A brief review of marketing accountability, and a research agenda

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Abstract

Purpose – This paper aims to review previous work in the domain of marketing accountability, an issue which has become of increasing concern to chief executive and financial officers. It principal purpose is to attempt an elementary epistemology, with a view to setting a research agenda for scholars in finance, microeconomics or marketing.

Design/methodology/approach – The paper consists of a relatively catholic literature review of the domain of marketing accountability, exploring its antecedents in related domains such as strategy and finance and then proposing a research agenda.

Findings – Much confusion exists in the literature about the dimensions of marketing accountability. This review specifies a researchable model of the domain of marketing and proposes three related areas – the micro-promotional level, the strategic level and the financial, shareholder value added level and suggests an agenda for research for scholars.

Research limitations/implications – Because of the enormous breadth of the related domains of strategy and finance, the author had to adopt a somewhat normative approach based on his own research outputs in order to make the literature review manageable. While the proposed research agenda is justified by the foregoing review, it is recognised that other models may well be possible.

Practical implications – There is a growing body of evidence, amounting to what might be described as a "clamour" from the world of practice for more structure and guidance in the relatively under-researched domain of marketing accountability. This paper attempts to meet this challenge.

Originality/value – Much of the research emanating from the Cranfield Research Clubs is original, such as, for example, the model for marketing due diligence described in the paper.

Keywords Management accountability, Due diligence, Measurement, Shareholder value analysis, Marketing

Paper type Conceptual paper

Introduction

The author of this short paper was invited to deliver a keynote address at the Academy of Marketing's B2B Special Interest Group at De Montfort University in December 2007. In that address, he reviewed the failure of the three principal communities in marketing – practitioners, consultants and academics – to establish marketing as a respected discipline. (For a fully referenced critique of these communities, see McDonald, 2004)

Rather than rehearsing these criticisms here, the author will concentrate on one important aspect of the future of marketing in B2B organisations, where marketing as a function is less established than in fast moving consumer goods companies.

Marketing accountability is the one issue above all others that has been rising to the top of the agenda and the Deloitte (2008) report which focussed on the views of CEOs and CFOs, is merely the culmination of the growing calls for greater accountability from the marketing community. Here are just a few of the quotations from CEOs from this report.

> Like other departments, Marketing always requests more budgets from me, but without the metrics in place to demonstrate the impact marketing has in financial terms to our external stakeholders.
>
> Our focus must be to develop a standard set of auditable metrics that both the Marketing Director and I understand. Without these, Marketing should realise that I will continue to challenge their budgets. Also, until I'm confident that marketing metrics, both financial and non-financial, will accurately reflect our business, I will not be accountable for including these in my reporting to the investors and the City.
>
> I do support the idea that marketing is the engine of growth in the business but I need the Marketing department to adopt a more rigorous, quantitative approach for me to be 100% behind them.
>
> Marketing has a tendency to be more activity based – focusing on the number of campaigns it runs or how many people it needs to employ, rather than justifying the impact of marketing on the bottom-line and cash flow. One of the reasons for this attitude is the relative lack of hard measurement that demonstrates the contribution of Marketing to revenue and corporate strategy.
>
> Why is it that brand equity measurement is performed as an integral part of due diligence when a company is bought and sold but not always included as part of annual reporting?
>
> Undoubtedly, my biggest issue is marketing measurement. I understand that this is what's required now but it's not always as straight forward as looking for an uplift in sales.

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> Reporting to investors and the City is, of course, high on my agenda. Brand equity is the most important and most valuable asset in my business. You can take all my other assets so long as you leave me with that one! Recognising the value of intangible assets of brand and goodwill, I mandate Finance and Marketing to work in tandem to agree realistic and robust reporting measurements.
>
> My organisation has, until recently, worked on measuring marketing spend and determining the effectiveness of it, but we are now looking at how to measure these intangibles. It is my job to accurately account for this business and its success – and marketing measurements definitely have a role to play. My key issue is that I don't have a framework in place for this yet.
>
> Marketing have constantly hidden behind a fog of measures that are based purely on tactical marketing activity, rather than solid financial metrics that are relevant to the City.
>
> - The focus on marketing measures is intensifying.
> - There is still no consistent view on how to measure and report marketing success.
> - Expect to see a stronger focus on brand and customer equity.
> - Marketing performance metrics need to be shared across the executive management team and aligned with corporate strategy.
> - The communication of marketing effectiveness measures will continue to grow.
> - There is a greater expectation for marketing measures to cover both short-term and long-term goals.

Marketing

One major stumbling block to agreeing metrics is the cacophony of definitions of marketing that exists. It does not help when one of CIM's ex Presidents, Diane Thompson declared: "Marketing isn't a function. It is an attitude of mind". Many will wonder how an attitude of mind can be measured, researched, developed, protected, examined, etc. Of course she was correct in one sense, because marketing as a function can never be effective in any organization that does not put the customer at the core of its operations. Add to this the hundreds of different definitions of marketing to be found in books and papers on marketing and the confusion is complete. A selection of 30 such definitions are to be found in McDonald's 6th edition of *Marketing Plans*, most of which involve doing things to customers (McDonald, 2007).

