

# Chapter

# 13

## MEASURING THE EFFECTIVENESS OF MARKETING PLANNING

### SUMMARY

- An appraisal of marketing investment techniques
- Shareholder value added
- Marketing due diligence and assessing the riskiness of strategic marketing plans
- Linking marketing expenditure to corporate financial objectives
- Measuring promotional expenditure effectiveness.
- Exercises to turn the theory into practice

### A THREE-LEVEL MARKETING ACCOUNTABILITY FRAMEWORK

The ultimate test of marketing investment, and indeed any investment, is whether it creates value for shareholders. But few marketing investments are evaluated from this perspective, and many would argue that it is almost impossible to link financial results to any specific marketing activity.

But increasingly, boards of directors and city analysts the world over are dissatisfied with this lack of accountability for what are, very often, huge budgets. Cranfield School of Management decided to tackle this problem systematically with a thorough, multi-year research project through its Marketing Value Added Research Club, later renamed the Marketing Accountability Research Club, a syndicate of several blue-chip companies. The club set out to create and test a new framework which shows how marketing systematically contributes to shareholder value, and how its contribution can be measured in an objective and comparable way.

### MARKETING INSIGHT

There is an urgent need for such a framework. Not only does marketing need it, to answer the widespread accusations of poor performance,<sup>1</sup> but corporate and financial strategists need it too, to understand how to link marketing activities to the wider corporate agenda. All too often marketing objectives and strategies are not aligned with the organization's overall plans to increase shareholder value.

The purpose of this chapter is to set out the logic of this framework, which is underpinned by two Cranfield PhDs (Wilson, 1996<sup>2</sup> and Smith, 2003<sup>3</sup>).

The chapter starts with a brief justification of the need for a wholly new approach to measuring the effectiveness of marketing.

It then proceeds to set out another accountability framework also developed in the Cranfield Research Clubs.

Cranfield's work on this topic is continually evolving, and now forms part of the work of the Cranfield Customer Management Forum. However, this chapter provides some fundamental principles of marketing metrics.

## WHAT COUNTS AS MARKETING EXPENDITURE?

Historically, marketing expenditure has tended to escape rigorous performance appraisal for a number of reasons. First, there has been real confusion as to the true scope and nature of marketing investments. Too often, marketing expenditure has been assumed to be only the budgets put together by the marketing function, and as such, a (major) cost to be controlled rather than a potential driver of value. Second, the causal relationship between expenditure and results has been regarded as too difficult to pin down to any useful level of precision.

Now, because of the demands of increasingly discerning customers and greater competition, marketing investments and marketing processes are under scrutiny as never before. From the process point of view, as a result of insights from management concepts such as the quality movement and re-engineering, marketing is now much more commonly seen as a cross-functional responsibility of the entire organization rather than just the marketing department's problem.

Howard Morganis, past Chairman of Procter and Gamble, said, 'There is no such thing as a marketing skill by itself. For a company to be good at marketing, it must be good at everything else, from R&D to manufacturing, from quality controls to financial controls.' Hugh Davidson<sup>4</sup> in *Offensive Marketing* comments, 'Marketing is an approach to business rather than a specialist discipline. It is no more the exclusive responsibility of the marketing department than profitability is the sole charge of the finance department.'

But there is also a growing awareness that, because of this wider interpretation of marketing, nearly all budgets within the company could be regarded as marketing investments in one way or another. This is especially the case with IT budgets. The exponential increase in computing power has made it possible to track customer perceptions and behaviours on a far greater scale,

and with far greater precision than previously. When used correctly, these databases and analytical tools can shed a much greater light on what really happens inside the 'black box'. However, the sums involved in acquiring such technologies are forcing even the most slapdash of companies to apply more rigorous appraisal techniques to their investments in this area.

This wider understanding of what 'marketing' is really all about has had a number of consequences. First, the classic textbook treatment of strategic issues in marketing has finally caught up with reality.

Topics such as market and customer segmentation, product and brand development, databases and customer service and support are now regularly discussed at board level, instead of being left to operational managers or obscure research specialists.

CEOs and MDs are increasingly accepting that they must take on the role of chief marketing officer if they want to create truly customer-led organizations. Sir Clive Thompson commented, 'I am convinced that corporate and marketing strategy are more or less the same things. The chief executive has to be the chief marketer. If you delegate that responsibility, you are not doing your job.'

Second, because of their 'new' mission-critical status, marketing investments are attracting the serious attention of finance professionals. As part of a wider revolution in thinking about what kind of corporate assets are important in today's business environment, intangibles such as knowledge about customers and markets, or the power of brands, have assumed a new importance. The race is on to find robust methods of quantifying and evaluating such assets for the benefit of corporate managements and the wider investment community.

Unfortunately, this new focus on the importance of marketing has not improved the profile of marketing professionals. Instead, the spotlight has merely highlighted their weaknesses and shortcomings. After one 1997 survey on the perceived status of the profession, John Stubbs, CEO of the UK Marketing Council, was forced to comment, 'I was taken aback by just how little reputation marketing actually has among other functions . . . marketing and marketers are not respected by the people in their organizations for their contributions to business strategy, results or internal communication. We often do not know what or who is good or bad at marketing; our measurements are not seen as credible; our highest qualifications are not seen to have compatible status with other professions.'

#### MARKETING INSIGHT

A survey at Cranfield during a two-year period has revealed that marketers are seen as 'slippery, expensive, unreliable and unaccountable'.<sup>5</sup>

## WHAT DOES 'VALUE ADDED' REALLY MEAN?

The term 'value added' is fast becoming the new mantra for the early 21st-century business literature, and is often used quite loosely to indicate a business concept that is intended to exceed either customer or investor expectations, or both. However, from the point of view of this chapter, it is important to remember that the term has its origin in a number of different management

ideas, and is used in very specific ways by different sets of authors. Most of the ideas come from the USA, and have originated in business school and consultancy research in the mid-1980s.

These ideas and concepts were discussed in detail in Chapter 4 under the section about value propositions.

## THREE DISTINCT LEVELS FOR MEASURING MARKETING EFFECTIVENESS

When one of the authors was marketing director of a fast-moving consumer goods (fmcg) company 30 years ago, there were many well tried-and-tested models for measuring the effectiveness of marketing promotional expenditure. Indeed, some of these were quite sophisticated and included mathematical models for promotional campaigns, for advertising threshold and wear-out levels and the like.

Indeed, it would be surprising if marketing as a discipline did not have its own quantitative models for the massive expenditure of fmcg companies. Over time, these models have been transferred to business-to-business and service companies, with the result that, today, any organization spending substantial sums of shareholders' money on promotion should be ashamed of themselves if those responsible could not account for the effectiveness of such expenditure.

