Special issue papers and case studies

Do your marketing strategies create or destroy shareholder value?

Malcolm McDonald

is Emeritus Professor of Marketing at Cranfield School of Management. He was formerly Professor of Marketing and Deputy Director of Cranfield School of Management, with special responsibility for E-business. Among his many publications is the bestseller, *Marketing Plans: How to Prepare Them, How to Use Them*. This paper is based on concepts discussed in *Marketing Due Diligence: Reconnecting Strategy to Share Price* (Butterworth-Heinemann Ltd, 2005), co-authored by Professor McDonald, Keith Ward and Brian Smith.

In the summer of 2005, I found myself writing and talking at length about an issue that is central to doing business, first, in response to some worthy, but backward looking views on marketing effectiveness and later in a keynote address to the Henry Stewart Symposium on Marketing Operations Management.

In both cases, my purpose was to outline why a new process is necessary for demonstrating the shareholder value inherent (or lacking) in the business plan, and to demonstrate how company valuation can be taken from an art to a science.

I believe that the time has come for marketers to move into the c-suite by talking the language of the boardroom.

That, in turn, requires that they understand:

- The new science of evaluating marketing strategies and return on marketing investment (ROMI);
- How analysis of marketing expenditures and returns can provide a better insight into sustainable competitive advantage, or ‘super profits’, than financial accounts;

- How to unlock the value of intangible assets and deliver sustainable value for shareholders;
- How to escape the perception that marketing is ‘unaccountable, untouchable, expensive and slippery’;
- How to evaluate the risks associated with marketing expenditure and linking this assessment directly with shareholder value;
- Whether money is being well spent.

This last point brings us to the focus of this special issue — the latest tools for holding marketers accountable for their budgets, collectively known as marketing resource management (MRM) or marketing operations management (MOM).

MARKETING ACCOUNTABILITY

It seems to have escaped our attention that in capital markets, success is measured in terms of shareholder value added; having taken account of the risks associated with our declared strategies for the future, the time value of money and the cost of capital. This is totally

Malcolm McDonald
Emeritus Professor
Cranfield University
Cranfield School of
Management
Cranfield Bedford MK43
OAL, UK
Tel: 01234 751122
e-mail:
m.mcdonald@cranfield.ac.uk

Figure 1: Map of the marketing domain

different from traditional notions of profit — and until we take account of this in the marketing community, we will never justify a place in the c-suite.

MEASURING MARKETING EFFECTIVENESS

Before explaining how we can do this, however, I want to briefly put this whole measurement business into perspective.

The problem with marketing accountability has never been how to measure the effectiveness of promotional expenditure, we have had this for many years. No, the problem occurs because marketing isn't just a promotional activity. In world class organisations 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 organisation responsible for delivering this value; for playing their own part in delivering this value; and for monitoring whether the promised value is being delivered.

This definition of marketing as a function for strategy development, as well as for tactical sales delivery, means that we can use a map to clarify the whole problem of how to measure marketing effectiveness (see Figure 1).

The map has three levels of measurement, or metrics.

Level 1

This is the most vital level. 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. Using the

strategic plan to assess whether shareholder value is being created or destroyed is justified because, as Sean Kelly 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’.¹

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 be created or destroyed, a point that will be expanded on later.

Level 3

This is the level of micro promotional measurement described above. It is concerned with, *inter alia*, up-selling, cross-selling, customer churn, cost-effectiveness and the like.

Level 2

There is another level, however, that few academics or practitioners have addressed to date. It is only briefly described here, although once Level 1 measurement has been applied to the long range marketing strategy, it remains central to the issue of marketing metrics and marketing effectiveness.