While definitions such as CIM's are admirable and correct, they provide little guidance on what should be included and excluded, with the result that they are difficult to use for a research exercise on what should be measured in marketing. Therefore, let us be unequivocal about marketing. Just like finance, or HR, or IT, it is a function, a specific business activity that fulfils a fundamental business purpose. The following describes marketing in terms of what it actually entails (McDonald, 2007).

Marketing is a process for:

- Defining markets in terms of needs.
- Quantifying the needs of the customer groups (segments) within these markets.
- Putting together the value propositions to meet these needs and communicating these value propositions to all those people in the organisation responsible for delivering them.
- Playing an appropriate part in delivering these value propositions (usually only communications).
- Monitoring the value actually delivered.
- For this process to be effective, organisations need to be consumer/customer-driven.

This consolidated summary of the marketing process is shown diagrammatically in Figure 1.

The map of the process in Figure 1 works to simplify what is a complex process into a series of manageable steps. It provides a practical framework for understanding and tackling the multitude of issues that comprise marketing, leading to sustainable competitive advantage, but in particular, it helps to determine the parameters of measurement and accountability.

Steps 1 and 2 are about strategy determination, while steps 3 and 4 are about tactical implementation and measurement. It is these latter two that have come to represent marketing as a function, which is still principally seen as sales support and promotion.

We have used the term "Determine value proposition", to make plain that we are here referring to the decision-making process of deciding what the offering to the customer is to be – what value the customer will receive and what value (typically the purchase price and on-going revenues) the organisation will receive in return. The process of delivering this value, such as by making and delivering a physical product or by delivering a service, is covered by "Deliver value proposition".

It is well known that not all of these marketing activities will be under the control of the marketing department, whose role varies considerably between organisations. The marketing department should be in charge of the first two sub processes, "define markets and customer value" and "determine value proposition", although even these need to involve numerous functions, albeit co-ordinated by specialist marketing personnel. However, responsibility for delivering value is the shared domain of the whole company, requiring cross-functional expertise and collaboration. It will include, for example, product development, manufacturing, purchasing, sales promotion, direct mail, distribution, sales and customer service.

The marketing process is clearly cyclical, in that monitoring the value delivered will update the organisation's understanding of the value that is required by its customers. The cycle may be predominantly an annual one, with a marketing plan documenting the output from steps 1 and 2, but equally changes throughout the year may involve fast iterations around the cycle to respond to particular opportunities or problems.

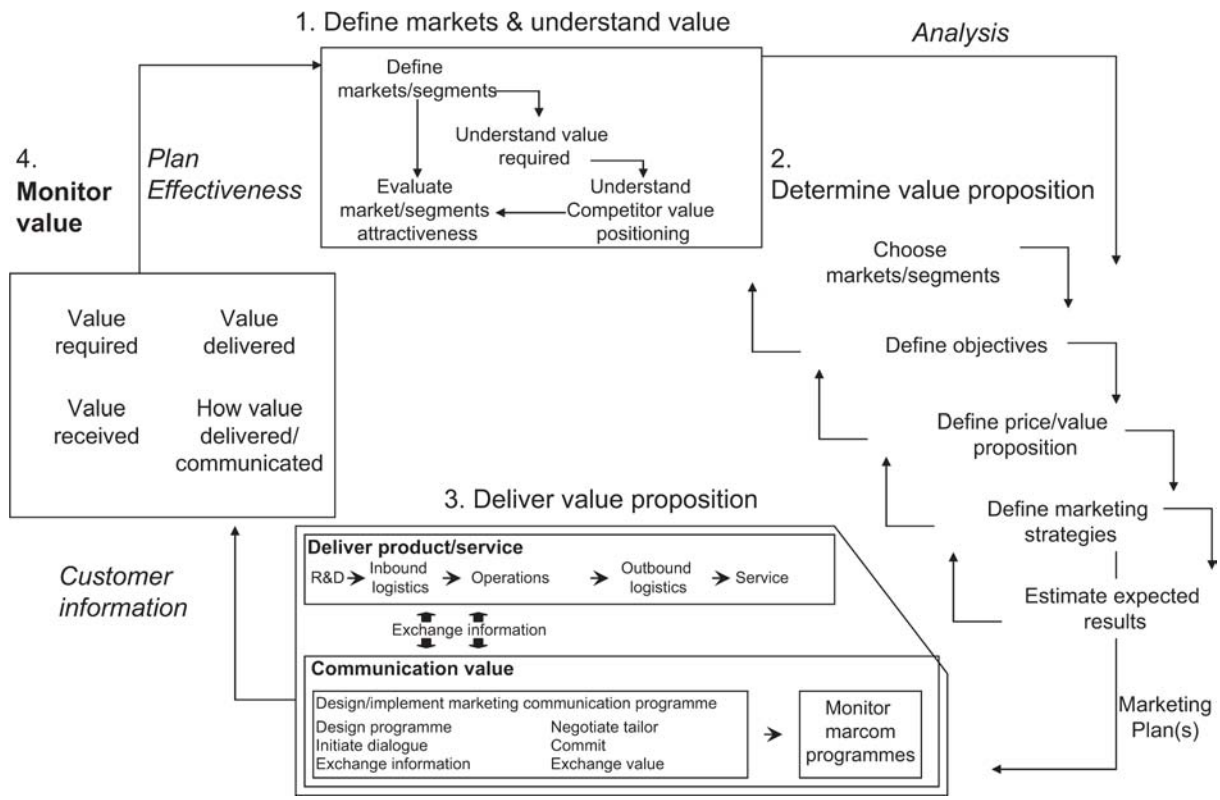
The various choices made during this marketing process are constrained and informed not only by external factors in the marketing environment, but also by the organisation's asset base. Whereas an efficient new factory with much spare capacity might underpin a growth strategy in a particular market, a factory running at full capacity might consider whether price should be used to control demand, unless the potential demand warranted further capital investment. Choices may be influenced by physical assets and/or the less tangible but substantial value afforded by the organisation's people, brands, financial status and information technology.