### MARKETING INSIGHT

Nonetheless, with the advent of different promotional methods and channels, combined with an empowered and more sophisticated consumer, the problems of measuring promotional effectiveness have increased considerably.

Consequently, this remains one of the major challenges facing the marketing community today and, as mentioned above, the research and practice of specialists at Cranfield School of Management continue apace.

But, at this level, accountability can only be measured in terms of the kinds of effects that promotional expenditure can achieve, such as awareness or attitude change, both of which can be measured quantitatively.

But to assert that such expenditure can be measured directly in terms of sales or profits is intellectually indefensible, when there are so many other variables that affect sales, such as product efficacy, packaging, price, the sales force, competitors and countless other variables that, like advertising, have an intermediate impact on sales and profits. Again, however, there clearly is a cause and effect link, otherwise such expenditure would be pointless. This issue is addressed later in this chapter.

Indeed, this definition of marketing as a function for strategy development as well as for tactical sales delivery, when represented as a map (see Figure 13.1), can be used to clarify the whole problem of how to measure marketing effectiveness.

So, the problem with marketing accountability has never been with how to measure the effectiveness of promotional expenditure, for this we have had for many years. No, the problem occurs because marketing isn't just a promotional activity. As explained in detail in Chapter 1, in world class organizations where the customer is at the centre of the business model, marketing as a discipline is responsible for defining and understanding markets, for segmenting these markets, for developing value propositions to meet the researched needs of the customers in the segments, for getting buy-in from all those in the organization responsible for delivering this value, for playing their own part in delivering this value and for monitoring whether the promised value is being delivered.

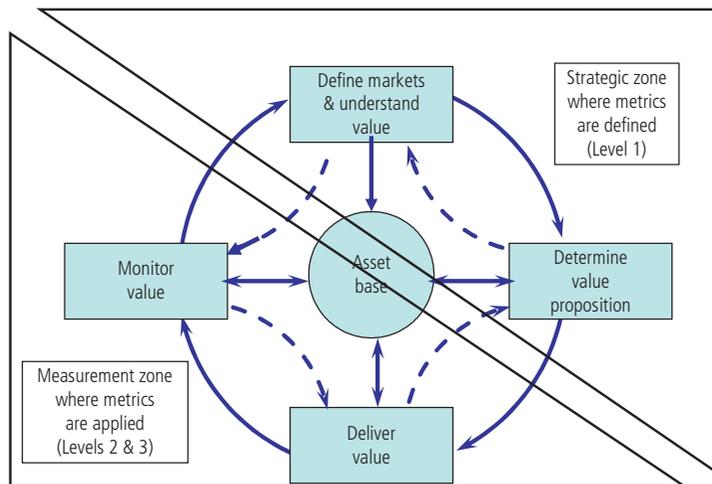


Figure 13.1: Map of the marketing domain and the three-level accountability framework.

Level of marketing effectiveness	Areas considered	Outputs
Level 1 Marketing due diligence	The marketing strategy, i.e. the choice of target customers and value proposition	An objective assessment of whether or not the marketing strategy will create or destroy shareholder value, together with the identification of how the strategy may be improved
Level 2 Marketing effectiveness	The marketing tactics (i.e. the full range of products, pricing, promotional and channels), employed for each segment identified and targeted by the marketing strategy	The likelihood of the marketing tactics creating the necessary competitive advantage in each segment
Level 3 Promotional effectiveness	The marketing communications strategy (i.e. advertising, sales team, etc.), employed to communicate with each segment	The effectiveness of the communications activity in achieving marketing communications objectives such as awareness recall, etc.

## Level 1: Shareholder Value Added (SVA)

SVA is profit after tax, minus net capital employed multiplied by the cost of capital. There are only three things you can do to affect SVA:

- increase revenue
- decrease costs
- decrease the amount of capital tied up in the business.

All of these are highly influenced by the strategic marketing plan. A very simple example of how SVA can be calculated follows: A has £15,000 invested in the company. The cost of capital is 10 per cent. The company makes a net profit of £2,000. Therefore, the company has created £500 SVA ( $£15,000 \times 10\% - £2,000 = +£500$ ).

Level 1 is the most vital of all three, because this is what determines whether or not the marketing strategies for the longer term (usually three to five years) destroy or create shareholder value added. It is justified to use the strategic marketing plan for assessing whether shareholder value is being created or destroyed because, as Sean Kelly<sup>6</sup> agrees:

The customer is simply the fulcrum of the business and everything from production to supply chain, to finance, risk management, personnel management and product development, all adapt to and converge on the business value proposition that is projected to the customer.

Thus, corporate assets and their associated competences are only relevant if customer markets value them sufficiently highly that they lead to sustainable competitive advantage, or shareholder value added. This is our justification for evaluating the strategic plan for what is to be sold, to whom and with what projected effect on profits as a route to establishing whether shareholder value will be created or destroyed.

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A company's share price, the shareholder value created and the cost of capital are all heavily influenced by one factor: risk. Investors constantly seek to estimate the likelihood of a business plan delivering its promises, while the boards try to demonstrate the strength of their strategy.

How much is a company really worth? We spelled out in Chapter 1 the huge discrepancy between the tangible assets and the share price; there are innumerable tools that try to estimate the true value of intangibles and goodwill. However, these mostly come from a cost-accounting perspective. They try to estimate the cost of recreating the brand, intellectual property or whatever is the basis of intangible assets. Our research into companies that succeed and fail suggests that that approach is flawed, because what matters is not the assets owned, but how they are used. We need to get back to the basics of what determines company value.

We should never be too simplistic about business, but some things are fundamentally simple. We believe that a company's job is to create shareholder value, and the share price reflects how well the investment community thinks that is being done. Whether or not shareholder value

is created depends on creating profits greater than investors might get elsewhere at the same level of risk. The business plan makes promises about profits, which investors then discount against their estimate of the chance a company will deliver it. So it all comes down to this. A company says it will achieve \$1 billion, investors and analysts think it is more likely to be \$0.8 billion. The capital markets revolve around perceptions of risk. What boards and investors both need, therefore, is a strategic management process that gives a rigorous assessment of risk and uses that to assess and improve shareholder value creation. Just such a process has emerged from many years of research at Cranfield, a process we have called, appropriately, 'marketing due diligence'.

There is a whole book dedicated to explaining this process,<sup>7</sup> so we will provide only a brief summary here.

## Where Does Risk Come From?

Marketing due diligence begins by looking for the risk associated with a company's strategy. Evaluation of thousands of business plans suggests that the many different ways that companies fail to keep their promises can be grouped into three categories:

- The market wasn't as big as they thought.
- They didn't get the market share they hoped for.
- They didn't get the profit they hoped for.

Of course, a business can fail by any of these routes or a combination of them. The risk inherent in a plan is the aggregate of these three categories, which we have called, respectively, market risk, strategy risk and implementation risk. The challenge is to accurately assess these risks and their implications for shareholder value creation.

