Part 1

What is Marketing Due Diligence?

1 The Lessons of Experience

'Diligence is the mother of good fortune'

—*Benjamin Disraeli*

Fast track

Almost all businesses prepare a business plan and have it reviewed by senior executives. Whatever the business, the plan consists of a request for resources, some description of how they will be used and a promised outcome. Despite the large amount of effort put into preparing, reviewing and revising these plans, they often fail and, in doing so, they destroy shareholder value and waste precious resources. It is dangerous to draw simple conclusions from stories of business success and failure, but the rigorous study of enough cases reveals some useful general patterns. We can see common factors that lie behind success, such as making sure the market is really there and ensuring that the business has and uses a distinctive strength. Similarly, we can see patterns in business failures, such as the failure to identify the target customer correctly or to anticipate where the market is headed. Identifying these common factors is important because traditional metrics of firm performance and marketing accountability can be manipulated easily and, in most cases, look backwards rather than forwards. This chapter introduces a new way at looking at a business strategy and connecting it to firm performance. This approach, known as Marketing Due Diligence, is based on the fundamental factors that underlie almost all successful business strategies.

Introduction

There are few things in business life that are more universal or more ubiquitous than the business plan. From the entrepreneur trying to convince his backers, to the CEO of a multinational trying to assuage a room full of demanding investment analysts, the business plan occupies much of the attention of business leaders, their subordinates and those who invest in the enterprise. A strong business plan may not guarantee commercial success, but a weak one almost certainly guarantees failure, so the ability to craft a strong plan and to differentiate between weak and strong plans is, arguably, one of the core capabilities of any business executive. This book is written for those people – owners, executives, investors – whose career and livelihood depends upon their business planning competence. It does not, however, prescribe methodologies for preparing a plan; there are already many good books that do that. Instead, this book addresses a much more neglected question: How do we know if the business plan is likely to succeed? We think this question is important to every executive but, when we conceived the book, we did have two particular audiences and one particular context in mind; senior finance executives, senior marketers and the interface between them. For both, assessing and insuring the success of a business plan is an essential part of their job but, in our experience, the two professions look at this problem from very different perspectives, often leading to conflict where cooperation is, in fact, most needed. We've therefore written this book with the aim of encouraging a shared perspective between senior finance and marketing colleagues, one that combines the distinct value each brings to commercial management, with the intention that cooperation at the marketing/finance interface will lead to stronger business plans and better commercial outcomes.

Business plans appear to vary greatly between different types of company, but when one dissects them, they are in fact remarkably similar in their fundamentals. Whatever the nature of the enterprise, most business plans are, in essence, a request, a description and a promise. They request the allocation of some resources, describe how those resources will be used and promise to deliver an objective. Whether the plan is a two-pager for a small business or a 15Mb PowerPoint deck for a strategic business unit of a global multinational, it almost always boils down to that fundamental structure of a request, a description and a promise. This is no coincidence. It is an obvious and direct corollary of the simple reality that almost all businesses require investment in order to achieve their goals and almost all investors want to know how their money is going to be spent.

With well over a century of executive experience and academic research behind us, the three authors of this book have been involved in more business plans than we like to be reminded of. We've prepared them, presented them, analysed them and followed up on their outcomes. We have written them ourselves and been through the plan presentation and approval ritual many times; and we've coached hundreds, perhaps thousands, of executives through the process in industries ranging from consumer goods to pharmaceuticals and from high technology to incontinence products. By and large, we find the business plan review process, as it is practised in most companies, to be ineffective or at least inefficient. It is supposed to produce agreement on a plan that has a high probability of delivering its promises. In practice, it often does the opposite. Executives, operating in a highly uncertain environment, write plans that they think will work but in which the risks are poorly understood. They anticipate the challenges of their leaders and build in spare resources and soft targets. Their leaders, without their subordinates' knowledge of the market environment but with long experience of how executives behave, counter these tactics by instinctively demanding better outcomes and less expenditure, whatever the initial proposal. Overall, the outcome is a plan in which there is more resigned acceptance than committed agreement and one in which the probability of delivering the objectives is low or, worse, poorly understood. To quote one executive from our research, the business plan review process, rather than being an essential and value-adding activity, is often a game that gets in the way of doing business.