The author makes a plea here that rather than arguing incessantly about a suitable definition of marketing, we at least take this one as a starting point, for as will be shown below, at least three levels of accountability can be attached to this map of the process.

Three distinct levels for measuring marketing effectiveness

The above definition of marketing as a function for strategy development as well as for tactical sales delivery, can be used

Figure 1 Summary of marketing map



to clarify the whole problem of how to measure marketing effectiveness.

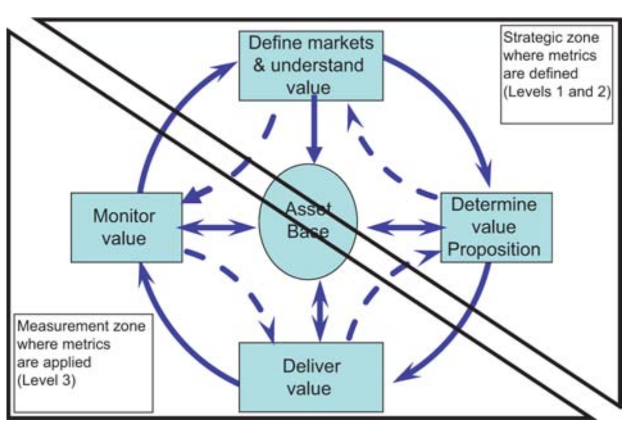
The map given above is summarised here in Figure 2.

From this map, it can be seen that there are three levels of measurement, or metrics.

Level 1: shareholder value added

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, having taken account of the risks of declared future strategies the time value of money and the cost of capital. This was the topic of research over a number of years by Professors McDonald and Shaw at Cranfield and the methodology for measurement is explained in detail in McDonald *et al.* (2006). We will summarise this here.

Figure 2 Map of the marketing domain



Shareholder value added is created by managing assets strategically. The problem, however, is that most of these assets are not on the balance sheet, as they are intangible.

The growing importance of intangible assets

In 2006, Proctor and Gamble paid £31 billion for Gillette, of which only £4 billion was accounted for by tangible assets, as Table I shows (Haigh, 2006).

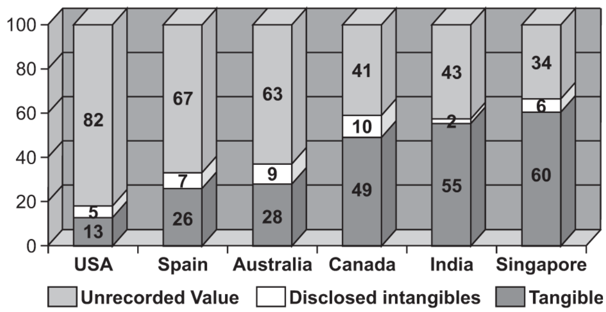
Recent estimates of companies in the USA and in the UK (Figure 3) show that over 80 per cent of the value of companies resides in intangibles. Yet very little is known about intangibles by shareholders and the investment community. Traditional accounting methods are biased towards tangible assets, for this is where the wealth used to reside.

The point is that, incongruously, most large companies have formally-constituted audit committees doing financial

Table I

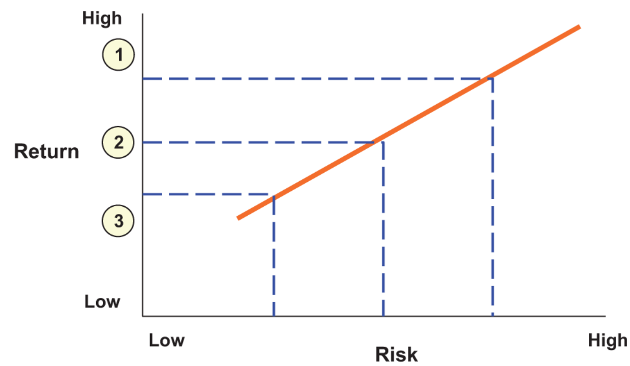
	£billion
Gillette Brand	4.0
Duracell Brand	2.5
Oral B	2.0
Braun	1.5
Retail and Supplier Network	10.0
Gillette Innovative Capability	7.0

Figure 3 Asset split across selected economies



© Brand Finance pic 2004
Source: Bloomberg

Figure 4 Financial risk and return



Source: Adapted from Ward, Cranfield School of Management

due diligence on major investments such as plant and machinery, using discounted cash flows, probability theory, real option analysis and the like, yet few have anything even remotely rigorous to evaluate the real value of the company – intangibles. There is a massive body of research over the past 50 years on how companies carry out strategic planning and much of it verifies that a lot of what passes for strategy amounts to little more than forecasting and budgeting, which are of little value to the investment community in estimating risk, with the result that they use their own methods and frequently downgrade the capital value of shares, even when the earnings per share have been raised and when forecasts appear to look good.

