CHAPTER 2

Marketing Metrics and Marketing Profitability

Introductory Exercise

FedEx measures customer satisfaction monthly but measures its service quality daily with a process metric that tracks the top ten mistakes, weighted by their negative impact on the customer, that result in customer dissatisfaction. The day on which this internal forward-looking metric was at its lowest (fewest mistakes), FedEx produced its highest daily profit.

1. Discuss the value of both measures (customer satisfaction and service quality) and how one relates to the other.
2. Discuss why these are important forward-looking metrics, and how each contributes to performance.
3. Discuss why FedEx's profit would be at its highest when the company's internal measure of service quality was at its lowest (fewest errors).

Teaching Objectives

- Present the importance of marketing performance metrics and make clear the characteristics and roles of external and internal metrics and of forward-looking and backward-looking performance metrics.
- Illustrate how a market-based business continues to reengineer itself around markets as customer needs and competition change and new market opportunities emerge.
- Demonstrate the importance of market-level measures of profitability and how the mechanics of the net marketing contribution can be applied to a variety of marketing strategies.

Harvard Business School Case Materials

- **Harrah's Entertainment, Inc.** HBS Case 50201. Describes a situation facing Philip Satre, chairman and CEO of Harrah's Entertainment Inc. Satre has just read a May 2000 *Wall Street Journal* story that discussed the company's marketing success in targeting low rollers, the 100 percent growth in stock price and profits for 1999, and the revenue growth of 50 percent, which significantly outpaced the industry. The exciting article aroused Satre's desire to know more about the activities of then-COO Gary Loveman and his team of "propeller heads" with respect to their database marketing efforts and the Total Reward Program. Satre was interested in two questions: He wanted to know how much these marketing efforts had contributed to Harrah's overall performance and whether these marketing results were a one-time event or could be repeated year after year, especially as competitors move to introduce similar programs. 27 pages.
- **Buy Low, Sell High: Creating and Extracting Customer Value by Enhancing Organizational Performance.** HBS Case 9-0597-0071. This case study provides a framework for creating customer value and managing firm-level profitability. It focuses on the use of product line management and customer service to achieve customer satisfaction and high profitability.
- **Guest First Hotel (A).** HBS Case 9-602-099. Presents a hotel management situation in which customer loyalty is linked to financial performance. This case uses years of hotel data that students need to analyze to uncover the relationship between customer loyalty and financial performance. Although there is no relationship in a single year, over time a key marketing profitability relationship emerges. 4 pages.
- **Winchell Lighting, Inc.** HBS Case 9-187-074. This case documents how a midsize lighting company tracks it marketing costs, as well as unit costs and allocated costs, to more fully understand its profitability. Teaching Note: 5-192-034. Supplement: 9-187-075.
- **Direct Product Profitability at Hannaford Brothers Co.** HBS Case 9-591-002. Concerns the pioneering use of a method of accounting in retailing which takes into account not only sales and the cost of goods sold but, at the item level, all of the variable costs associated with each item sold. This case focuses on the strengths and weaknesses of Hannaford's use of direct product profit and the opportunities for, and obstacles hindering, improvement and extension of the direct product profit system.

■ **The Customer Pyramid.** HBS Case CRM 211. This reading provides students with an insight into different levels of customer profitability. "The Customer Pyramid" provides a marketing management tool that strengthens the link between service quality and profitability. 26 pages.

Market-Based Strategic Thinking

1. **How could marketing metrics help General Motors turn around its decline in sales and profits?**

   GM has many internal performance metrics with regard to production, employee productivity, and financial performance. Metrics for these categories are standard for manufacturing companies. The importance of marketing metrics rests in their external measurements of performance. Ratings of customer satisfaction, intentions to repurchase, brand preference, and customer complaints provide an external scorecard for assessing current performance. Many of these marketing metrics are forward-looking metrics that help forecast future performance. For example, declining customer satisfaction and decreasing intentions to purchase GM vehicles in the future would signal a serious problem ahead. Likewise, improvements in these marketing metrics would signal the potential for a bright future.

2. **If a company dominates a market the way Microsoft, Google, and Intel dominate their markets, why should that company bother to track marketing metrics?**

   All market leaders stumble at some point. U.S. Steel, GM, and IBM all seemed invincible at one time. Without external marketing metrics, a company is vulnerable to listening to itself and not the voice of the customer. Customer complaints, shifting customer preferences, customer satisfaction, and intentions to repurchase are valuable external barometers that can warn a company before declines in sales and profits occur. A company could have many captive customers, unhappy but with no place to go. When presented an opportunity to buy elsewhere, however, these dissatisfied captive customers will exit en masse.

