EXERCISES

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

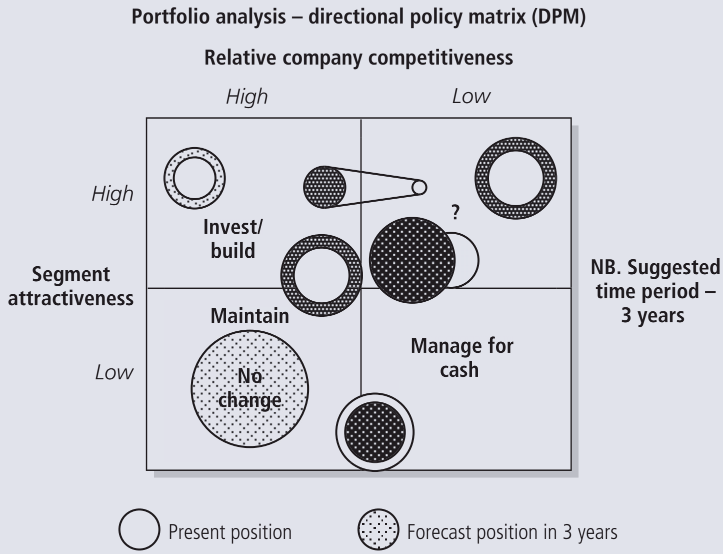
The first entails getting a team together and going through the following repeat of Figure 13.2. Just follow the directions and take your time over it.

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 3 and 5 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 3 or 5 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% 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.



The second 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, etc. 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:

- Ones that are currently delivering a high level of value, and 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
- 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 – that is, those with a high 'gearing'
- identify and agree the appropriate metrics to track the actions, budget funding and impact in achieving goals.

(*Continued*)

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.