There are some basic concepts relating to risk and return and stock markets all over the world that are best explained here. A combination of high business and financial risk can be fatal. Although there were other factors at play, Sir Freddie Laker's airline in the 1970s involved a high financial gearing. He then chose to compete on the busy high risk London/North Atlantic route, employing a low price strategy. His high financial gearing/breakeven model subsequently left him open to tactical low price promotions from more global, established airlines such as British Airways. The result was financial disaster.

Compare this with Virgin's low financial risk entry in the same market, with a highly differentiated marketing strategy. Virgin is now an established and profitable international airline.

Figure 4 shows a typical stock exchange, with shares plotted against return and risk. From this it can be seen that a Beta is drawn (the diagonal line).

At the low end, investors do not mind a lower return for a low risk investment, while at the high end investors expect a high return for a high risk investment. At any point on the line (take the middle point for example), the point of intersection represents the minimum that any investor would be prepared to accept from an investment in this sector. This weighted average return on investment is referred to as the cost of capital. Any player in such a sector returning the weighted average cost of capital is neither creating nor destroying shareholder value. To return more is creating shareholder value. To return less is destroying shareholder value.

It is interesting to note, however, that the reason the capital value of shares is often marked down after a company has created shareholder value, is that the investment community does not believe that such a performance is sustainable. This is often because they have observed that the source of profit growth has been cost cutting, which is, of course, finite, whereas customer value creation is infinite and is only limited by a company's creativity and imagination.

A good example of this is a major British retailer in the mid 1990s, shown in Figure 5, from which it can be seen that, while underlying customer service was steadily declining, the share price was rising.

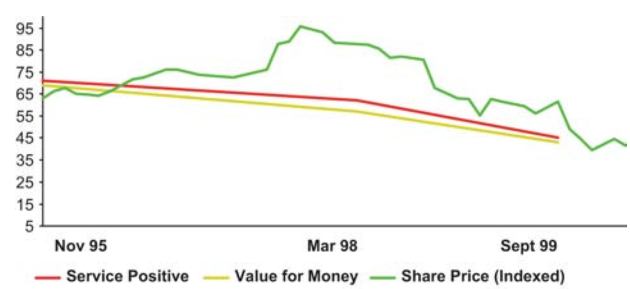
The inevitable almost terminal decline of this retailer was only reversed after a customer orientated Chief Executive began to focus again on creating value for consumers rather than boosting the share price by cost cutting. Shareholders in the meantime suffered almost a decade of poor returns

It is, of course, not as simplistic as this and those readers who would like a more detailed explanation of the technical aspects of stock market risk and return, together with the relevant financial formulae, are directed to chapter 3 of *Marketing Due Diligence: Reconnecting Strategy to Share Price* (McDonald *et al.*, 2006).

The marketing investment time lag and P&L

One of the major problems of marketing expenditure is that it takes time for the effects to manifest themselves in the market. This time lag often transcends the annual fiscal profit and loss account measurement. The reverse is true, of course, in that without additional market-based data in the boardroom, directors are often flying blind. When the financials tell them there is a problem, they have already missed the optimal point for taking appropriate corrective action. This can be seen from the data in Table II, from which it would appear that Intertech (a disguised name for confidentiality reasons) are doing extremely well.

Figure 5 A major UK retailer



Source: M&S Customers

Journal of Business & Industrial Marketing
Volume 25 · Number 5 · 2010 · 383–394

Table II Inter Tech's five year performance

Performance (£ million)	Base year	1	2	3	4	5
Sales revenue (£ m)	254	293	318	387	431	454
Cost of goods sold	135	152	167	201	224	236
Gross contribution (£ m)	119	141	151	186	207	218
Manufacturing overhead	48	58	63	82	90	95
Marketing and sales	18	23	24	26	27	28
Research and development	22	23	23	25	24	24
Net profit (£ m)	16	22	26	37	50	55
Return on sales (%)	6.3	7.5	8.2	9.6	11.6	12.1
Assets (£ m)	141	162	167	194	205	206
Assets (% of sales)	56	55	53	50	48	45
Return on assets (%)	11.3	13.5	15.6	19.1	24.4	26.7

A quick glance at Table III, however shows that most market indicators are negative. It is obvious that, when market conditions are less benign, this company will not last long.

In terms of accountability, all the above raises the issue of the value of profit and loss accounts in the boardroom. There is frequently only one line for revenue and dozens of lines for costs. The result frequently is that most of the discussion revolves around variances related to cost ratios. The point here is that there is a case for a more detailed breakdown of revenue and indeed there is a trend among some leading companies to appoint a "Director of Revenue Generation" in order to address this problem.