This book is written for those executives who write and assess business plans and who want their time spent planning to create value rather than to be a political game. The bulk of the book, from Chapter 2 onwards, describes a two-part process for improving a business plan: diagnosis of its weaknesses and then therapeutic steps to address them. The process, which we've called Marketing Due Diligence, is based on our extensive practical experience and on many years of studying the experience of firms whilst working as professors at some of the world's leading business schools. Before we become immersed in that, however, this chapter aims to introduce some of the basic ideas in the book by discussing some educative examples of business success and failure.

Success stories

As the English proverb has it, success has many fathers whilst failure is an orphan. This reminds us that it is almost impossible to attribute corporate success to one cause. To succeed, firms need to do the right things, to do them well and, not least, to be blessed with luck. But notwithstanding that, our research has revealed to us a pattern of features that characterize almost every successful business strategy and which can be seen in the following well-known examples.

Starbucks: A holistic offer based on insight and culture

From its humble origins in 1970s Seattle, Starbucks now has about 20,000 outlets worldwide, an annual revenue approaching $12 billion[1] and has become an icon of urban life. Much of this success is attributable to its core strategy developed by its CEO Howard D. Schultz, who led both its initial expansionary phase after he acquired the firm in 1988 and, resuming the CEO role, its impressive comeback after the 2007 crash.[2]

The core of Schultz's strategy is to create neighbourhood coffee shops with an atmosphere and experience that differentiate them from the multitude of rivals, which include local, single store, coffee shops and other 'me too' chains, as well as indirect rivals such as McDonald's. In his interviews (see, for example, the interview with Howard Schultz[3]), Schultz talks compellingly about the challenge of balancing growth with maintaining that differentiation. He has even talked of growth itself as a carcinogen to the culture and values that underpin the friendly, high-quality, localized experience that he sees as central to Starbuck's competitive positioning. And whilst Starbucks, like many global multinationals, has become one of those companies that everyone likes to criticize, its commercial success is one that many companies would like to emulate.

The interesting question is what Starbucks might tell us about strategy. Out of the many things that Starbucks teaches us, two things stand out. Firstly, their 1990s expansion was into a new market. Although there were, of course, local coffee shops it was by no means certain that the market was the size that it turned out to be. Schultz's insight was to infer, from the presence of other coffee shops and other social meeting places, that there existed a market for a 'Third Place' (to use Ray Oldenburg's term[4]) between work and home. His second insight was to understand the holistic nature of an offer to the customer required to differentiate Starbucks from its competitors. He could have simply emphasized the quality of the coffee or competed on price but he eschewed both of these traditional approaches because he perceived that product and price (two of the traditional 4 or 7Ps of marketing) were simply components of the experience he wanted to offer to the customer.

In his interviews and in his book,[5] Schultz talks about everything from the importance of grinding coffee on the premises to the need to prevent local initiatives diluting the brand experience, but the two lessons that are most generalizable to other businesses are the identification of a new, or at least dormant, market space and the essentially holistic, coherent nature of a strong customer offer.

The Economist: Side stepping in time to the future

It is hard to think of a business more different from Starbucks, an iconic brand of early 21st century consumerism, than *The Economist*, a global business magazine that was founded in 1843 'to take part in a severe contest between intelligence, which presses forward, and an unworthy, timid ignorance obstructing our progress'.[6] Owned along with the *Financial Times* by the Pearson Group, *The Economist* seems to share little strategic context with Starbucks, other than strong competition; but there are interesting parallels and contrasts. Operating in an established market for business and management information, there is no doubt that the market exists. But the plethora of existing competitors such as *Business Week* and other newspapers and the explosion of new, web-based, information sources means that *The Economist* has a huge challenge to be profitable. However, it has established a uniquely attractive brand and, as part of the Economist Group, continues to grow revenues and profit in an environment that might be expected to be especially difficult for what is essentially a premium priced newspaper.

The Economist reinforces a lesson from Starbucks (which of course it predated) and tells us at least two more. Like Schultz's Starbucks strategy, *The Economist* attempts a strongly differentiated value proposition. In this case, it is based upon a level of knowledgeable, independent insight with which others struggle to compete. To complement this, it wraps its value proposition in a slightly arrogant, aspirational brand position.

The additional lessons from *The Economist* strategy are less obvious but just as important. Its choice of position in a very crowded market is based on avoiding or side-stepping its competitors. *The Economist* chooses to avoid competing, for example, on timeliness, industry specificity or price, as web-based news services, trade magazines and free, loss-leading, consultants' reports do respectively. This avoidance of head-on competition is one of the characteristics of strong strategy that we will return to.

