



How to Speak CFO: Making the Business Case for Communications

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Why Speak CFO?



Why Speak CFO?

Basic function of CEO is to allocate corporate resources

CFO is responsible for the financial resources of the company

- Holds the purse strings for communications expenditures
- Communications expenditures compete with other projects (plant upgrades, equipment replacement, R&D) for a scarce resource **Cash**

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Cash is King

Recent economic downturn reinforces importance of available cash

- Doesn't decline in value, like stocks, other investments can
- Harder to conceal through accounting trickery

Cash **now** is worth more than in the future

- Can deposit and earn interest
- Don't need to borrow at high rates
- Can invest in business to improve future cash flow

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Capital Budgeting Primer

Capital budgeting is the process by which CFO's determine whether or not proposed expenditures are worthwhile.



Capital Budgeting Primer

By examining every conceivable projected cost and resultant income over time, management is able to objectively develop, analyze and determine the inherent value of such ventures.




Project Number:	Form 1 of 3	Date:	N/A
Business Case Checklist - Market Assessment			
Strategy			
Directly state the strategic direction of the business			
Market Assessment			
Specific Data Requirements			
Market Drivers			
List specific drivers, forecasted change in each driver and weighting of driver relative to industry demand			
Industry Sales Volume			
Indicate current and projected annual volume in units			
Industry Capacity			
Indicate current and projected annual capacity and industry capacity utilization			
JM Sales Volume			
Indicate current and projected annual volume in units			
Market Share			
Indicate current and projected market share for JM and each major competitor			
Selling Price			
Indicate current and projected selling price			
Commentary			
Industry Structure			
Describe factors that determine market share position of JM and competitors.			
Describe impact of the project on industry structure and profitability.			
Competitive Reaction			
Assess each competitor's strategy over the projected period with respect to marketing and pricing.			
Indicate tactical actions to be taken by competitors in response to project being considered.			
Sensitivity			
Assess risk factors associated with industry projections for volume and price.			
Strategic Fit			
Describe how project addresses strategic objectives of the business from a marketing perspective.			
Evaluate alternatives to the project in relation to the strategic objectives of the business.			
Assertion			
Based on my assessment of the market environment and my review of the proposed project, I believe this project is necessary to meet the needs of the business.			
Name & Date:			



Project Number:	Form 2 of 3	Date:	N/A
Business Case Checklist - Manufacturing Assessment			
Manufacturing Assessment			
Specific Data Requirements			
JM Capacity			
Indicate current and projected annual capacity and capacity utilization for JM			
Cost Breakdown			
Indicate projected direct costs of production by element.			
Cost Drivers			
List specific drivers and projected change for each major element of cost.			
Environmental			
Indicate any environmental or industrial hygiene impacts of this project. Include any environmental permitting requirements.			
Commentary			
Cost Position			
Assess the cost position of JM relative to competitors.			
Describe the impact of the project on the industry cost structure.			
Address raw material availability, supplier relationships, and labor situation.			
Sensitivity			
Assess risk factors associated with cost position and productivity improvements.			
Competitive Reaction			
Assess each competitor's strategy over the projected period with respect to changes in capacity and cost reduction programs.			
Indicate tactical actions to be taken by competitors in response to project being considered.			
Strategic Fit			
Describe how project addresses strategic objectives of the business from a manufacturing perspective.			
Evaluate alternatives to the project in relation to the strategic objectives of the business.			
Assertion			
Based on my assessment of the manufacturing environment and my review of the proposed project, I believe this project is necessary to meet the needs of the business.			
Name & Date:			




Project Number:	Form 3 of 3	Done	N/A
Business Case Checklist - Technology Assessment			
Technology Assessment			
Commentary			
New Technology Risks			
Is this technology already proven in the industry?			
Is this technology new to Johns Manville?			
Assess the probability of success and the identified risks of this technology.			
Emerging Technology			
Discuss opportunities created by emerging/potential technology.			
Discuss the degree of threat from emerging/potential technology or product substitution.			
Discuss how current technologies, future technologies, product substitution opportunities and threats affect the specific business.			
Competitive Reaction			
Assess each competitor's strategy over the projected period with respect to new technology and product activities.			
Indicate tactical actions to be taken by competitors in response to project being considered.			
Strategic Fit			
Determine how project addresses strategic objectives of the business from a technological perspective.			
Evaluate alternatives to the project in relation to the strategic objectives of the business.			
Assertion			
Based on my assessment of the technology environment and my review of the proposed project, I believe this project is necessary to meet the needs of the business.			
Name & Date:			



Evaluation Tools

Determining the value of communications/marketing campaigns is infinitely less complex although some of the same evaluation tools can be used.