3. **How would marketing metrics help a company like McDonald's better manage its profitability?**

   By measuring the net marketing contribution, marketing ROI, and marketing ROS of each of its restaurants, McDonald's could better understand average performance as well as above- and below-average performance. A portfolio performance analysis could be performed, similar to Figure 2-17, to show the overall company average and all stores in different regions, and the average performance for different regions. Other marketing metrics like complaint behavior and customer satisfaction scores could be tied to these marketing profitability metrics to further illuminate and help improve the company's performance.

4. **How would Toyota use forward-looking marketing metrics to better understand future sales and profits in the U.S. market?**

   Changes in customer satisfaction, and particularly changes in the percentage of "very satisfied" customers, along with measurements of intentions to repurchase, provide external metrics of company performance that shape future sales and profit performance. These forward-looking marketing metrics provide early warning signs of problems, but they can also be encouraging signs when the metrics are improving.

5. **How could a Wall Street analyst benefit from access to a company's marketing metrics for a company like BioTronics?**

   Wall Street analysts could benefit from measuring a company's marketing ROI and marketing ROS. Improvements or declines in these marketing profitability metrics provide a measure of company performance in addition to the company's internal financial metrics. If the difference between marketing ROS and operating income as a percentage of sales is abnormally high, it would indicate excess company overhead. Analysts could benchmark a company against publically traded peers, as in Figure 2-23, and they could also benchmark company performance against Fortune 500 companies, as in Figure 2-24.

6. **Why are most financial metrics backward-looking metrics?**

   Financial metrics like sales, percent gross margin, operating income, earnings per share, and all return measures, such as ROS, ROA, ROE, ROC, are measured at the end of a financial accounting period. They are a measure of what happened, not what is happening or could happen in the future. They are by definition backward-looking performance metrics.

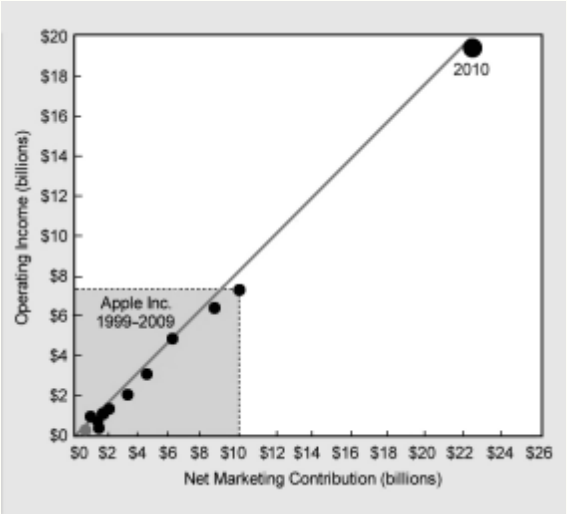
7. **Why would chief financial officers and senior management be comfortable with net marketing contribution as a financial measure of marketing profitability?**

   CFOs and senior managers can easily see that the net marketing contribution is a financial metric derived from company accounting information. The one additional step needed is to separate marketing and sales expenses from sales, general, and administrative expenses. Some companies, though, already separate the expenses in their reporting, as shown in Figure 2-12. With this information, we need to only add two lines to the company income statement, as in Figure 2-9. There are no assumptions and no need to collect additional information. We now have a financial-performance-derived measure of the contribution made by the company's investment in marketing and sales. Of course, for comparison, separate net marketing contributions can also be figured for the company's product lines or markets, or for the businesses, divisions, or regions within the company.

8. **Compute Apple's net marketing contribution for company's last fiscal year and add it to Figure 2-22. Then explain how this level of net marketing contribution could be used in Apple's marketing plans to project Apple's operating income for the current year.**

Apple Inc.	Sales	Gross Margin	Sales, Gen., & Adm. Exp.	Marketing & Sales Exp.*	Net Marketing Contribution	Operating Income
2010 ($ billions)	$65.20	41%	$5.54	$4.16	$22.58	$18.82

*Estimated at 75% of sales, general, and administrative expenses.



Shown above are Apple's 2010 financial results. The net marketing contribution of $22.58 billion is based on estimated marketing and sales expenses of $4.16 billion. Apple's operating income in 2010 was $18.82 billion.

In the graph we can see how Apple's net marketing contribution went through the roof in 2010. And, as shown, the pattern established between the net marketing contribution and operating income during the previous 10 years stays intact.