The third lesson from *The Economist* concerns change. In a market environment that has been hugely disrupted by technological, political and social trends, a premium, UK-centric, paper newspaper was uniquely vulnerable, as the profit margins of other 'quality' newspapers attest. The web and mobile devices threaten paper; email reduces attention spans; and globalization reduces the UK to a secondary country in economic terms. *The Economist*'s strategy, however, anticipates these changes and makes use of market trends. Its electronic versions complement its paper editions; its content has globalized into regional editions and the quality of its content aims to win share of the reducing amount of quality reading time.

Like all of these examples, *The Economist* is a whole case study in itself but the three lessons of tailored proposition, competitive side-stepping and 'going with the grain' of market changes are the three that have the most applicability to other businesses.

Yamazaki Mazak: Matching itself to the market

It would be easy, by choosing well-known examples, to inadvertently imply that strategy lessons come only from the big brand names that everyone recognizes. But this would be misleading. Some of the most important strategy lessons are to be learned from firms that most of us have never heard of because they occupy specialized markets or sell only to other companies and not to consumers. An outstanding example of this is Yamazaki Mazak, the world leader in the machine tools market, a sector which is expected to reach $166bn by 2017.[7] Like the other markets described above, the machine tools market is competitive and there is no shortage of alternatives for Yamazaki Mazak's customers to choose from. But the nature of this business, like many capital-intensive, business-to-business sectors, doesn't lend itself to creating a relatively monolithic value proposition that is clearly and simply differentiated from the alternatives. The business is complex both technologically and also in terms of product categories, geography and the industry sectors it must serve.

Bridging all of this complexity of different product categories, industry specialisms and geographical variation, however, is a pervasive underlying strategy. The hallmark of Yamazaki Mazak's strategy is its unusually developed global network of technology centres and manufacturing facilities. This developed partly as a result of force majeure, following the market and major customers.[8] However, it led to a relative strength, compared to its competitors, in the capability to design and support customized solutions for machine-tool users. This and other strengths in understanding customer processes shaped their strategy. At the same time, the company's strategy was shaped by recognition of its relative weaknesses, such as relatively high costs (compared to cheap imitators) and, at least in its early years, the burden of a weak brand and

Japanese name. It is the shaping of its strategy to fit with its unique profile of strengths and weaknesses that emerges as a lesson from Yamazaki Mazak. More obvious strategies might have been to compete on price or on technological superiority; but the former is vulnerable to low-cost competition and the latter is very hard to sustain across a wide range of product categories with short life cycles and in the face of intense US and European competition. In simple terms, Yamazaki Mazak achieved market leadership by being 'customer intimate' to use the term coined by Treacey and Wiersema[9] but it was not this strategy itself that created its competitive advantage. Yamazaki Mazak's strategy would not have worked as well had it been tried by another firm with a different unique profile of strengths and weaknesses. This is because customer intimacy, in this market, depends on a global network, an understanding of customers' specific needs and, perhaps, something in Yamazaki Mazak's culture that is hard to articulate.

So the particular lesson to learn from Yamazaki Mazak, and many other specialized, knowledge-based companies, is the importance of strategy as an alignment process. Strong strategies leverage strengths against market opportunities and mitigate or correct weaknesses in the face of market threats. Effective strategies often depend, therefore, on understanding that alignment process.

Essilor: Growing the pie

Essilor is another company most people have not heard of but that anonymity has a slight irony to it, given that many readers will be reading these words looking through its products. Essilor, a French company, is the world's largest manufacturer of ophthalmic lenses, with sales of about 4 billion Euro and operations in over a hundred countries. At first look, Essilor's strategy reveals nothing more than those of Starbucks, *The Economist* and Yamazaki Mazak. Like the others, it has tried to develop a distinctive customer offer based on distinctive capabilities and, in doing so, attempts to avoid comparison with direct rivals. However, closer examination of this sector raises a question that yields another lesson of strong strategy.

Essilor describe the four strands to their strategy[10] thus:

- Innovation not only in products but also in services and marketing approaches;
- Growth from the emerging middle classes of developing economies, supported by acquisition and partnerships;
- Market development to expand the use of their products;
- Focus on mass-customization rather standardized lenses.

This strategy is interesting when compared to the more obvious alternatives. It would have been easier, at least superficially, to focus on the existent, developed markets, perhaps using scale to compete on price or customization to dominate that segment of the market. But asking the question 'Who has Essilor fought?' reveals the advantages of their strategy. It would appear that their growth has come either from people who have never bought lenses before (in developing markets) or by increasing the size of the market (by volume or value) in developed markets. From a competitor's point of view, Essilor's strategy has had little impact on them and has in fact expanded the profit pool of the sector (that is, the total profit made by all competitors in the industry). In doing so, Essilor has avoided stimulating a competitor response. Such a response would have either led to a price war and commoditization or, perhaps, increased direct competition through sales and marketing activity.