Evaluation Tools

Internal rate of return (IRR) is essentially the rate of return earned by a company from its investment in itself versus investing in stocks, bonds or other financial products.



Evaluation Tools

Net present value (NPV) compares the value of a dollar today vs. that same dollar at some time in the future after the consideration of inflation, cost of capital, and often perceived risk. It is believed to be the most widely-used evaluative tool. If NPV is positive, the project should go forward. If competing projects are under consideration, those with highest NPV should take precedence.



Evaluative Tools

This example illustrates the calculation of Net Present Value. Consider Capital Budgeting projects **A** and **B** which yield the following cash flows over their five year lives. The *cost of capital* for the project is 10%.

	Project A	Project B
Year	Cash Flow	Cash Flow
0	(\$1,000)	(\$1,000)
1	500	100
2	400	200
3	200	200
4	200	400
5	100	700

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Evaluative Tools

Net Present Value

Project A:

$$NPV = -1000 + \frac{500}{(1+.10)^1} + \frac{400}{(1+.10)^2} + \frac{200}{(1+.10)^3} + \frac{200}{(1+.10)^4} + \frac{100}{(1+.10)^5} = \$134.08$$

Project B:

$$NPV = -1000 + \frac{100}{(1+.10)^1} + \frac{200}{(1+.10)^2} + \frac{200}{(1+.10)^3} + \frac{400}{(1+.10)^4} + \frac{700}{(1+.10)^5} = \$114.31$$

This calculation available on MicroSoft Excel or with a financial calculator.

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Evaluative Tools

Present Value of \$1 to Be Paid in the Future

This table shows how much \$1, to be paid at the end of various periods in the future, is currently worth, with interest at different rates, compounded annually.

Years	3.00%	3.50%	4.00%	4.50%
1	\$0.97	\$0.97	\$0.96	\$0.96
2	\$0.94	\$0.93	\$0.92	\$0.92
3	\$0.92	\$0.90	\$0.89	\$0.88
4	\$0.89	\$0.87	\$0.85	\$0.84
5	\$0.86	\$0.84	\$0.82	\$0.80



Evaluative Tools

Discounted Cash Flow (DCF)

Based on the premise that a dollar today is worth more than that same dollar at sometime in the future, projected cash flows are discounted back at some appropriate interest rate to determine intrinsic value.



Evaluative Tools

Contribution Margin

The difference between total sales dollars minus the variable cost of goods sold expressed as a percentage. Represents funds available to cover fixed costs, profits.



Contribution Margin

Beta Sales Company		
Contribution Format Income Statement		
For Year Ended December 31, 200X		
Sales	\$462,452	
Less Variable Costs:		
Cost of Goods Sold	230,934	
Sales Commissions	58,852	
Delivery Charges	13,984	
Total Variable Costs	\$303,770	
Contribution Margin	\$158,682	34%
Less: Fixed Costs:		
Advertising	1,850	
Depreciation	13,250	
Insurance	5,400	
Payroll Taxes	8,200	
Rent	9,600	
Utilities	17,801	
Wages	40,000	
Total Fixed Costs	\$96,101	



Evaluative Tools

Time to Payback

The duration from onset of a project until income equals start up cash out flows.



Evaluative Tools

Maximum Cash Exposure

Expressed both in terms of time and the amount of cash outflows from investments in a new venture or program.



Feeding the Analysis Process



Defining Communications Objectives

Typical Objectives

- New Customer Acquisition
- Customer Retention/Loyalty
- Incremental Sales to Existing Base
 - Increased Usage, Upselling, Cross-Selling
- Brand Building

All require slightly different data and approaches



New Customer Acquisition

Start with Potential Prospects

Refine into Segments

Then use Some Measure of Response

- Can be trial, attitude, awareness
- Tricky because of uncertainty



Quantifying Prospects

B2B Environment

- **Counts of establishments by firmographics**
 - Census Bureau County Business Patterns
 - Zapdata – Dun & Bradstreet
 - InfoUSA
 - Yellow Page Listings – Switchboard, Super Pages
- **Counts of enterprises by firmographics**
 - Census Bureau Statistics of US Businesses
 - InfoUSA allows selection
- **Building counts**
 - CoStar, Building Facts from Claritas
- **People counts by occupation**
 - Bureau of Labor Statistics – industry/occupation matrix
 - Trade Associations
 - List compilers/trade pubs, like Reed Business (dm2 lists)



Quantifying Prospects

B2C Environment – Demographics

- People - Census Bureau
- Families - Census Bureau
- Households
 - Census Bureau
 - Census Bureau Housing Survey
 - Claritas
 - Federal Reserve Board – assets, net worth
 - IRS - income
 - InfoUSA Residential Database



Example

You are considering a \$1 million new customer acquisition campaign to launch at year-end. Impact will continue for 3 years

	2004	2005	2006
Additional Prospects	80,000		



Segmentation – Usage

Can use firmographics/demographics

Usage - Statistical Abstract of U.S.