9. **How would Vizio use net marketing contribution at the market level to increase its knowledge of the U.S. flat-panel television market?**

   Net marketing contribution is sales times percent margin minus marketing and sales expenses. There are several markets for flat-panel televisions in the U.S., including consumer households, corporations (trade shows and lobbies), restaurants and bars, heath care facilities (monitors), and airports (gate information). Each market has a net marketing contribution based on sales, percent margin, and the investment in marketing and sales expenses. The NMCs of each market would tell Vizio the marketing profits of the markets. Computing the marketing ROI and marketing ROS for each would make it easy for the company to compare the markets with regard to marketing cost efficiency and profit impact.

10. **How would Procter & Gamble use a product-level measure of net marketing contribution for the Tide brand in the U.S. market?**

    Tide is but one of nine brands in P&G's detergent product line. The others are Bold, Cascade, Cheer, Dash, Dawn, Dreft, ERA, and Gain. Each has a net marketing contribution based on sales, percent margin, and marketing and sales expenses. Computing the NMC for each brand allows P&G to see which ones contribute the most marketing profits to the product line and how much any one brand, such as Tide, contributes to marketing profits. Creating a marketing profitability portfolio, as in Figure 2-17 (marketing ROI versus marketing ROS), showing the product line average, the company average, and each brand's performance, would give P&G a clear understanding of the relative performance of each brand.

11. How could Apple's chief marketing officer use Figure 2-23 to explain to Apple's CFO the value of marketing ROS and marketing ROI as corporate performance metrics?

CFOs are interested in financial numbers. They are less impressed by survey data or the opinions of marketing managers. Figure 2-23 is based on the financial results of Apple and four competing benchmark companies. Both graphs show how marketing ROI and marketing ROS correspond to operating income. Their relationship to operating income adds credibility to these two marketing profitability metrics. Additionally, each graph demonstrates Apple's superior performance with respect to its investment in marketing and sales expenses.

12. Shown below are HP's six major business segments and their percentages of sales for 2009. How would a marketing profitability portfolio (similar to Figure 2-17) help the HP chief marketing officer communicate to senior management the relative performance of each business segment when compared to the HP average.

In 2009, HP as a company had a marketing ROS of 17 percent and a marketing ROI of about 200 percent (see Figure 2-23). Each of HP's six major business segments also has a marketing ROS and a marketing ROI. Both may be easily computed from existing financial data and used to create a graph similar to Figure 2-17. This marketing profitability portfolio would show the HP average and the average of each business segment, revealing which ones are bolstering the HP average and which ones are dragging it down.

HP Business Segments	Personal Systems	Imaging & Printing	Enterprise Storage	HP Services	Software	HP Financial Services
Sales (%)	34%	20%	14%	28%	3%	1%

13. In 2009, Netflix had a marketing ROI of 178 percent. What does this mean in terms of the company's investment in marketing and sales?

A marketing ROI of 178 percent means that for each dollar Netflix invested in marketing and sales to grow the company, it produced $1.78 in net marketing contribution (after paying the $1 investment back). From the net marketing contribution, Netflix deducts its general and administrative expenses and other overhead to figure its operating income. If the company improved its marketing ROI to 200 percent, this would mean it is producing $2 in net marketing contribution for every $1 it invested in marketing and sales expenses.

14. For any airline of interest, compute its 2010 marketing ROS, marketing ROI, and operating income (as a percentage of sales) using the airline's 2010 income statement in its annual report. Assume marketing and sales expenses are 75 percent of SGA expenses. Then plot the results in Figure 2-24 and interpret the airline's performance.

We have computed this information for three airlines. As shown in the table, the airlines' operating incomes as a percentage of sales varied with the airlines' marketing ROS and marketing ROI. When compared to the averages shown in Figure 2-24 for 2009, all three airlines were below average. Delta had the best performance and US Air the worst.

Airline – 2010 ($ billions)	Sales	% Gross Margin	Sales, Gen., & Adm. Exp.	Marketing & Sales Exp.*	Marketing ROS	Marketing ROI	Operating Income
Southwest	$12.1	44.0%	30.6%	22.9%	21%	92%	8.2%
Delta	$31.8	45.3%	27.0%	20.3%	25%	123%	15.0%
US Air	$11.9	41.3%	32.4%	24.3%	17%	70%	6.6%

*Estimated at 75% of sales, general, and administrative expenses.

15. Why would companies that sell energy and raw materials, such as ExxonMobil and Alcoa, have very large marketing ROIs.

