

D.5 Projecting Outcomes

THE ROLE OF OUTCOME PROJECTION IN MARKETING DECISION MAKING

Outcome projection is a process that helps the marketer evaluate alternatives and verify that a decision meets the needs of a problem.

Verifying the Decision. The process for making a marketing decision can be thought of as having three steps (see Chapter 3). In step one, the problem is defined; in step two, the problem is analyzed and one or more alternatives developed; and in step three, the decision is verified.

The purpose of outcome verification is to enable the marketer to evaluate alternative solutions to a problem (alternative decisions) to determine which one would best solve the problem. The process of verifying the outcome of a decision has four steps:

1. Select an alternative and project its outcome.
2. Compare the outcome to the problem and refine the alternative as necessary.
3. If there are other alternatives, repeat steps 1 and 2 for each one.
4. Compare the outcomes for each of the alternatives and select the alternative with the best outcome as the final decision.

Outcome projection, as can be seen above, is part of the outcome verification process. **Outcome projection** consists of estimating how the problem situation will change if the alternative decision is put into effect. It provides the basis for choosing between alternatives and for deciding if a decision will solve the problem for which it was designed. Outcome projection also suggests ways in which a possible decision can be refined so that it better solves the problem.

Outcome projections can be both finan-

cial and nonfinancial. In most situations, both types of projections are needed, since most marketing decisions influence both financial and nonfinancial dimensions of the problem situation. Financial outcomes would include influences on sales revenues, costs, and profits. Nonfinancial outcomes could include such dimensions as the influence on brand loyalty, level of distribution, and product awareness or the legality and ethical acceptability of the results.

Outcome Projection in Marketing Planning.

Outcome projection is also a part of the **marketing planning process** (see Chapter 4). The marketing planning process has four steps:

1. The **situation analysis** analyzes the context in which the marketing strategy is to be implemented.
2. **Positioning** defines how the product will compete and marketing objectives define how the product will respond to problems and opportunities facing it. Both provide direction for the marketing mix programs.
3. The **marketing mix** defines marketing programs that will carry out the positioning and objectives set for the product.
4. **Outcome projection** estimates the results of implementing the marketing strategy (positioning and marketing mix) for the product.

Outcome projection, then, is the final step in the marketing planning process. Its purpose is to permit evaluation of a proposed marketing plan by specifying what is expected to happen if the marketing plan is implemented. Outcome projection also provides control standards by defining levels of expected performance. Control standards are used as part of the **marketing control system** (see GLOSSARY entry D.3).

Timing of Outcome Projection. It is important to note that outcome projection takes place after decision alternatives have been formulated. Both the revenue and cost estimates necessary for projecting financial outcomes depend on the details of the alternatives. Such things as price, promotional budgets, and product costs must be known

before financial projections can be made. The same is necessary in projecting nonfinancial outcomes. If, for example, the level of distribution is to be projected, it is first necessary to know such things as how large the sales force will be, the level of trade discounts, and the amount of trade advertising.

For the same reason, outcome projection occurs as the final step in the marketing planning process. The outcome of a marketing strategy cannot be projected until the strategy has been fully formulated.

OUTCOME PROJECTION METHODS

The decisions that marketers are called upon to make are frequently highly complex with multiple outcomes that need to be projected. In most decisions, profit prospects for the product will be affected and should be evaluated. In addition, there will be other outcomes that, although they may affect long-term profit, can be projected only in nonfinancial terms. The outcome projection methods discussed below are divided into the same two classes—financial and nonfinancial.

Projecting Nonfinancial Outcomes. Marketing decisions for complex problems usually have nonfinancial objectives as well as profit-oriented ones. Two obvious nonfinancial evaluations that must be made are to determine the legality of the proposed action and to determine whether the decision is ethically right. There are numerous other nonfinancial outcomes that may be termed **performance outcomes**. With these outcomes, the question is, will the decision “perform” as intended? Typical performance outcomes are concerned with the effect of the decision on consumer behavior, on competitive response, or on channel member cooperation.

Nonfinancial outcomes appear more difficult to project because the measures are nonquantitative. However, there are marketing concepts that provide processes and guidelines for evaluating nonfinancial outcomes. Three approaches to projecting nonfinancial outcomes are use of evaluation

standards, use of models, and use of pretest marketing research.