Our research found that most estimates of business risk were unreliable because they grouped lots of different sources of risk under one heading. Since each source of risk is influenced by many different factors, this high-level approach to assessing business risk is too simplistic and inherently inaccurate. A better approach is to subdivide business risk into as many sources as practically possible, estimate those separately and then recombine them. This has two advantages. First, each risk factor is 'cleaner', in that its causes can be assessed more accurately. Second, minor errors in each of the estimations cancel each other out. The result is a much better estimate of overall risk.

## How Risky is a Business?

Marketing due diligence makes an initial improvement over high-level risk estimates by assessing market, strategy and implementation risk separately. However, even those three categories are not sufficiently detailed. We need to understand the components of each, which have to be teased out by careful comparison of successful and unsuccessful strategies. Our research indicated that each of the three risk sources could be subdivided further into five risk factors, making 15 in all. These are summarized in Table 13.1.

Armed with this understanding of the components and subcomponents of business risk, we are now half-way to a genuine assessment of our value creation potential. The next step is to accurately assess our own business against each of the 15 criteria and use them to evaluate the probability that our plan will deliver its promises.

Overall risk associated with the business plan		
Market risk	Strategy risk	Implementation risk
Product category risk, which is lower if the product category is well established and higher for a new product category.	Target market risk, which is lower if the target market is defined in terms of homogeneous segments and higher if it is not.	Profit pool risk, which is lower if the targeted profit pool is high and growing and higher if it is static or shrinking.
Segment existence risk, which is lower if the target segment is well established and higher if it is a new segment.	Proposition risk, which is lower if the proposition delivered to each segment is segment specific and higher if all segments are offered the same thing.	Competitor impact risk, which is lower if the profit impact on competitors is small and distributed and higher if it threatens a competitor's survival.
Sales volumes risk, which is lower if the sales volumes are well supported by evidence and higher if they are guessed.	SWOT risk, which is lower if the strengths and weaknesses of the organization are correctly assessed and leveraged by the strategy and higher if the strategy ignores the firm's strengths and weaknesses.	Internal gross margin risk, which is lower if the internal gross margin assumptions are conservative relative to current products and higher if they are optimistic.
Forecast risk, which is lower if the forecast growth is in line with historical trends and higher if it exceeds them significantly.	Uniqueness risk, which is lower if the target segments and propositions are different from that of the major competitors and higher if the strategy goes 'head on'.	Profit sources risk, which is lower if the source profit is growth in the existing profit pool and higher if the profit is planned to come from the market leader.
Pricing risk, which is lower if the pricing assumptions are conservative relative to current pricing levels and higher if they are optimistic.	Future risk, which is lower if the strategy allows for any trends in the market and higher if it fails to address them.	Other costs risk, which is lower if assumptions regarding other costs, including marketing support, are higher than existing costs and higher if they are lower than current costs.

Table 13.1: Factors contributing to risk.

This gradation of risk level is not straightforward. It is too simplistic to reduce risk assessment to a tick-box exercise. However, a comparison of a strategy against a large sample of other companies' strategies does provide a relative scale.

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By comparing, for instance, the evidence of market size, or the homogeneity of target markets, or the intended sources of profit against this scale, a valid, objective, assessment of the risk associated with business plan can be made.

## What Use is this Knowledge?

Marketing due diligence involves the careful assessment of a business plan and the supporting information behind it. In doing so, it discounts subjective opinions and side-steps the spin of investor relations. At the end of the process the output is a number, a tangible measure of the risk associated with a chosen strategy. This number is then applied in the tried and trusted calculations that are used to work out shareholder value. Now, in place of a subjective guess, we have a research-based and objective answer to the all-important question: 'Does this plan create shareholder value?'

Too often, the answer is no. When risk is allowed for, many business plans create less value than putting the same money in a bank account or index-linked investment. Such plans, of course, actually destroy shareholder value because their return is less than the opportunity cost of the investment. An accurate assessment of value creation would make a huge difference to the valuation of the company. The result of carrying out marketing due diligence is, therefore, of great interest and value to both sides of the capital market.

For the investment community, marketing due diligence allows a much more informed and substantiated investment decision. Portfolio management is made more rational and more transparent. Marketing due diligence provides a standard by which to judge potential investments and a means to see through the vagaries of business plans.

For those seeking to satisfy investors, the value of marketing due diligence lies in two areas. First, it allows a rigorous assessment of the business plan in terms of its potential to create shareholder value. A positive assessment then becomes a substantive piece of evidence in negotiations with investors and other sources of finance. Second, if a strategy is shown to have weaknesses, the process not only pinpoints them but also indicates what corrective action is needed.

For both sides, the growth potential of a company is made more explicit, easier to measure and harder to disguise.

For anyone involved in running a company or investing in one, marketing due diligence has three messages. First, business needs a process that assesses shareholder value creation, and hence the value of a company, in terms of risk rather than the cost of replacing intangible assets. Second, business risk can be dissected, measured and aggregated in a way that is much more accurate than a high-level judgement. Finally, marketing due diligence is a necessary process for both investors and companies.

Eventually, we anticipate that a process of marketing due diligence will become as *de rigueur* for assessing intangible value as financial due diligence is for its tangible counterpart. Until then, early adopters will be able to use it as a source of competitive advantage in the capital market.

Figure 13.2 is a summary of how SVA should be calculated using the marketing due diligence process.

This high-level process for marketing accountability, however, still does not answer the dilemma of finding an approach which is better than the plethora of metrics with which today's marketing

### Background/Facts

- Risk and return are positively correlated, i.e. as risk increases, investors require a higher return.
- Risk is measured by the volatility in returns, i.e. high risk is the likelihood of either making a very good return or losing all your money. This can be described as the quality of returns.
- All assets are defined as having future value to the organization. Hence assets to be valued include not only tangible assets like plant and machinery, but intangible assets, such as key market segments.
- The present value of future cash flows is the most acceptable method to value assets including key market segments.
- The present value is increased by:
  - increasing the future cash flows
  - making the future cash flows 'happen' earlier
  - reducing the risk in these cash flows, i.e. improving the certainty of these cash flows, and, hence, reducing the required rate of return.