These companies have gross margins from about 18 to 39 percent, as shown in the table. But what makes their marketing ROIs so high is their low level of marketing and sales expenses as a percentage of sales. For both companies, the investment in marketing and sales is less than 3.5 percent of sales. This makes the denominator of the marketing ROI equation small relative to Fortune 500 companies in other sectors.

Company	Gross Margin	Marketing & Sales Exp.	Marketing ROS	Marketing ROI
Alcoa	17.9%	3.3%	14.6%	542%
ExxonMobil	39.4%	2.5%	36.9%	1,576%

Marketing Performance Tools and Application Exercises

2.1 Company-Level Net Marketing Contribution: Figure 2-15 is used with this marketing performance tool to address analysis items A (next page) and B (page 19). The starting data are shown here to make comparisons with the analysis items easy.

Starting Data	Scale	Millions			
Santa Fe Sportswear Performance (millions)	**Khaki Pants**	**Wind Breakers**	**Classic Polo**	**Casual Shorts**	**Knitted Sweaters**	**Company Total**
Market Demand	12.0	10.0	16.7	20.0	6.7	65.4
Market Share	12.5 %	5.0 %	3.0 %	2.0 %	3.0 %	4.7%
Unit Volume Sold	1.5	0.5	0.5	0.4	0.2	3.1
Average Selling Price (*)	$ 80.00	$ 100.00	$ 60.00	$ 50.00	$ 150.00	$80.66
Channel Discount	50 %	50 %	50 %	50 %	50 %	50%
Net Selling Price (*)	$40.00	$50.00	$30.00	$25.00	$75.00	$40.33
Sales Revenues	$60.0	$25.0	$15.0	$10.0	$15.1	$125.1
Cost per Unit (*)	$ 24.00	$ 30.00	$ 15.00	$ 18.75	$ 10.50	$19.65
Percent Margin	40.0 %	40.0 %	50.0 %	25.0 %	30.0 %	38.8%
Gross Profit	$24.0	$10.0	$7.5	$2.5	$4.5	$48.5
Marketing & Sales Expenses	$ 8.5	$ 4.0	$ 2.0	$ 1.5	$ 2.5	$18.5
Net Marketing Contribution	$15.5	$6.0	$5.5	$1.0	$2.0	$30.0
G & A and Other Expenses	$ 10.0	$ 4.0	$ 2.0	$ 2.0	$ 2.0	$20.0
Net Profit (before taxes)	$5.5	$2.0	$3.5	-$1.0	$0.0	$10.0
Marketing Profitability Metrics						
Marketing ROS	25.8%	24.0%	36.7%	10.0%	13.4%	24.0%
Marketing ROI	182%	150%	276%	67%	81%	162%

(*) Not Scaled

A. Evaluate the profit impact of eliminating the casual shorts and knitted sweaters product lines.

Analysis	Scale	Millions			
Santa Fe Sportswear Performance	Khaki Pants	Wind Breakers	Classic Polo	Casual Shorts	Knitted Sweaters	Company Total
Market Demand	12.0	10.0	16.7	20.0	6.7	65.4
Market Share	12.5 %	5.0 %	3.0 %	0.0 %	0.0 %	3.8%
Unit Volume Sold	1.5	0.5	0.5	0.0	0.0	2.5
Average Selling Price (*)	$ 80.00	$ 100.00	$ 60.00	$ 50.00	$ 150.00	$79.99
Channel Discount	50 %	50 %	50 %	50 %	50 %	50%
Net Selling Price (*)	$40.00	$50.00	$30.00	$25.00	$75.00	$40.00
Sales Revenues	$60.0	$25.0	$15.0	$0.0	$0.0	$100.0
Cost per Unit (*)	$ 24.00	$ 30.00	$ 15.00	$ 18.75	$ 10.50	$19.65
Percent Margin	40.0 %	40.0 %	50.0 %	25.0 %	30.0 %	41.5%
Gross Profit	$24.0	$10.0	$7.5	$0.0	$0.0	$41.5
Marketing & Sales Expenses	$ 8.5	$ 4.0	$ 2.0	$ 0	$ 0	$14.5
Net Marketing Contribution	$15.5	$6.0	$5.5	$0.0	$0.0	$27.0
G & A and Other Expenses	$ 10.0	$ 4.0	$ 2.0	$ 2.0	$ 2.0	$20.0
Net Profit (before taxes)	$5.5	$2.0	$3.5	-$2.0	-$2.0	$7.0
Marketing Profitability Metrics						
Marketing ROS	25.8%	24.0%	36.7%	0	0	27.0%
Marketing ROI	182%	150%	276%	0	0	186%

(*) Not Scaled

Teaching Note: Sales drop by $25 million and the net marketing contribution drops by $3 million. More importantly, net profit (before taxes) falls by 30 percent, from $10 million to $7 million. The point for students to understand is that, as long as the market profit is positive, it is contributing to other fixed costs and profits. The $20 million in operating expenses is not product related but represents overhead expenses that will still occur without these two product lines. Then the operating expenses would have to be covered by the remaining product lines.