Shareholder value added

As we have seen, in capital markets, success is measured in terms of shareholder value added, having taken account of the risks associated with declared future strategies, the time value of money and the cost of capital.

The problem, however, as stated earlier, is that little is known about how to assess quantitatively whether a company's strategy will create or destroy shareholder value. It is to this topic that we now turn.

In his book *The Customer Information Wars*, Sean Kelly (2005) states:

> 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.

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 all know about 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 re-creating the brand, intellectual property or whatever is the basis of intangible assets. Our research into companies that succeed and fail suggests that approach is flawed, because what matters is not the assets companies have, 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. One of a company's primary tasks is to create shareholder value, and its share price reflects how well it is thought to be doing that. Whether or not company creates shareholder value depends on creating profits greater than might be obtained elsewhere at the same level of risk. The business plan makes promises about profits, which investors then discount against their estimate of the chance it will deliver. So it all comes down to that.

A board of directors might say that it will achieve £1bn, investors and analysts think it is more likely to be £0.8bn. The

Table III InterTech's five year market-based performance

Performance (£ million)	Base year (%)	1 (%)	2 (%)	3 (%)	4 (%)	5 (%)
Market revenue	18.3	23.4	17.6	34.4	24.0	17.9
InterTech sales growth	12.8	17.4	11.2	27.1	16.5	10.9
Market share	20.3	19.1	18.4	17.1	16.3	14.9
Customer retention	88.2	87.1	85.0	82.2	80.9	80.0
New customers	11.7	12.9	14.9	24.1	22.5	29.2
% dissatisfied customers	13.6	14.3	16.1	17.3	18.9	19.6
Relative product quality	+10	+8	+5	+3	+1	0
Relative service quality	+0	+0	−20	−3	−5	−8
Relative new roduct sales	+8	+8	+7	+5	+1	−4

Journal of Business & Industrial Marketing
Volume 25 · Number 5 · 2010 · 383–394

capital markets revolve around perceptions of risk. What boards and investors both need, therefore is a strategic management process that gives them a rigorous assessment of risk and uses that to assess and improve their shareholder value creation. One such a approach is known as marketing due diligence.

Where does risk come from?

Marketing due diligence begins by looking for the risk associated with a 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:

(1) The market was not as big as thought.
(2) The company did not get the market share it hoped for.
(3) The company did not get the profit it 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.

Research has 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 sub-divide business risk into as many sources as practically possible, estimate those separately and them 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 sub-divided further into five risk factors, making fifteen in all. These are summarised in Table IV.

Armed with this understanding of the components and sub-components 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 fifteen criteria and use them to evaluate the probability that our plan will deliver its promises.

Again, there are many technical aspects to how marketing due diligence is translated into a financial value, but essentially the formula is as follows:

$$\text{Probability} - \text{Adjusted cash flows}$$
$$- \text{Value of capital employed} \times \text{Required rate of return}$$
$$- \text{Potential loss from capital at risk}$$

Again, for more technically-minded readers a full and detailed explanation of how these calculations are made, see " Marketing due diligence", referred to above 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 company's strategies does provide a relative scale. By comparing, for instance, the evidence of a 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 a 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 used 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. If, on the other hand, 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.

Level 2: linking activities and attitudes to outcomes

There is another level, however, that few academics or practitioners have addressed 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, although as McGovern *et al.* 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 (McGovern *et al.*, 2004).

Journal of Business & Industrial Marketing
Volume 25 · Number 5 · 2010 · 383–394

Table IV Factors contributing to risk

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 homogenous 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 organisation 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

Neither is the budget and all the energy employed in measuring it a proxy for measuring marketing effectiveness. As Caulkin (2005) says:

> 90% of USA and European firms think budgets are cumbersome and unreliable, providing neither predictability nor control.
> - They are backward-looking and inflexible. Instead of focussing managers' time on the customers, the real source of income, they focus their attention on satisfying the boss, i.e. The budget becomes the purpose.
> - Cheating is endemic is all budget regimes. The result is fear, inefficiency, sub optimisation and waste.
> - In companies like Enron, the pressure to make the numbers was so great that managers didn't just doctor a few numbers, they broke the law.
> - People with targets and jobs dependent on meeting them will probably meet the targets, even if they have to destroy the enterprise to do it.

With this important warning, how do we set about linking our marketing activities to our overall objectives? A possible useful starting point is the Ansoff Matrix shown in Figure 6. Each of the cells in each box (cells will consists 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. All of these add up to the corporate revenue and profit objectives for the planning period.

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) – often referred to by different terms by different marketing academics and practitioners – 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.

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 the need to improve the CSF scores.

CFSs at least indicate where metrics are most needed.

There are other factors, of course, that influence what is sold and to whom. These may be referred to as "Hygiene factors" (HF) – i.e. those standards that must be achieved by any competitor in the market. Other factors may be referred to as "Productivity factors" (PF) – ie. those issues which may impact on an organisation'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 7 summarises 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. 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 paper.

We stress, however, that the corporate revenue and profits shown in the right of Figures 7, 8 and 9 are not the same as shareholder value added referred to in level 1.