- *Evaluation Standards.* One approach to projecting nonfinancial outcomes is to use evaluation standards as guides in estimating likely outcomes of a decision. This approach is applicable to projecting ethical and legal outcomes. The **ethical evaluation** concept (see GLOSSARY entry D.1) provides a set of questions that will help the marketer judge if a decision will have an ethical outcome. The legal acceptability of a decision can be evaluated by determining whether or not it falls into a legally sensitive area. If it does, the legal risk must be evaluated by measuring the decision against the requirements of the applicable law. GLOSSARY entry D.2 on **legal requirements** provides guidance in identifying potential legal problems. Various other decision-making concepts contain evaluation standards that can be used to evaluate whether or not a decision outcome will be valid and accurate. For example, the **marketing research process** provides guidance in projecting whether or not research decisions will have acceptable outcomes (see GLOSSARY entry A.11). In the same way, the criteria for selecting a **sales forecasting** method provide standards for evaluating the likely outcome of that decision (see GLOSSARY entry A.16).
- *Use of Models.* Both conceptual and mathematical models can be used to project the nonfinancial outcomes of decisions. The model of the **consumer decision making process** (see GLOSSARY entry A.2) can be used to project consumer reaction to changes in the marketing program for a product and the **competitive market structure** model can be used to predict how competitors will react to changes in marketing programs (see GLOSSARY entry A.1). Other conceptual models useful for projecting decision outcomes include the **store choice** decision concept (GLOSSARY entry A.18), the **new product adoption process** (GLOSSARY entry A.12), the **product life cycle** (GLOSSARY entry A.15), and the **organizational buying process** (GLOSSARY entry A.13).

Mathematical marketing models have as a primary function the projection of decision outcomes and, for many models, these outcomes are nonfinancial. To cite one example, inventory models are available that enable the decision maker to evaluate the effect of stock levels on customer service (see GLOSSARY entry C.15). Firms with well-developed **marketing in-**

formation systems will have models in their information processing section available to respond to requests for outcome estimations (see GLOSSARY entry D.4).

- *Use of Marketing Research.* Marketing research can be used to pretest marketing decisions by providing estimates of nonfinancial outcomes. Advertising, for example, is frequently pretested with consumers to project changes in awareness, product knowledge, and purchase intention (see GLOSSARY entry C.3). Home-use tests are used to predict consumer reactions to proposed product changes (see GLOSSARY entry C.25). Surveys can be used to estimate a variety of nonfinancial outcomes such as channel member reactions and consumer reactions to decisions that affect them. Simulated and traditional test markets can also be used to estimate outcomes experimentally (see GLOSSARY entry C.18).

Projecting Financial Outcomes. The financial outcomes of marketing decisions are projected using tools of financial analysis. The objective in projecting financial outcomes is to estimate how revenue, cost, and, especially, profit will change if a particular decision or alternative is implemented. Three financial analysis methods commonly used for this purpose are the projected profit and loss statement, return on investment, and breakeven analysis.

- *Projected Profit and Loss Statements.* Perhaps the most straightforward approach to projecting financial outcomes is to prepare a projected profit and loss statement reflecting each decision alternative being considered. Preparation of profit and loss statements requires that the changes in cost be estimated for each alternative. In addition, changes in revenue resulting from each alternative must be projected. The statement projects profit by subtracting the total cost under an alternative from the total revenue under that alternative.

Profit and loss statements can be projected for an entire business, for a product, for a market segment, or for a single element of the marketing mix. Projecting profits for segments or marketing mix elements requires that both revenues and costs be stored in a disaggregate data base so that they can be reassembled in terms of the appropriate decision-

making unit. Marketing information systems are used to gather and store such information in the system data base (see GLOSSARY entry C.3). The unit chosen for profit projection should be the same as the decision-making unit. If the decision concerns the market strategy for the business, the profit of the business should be projected. If the decision concerns a single product, the projection should be limited to that product, and if the decision effects are limited to a single segment or a single marketing mix element, the profit projection should focus on that segment. (See GLOSSARY entry D.3 for more on segmental analysis.)

Profit and loss statements can be projected on an incremental basis rather than on a total basis. To determine the incremental profits of an alternative, changes in cost are subtracted from changes in revenue. The incremental approach focuses on the changes in profit that are expected from an alternative. Another alternative is to use a contribution rather than net profit approach. To do so, costs must be divided into those that vary with sales or output and those that remain fixed regardless of volume. If only variable costs are deducted from revenue, the remainder is the **contribution** available to pay fixed costs and for profit. The advantage of the contribution approach is that it focuses decision making on controllable variables. (For more on the contribution approach, see GLOSSARY entry D.3).

Important disadvantages of the profit and loss approach to projecting financial outcomes is that (1) profit results are not related to the level of investment required to generate the profits and, as a result, profits of different alternatives are not comparable, and (2) there is frequently no reasonable basis for estimating the sales results that will be achieved as a result of implementing the decision.

- *Return on Investment.* The return on investment (ROI) approach attempts to make the outcomes of alternatives comparable by expressing profits in relationship to the level of investment required to generate those profits. ROI is calculated by dividing the projected profit resulting from a decision by the assets employed to earn those profits. Thus

Return on investment

$$= \frac{\text{Net profits from decision}}{\text{Assets employed by decision}}$$

ROI represents the return that is expected on the assets invested to carry out a decision. An alternative approach is to subtract from the projected profit the imputed interest cost charged to the value of the investment employed in the decision. If the company's cost of capital is used as the interest rate charged, the resulting return represents the profit after cost of capital.¹ As in the case of projected profit and loss statements, ROI can be calculated on an incremental basis and the unit of analysis can be the business, the individual product, a segment, or an individual element of the marketing mix. The advantage of the ROI approach is that it facilitates profit comparison of alternatives with different levels of investment.