So, the lesson we can draw from Essilor is to avoid ruffling feathers. Strategies such as theirs lead to growth without upsetting the competition and stimulating a response. Other firms, unable to do this, might design their strategies to have a small impact across many competitors or to impact heavily only on weak competitors. Whatever the detail, a characteristic of strong strategy is that it avoids the consequences of walking up to the biggest, strongest competitor and poking it in the eye. Despite the aggressive, combative language often used to describe strategies, it seems that strong strategies avoid fights when they can.

This small handful of success stories, chosen to represent a breadth of business types, is of course meant only to be illustrative. Whilst there is much published academic work, including our own, about what makes firms successful, we find that short, interesting anecdotes about real firms are a better way to introduce our concepts. Later in the book, we'll develop the idea of what makes a strategy successful and how to apply this knowledge to achieve success and create shareholder value. For now, we think it would be worthwhile to reinforce our points from the opposite perspective of business failure.

Failure stories

It's too easy to criticize firms that have failed. We have enough experience of success and failure to know that it is rarely the result of stupidity, laziness or some other vice and more often born out of the honest mistakes that always accompany trying hard. We therefore write this section in admiration of those who tried and with thanks for the lessons we can draw rather than with any sense of superiority. That said, the commercial failure of organizations filled with bright, educated and committed people provides specific lessons as well as a general warning against hubris.

Blockbuster: Left behind

For about 20 years after it was founded in 1985, Blockbuster might have seemed an exemplar of success rather than failure. It rose, largely by acquisition as the sector consolidated, to dominate the video and game rental market and was a major brand in 18 countries. At its height, it had some 60,000 employees in thousands of stores. It also appeared to adapt well to market change, managing well the transition from VHS to DVD formats and developing its proposition to include by-mail services. Its strong brand made it so valuable that, in 1994, Viacom purchased Blockbuster for $8.4 billion, although it later reversed that decision. And yet by 2010 Blockbuster was bankrupt, with some $900 million of debt. Soon after that, it was acquired for $320 million and the new owners, Dish Network, began to close its many unprofitable stores.

Blockbuster's demise didn't happen because people stopped watching movies at home. In fact, many analysts expected the home entertainment sector in which it operated to thrive in times of recession as customers cut back on trips to the cinema. Rather, Blockbuster reinforces, from a negative perspective, the importance of responding to market changes and maintaining a differentiated value proposition. Its core value proposition of renting physical formats such as DVD has low barriers to entry and, since Blockbuster failed to offer the customer very much beyond access to the movie, their offer was easy to copy and hard to price at a premium. Their direct competition included other rental chains but also local general stores offering to rent the most popular films. Indirect competition came from the relatively low cost of buying a movie at a supermarket or other outlet. But perhaps Blockbuster's most striking failure was to respond quickly enough to the availability of on-demand video enabled by broadband access. This brought new competitors, notably Netflix, and, although Blockbuster eventually developed an on-demand based offer, it still failed to differentiate its value proposition. And, with an undifferentiated offer, Blockbuster was essentially fighting head-on with its competitors.

No one at Blockbuster would have advocated a strategy that involved going head-on with competitors with an undifferentiated offer. Nor would they have chosen to allow new technology to enable new competitors to find new routes to market, but that's more or less exactly what they did. Even when they held a dominant position in the sector, they failed to use that position and their financial strength to build a sustainable competitive position. The basic concepts that explain their demise – low entry barriers, differentiation, technological change and new entrants – have all been written about for decades and were surely known and understood by Blockbuster's experienced and well-paid board. Yet Blockbuster has gone, in about two decades, from a very successful business to a footnote in the history of strategy.