Journal of Business & Industrial Marketing
Volume 25 · Number 5 · 2010 · 383–394

Figure 6 Ansoff matrix

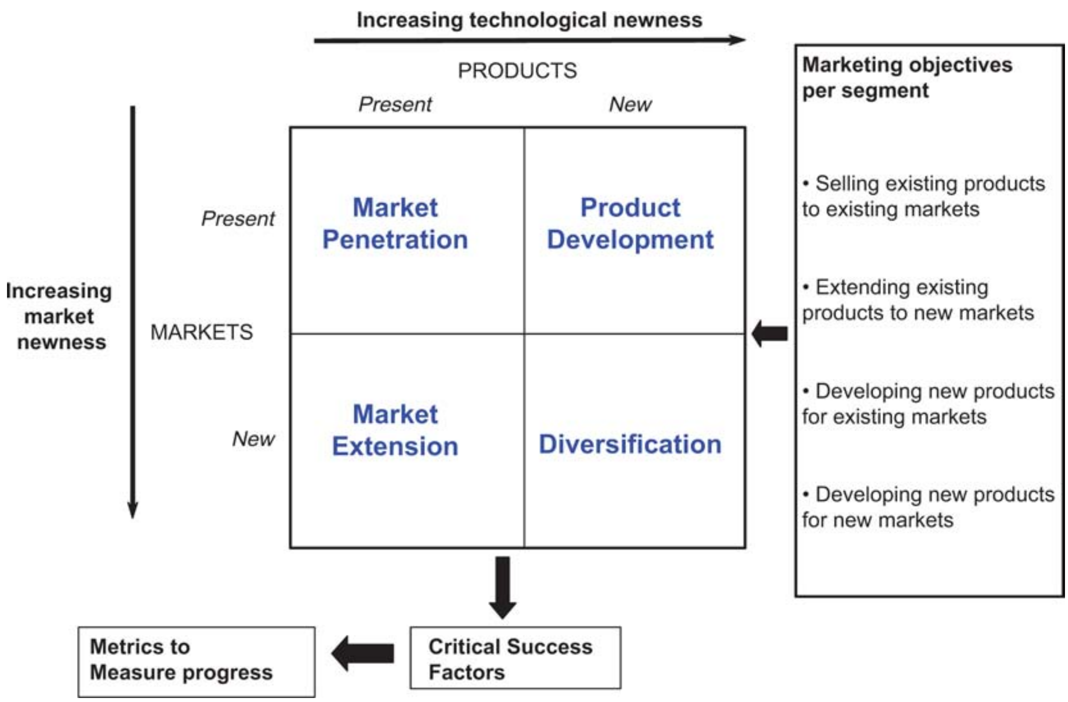
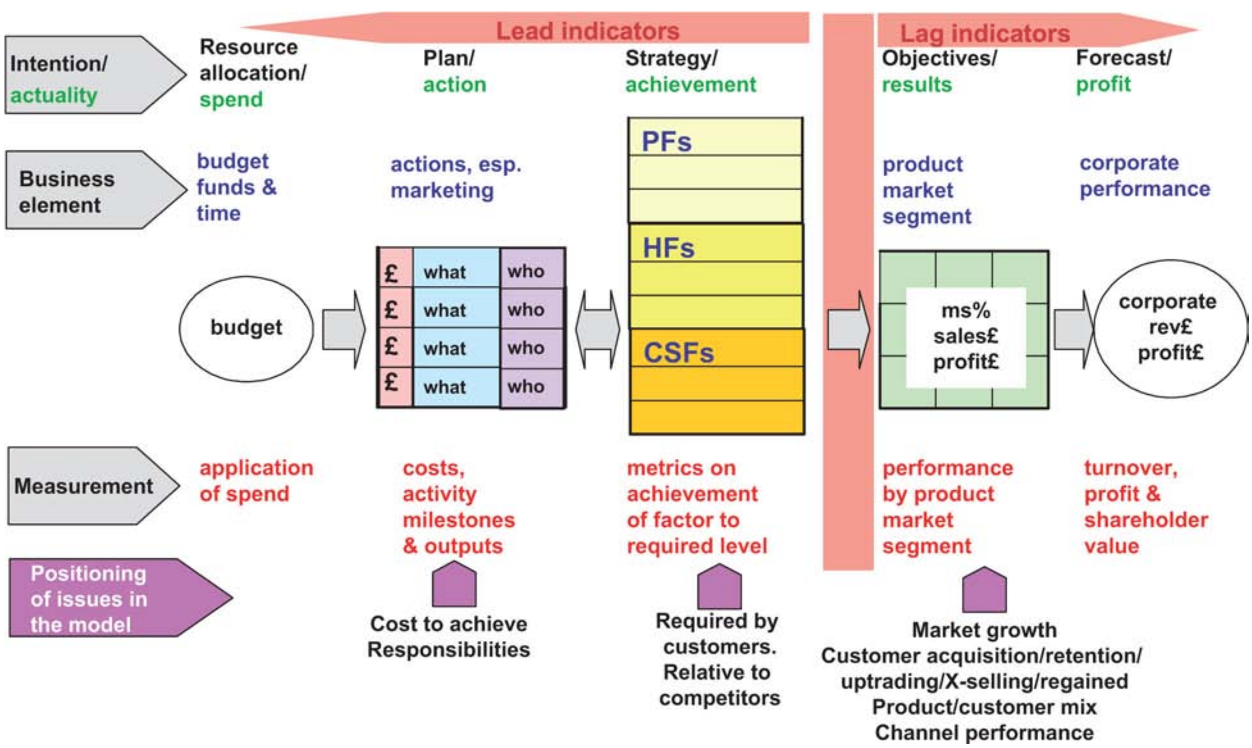