### Suggested Approach

- Identify your key market segments. It is helpful if they can be classified on a vertical axis (a kind of thermometer) according to their attractiveness to your company. 'Attractiveness' usually means the potential of each for growth in your profits over a period of between three and five years. (See the attached matrix)
- Based on your current experience and planning horizon that you are confident with, make a projection of future net-free cash in-flows from your segments. It is normal to select a period such as three or five years.
- These calculations will consist of three parts:
  - revenue forecasts for each year
  - cost forecasts for each year
  - net-free cash flow for each segment for each year.
- Identify the key factors that are likely to either increase or decrease these future cash flows.
- These factors are likely to be assessed according to the following factors:
  - the riskiness of the product/market segment relative to its position on the ANSOFF matrix
  - the riskiness of the marketing strategies to achieve the revenue and market share
  - the riskiness of the forecast profitability (e.g. the cost forecast accuracy).
- Now recalculate the revenues, costs and net-free cash flows for each year, having adjusted the figures using the risks (probabilities) from the above.
- Ask your accountant to provide you with the overall SBU cost of capital and capital used in the SBU. This will not consist only of tangible assets. Thus, £1,000,000 capital at a required shareholder rate of return of 10 per cent would give £100,000 as the minimum return necessary.
- Deduct the proportional cost of capital from the free cash flow for each segment for each year.
- An aggregate positive net present value indicates that you are creating shareholder value – i.e. achieving overall returns greater than the weighted average cost of capital, having taken into account the risk associated with future cash flows.

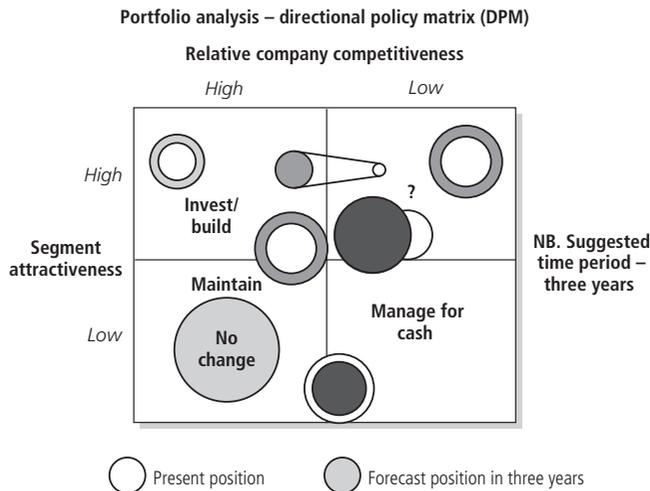


Figure 13.2: Valuing key market segments.

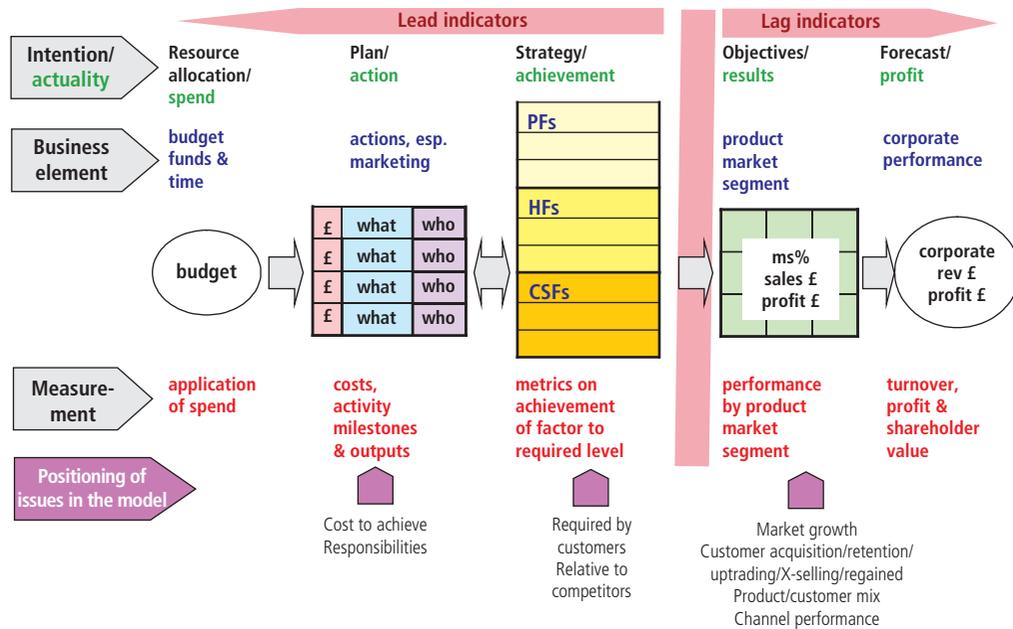


Figure 13.3: Overall marketing metrics model.

directors are bombarded, so Cranfield’s Research Club took this issue on board in an attempt to answer the following questions:

- What needs to be measured.
- Why it needs to be measured.
- How frequently it needs to be measured.
- To whom it should be reported.
- And the relative importance of each.

The approach we took to answering these questions was to drive metrics from a company’s strategy and the model shown in Figure 13.3 was developed. This clearly shows the link between lead indicators and lag indicators.

This process model is explained in much greater detail in *Marketing Value Metrics*,<sup>8</sup> so here we will provide a brief summary only.

## Level 2: Linking Activities and Attitudes to Outcomes

Few academics or practitioners have addressed this second level to date, which links marketing actions to outcomes in a more holistic way. We shall describe it briefly here, although it must be stressed that it is central to the issue of marketing metrics and marketing effectiveness.

First, however, let us destroy once and for all one of the great myths of measurement – marketing return on investment. This implies ‘return’ divided by ‘investment’ and, for marketing expenditure such as promotional spend, it is an intellectually puerile notion. It’s a bit like demanding a financial justification for the wings of an aircraft! Also, as McGovern et al.<sup>9</sup> say:

Measuring marketing performance isn't like measuring factory output – a fact that many non-marketing executives don't grasp. In the controlled environment of a manufacturing plant, it's simple to account for what goes in one end and what comes out the other and then determine productivity.

But the output of marketing can be measured only long after it has left the plant.

Neither is the budget and all the energy employed in measuring it a proxy for measuring marketing effectiveness, a point we emphasized in great detail in Chapter 1.

In Figure 13.3, reading from right to left, it can be seen that the corporate financial objectives can only be met by selling something to someone – represented in the figure as the Ansoff Matrix (yellow box).

So how do we set about linking our marketing activities to our overall objectives? We will start with the Ansoff Matrix shown in Figure 13.4.

Each of the cells in each box (cells will consist of products for segments) are planning units, in the sense that objectives will be set for each for volume, value and profit for the first year of the strategic plan.

For each of the products-for-segment cells, having set objectives, the task is then to determine strategies for achieving them. The starting point for these strategies is critical success factors (CSFs), the factors critical to success in each product for segment, which will be weighted according to their relative importance to the customers in the segment. See Figure 13.5.

In these terms, a strategy will involve improving one or more CSF scores in one or more product-for-segment cells. It is unlikely, though, that the marketing function will be directly responsible for what needs to be done to improve a CSF. For example, issues like product efficacy, after-sales service, channel management and sometimes even price and the sales force are often controlled by other functions, so marketing needs to get buy-in from these functions to improve the CSF scores.