– B2B

- BEA Input Output Model - usage by industry
- BLS Input Output Model
- Census Annual Sector Surveys
- Regulatory Agencies

– B2C

- BLS Consumer Expenditure Survey/CPI Index Weights
- Census Retail Sales
- Census E-Commerce
- Consumer Research Center of Conference Board
- AC Nielsen Consumer Insight - distribution channel



Segmentation – Growth Rates

Business cases typically span more than 1 year, so you should consider your target segments' growth rates

– B2B

- BLS Input Output Model projects demand by industry over a 10-year period
- Energy Information Administration Forecasts
- Private Econometric Modelers - GlobalInsight
- Trade Associations
- Purchased Reports - Market Research.com, IDC, Gartner, Freedonia Group
- Securities Analysts, if you believe them

– B2C - The Above, Plus

- General Economic Forecasts - International Monetary Fund, Philadelphia Federal Reserve Board
- CIA - Global Trends 2015, Long-Term Demographic Trends
- Census Bureau Projections
- Claritas, Consumer Research Center



Segmentation – Attitudes/Behaviors

Article Search

– Lexis/Nexis, Dialog, Factiva, American City Journals, EBSCO, Business News Bank

Compiled Lists/Magazine Circulation

Associations

Polls – Harris Interactive, Gallup

Primary Research



Example After Segmentation

Determined that 50% of prospects in target segments

5% annual growth rate

	2004	2005	2006
Additional Prospects	80,000	84,000	88,200
Segmented Additional Prospects	40,000	42,000	44,100



Response Measures

Direct Marketing

- Requests for information, click-throughs, opens
 - .5 - 2% outside list direct mail
 - Accudata - 1% good for e-mail campaign click-throughs
- Sales to new customers - 10-30% of inquirers may convert

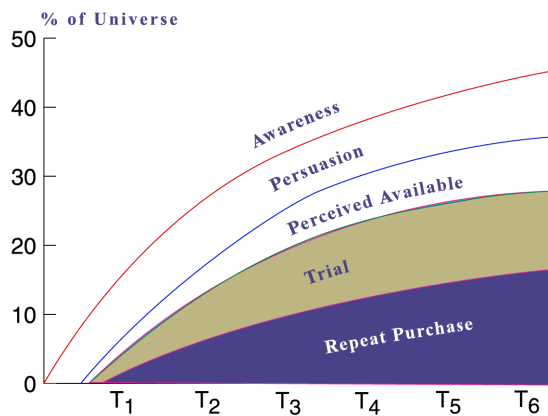
Communications

- Awareness - survey
- Attitude - survey
- Trial - sales records



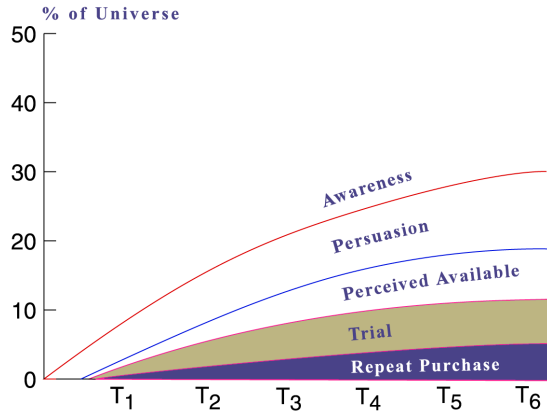
Response Measures

New Product Launch - Heavy Introductory Promotion



Response Measures

New Product Launch - Moderate Introductory Promotion



Example With Response

Expect 15% 2004 penetration, declining subsequently

	2004	2005	2006
Additional Prospects	80,000	84,000	88,200
Segmented Additional Prospects	40,000	42,000	44,100
Segmented Prospect Trial	15%	5%	2%