B. What would be the profit impact of increasing market share from 2 to 3 percent for the casual shorts product line if marketing and sales expenses were doubled ($1.5 million to $3 million)?

Analysis	Scale	Millions				
Santa Fe Sportswear Performance	Khaki Pants	Wind Breakers	Classic Polo	Casual Shorts	Knitted Sweaters	Company Total
Market Demand	12.0	10.0	16.7	20.0	6.7	65.4
Market Share	12.5 %	5.0 %	3.0 %	3.0 %	3.0 %	5.0%
Unit Volume Sold	1.5	0.5	0.5	0.6	0.2	3.3
Average Selling Price (*)	$ 80.00	$ 100.00	$ 60.00	$ 50.00	$ 150.00	$78.80
Channel Discount	50 %	50 %	50 %	50 %	50 %	50%
Net Selling Price (*)	$40.00	$50.00	$30.00	$25.00	$75.00	$39.40
Sales Revenues	$60.0	$25.0	$15.0	$15.0	$15.1	$130.1
Cost per Unit (*)	$ 24.00	$ 30.00	$ 15.00	$ 18.75	$ 10.50	$19.65
Percent Margin	40.0 %	40.0 %	50.0 %	25.0 %	30.0 %	38.3%
Gross Profit	$24.0	$10.0	$7.5	$3.8	$4.5	$49.8
Marketing & Sales Expenses	$ 8.5	$ 4.0	$ 2.0	$ 3.0	$ 2.5	$20.0
Net Marketing Contribution	$15.5	$6.0	$5.5	$0.8	$2.0	$29.8
G & A and Other Expenses	$ 10.0	$ 4.0	$ 2.0	$ 2.0	$ 2.0	$20.0
Net Profit (before taxes)	$5.5	$2.0	$3.5	-$1.3	$0.0	$9.8
Marketing Profitability Metrics						
Marketing ROS	25.8%	24.0%	36.7%	5.0%	13.4%	22.9%
Marketing ROI	182%	150%	276%	25%	81%	149%

(*) Not Scaled

Teaching Note: While this strategy would produce $5.1 million more in sales, the net marketing contribution would drop by $200,000. The gains in market share and sales are not enough at current margins to offset a $1.5 million increase in marketing and sales expenses. As shown, this loss drops to the bottom line where net profit (before taxes) also drops by $200,000. You could instruct students to search for the market share needed to make this strategy equal the current net marketing contribution (starting data). This exercise produces an interesting benchmark, as the needed market share would be the minimum share level required to keep the strategy from adversely impacting net profit.

2.2 Market-Level NMC, Marketing ROS, and Marketing ROI: Figure 2-18 is used with this marketing performance tool to address analysis items A (next page) and B (page 22). The starting data are shown here to make comparisons with the analysis items easy.

Starting Data	Scale	Millions		
Santa Fe Sportswear Performance	Traditional Buyer	Fashion Buyer	Trend Setter	Company Total
Market Demand (customers)	7.0	5.89	8.0	21
Market Share	9.0 %	3.5 %	6.0 %	4.8%
Customer Volume	1	0	0	1
Average Revenue per Customer (*)	$ 180.00	$ 360.00	$ 130.00	$189.96
Channel Discount	50 %	50 %	50 %	50%
Net Revenue per Customer (*)	$90.00	$180.00	$65.00	$94.97
Sales Revenues	$56.7	$37.1	$31.2	$125.0
Cost of Goods per Customer (*)	$ 54.00	$ 115.38	$ 39.00	$58.13
Percent Margin	40.0 %	35.9 %	40.0 %	38.8%
Gross Profit	$22.7	$13.3	$12.5	$48.5
Marketing & Sales Expenses	$ 7.0	$ 6.5	$ 5.0	$18.5
Net Marketing Cont.	$15.7	$6.8	$7.5	$30.0
G & A and Other Expenses	$ 8.0	$ 6.5	$ 5.5	$20.0
Net Profit (before taxes)	$7.7	$0.3	$2.0	$10.0
Marketing Profitability Metrics				
Marketing ROS	27.7%	18.4%	24.0%	24.0%
Marketing ROI	224%	105%	150%	162%