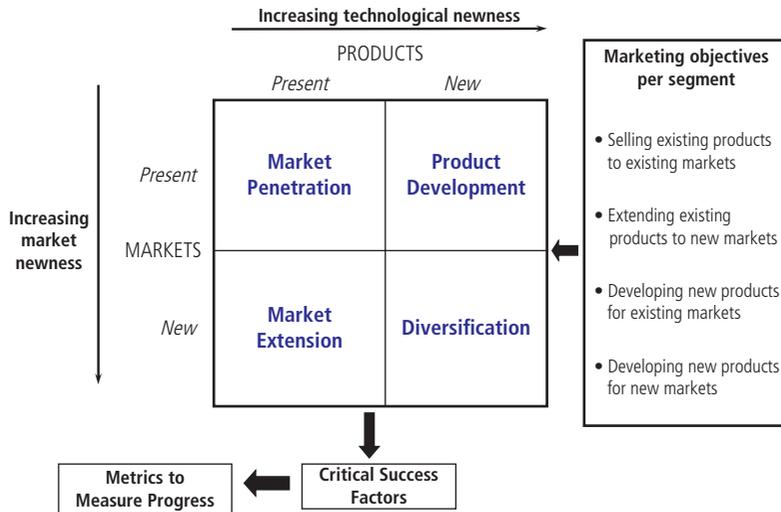


Figure 13.4: Ansoff matrix.

Critical success factors	Weighting factor	Your organization	Competitor A	Competitor B	Competitor C
CSF 1					
CSF 2					
CSF 3					
CSF 4					
Total weighted score (score x weight)	100				

• Strategies to improve competitive position/achieve objectives over time (4Ps)  
 • Metrics (each CSF) to measure performance over time in achieving goals

Figure 13.5: CSFs: in each segment, defined by the segment.

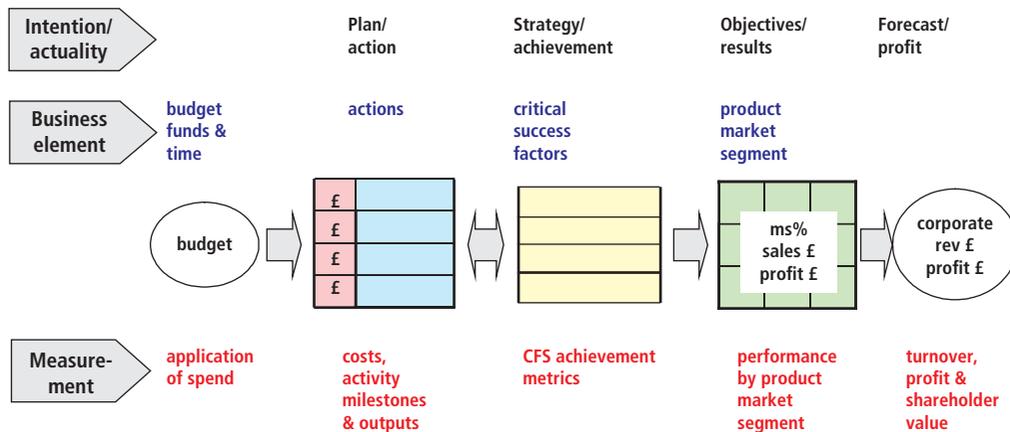


Figure 13.6: Marketing metrics model.

It is very rare for this information to be perfectly available to the marketer. While models such as price sensitivity, advertising response or even marketing mix or econometric approaches may help to populate the CSF form, there are generally several other factors where information is less easy to gather. Nevertheless, a CSF analysis indicates where metrics are most needed, which can steer the organization towards measuring the right things.

Figure 13.6 shows the actions that have to be taken, by whom and at what cost in order to improve the CSFs.

Figure 13.7 shows how these actions multiply for each box of the Ansoff Matrix.

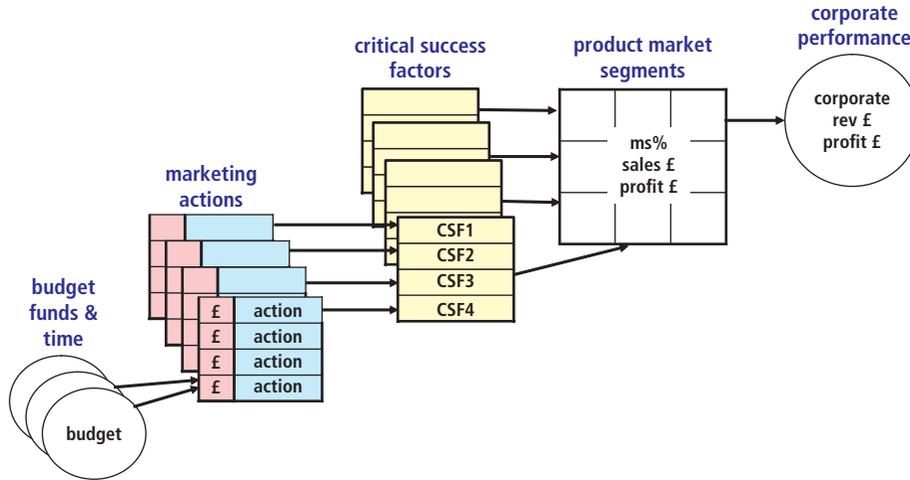


Figure 13.7: Cascading actions from the Ansoff matrix.

There are other factors, of course, that influence what is sold and to whom. These may be referred to as 'Hygiene Factors' (HFs) – that is, those standards that must be achieved by any competitor in the market. Other factors may be referred to as 'Productivity Factors' (PFs) – that is, those issues which may impact on an organization's performance unless the required productivity is achieved in its relevant activities.

Thus, it can be seen how the expenditure on marketing and other functional actions to improve CSFs can be linked to marketing objectives and, ultimately, to profitability, and it becomes clear exactly what must be measured and why. It also obviates the absurd assumption that a particular marketing action can be linked directly to profitability. It can only be linked to other weighted CSFs which, if improved, should lead to the achievement of volumes, value and, ultimately, profits.

Figure 13.3 is repeated here as Figure 13.8, as it summarizes all of this in one flow chart, which clearly spells out the difference between 'lag indicators' and 'lead indicators'. Lead indicators are the actions taken and the associated expenditure that is incurred. These include, of course, promotional expenditure, which will be addressed later in this chapter. Lag indicators are the *outcomes* of these actions and expenditures and need to be carefully monitored and measured. Thus, retention by segment, loss by segment, new customers, new product sales, channel performance and the like are *outcomes*, but these need to be linked back to the appropriate *inputs*, an issue which is addressed later in this chapter.