Gateway: Playing a zero-sum game

During the 1990s, the transition of the PC market from a geeky niche to a mass-market consumer goods market led to the emergence of several firms that seemed to contend for leadership. One of these was Gateway Inc., whose cow-patterned boxes and extensive advertising helped to create the market. It's hard to imagine now, but Gateway were talked about in the same context as Dell as one of the new firms shaping and controlling this vibrant new market. After selling its online business to AOL in 1998, it focused on selling direct to consumers and shifting its focus from high-end and business machines to low-cost and home machines, including the acquisition of eMachines for $262 million in 2004. Like all PC makers, Gateway was hit by the dotcom crash of 2000/2001 and sought volume and scale as a response to a commoditizing market. It also retreated into its home market and tried to enter the consumer electronics market. This strategy failed, partly due to some operational aspects, such as problems with customer service, but mostly because it didn't deliver the profit margins promised in the business plan. Selling both through direct channels and low-end retailers, prices eroded much faster than expected and competitor response meant that low prices were not rewarded with increased share. The company shed executives and, in 2007, it was sold in parts to Acer and the MPC Corporation. At that time, Gateway's share price was $1.90, compared to a 1999 high of $84.00, a quite spectacular destruction of shareholder value.

The lesson of Gateway, and indeed that of some of its rivals in the PC sector who also went out of business, is not that building scale in a commoditizing market is necessarily wrong. That sector has eventually consolidated to a small number of major players who benefit from economies of scale and supplier power, although they are now facing the challenges of an industry transition involving tablets and cloud computing. But this kind of 'grow to survive' strategy involves very narrow profit margins and, accordingly, the need to make good judgements about future costs, prices and the ability to avoid or minimize aggressive competitor response. Crucially, Gateway's strategy in the PC sector made poor, inaccurate forecasts about costs and prices. This is a phenomenon often seen as a by-product of an adversarial business planning process, when combative boards make executives feel pressured to deliver unrealistic numbers. In addition, Gateway's pricing tactics were simplistic and, in the eyes of their competitors, confrontational. They gave firms like Compaq, Dell and HP no choice but to respond with their own price reductions, effectively reducing the profit pool of the sector overall. Attempts to grow share by price wars are a kind of zero-sum game, in which any gain in profitability is somebody else's loss and, especially when combined with poor costing estimates, reduce the probability of the business plan delivering on its promises.

Microsoft's Zune: So what's better?

Some strategy failures can be put down to insufficient or inappropriate assets, but in 2006 Microsoft was the world's largest software company when it responded to the shift of music from CDs to digital media, four years after the launch of Apple's iPod. As we now know, it was good strategic judgement to predict that Apple's success would change the industry and that digital downloads and portable devices were a sector worth entering. Microsoft did some things very well, especially in getting the four largest music labels to sign distribution agreements. It developed a good product, Zune, and a supporting marketplace infrastructure that, over the course of four generations, had some innovative features. Given that by that time Apple had already sold 100 million iPods, the market was developed and ready for exploitation. Yet Microsoft Zune failed completely.[11] In the first six months, it sold only 1.2 million units and in the next year sold less than a million more. Although the company tried to revive the product as the MP3 player market grew hugely, none of its technical innovations made any difference and technical problems, such as software glitches, added to its problems. Eventually, in June 2011, Microsoft announced the discontinuation of all Zune hardware and a year later announced plans to discontinue the brand. It's not clear how much money Microsoft lost on Zune but, whatever the figure, it was additional to the damage to Microsoft's corporate brand and reputation as an effective commercializer of technology.

Perhaps the first lesson to draw from the Zune story is that failure is not just for small, under-resourced or incompetent companies. Microsoft is a great company and, although they carry the incumbent's burden of being everyone's favourite company to criticize, they will go down in history as a company that changed the world. This makes it all the more remarkable that they could fail so ignominiously with Zune and points to failings in their strategy that were either missed by or, worse, created by their business plan review process. In the case of Zune, we can strip away the detail about product design and marketplace infrastructure and see that, compared to a great product like the iPod, it offered nothing different. Markets have inertia of their own and, since Apple had spent four years getting everyone to love their product, customers need a reason to buy something different from what everyone else is buying. Zune failed to provide any significant point of differentiation to the iPod in its overall value proposition. Underlying this was a failure to gain any insight into how this market is segmented and what differentiated value propositions may have appealed to different segments.

Nortel: Playing the wrong game

Whilst all real-world examples of failure are necessarily simplifications, some must be more simplified than others and the challenge is to identify the lesson to be learned whilst also recognizing the wider context. This is especially true of the Nortel case. Nortel had its origins in the 19th century and, for most of its history, made telephony switchboard and related equipment. In the 1970s, it was among the first to recognize the importance of the digital revolution in its sector. It grew quickly in the technology boom of the 1990s and at one point represented over one third of all the value in the Canadian Stock Exchange. But the end of the 20th century and the beginning of the 21st saw it struggle and in 2009 it filed for protection from its creditors. Eventually, what value was left in the company was picked over by Apple, Google and others bidding for Nortel's few remaining valuable patents.

