://www.euromonitor.com)); and various public sources: trade press, company research and reports, interviews

## QUESTIONS FOR DISCUSSION

- 1 Why is customer profitability sometimes a better unit of measurement than market profitability?
- 2 Why is it important to consider customer lifetime value (CLTV)?

- 3 How can a firm increase CLTV?
- 4 Discuss why firms need marketing controls.
- 5 What is meant by performance indicators? What are they? Why does a firm need them?
- 6 Discuss the benefits gained by adopting a matrix organisational structure.
- 7 Discuss the problems involved in setting up and implementing a marketing control system.
- 8 To what general criteria should 'good' marketing objectives conform?

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