(*) Not Scaled

A. Evaluate the profit impact of exiting the fashion segment.

Analysis	Scale	Millions		
Santa Fe Sportswear Performance	Traditional Buyer	Fashion Buyer	Trend Setter	Company Total
Market Demand (customers)	7.0	0	8.0	15
Market Share	9.0 %	3.5 %	6.0 %	6.7%
Customer Volume	1	0	0	1
Average Revenue per Customer (*)	$ 180.00	$ 360.00	$ 130.00	$158.38
Channel Discount	50 %	50 %	50 %	50%
Net Revenue per Customer (*)	$90.00	$180.00	$65.00	$79.19
Sales Revenues	$56.7	$0.0	$31.2	$87.9
Cost of Goods per Customer (*)	$ 54.00	$ 115.38	$ 39.00	$47.48
Percent Margin	40.0 %	35.9 %	40.0 %	40.0%
Gross Profit	$22.7	$0.0	$12.5	$35.2
Marketing & Sales Expenses	$ 7.0	$ 0.0	$ 5.0	$12.0
Net Marketing Cont.	$15.7	$0.0	$7.5	$23.2
G & A and Other Expenses	$ 8.0	$ 6.5	$ 5.5	$20.0
Net Profit (before taxes)	$7.7	-$6.5	$2.0	$3.2
Marketing Profitability Metrics				
Marketing ROS	27.7%	0	24.0%	26.3%
Marketing ROI	224%	0	150%	193%

(*) Not Scaled

Teaching Note: This would be a disastrous decision. Despite a low pretax net profit of $300,000, the fashion segment generates $6.8 million in marketing profits. This amount covers the $6.5 million in allocated operating expenses, which the business would have to pay regardless of whether it exits this segment. While the strategy lowers the marketing budget by $6.5 million, the business's overall net profit would be reduced by $6.8 million, the exact amount of the current net marketing contribution for the fashion segment.

B. In the fashion segment, how much market share would the business have to obtain to keep the same level of marketing profits if the business doubled marketing and sales expenses in that segment?

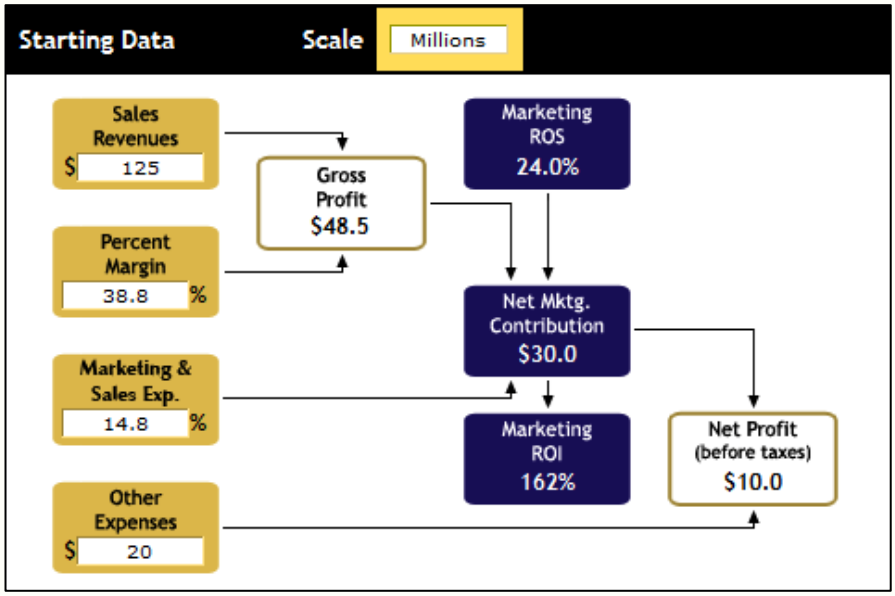
Analysis	Scale	Millions		
Santa Fe Sportswear Performance	Traditional Buyer	Fashion Buyer	Trend Setter	Company Total
Market Demand (customers)	7.0	5.89	8.0	21
Market Share	9.0 %	5.2 %	6.0 %	4.8%
Customer Volume	1	0	0	1
Average Revenue per Customer (*)	$ 180.00	$ 360.00	$ 130.00	$205.20
Channel Discount	50 %	50 %	50 %	50%
Net Revenue per Customer (*)	$90.00	$180.00	$65.00	$99.49
Sales Revenues	$56.7	$55.1	$31.2	$143.0
Cost of Goods per Customer (*)	$ 54.00	$ 115.38	$ 39.00	$62.72
Percent Margin	40.0 %	35.9 %	40.0 %	37.9%
Gross Profit	$22.7	$19.8	$12.5	$55.0
Marketing & Sales Expenses	$ 7.0	$ 13.0	$ 5.0	$25.0
Net Marketing Cont.	$15.7	$6.8	$7.5	$30.0
G & A and Other Expenses	$ 8.0	$ 6.5	$ 5.5	$20.0
Net Profit (before taxes)	$7.7	$0.3	$2.0	$10.0
Marketing Profitability Metrics				
Marketing ROS	27.7%	12.3%	24.0%	20.9%
Marketing ROI	224%	52%	150%	120%