- *Breakeven Analysis.* Breakeven analysis, or target volume analysis, is widely used in marketing outcome projection because it does not require that revenues be forecast first. Instead of determining what profits will be realized at a forecast level of sales, **breakeven analysis** reverses the process by determining the level of sales that will be necessary in order to reach a target level of profits or to reach a breakeven (zero profit or loss) point. This is frequently appropriate since decision objectives are frequently expressed in terms of profits, and sales resulting from a particular decision are difficult to forecast.

Breakeven analysis can be conducted on an aggregate or incremental basis and on the level of the business, product, segment, or marketing mix variable. As above, the choice depends upon the scope of the decision and the availability of disaggregate cost data. Breakeven analysis requires that costs related to the decision be projected first and then divided into fixed and variable components as described above. Then the breakeven point can be determined. Breakeven is the sales volume needed to recapture costs. Breakeven can be determined graphically or algebraically. In Figure D.5-1, fixed costs are plotted to remain unchanged with volume. Variable costs, shown increasing with volume, are added to fixed costs to determine total cost. Sales at an assumed price are shown increasing with units sold. The breakeven point is at the intersection of revenue and total cost.

¹See Frank H. Mossman, W.J.E. Crissy, and Paul M. Fischer, *Financial Dimensions of Marketing Management* (New York: John Wiley, 1978), pp. 7-24.

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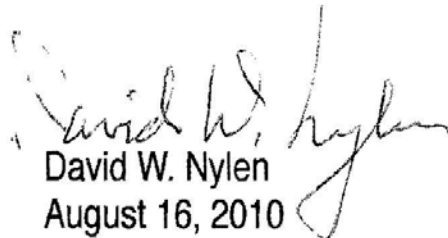
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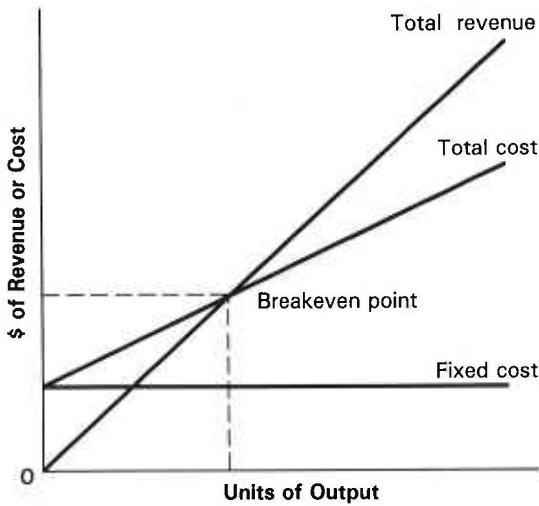


FIGURE D.5-1

Graphical Determination of Breakeven

Algebraic determination of breakeven is usually more convenient. Breakeven is the point at which total revenue equals total sales. Thus,

At breakeven:

$$\begin{aligned} \text{Total revenue} &= \text{Total cost} \\ \text{Total revenue} &= \text{Price} \times \text{Quantity} \\ \text{Total cost} &= \text{Fixed cost} + (\text{Quantity} \\ &\quad \times \text{Unit variable cost}) \end{aligned}$$

Substituting:

$$\text{Price} \times \text{Quantity} = \text{Fixed cost} + (\text{Quantity} \times \text{Unit variable cost})$$

Solving for Quantity:

$$\begin{aligned} (\text{Breakeven}) \text{ Quantity} \\ &= \frac{\text{Fixed cost}}{\text{Price} - \text{Unit variable cost}} \end{aligned}$$

Breakeven analysis can be modified to determine the sales volume necessary to achieve a target profit level. To do this, the dollar

amount of desired profit is added to the fixed costs in the graphical approach, thus increasing total cost and raising the breakeven point. Algebraically, the target profit is added to fixed costs and the equation solved for quantity as before. The solution represents the level of volume needed to achieve the target profits.

Breakeven analysis can also be used to determine the level of contribution generated by various levels of sales. Graphically this is done by inverting the fixed and variable cost curves, putting variable cost on the bottom and adding fixed cost to it to get total cost. Contribution is represented by the height of revenue over variable cost. Algebraically this can be accomplished by substituting a target contribution figure for fixed cost and solving for the quantity that will provide the target contribution.

Breakeven analysis can be used on an incremental basis to evaluate changes in marketing programs. If, for example, a marketing decision calls for an increase in fixed cost (such as an increase in advertising budget), the change in fixed cost divided by the contribution margin (price - variable cost per unit) would yield the sales needed to breakeven on the increase in the advertising budget.

As an output projection method, breakeven analysis does not forecast what sales will be if a decision is implemented. Instead, it defines what sales need to be if the decision is to breakeven or reach a target profit level. The marketer must then apply the test of reasonableness to the breakeven results, asking: Is it reasonable to believe that the target level of sales can be achieved? Similarly, comparisons can be made between alternatives to determine which is most likely to achieve breakeven targets.

SUGGESTIONS FOR FURTHER READING

MOSSMAN, FRANK H., W.J.E. CRISSY, and PAUL M. FISCHER. *Financial Dimensions of Marketing Management*. New York: John Wiley, 1978.