There is one other crucial implication to be drawn from this model. Most operating boards on scrutinizing profit and loss accounts typically see only one line for revenue, while costs are covered in considerable detail and it's around costs that most of the discussion takes place. In the view of the authors, there should be at least two sets of figures – one to detail where the sales revenue has come from, as outlined above, another to detail costs. A key task of marketers, rarely carried out, is to link the two documents together. Figure 13.3 goes some way towards this.

We stress, however, that the corporate revenue and profits shown in the right of Figures 13.3, 13.6 and 13.7 are not the same as shareholder value added, which takes account of the risks involved in the strategies, the time value of money and the cost of capital. This brings us to Level 3.

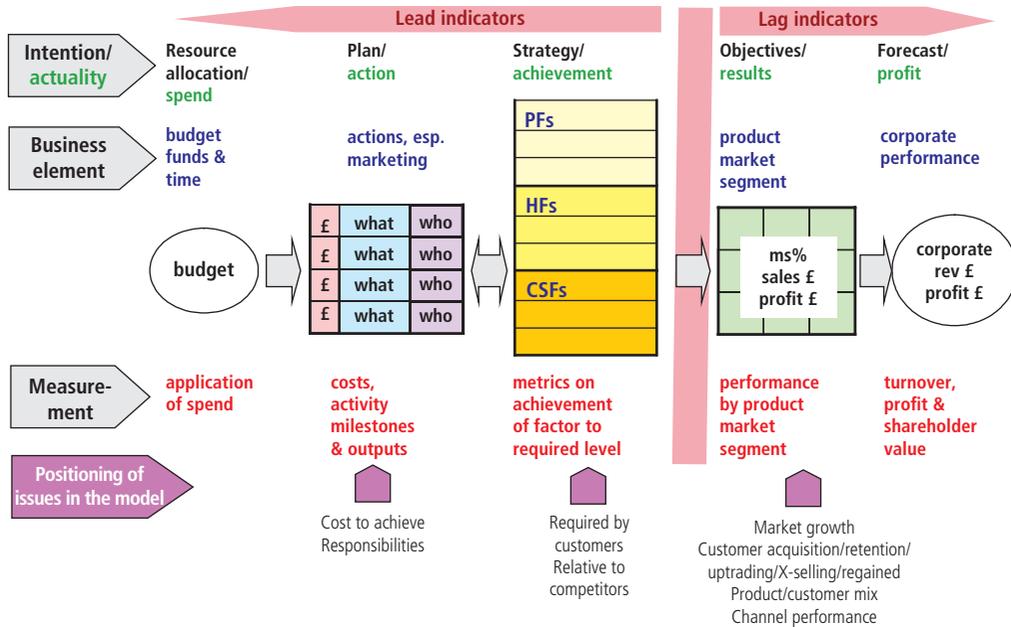


Figure 13.8: Overall marketing metrics model.

### Level 3: Promotional Effectiveness

Level 3 is the fundamental and crucial level of promotional measurement.

It would be surprising if marketing as a discipline did not have its own quantitative models for the massive expenditure of fmcg companies. Over time, these models have been transferred to business-to-business and service companies, with the result that, today, any organization spending substantial sums of shareholders' money on promotion should be ashamed of themselves if those responsible could not account for the effectiveness of such expenditure.

Nonetheless, with the advent of different promotional methods and channels, combined with an empowered and more sophisticated consumer, the problems of measuring promotional effectiveness have increased considerably. Consequently, this remains one of the major challenges facing the marketing community today.

For example, in fast-moving consumer goods, supermarket buyers expect and demand a threshold level of promotional expenditure in order to be considered for listing. Indeed in most commercial situations, there is a threshold level of expenditure that has to be made in order just to maintain the status quo – that is, keep up the product or service in consumer consciousness to encourage them to continue buying. The authors refer to this as 'maintenance' expenditure.

In most situations, however, not to maintain existing levels of promotion over time results in volume, price and margin pressure, market share losses and a subsequent declining share price.

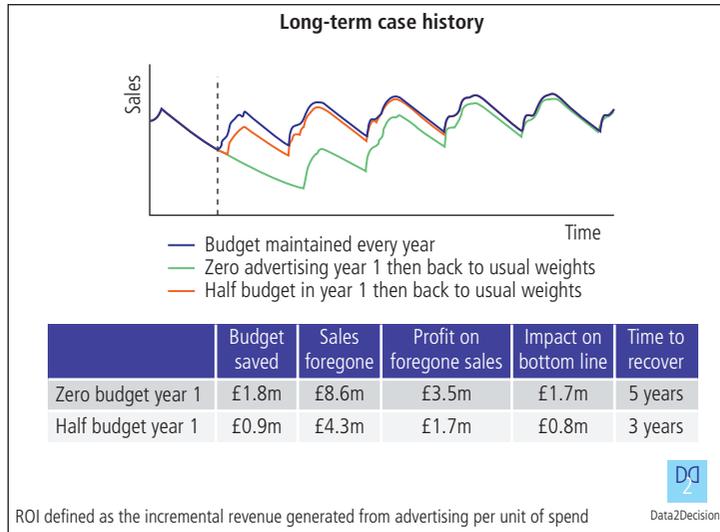


Figure 13.9: ROI – long-term case history.

There is some evidence from the IPA's analysis of almost 900 promotional campaigns, presented in a report.<sup>10</sup> The graph in Figure 13.9 shows that, in one experimental scenario, the promotional budget was cut to zero for a year, then returned to normal, while in another, the budget was cut by 50 per cent. Sales recovery to pre-cut levels took five years and three years respectively, with cumulative negative impacts on net profits of £1.7 million and £0.8 million.

It is important to make one final point about measuring the effectiveness of promotional expenditure in taking account of 'maintenance' expenditure. This point relates to the tried and tested method of measuring the financial impact of promotional expenditure – net present value (NPV).

As can be seen from the following, by not taking account of the expenditure to maintain current sales and by including total promotional expenditure in the NPV calculations, a totally false result ensues. However, by taking account of maintenance expenditure, a much better result emerges.

### Present values

Discounting a future stream of revenue into a 'present value' assumes that a rational investor would be indifferent to having a dollar today, or to receiving in some future year a dollar plus the interest that could have been earned by investing that dollar for those years.

Thus it makes sense to assess investments by dividing the money to be received in future years by  $(1 + r)$ , where  $r$  is the discount rate (the annual return from investing that money) and  $n$  is the number of years during which the investment could be earning that return.

PV, or NPV or DCF, is denoted as:

$$PV = \frac{\sum C_t}{(1 + r)^n}$$

where  $\Sigma$  is the sum of the cash flows in years  $t$  (1, 2, 3, 4, etc.).

This summation of the cash flows is then divided by  $(1 + r)^n$  where  $r$  is the discount rate and  $n$  is the number of years the investment could be earning that return.