(*) Not Scaled

Teaching Note: The current market share of 3.5 percent would have to increase to 5.2 percent to maintain a net marketing contribution of $6.8 million when the marketing and sales budget is doubled to $13 million. As shown, this level of market share also holds net profit at $10 million, while sales increase by $18 million. These data provide a basis for a discussion around profitability and market share. Is it reasonable to expect the business would gain 1.7 percent in market share if it doubles the marketing and sales budget? Obviously, the larger the share gain needed to hold profits, the greater is the risk of lower profits.

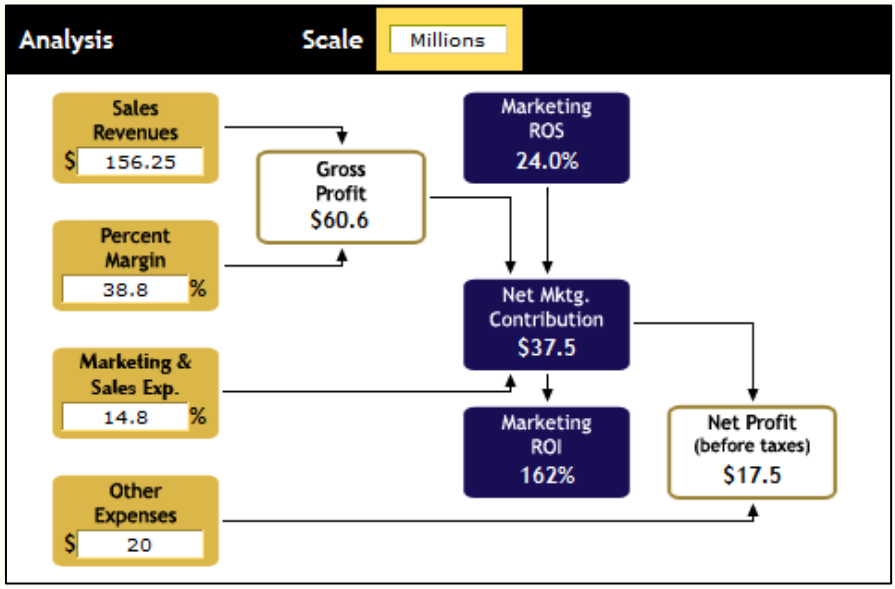
2.3 Company Net Marketing Contribution and Marketing ROI: Figure 2-13 is used with this marketing performance tool to address items A and B (below) and C (next page).

A. For a company of interest, obtain the required input from a company annual report. Evaluate the company's marketing profitability and how it contributes to net profit before taxes.