ROMI — More than a financial return

Tim Ambler was made a quest of ridding the world of one of the great myths of

measurement — marketing return on investment — and we should all support him in this. 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! Moreover:

‘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’.²

Or, as PricewaterhouseCoopers observe:

‘The information appearing in the majority of boardrooms remains predominantly financial in nature. Without (additional) information on value-creating activities management are typically flying blind — when financials tell them there is a problem management have already missed the optimal point for taking appropriate corrective action’.³

Neither is the budget and all the energy employed in measuring it a proxy for measuring marketing effectiveness. Indeed, as Simon Caulkin 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, ie. The budget becomes the purpose.
- ‘Cheating is endemic in all budget regimes. The result is fear, inefficiency, suboptimisation 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.

Figure 2: The Ansoff Matrix

- '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'.⁴

THE ONE-YEAR PLAN

Let us, then, turn our attention to what needs to be measured in the one year plan.

Each of the cells in each box (cells will consists of products for segments) of the Ansoff Matrix (see Figure 2) are planning units, in the sense of objectives which are set for each for volume, value and profit for the first year of the strategic plan.

Objectives must be set for each of the products for segment cells. The task is then to determine strategies for achieving the objectives. These strategies, or critical success factors (CSFs), will be weighted according to their relative importance to the customers in the segment (Figure 3).

It is unlikely 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 persuade these functions to buy in to the need to improve the CSF scores.

Figure 4 shows another level of detail; the actions that have to be taken, by whom and at what cost. These actions obviously multiply for each product for market planning unit in the Ansoff Matrix.

Now 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. Moreover, 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

Critical success factors	Weighting factor	Your organisation	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 3: Critical success factor (CSFs) for each segment, defined by the segment

improved, should lead to the achievement of volumes, value and, ultimately, profits.

SHAREHOLDER VALUE ADDED

It must be stressed that the corporate revenue and profits shown to the right of Figures 3 and 4 are *not* the same as shareholder value added, so let us turn our attention briefly to this.

As a result of many years of research at Cranfield School of Management, it is now possible to establish quantitatively whether a company's planned strategies will create or destroy shareholder value.

Briefly, there are three kinds of risk:

- Market risk: the market might not be as big as you think it is
- Strategy risk: you might not win the market share you plan to
- Profit risk: you might not get the profit margins you plan to

A detailed pathology of business plan failures over the past fifty years shows

that each of these three categories of risk can be subdivided into five further categories, giving 15 factors that make a plan risky.

These different risks are cumulative and, whilst market risk and strategy risk affect revenue, the profit pool risk impacts on margin. Taken together they form the basis of risk-adjusted assessment. It is then comparatively easy to deduct the cost of capital from these cash flows to establish whether shareholder value is being created or destroyed.

Over the last few years, there have been several drivers towards implementing such a quantitative approach to marketing. First, as this special issue highlights, there have been increasing (legislative) pressures on companies to start thinking about marketing due diligence. This has important implications for four groups:

- Investors and their proxies: A way to see through the smoke and mirrors of 'investor relations'

Figure 4: Actions that have to be taken, by whom, and at what cost

- Boards and equivalents: A way to prove your value creation to financiers
- Strategy makers: A way to prove your value to the board
- Strategy implementers: A way to prove your value to your boss!

The second reason, is the simplest reason of all; because we can. Through technologies such as MRM, marketers are now able to gain a much greater toehold on the fundamentals of their business: particularly, the cost of what they do and the value of that activity.

CONCLUSION

I hope that I have demonstrated in this short piece, that there are new and proven approaches that can aid marketers

in analysing their business. Our work at Cranfield means that there is a rigorous process for assessing whether a market strategy will create or destroy shareholder value.

It is this latter achievement which will put marketing back where it belongs — in the boardroom.

© Professor Malcolm McDonald

References

- 1 Kelly, S. (2005) 'The customer information wars', Wiley, London, UK.
- 2 McGovern, G. Court, D., Quelch, A. and Crawford, B. (2004) 'Bringing customers into the boardroom', *Harvard Business Review*, November, pp. 71–80.
- 3 PricewaterhouseCoopers (2003) 'Value Reporting™ Review 2003: Transparency in corporate reporting', p. 25.
- 4 Caulkin, S. (2005) 'Escape from the budget straitjacket', *Management Today*, pp. 47–49.