Hence, for a net-free cash flow of \$2 million a year over four years and a cost of capital of 10 per cent, the net present value is:

$$\frac{2}{(1.1)} + \frac{2}{(1.1)^2} + \frac{2}{(1.1)^3} + \frac{2}{(1.1)^4} = \$6.4 \text{ million}$$

Minus an initial investment of, say, \$5 million, the NPV of this investment is \$1.4 million.

However, a promotional investment of, say, \$7 million, using the above figure, would produce a loss of \$0.6 million. If, however, a company needs to spend, say, \$6 million just to maintain current sales, the investment is only \$1 million and the NPV would then be:

$$-\$1 \text{ million} + \frac{2}{(1.1)} + \frac{2}{(1.1)^2} + \frac{2}{(1.1)^3} + \frac{2}{(1.1)^4} = \$5.4 \text{ million}$$

The research issue facing our community is how to estimate what might be classified as ‘maintenance’ promotion and what as ‘investment’ promotion. This is complicated by the different forms of promotion and the many different channels available today, but it is not impossible.

## APPLICATION QUESTIONS

Having provided some insights into marketing accountability, it should make it slightly easier to answer the following questions:

- What needs measuring?
- Why?
- When?
- How?
- How frequently?
- By whom?
- Reported to whom?
- At what cost?
- Etc.

It is suggested that the following also need to be explored:

1. What counts as marketing expenditure?
2. What does ‘added value’ really mean?
  - value chain analysis
  - shareholder value added (SVA)
  - customer value
  - brand value
  - accounting value
  - value-based marketing.
3. What are the major ‘schools of thought’? What are the strengths and weaknesses of each?
4. Preliminary conclusions from the above with our own recommendations/hypotheses.
5. Some small-scale field work to test findings on world-class companies.

The metrics below show a summary of some of the more common metrics that are in use in companies today:

- brand awareness
- channel efficiency
- cost per lead
- customer satisfaction
- growth in customers
- lead conversion rate
- orders: number average, total value
- repurchase rate
- share of customer
- total marketing cost per order.

Whatever models emerge from the above, it is highly unlikely that any organization will be using them all. There will be examples of excellence along a number of dimensions, which will help us to refine and develop the models.

## CHAPTER 13 REVIEW

The chapter outlined a number of marketing investment appraisal techniques, starting with a discussion of what counts as marketing expenditure.

It continued by describing three levels of marketing measurement:

1. *Marketing due diligence.* Marketing due diligence assesses the risks associated with the three main components of strategic marketing plans: the market; the marketing strategy; and the profit pool. The forecast net-free cash flows for the planning period are reduced if appropriate by the probability that they can be achieved. The accountant will then take account of the cost of capital to assess whether these risk-adjusted net-free cash flows will create or destroy shareholder value.
2. *Marketing spend evaluation.* The model provided a framework for linking principal products for market (the Ansoff Matrix) to critical success factors, productivity factors and hygiene factors. These are then translated into actions, with costs and responsibilities associated with each action.
3. *Promotional spend evaluation.* Here, the difference between maintenance and investment expenditure was explained and examples provided, which illustrated the very different net present value outcomes based on maintenance and investment expenditure.

### ***Questions raised for the company***

Ask the marketing team to attempt to answer the following questions:

1. What needs measuring?
2. Why?
3. When?
4. How?
5. By whom?
6. How frequently?
7. Reported to whom?
8. At what cost?

## EXERCISES

For this difficult topic, the authors suggest two main exercises.

### Exercise 13.1 Valuing key market segments

Get a team together and go through the following repeat of Figure 13.2. Just follow the directions and take your time over it.

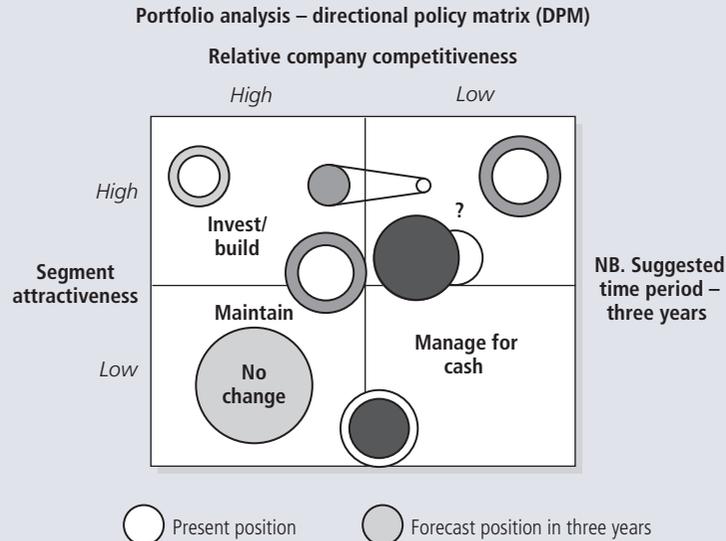
#### Background/Facts

- Risk and return are positively correlated, i.e. as risk increases, investors require a higher return.
- Risk is measured by the volatility in returns, i.e. high risk is the likelihood of either making a very good return or losing all your money. This can be described as the quality of returns.
- All assets are defined as having future value to the organization. Hence assets to be valued include not only tangible assets like plant and machinery, but intangible assets, such as key market segments.
- The present value of future cash flows is the most acceptable method to value assets including key market segments.
- The present value is increased by:
  - increasing the future cash flows
  - making the future cash flows ‘happen’ earlier
  - reducing the risk in these cash flows, i.e. improving the certainty of these cash flows, and, hence, reducing the required rate of return.

#### Suggested Approach

- Identify your key market segments. It is helpful if they can be classified on a vertical axis (a kind of thermometer) according to their attractiveness to your company. ‘Attractiveness’ usually means the potential of each for growth in your profits over a period of between three and five years. (See the attached matrix)
- Based on your current experience and planning horizon that you are confident with, make a projection of future net-free cash in-flows from your segments. It is normal to select a period such as three or five years.
- These calculations will consist of three parts:
  - revenue forecasts for each year
  - cost forecasts for each year
  - net-free cash flow for each segment for each year.
- Identify the key factors that are likely to either increase or decrease these future cash flows.
- These factors are likely to be assessed according to the following factors:
  - the riskiness of the product/market segment relative to its position on the ANSOFF matrix
  - the riskiness of the marketing strategies to achieve the revenue and market share
  - the riskiness of the forecast profitability (e.g. the cost forecast accuracy).
- Now recalculate the revenues, costs and net-free cash flows for each year, having adjusted the figures using the risks (probabilities) from the above.
- Ask your accountant to provide you with the overall SBU cost of capital and capital used in the SBU. This will not consist only of tangible assets. Thus, £1,000,000 capital at a required shareholder rate of return of 10 per cent would give £100,000 as the minimum return necessary.
- Deduct the proportional cost of capital from the free cash flow for each segment for each year.
- An aggregate positive net present value indicates that you are creating shareholder value – i.e. achieving overall returns greater than the weighted average cost of capital, having taken into account the risk associated with future cash flows.