There are numerous possible explanations for Nortel's demise, all of which play a part in the story. Nortel failed to recognize the market bubble and so made poor predictions about the size and profitability of their market. Their leaders seemed to have forgotten the value of a healthy bottom line and used financial devices such as customer financing to disguise their problems. But, for our purposes, perhaps the most important factor was how they responded to the technology changes and disruptive innovation that occurred in their market. Nothing Nortel could have done would have prevented this change of course, nor could Nortel have prevented the emergence of new competitors, such as Cisco, enabled by the new technology. But the strategy of John Roth, appointed as CEO in 1997, made things much worse.[12] Roth saw Nortel's future as a 'software-centred telecom product company'. But this strategy ignored Nortel's strength in electrical engineering and chose to compete with Cisco and others at a game the competitors were better equipped to win. This might have been compensated for if Nortel had been able to acquire or develop appropriate competencies quickly, but they could not. The idea of playing to one's strengths and mitigating one's weaknesses is as important an idea in business strategy as it is in any sphere of life. In addition to its other mistakes, this concept of SWOT alignment, as we will discuss later in the book, helps explain what happened to Nortel.

Woolworth's: Failure to focus

Some businesses have longevity and, associated with that, a place in public consciousness that make them a part of popular culture. In the UK, FW Woolworth's held that position for generations of Britons. The firm, which had its origins in the US chain but was legally separate from 1982, had over a thousand stores around the UK and was famous for its wide range of low-end products from toys and sweets to clothes and household items. The period from 1982 saw huge changes in the UK retail market, including the move to out-of-town stores, the rise and expansion of large retailers such as Tesco and then the development of online retail channels. Woolworth's reaction to these competitive trends looks, with hindsight, to have been erratic and fragmented. Like other retailers, it developed own-label brands. It attempted to mimic others with some larger format stores under the Big W name and a catalogue-based direct selling channel, a direct reaction to rival Argos. None of this disjointed collection of tactics stemmed Woolworth's gradual decline. It closed stores, cut costs and made other financially-driven expediencies all to no avail. In 2008, it announced large losses and shortly thereafter went into administration. Although Woolworth's demise coincided with and was blamed on the economic crisis of that time, the reality is that this once great institution had been in decline for decades.

Whilst the causes of Woolworth's failure include changes in the marketplace and macro-economic conditions, it is more informative to see the firm as an example of long-term strategy weakness, which decades of business plan reviews had failed to detect or correct and, perhaps, had actually embedded. The most telling of the many flaws in Woolworth's strategy was its lack of focus. It failed to concentrate its limited resources on a product category, a market segment or a geographical area. As competition intensified, it had neither the resources nor the competitive position to fight off any of the innumerable competitors that its wide product range implied. When large-scale trends destroyed its competitive advantages in areas such as clothing and music, it still failed to concentrate on the convenience, ad hoc, price sensitive purchasing segment that its store locations, brand reputation and procurement capabilities favoured. Weak business plan review processes are often guilty of saying yes too often and no too rarely and in Woolworth's attempt to sell everything to everyone we see an example of this.

Seeing a pattern

Each of these positive and negative examples is interesting in its own right but their real value lies in how they provide general lessons beyond the specific context of the case. If we are to improve the way that we make and review business plans, we need to see the patterns that these successes and failures illustrate, and turn that pattern into a usable, practical management tool. In the following chapters, that is what this book will attempt to do. However, as authors we would be naive to assume that our readers start with a blank slate and so, before we move on to the detail of the Marketing Due Diligence process, it is worth making clear how it will differ from the approaches many managers currently use to assess business plans.

Financial smoke and mirrors

Without doubt, the most prominent approach to testing a business plan is a rigorous assessment of the numbers and we wouldn't argue with the importance of quantitative rigour. Ultimately, a detailed financial analysis of the business plan is necessary. However, as any experienced executive will tell you, financial analysis can be twisted to tell the story required. For example, take a few moments to look carefully at the numbers in Tables 1.1 and 1.2.

Which of these two firms is performing best and, if these numbers were in two competing business plans, in which of the two would you invest? The first set of sales-based figures seems to be clearly superior and shows a very good and improving return on assets. The second set of figures shows a firm that is being run down as it fails to develop new products and destroys its relationship with its customers. Given a choice between the two firms, there seems no doubt that the first firm would attract investment at the expense of the second.