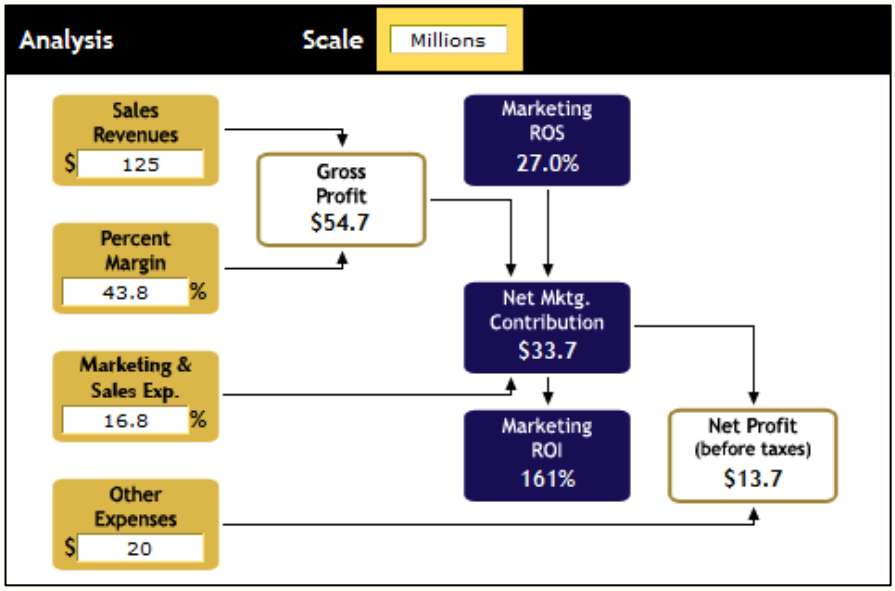
Teaching Note: If students obtain their company data off the Internet, they will probably have to use SGA expenses (sales, general, and administrative expenses), as most companies do not report marketing and sales expenses separately. Because SGA expenses include other expenses, I recommend using 75 percent of SGA expenses as an approximation of the marketing and sales expenses.

B. How would marketing profits and net profit change if sales increased by 25 percent?



Teaching Note: For the data presented above, when sales are increased 25 percent with no other changes, profits and marketing profitability metrics all improve. If we also increase marketing and sales expenses by 25 percent, profits still go up but the marketing profitability metrics (marketing ROS and marketing ROI) stay the same. A good point for discussion is, "How much should the marketing and sales expenses increase to achieve a 25 percent gain in sales?" There is no right or wrong answer, except something has to change to account for the increase in sales, even in a market growing at 25 percent annually.

C. Evaluate the profit impact of a strategy in which the percent margin is increased by 5 points and marketing and sales expenses are increased by 2 percentage points.



Teaching Note: As shown, this strategy produces an increase of $3.375 million in the net marketing contribution. An additional assignment would be to instruct students to find the level of percent margin that would yield no increase in the net marketing contribution while still spending the extra 2 percent on marketing and sales. This occurs at 40.8 percent. If the company cannot increase its margins beyond 40.8 percent, it will see no increase in marketing profits. You can use this variation on the assignment to start a discussion around the risk of such a strategy.

2.4 Benchmarking Marketing ROI versus Operating Income as a Percentage of Sales: Figure 2-23 is used with this marketing performance tool to create the data needed to address items A (below) and B (next page).

Starting Data		
Performance		
Scale: Billions	GM 2011	Ford 2011
Sales Revenues	$ 150.3	$ 136.3
Percent Margin	17.8 %	20 %
Marketing & Sales Exp. (% sales)	6.1 %	6.4 %
Net Marketing Contribution	$17.6	$18.5
Operating Income	$ 5.66	$ 6.94
Performance Metrics		
Operating Income (%sales)	3.8%	5.1%
Marketing ROS	11.7%	13.6%
Marketing ROI	192%	213%

A. For a company of interest, go online and obtain the operating income and the data needed to estimate the company's marketing ROI. You will probably need to use 75 percent of SGA expenses as your estimate of marketing and sales expenses, because companies rarely report marketing and sales expenses separately in their financial statements.

Teaching Note: I recommend using the following keywords to search for a company income statement:

Google Keywords: *Company Name Year* Income Statement Forbes
Example: General Motors 2011 Income Statement Forbes

In this example, we used General Motors' 2011 Income Statement for the company focus and for the data shown above under "GM 2011."

B. Next, collect the same data for a major competitor. How does the first company compare with this competitor in terms of the marketing profitability metrics (marketing ROS and marketing ROI) and operating income as a percentage of sales? How would these results compare with the average performance shown in Figure 2-24?

Teaching Note: For the GM's benchmark competitor, we used Ford's 2011 Income Statement. The profile in the chart on quest A (previous page) shows important differences in performance. While GM had higher sales ($150.3 billon) than Ford ($136.3 billion), Ford had a higher net marketing contribution and a higher operating income, as well as a higher marketing ROI (213%) and a higher operating income as a percentage of sales (5.1%). You could ask students to explain Ford's better overall performance despite the company's lower sales.

With respect to Figure 2-24, the marketing ROIs for General Motors and Ford are higher than the average of 163 for the sample of Fortune 500 companies in Figure 2-24, but the operating income as a percentage of sales, for both companies, is much lower than the average of 10.4 percent.

A very good exercise for students would be for them to do the same analysis for 2009 and 2010. The exercise would demonstrate how far GM has come from its disastrous performance in 2009.