*(Continued)*



### Exercise 13.2 Workshops

This exercise involves a number of workshops, as follows.

#### Workshop 1

This workshop has two objectives. The first is to identify those current corporate-level metrics that might be expected to be influenced by marketing activity, and the second is to develop a set of metrics for the key segments in the organization's market.

#### **Corporate metrics**

Those likely to be influenced by marketing activity might include measures such as gross sales, market share, gross margin, loyalty (e.g. net promoter score), customer satisfaction, brand equity/image, and so on. The reporting might be at total market or by key market segments. These metrics might be included within the customer section of a standard four business perspective balanced scorecard model. The discussion should also lead to possible gaps in the current measures being identified. As the model is designed to help meet medium-term targets, the corporate level goals for the current year and each of the measures over the following three years need to be identified. At this stage in the process, the key objective is simply to list the current metrics and the targets set for them over this three-year period. This list needs to be revisited at the end of the process to see if any other metrics should be recommended at board level, and to ascertain whether the application of the model has identified links between the actions proposed and the corporate measures (the blue arrows in the model).

#### **Market segment metrics**

As described earlier, the model process is segment based. As explained in Chapter 4, most markets can be divided into a number of key, differentiated, segments, a process that enables the organization to focus its resources more effectively. However, to apply

the model to all segments in one go would be overly complex. Therefore, organizations applying the model are advised to start by focusing on two segments in the initial application in order to gain a detailed, and manageable, understanding of the overall process, and then repeat it for remaining segments over time. In most situations, organizations don't try to cover an entire market. The objective of segmentation is to identify those segments likely to be most attractive when consumer needs/profiles are matched to the capabilities and goals of the organization. This means that once an organization has analysed the market and divided it into segments, using the methodology described in Chapter 4, a few key segments will be the focus of future attention, perhaps at the expense of others that the organization decides are no longer of prime interest. So, the second objective of the first workshop is to focus on two market segments and identify the metrics that are critical first to tracking the segment in the market over time, and second to measuring the performance of the organization against the goals set for each segment. It is recommended that the selected segments for the first application of the model are those likely to be of most value to the future success of the organization. Selected initial segments could be of three types:

- One that is currently delivering a high level of value, and is forecast to continue to do so.
- One that is identified as currently delivering poor returns but is considered as offering high future potential.
- One that the organization considers has potential but an appropriate strategy to deliver value has yet to be identified.

### **Workshop 2**

Once the segments have been identified and a full analysis of the two selected segments has been undertaken, the next step is to ensure that the strategies for achieving the goals defined in the marketing plan are appropriate, and that the key metrics necessary to track performance towards achieving these goals have been identified. The focus in the second workshop is on how to use an impact factor analysis to help develop effective strategies for each segment, and identify the metrics necessary to track performance of the strategy.

### **Workshop 3**

Once the strategy for each segment has been confirmed, and the necessary metric set identified using the impact factor analysis framework described earlier in this chapter, the next steps, covered in the third workshop are:

- Identify the actions necessary to deliver the strategy. Some of these actions might be under the control of marketing (e.g. develop and implement a specific direct marketing campaign), but others may be within the responsibilities of other departments (e.g. improve customer satisfaction either through changes in the logistics chain or revised call centre goals).
- Agree the budgets necessary to fund the agreed actions.

*(Continued)*

- Estimate the likely impact of these actions, in financial terms, and identify those actions that are forecast to give a disproportionately high return on investment – i.e. those with a high ‘gearing’.
- Identify and agree the appropriate metrics to track the actions, budget funding and impact in achieving goals.

### **Workshop 4**

The objective of the final workshop is to finalize the list of metrics and develop an outline plan for implementing the agreed measurement strategy. For example: Who will be exposed to different metrics? Who will be responsible for collecting the data and producing the metrics? Who is responsible for corrective action if a metric indicates that performance is below target?

### **The workshop team**

The implementation of the model process within the workshops is through a team of appropriate individuals drawn from relevant functions across the organization. Therefore, identifying the key members of this team and whether or not an independent facilitator or appointing one of the team to lead the discussions are vitally important to the success of the process. Having the most appropriate participants is vital to the success of the process. ‘Success’ is not just in terms of developing a set of metrics, it is also about agreeing an implementation strategy, which in turn relies on the organization having ‘bought into’ the process and sees the value to be gained in achieving the organization’s goals by implementing the recommendations from the workshops. This is particularly important at board level.

Experience gained in the pilot applications suggests that, for the workshops to be effective, this team needs to be kept small – but it is vital that its members are individuals who can play key roles in the marketing, financial and planning processes within the organization. It is also important that the members are sufficiently empowered by senior management to develop a strategy that stands a fair chance of being implemented.

The workshop team should comprise no more than six to eight members. It is suggested that key team members are the:

- market research manager
- corporate planning manager
- corporate finance manager
- customer database manager
- market planning manager
- finance manager (with responsibility for marketing)

- marketing communications/advertising manager
- senior marketing manager (acting as champion of the process)
- customer service (or operations) manager
- brand, product or customer segment manager.

Obviously, good facilitation will be essential to success. What do we mean by 'good facilitation'? The main criteria are: all participants are adequately briefed at the outset; the workshops are run objectively; goals are clearly defined; discussions remain focused on the themes and objectives described for each workshop, as described earlier in this chapter; all members are treated as equal participants; evidence provided by members is discussed and approved by the whole team; opinions are challenged; the principles of effective brainstorming are adhered to; the conclusions from each stage are clearly summarized; and actions/tasks are clearly identified at the end of each workshop and allocated to the appropriate members of the team.

In addition to developing a marketing metrics strategy appropriate for the organization, a further key role of the team is to identify responsibility within the strategy for:

- Collecting the data to ensure the metrics can be defined.
- Undertaking the measures.
- Taking action if the metrics show that performance is not on target.

Team members are also responsible for subsequently reviewing and, if possible, testing the agreed metrics identified in each workshop. This includes identifying whether the data necessary for developing the agreed metrics are currently available, and if not, to assess whether this might be possible in the future.

### **Exercise 13.3 Simulation practice**

In your game:

- a) What is the greatest risk to your company's Marketing Plan: is it market risk, strategy risk or implementation risk? Agree the key actions needed to mitigate the underlying risks.
- b) What are the CSFs for your company? To deduce these, you should use the Ansoff matrix and the SWOT analysis in the Marketing Plan and include your team performance in the scope of thinking
- c) What metrics should you use to measure the effectiveness of your marketing planning?
- d) Which of these are lag indicators and which are lead indicators?
- e) If enabled in your game, take a look at your NPV calculation in the Cash Flow Forecast. How has this changed over the course of the game and what does it say about the value of your strategy?

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