Table 1.1 Firm A five-year performance – sales revenue based

Performance	*Base year*	*1*	*2*	*3*	*4*	*5*
Sales revenue (£ million)	254	293	318	387	431	454
– Cost of goods sold	135	152	167	201	224	236
Gross contribution (£ million)	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 (£ million)	16	22	26	37	50	55
Return on sales (%)	6.3	7.5	8.2	9.6	11.6	12.1
Assets (£ million)	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

Table 1.2 Firm B five-year performance – market based

Performance	*Base year*	*1*	*2*	*3*	*4*	*5*
Market growth (%)	18.3	23.4	17.6	34.4	24.0	17.9
Firm B 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 (%)	+10	+8	+5	+3	+1	0
Relative service (%)	+0	+0	–20	–3	–5	–8
Relative new product (%)	+8	+8	+7	+5	+1	–4

In fact, the numbers are taken from a single, real company (albeit simplified and made anonymous) examined by one of the authors. Importantly, both sets of numbers, the sales-based and the market-based, are for the same company over the same period. The company is managing and presenting superficially good numbers by cutting investment in areas that have only long-term return, such as product development and marketing.

This is not a mythical example. Given the choice between developing and implementing a strong strategy with sustainable competitive advantage or cutting costs in areas where it will take some years for it to show, many executives are tempted to take the first option. Futhermore, whilst it is easy enough to do this with the current business, it is even easier to do it for the forward business plan. Almost any business proposal can be made to look good by making over-optimistic assumptions about sales and costs and neglecting the fundamentals of the business. More virtuous executives and investors need a way of seeing through the financial smoke and mirrors.

Share and share alike

Any business plan is built on an asset base and, except in the case of wholly new standalone businesses, they often share that asset base with other parts of the same business firm. Take, for example, a case where a business plan builds on another business incrementally, sharing the assets of that first business. We are used to this in the case of physical assets, where, for example, a car company launches an extension of an existing model. In such cases, the business plan for the new model depends on assets originally acquired for the older plan; for example, it may share the same production line. When this happens, management accountants rightfully demand that the cost of the shared assets are no longer attributed only to the first model but shared with the second. Without that approach, the new model would look an inappropriately good investment, even while it was parasitic on the old model.

But this basic lesson of management accounting is often forgotten in models of marketing accountability. Take, for example, the Microsoft Zune episode described earlier in this chapter. Or, current as we write, Apple's decision to switch from using Google Maps to its own mapping software in its iPhones and iPads. Standing alone, the business plans for each of these changes must have looked very attractive. In both cases, however, they were 'piggybacking' on the huge 'intangible' asset of the parent company brand. The failure of Zune and the huge embarrassment caused by the inadequacies of Apple's mapping software both detracted significantly from the parent brand. It is very hard to quantify, but the parent brands were undoubtedly put at risk and, in both these cases, damaged.

If we are to follow the sensible precedent of management accounting for physical assets, any rigorous approach should also consider assets like brands. If we don't, the idea of return on investment is flawed. Yet many business plan assessments make this mistake, calculating returns only on the marketing expenditure directly attributable to the new business and ignoring the reality that it is standing on the shoulders of giant and expensive brand assets.

Marketing accountability

In recent years, marketing accountability has, quite rightly, come into vogue. For too long, too many marketers have spent shareholders' money too freely with too little regard for the value it needs to create. However, many of the approaches to marketing accountability are flawed in their definition of marketing's scope.