Figure 7 Overall marketing metrics model



Level 3: micro measurement

Level 3 is the fundamental and crucial level of micro 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 organisation spending substantial sums of shareholders' money on promotion should be ashamed of themselves if

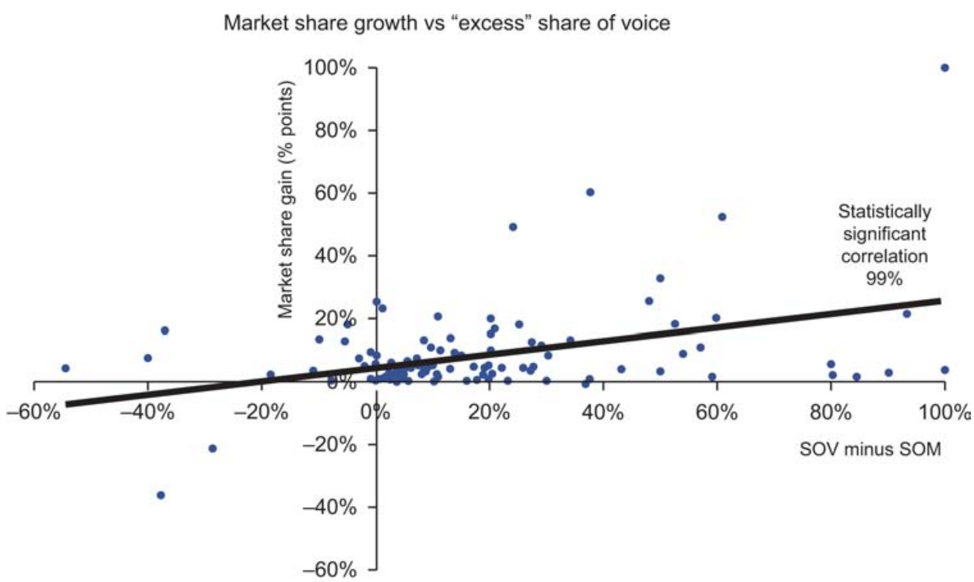
Journal of Business & Industrial Marketing
Volume 25 · Number 5 · 2010 · 383–394

Figure 8 Long term case history

	Budget saved	Sales foregone	Profit on foregone sales	Impact on bottom line	Time to recover
Zero budget year 1	£1.8m	£8.6m	£3.5m	£1.7m	5 years
Half budget year 1	£0.9m	£4.3m	£1.7m	£0.8m	3 years

Note: ROI defined as the incremental revenue generated from advertising per unit of spend

Figure 9 How SOV drives growth



Source: IPA DataBank (127 cases)

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.

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.

Nonetheless, CFOs continue to demand Net Present Value Calculations for promotional expenditure.

It appears that many executives, in evaluating the effectiveness of promotional expenditure such as advertising, compare the cash flow against a default situation of doing nothing. In other words, the present position and health of the company will persist indefinitely, even if the investment is not made. What should happen and for a better assessment of the investment's value, is that the comparison should be between the projected discounted cash flow and the more likely scenario of a decline in performance in the absence of the promotional investment.

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 – i.e. keep up the product or service in consumer consciousness to encourage them to continue buying. The author refers to this as "maintenance" expenditure.

Reverting to the issue of financial analysis and the method of discounting cash flow to calculate the net present value of an investment in promotional expenditure, discounting a further 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 or return that could have been earned by investing that dollar for those years. So, with that as an operating principle, 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.

The principal is straight forward, as the amount any rational investor will pay for an asset (the basis on which "present value" is founded) is the future net free cash flow (revenue minus all costs) it generates, discounted by the cost of capital, ie. the rate of return they would expect if they invested in assets of a similar risk. Present value, also referred to as "Net present value" and "DCF" is the sum of these cash flows and is denoted as:

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

Where Σ is the sum of the cash flows in years (t) 1, 2, 3, 4....... This summation of the net free 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 £2m each year over four years and a cost of capital of 10 per cent, the Net Present Value is:

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

The NPV of an asset is, therefore £6.4 million minus the initial investment of, say, £5 million so in this hypothetical example, the NPV of this investment is £1.4 million.

While the mathematics of discounting is logically impeccable, in the case of an investment in promotional expenditure, however, the first error is to assume that the base case of not investing in the promotion, (i.e. the present health of the company) will continue indefinitely into the future.

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.

There is some evidence from the IPA's analysis of almost 900 promotional campaigns, presented in a report (Binet and Field, 2007). The graph in Figure 8 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.

From the same database, Figure 9 shows that for every 10 points that share of voice (SOV) exceeds share of market (SOM), a brand can expect to gain 1 point of market share per annum. The corollary is true (Figure 9).

