



BALANCED SCORECARDS FOR SALES & MARKETING

“Linking Financial Outcomes and Shareholder Value”

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Executive Insights
Gordian Transformation Partners Inc.
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Overview

The finance team and the sales & marketing team frequently talk different languages during annual strategic planning and budgeting exercises and their failure to communicate effectively can lead to unprofitable sales growth or sales & marketing programs that don't deliver results. Boards, CEOs and CFOs speak in terms of hard-dollar sales, profits, margins, ROI and shareholder value, and they often find the metrics used by the sales & marketing people to be disconnected from these key measures.

Sales activity has come to be seen as a function of market demand, customer value propositions, customer awareness, customer satisfaction, sales channel strategies and customer buying behavior, and the linkages between these variables, the sales & marketing department budget and shareholder value can be tenuous at best. Companies today can not say that finance is a quantitative science and sales & marketing is an art and expect a good reception from Wall Street. Sales & marketing people need to understand the linkages between their sales & marketing programs and shareholder value, and to develop the language and metrics to communicate the benefits of their programs to financial people.

The Need for Balanced Scorecards

The subject of developing metrics for sales & marketing programs that lead to improved shareholder value has gained significant attention in recent years. One major source of new ideas has emerged from the continuing development of the *Balanced Scorecard*. As has now become well-known, the Balanced Scorecard is a methodology for translating strategy into a set of measurable activities viewed through the "perspectives" of the shareholder, internal processes, organizational learning and growth, and the customer. Metrics relating to revenue growth are developed within each of the four perspectives in such a way that their linkages show a clear path towards building shareholder value.

The revenue growth strategy has probably received the most attention from academics, consultants and practitioners in the Balanced Scorecard community since most companies consider revenue expansion to be the surest method for increasing shareholder value. A second source of new ideas on metrics for the sales & marketing function has emerged in the field of marketing science, which has found that marketing expenditures can be viewed as contributing to the value of the intangible assets of the firm. It is through this approach that the linkages between marketing and finance are most clearly drawn, and where it is useful to begin our exploration of this subject.

The Marketing Science Institute, an academic research group supported by institutions such as The Wharton School and McKinsey, has been told by its membership to consider marketing metrics and marketing productivity as its number one research priority. Marketing executives are under

increasing pressure to justify their programs in terms that finance people and Wall Street can understand. The MSI has noted that there has been a shift in the composition of the market value of companies over the past several decades from physical assets to intangible assets. In a landmark report on this subject, the Federal Reserve Board noted in 2002 that nearly half of the value of public companies is now comprised of intangible assets. Interestingly, many of these intangible assets are created by, or shaped by the sales & marketing function.

Three of the most highly valued intangible assets are the firm's customer base, the firm's brand equity, and the intellectual property of the firm. The first two intangible assets clearly fall within the realm of sales & marketing, and the third, intellectual property, is an asset that the sales & marketing people continually seek to mold in their attempts to build superior products and services for the marketplace.

If marketing-related intangible assets figure prominently in the value of the firm, then the tools used by finance and accounting people to value assets can be used in creating good sales & marketing metrics. In other words, if the intangible assets can be quantified, then the variables used in these calculations can be used as metrics and shown to have a direct link with shareholder value.

Where to Start

As a starting point, we know that financial theory tells us that the value of an asset is equal to the discounted present value of the net cash flows that come from that asset. This framework fits squarely with many of the metrics that are commonly used by sales & marketing groups in examining how sales can be gained from the existing customer base. The first step in the analysis is to determine the profitability of historical sales segmented by business lines, product groups, customer groups and, where possible, individual customers. This gives us a basis for forecasting the net cash flows that might come from customer groups in the future.

Next, many of the common sales & marketing metrics are applied in forecasting the costs of retaining these customers and the net profits that will ensue, such as:

- the likelihood of repeat purchases by existing customers under alternative sales & marketing scenarios;
- the revenues and costs of gaining repeat purchases under alternative sales & marketing programs;
- and the costs likely to be incurred by other parts of the organization in modifying the customer value proposition in order to meet the evolving demands of the marketplace.

The forecast of net cash flows that is derived from these assumptions is commonly referred to as *Customer Lifetime Value* ("CLV"), and any sales & marketing programs that will increase CLV can be

seen as building shareholder value. Similarly, sales & marketing costs that build brand value with the existing customer base, or that facilitate the closing of sales with new customers beyond what might be expected in the absence of such expenditures, can also be seen as building intangible assets and shareholder value. With this framework in mind, the sales & marketing group can construct metrics that have a direct link on financial outcomes and shareholder value.

We now turn to the types of metrics that have been developed within the Balanced Scorecard framework that provide similar but less mathematical linkages between sales & marketing programs and shareholder value. As previously mentioned, the Balanced Scorecard methodology translates strategy into operational metrics from the “perspectives” of the shareholder, the customer, internal processes and organizational learning and growth.

The creators of the Balanced Scorecard, professors Robert Kaplan and David Norton at the Harvard Business School, note that shareholder value is generically driven by a revenue growth strategy, whose two principal components are the enhancement of customer value and the creation of value from new products and services, and a productivity strategy, whose two principal components are the improvement of the cost structure and the increase in asset utilization (*Strategy Maps: Converting Intangible Assets into Tangible Outcomes*, 2004). For the “financial perspective” of the Balanced Scorecard methodology, the key metrics of the revenue growth strategy are customer profitability and new sources of revenue. These metrics are balanced against the metrics developed the productivity strategy, such as cost per unit and asset turnover rates, in order to ensure that revenue growth occurs on a profitable basis.

The revenue growth strategy requires that a specific value proposition be developed that describes how the organization will create differentiated, sustainable value to its targeted customer segments. Choosing the correct customer value proposition is seen as the central element of a successful strategy, and four distinct types of value propositions have been identified, depending on the firm’s competitive situation. These alternative customer value propositions include being the low cost provider (e.g., Wal-Mart), the product leader (e.g., Intel), the complete customer solutions provider (e.g., Goldman Sachs) or the “system lock-in” supplier that imposes high switching costs to customers (e.g., Boeing).

Metrics chosen for the “customer perspective” are developed to match the customer value proposition and the degree to which the revenue growth strategy is based on enhancing customer value with existing customers and products as compared to creating value from new products and services. These will often include metrics relating to customer retention, new customer acquisition, customer satisfaction and market share.

The Balanced Scorecard is rounded-out by developing organizational strategies and metrics from the internal processes perspective and the organizational learning and growth perspective. While the metrics developed for the financial and customer perspectives are viewed as “lagging” indicators of success, since they measure historical outcomes, the metrics for the internal processes

and organizational learning and growth perspectives are often “leading” indicators of future success. Internal processes create and deliver the value proposition for customers.

Metrics relating to the revenue growth strategy are most closely related to customer management processes and innovation processes, while operations management processes and regulatory/social processes are more closely related to the firm’s productivity strategy. Finally, the learning and growth perspective focuses on the employee competencies, enabling technologies and organizational culture that are required to support the unique demands of the customer value proposition and the internal processes on which it depends. The Balanced Scorecard will include metrics on the development of people and technology that are most closely aligned with these strategies.

We have now seen how the field of marketing science, with its focus on the valuation of intangible assets, and the field of strategic management, typified by the Balanced Scorecard methodology, have addressed the need for metrics that link sales performance and shareholder value. Some common threads are readily apparent. Both approaches view customer profitability as the key prism through which shareholder value is created. This requires that historical customer profitability be carefully examined, and that future customer profitability, encompassing the costs of customer retention, customer acquisition and the development of customer value propositions, also be incorporated in budgeting and strategic planning exercises.