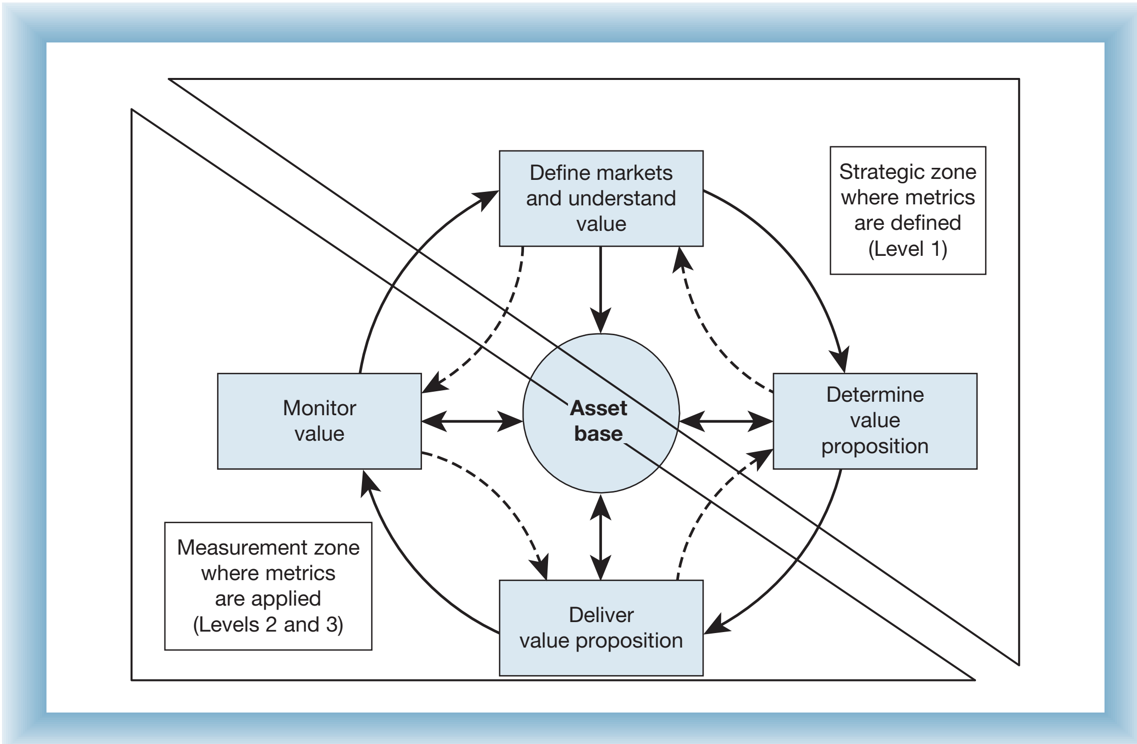

Figure 1.1 Map of the marketing domain

Despite the common, layman's perception that marketing is synonymous with promotion, the full scope of marketing is much broader than that, as shown in Figure 1.1 with both strategic and operational components. Current methods of marketing accountability tend to focus on the operational part of marketing and we can identify currently two broad approaches to marketing accountability, to which Marketing Due Diligence adds a third.

Level 3 of marketing accountability is the level of micro-promotional measurement that is most commonly referred to as marketing effectiveness although, as argued above, it is really only concerned with the narrow and tactical linkages between promotional spend and the direct outcomes of that spend, such as awareness or trial.

Level 2 is the level of measuring marketing effectiveness that considers the complete range of tactical marketing activity (not just promotion) and assesses its impact on the competitive strength of the overall value proposition in the target segment. Hence it is narrower in scope than Marketing Due Diligence, but broader than promotional effectiveness, as shown in Table 1.3.

Level 1 is the level at which Marketing Due Diligence operates. It is the most fundamental of the three levels, because this is what determines

Table 1.3 Scope and outputs of different levels of marketing effectiveness

Level of marketing effectiveness	*Areas considered*	*Outputs*
Level 1 Marketing Due Diligence	The marketing strategy (i.e. the choice of target customers and value proposition)	An objective assessment of whether or not the marketing strategy will create or destroy shareholder value, together with the identification of how the strategy may be improved
Level 2 Marketing effectiveness	The marketing tactics (i.e. the full range of products, pricing, promotion and channels) employed for each segment identified and targeted by the marketing strategy	The likelihood of the marketing tactics creating the necessary competitive advantage in each segment
Level 3 Promotion effectiveness	The marketing communications activity (i.e. advertising, sales team, etc.) employed to communicate with each target segment	The effectiveness of the marketing communications activity in achieving marketing communications objectives such as awareness, recall, etc.

whether the marketing strategies for the longer term (usually three to five years) destroy or create shareholder value added.

A new approach

In this chapter, we began from the non-contentious point of view that business plans are ubiquitous and important. We moved on to the hardly less contentious view that the process by which firms assess business plans is both inefficient and ineffective. We illustrated that view with examples of success and failure that were chosen to demonstrate two things. Firstly, even great businesses can write flawed business plans and, furthermore, these can pass the assessment and approval process. This observation suggests that current approaches are in need of improvement. Secondly, success and failure in business plans are differentiated by a relatively small number of fundamental characteristics. This suggests that current approaches can be improved by incorporating these lessons. In the following chapters, we develop that new approach of Marketing Due Diligence. Built on many years of research and applied in a growing number of companies, we hope it will be as practical as it is rigorous.

Endnotes

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