It could of course be claimed that the assumptions based on this are heroic. For example, the line of best fit used to show the relationships is possibly more to do with the distribution of out-lyers (which are weighted at the square of the distance from the line squared) So, it could well be that the correlation coefficient of the line of best fit is very low. Thus, to say 99 per cent significance without delving deeper into confidence limits could be meaningless

While not even the IPA claim that their data is anything other than indicative, it would appear that there is sufficient evidence that without at least a baseline of promotional expenditure, sales and profits will decline.

It is wrong to assess the value of the proposed investment by measuring whether it will make us better off than we are now, because if the status quo deteriorates on its own, we might be worse off than we are now, but better off than we would have been without it!

Therefore, a number of calculations need to be made, as follows:

(1) What level of promotional investment is necessary to maintain the status quo? (maintenance).
(2) What additional level of investment over and above (i) above is planned? (investment).
(3) The NPV calculation must then be made on the anticipated net free cash flows over time over and above present cash flows resulting from the investment estimated in (1) above.

Using the same figures as above, a promotional investment of, say, £7 million producing £2 million additional net free cash flow per annum for four years would yield the following NPV:

$$£-7\text{ million}+\frac{2}{(1+r)}+\frac{2}{(1+r)^2}+\frac{2}{(1+r)^3}+\frac{2}{(1+r)^4}$$

$$=£-0.6\text{ million}$$

If, however, say £6 million is the minimum investment in promotion to retain current levels of sales and profits and the additional £1 million produced an additional £2m per annum for four years, this would yield the following NPV:

$$£-1\text{ million}+\frac{2}{(1+r)}+\frac{2}{(1+r)^2}+\frac{2}{(1+r)^3}+\frac{2}{(1+r)^4}$$

$$=£5.4\text{ million}$$

Admittedly this example is very simplistic, but it serves to illustrate the point that it should be only additional promotional expenditure over and above the level required to maintain the status quo that should be evaluated in NPV terms. As long as this is positive, it is worth making the investment.

Such a calculation could also be done to compare returns from different promotional projects.

It is difficult to forecast the extent to which a firm's position might deteriorate, but not impossible, but such estimates must be made (see Figure 10).

In conclusion, 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.

Research requirements

Having provided some parameters for research 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 questions 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.
  - What are the major "schools of thought"? What are the strengths and weaknesses of each?
  - Preliminary conclusions from the above with our own recommendations/hypotheses.
  - Some small scale field work to test findings on world class companies.

Conclusion

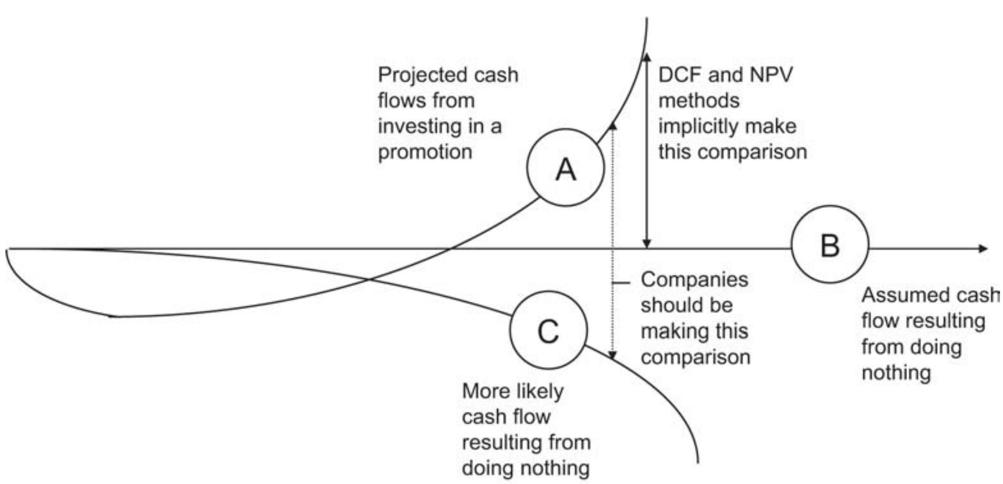
Whatever models emerge from the above, it is highly unlikely that any organisation will be using them all. There will be examples of excellence along a number of dimensions which will help us to refine and develop the models.

What is clear, however, is that such research is a major priority.

The recession currently being experienced by all nations has thrown the issue of marketing accountability into even greater focus. Experience from three previous recessions shows that one of the first actions of organisations suffering a downturn is to make what appear to be easy cuts in planned expenditure in the domain of marketing. Without a toolkit or a process based solidly on research to provide the evidence that such cuts damage the organisations chances of survival, this will continue to be the preferred response to crises. There is therefore, a pressing need for the kind of research spelled out in this paper.

If the B2B market is to thrive and prosper, instigating robust marketing metrics will guarantee its place alongside fast moving consumer goods companies in the league of marketing professionalism.

Figure 10



Notes: Most executives compare the cash flow from promotion against the default scenario of doing nothing assuming, incorrectly, that the present health of the company will persist indefinitely if the investment is not made. For a better assessment of the promotion's value, the comparison should be between the projected discounted cash flow and the more likely scenario of a decline in performance in the absence of promotional investment

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Further reading

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