Dealing with Risk

Some ways to make CFO comfortable with risk

- Use “best practices” checklist
- Test campaign before full launch – test market or survey research
- Compare with previous campaigns
- Compare to case studies of other campaigns
- Compute break-even analysis. Typically this is the change in sales needed to achieve break-even NPV.
- Create indifference curve by changing two variables



Complete Example

	2004	2005	2006
Additional Prospects	80,000	84,000	88,200
Segmented Additional Prospects	40,000	42,000	44,100
Segmented Prospect Trial	15%	5%	2%
Average Sale	\$ 500	\$ 500	\$ 500
Contribution Margin	30%	30%	30%
Revenue	\$ 3,000,000	\$ 1,050,000	\$ 441,000
Contribution	\$ 900,000	\$ 315,000	\$ 132,300
Present Value @ 15% Discount	\$ 782,609	\$ 238,185	\$ 86,989
Sum Present Value	\$ 1,107,783		
Campaign Cost (end of 2003)	\$ (1,000,000)		
Net Present Value	\$107,783		
IRR	24%		
Payback (Years)	1.22		



Customer Retention/Loyalty

Begins with Customer Base

- If subscription service, current subscribers
- If sales, can look at recency

May Segment Based on Lifetime Value

- May differ offers based on value (past or projected) without acquisition cost
 - Wireless telecom example: \$50 rev - \$25 variable cost = \$25 contribution margin/month for 3 years at 10% discount = \$775

Usually Measuring Churn Reduction Potential

- May want to conduct secondary (or primary) research to benchmark against competitors



Incremental Sales to Existing Base

Includes Usage Stimulation, Upselling, and Cross-Selling

Start with Existing Revenue per Customer

Determine Expected Revenue per Customer

- Can take data previously mentioned and transform to a per customer basis
- If targeted to low revenue segments, may want to compare to current high revenue segments
- If cross-selling, look at existing multi-purchasers and extrapolate to target customers
- Can use response to previous similar campaigns



Brand Building

May be a combination of acquisition, loyalty & incremental sales

Might also look at price premiums (5-10%), channel positioning, and speed to market acceptance (3-6 months)

Probably want to preface with research into awareness and attitudes. If looking at pricing, may want to perform a conjoint study.



Brand Campaign Example

You are considering a \$1.5 million brand campaign to launch at year-end.

	2004	2005	2006
Additional Prospects	80,000	84,000	88,200
Segmented Additional Prospects	40,000	42,000	44,100
Segmented Prospect Trial	18%	9%	5%
Average Sale	\$ 525	\$ 525	\$ 525
Contribution Margin	33%	33%	33%
Revenue	\$ 3,780,000	\$ 1,984,500	\$ 1,157,625
Contribution	\$ 1,260,000	\$ 661,500	\$ 385,875
Present Value @ 15% Discount	\$ 1,095,652	\$ 500,189	\$ 253,719
Sum Present Value	\$ 1,849,560		
Campaign Cost (end of 2003)	\$ (1,500,000)		
Net Present Value	\$ 349,560		
IRR	32%		
Payback (Years)	1.28		



Building the Business Case



Building the Business Case: Gates Brand Campaign

Objective: Increase the incidence of installers specifying Gates Brand

Methodology: Calculate the increase in sales required to produce a 15% DCFROR.

Campaign Cost Over 3 Years: \$2,075,000

Average Contribution Margin: 50%

Cost of Capital: 4.5%

Duration: 3 Years

Current Year Sales: \$205,000,000



Building the Business Case: Gates Brand Campaign

$$\$2,075,000 \times 1.15 = \$2,386,250$$

$$\$2,386,250 / .50 = \$4,772,500$$

$$\$4,772,500 / .876 = \$5,448,060$$

$$\$5,448,060 / \$205,000,000 = 2.65\%$$

Increase
Required

Management decision - is this achievable?



Building the Business Case: Graphic Packaging Blister Pack Introduction

Objective: Provide justification for recommended campaign to introduce new product line into the clinical trials market in the absence of any sales estimates

Methodology: Solve for year 1 sales volume required to produce 12% DCFROR on marketing investment

Internal Hurdle Rate of Return 12%

Contribution Margin: 25%

Total Out-of-pocket Marketing investment: \$61,900

Cost of Capital: 4.5%



Building the Business Case: Graphic Packaging Blister Pack Introduction

$\$61,900 \times 1.12 = \$69,328$
$\$69,328 / .25 = \$277,312$
$\$277,312 / .957 = \$289,772$
Market Share < 5%



Building the Business Case: Johns Manville

Objective: Provide justification for recommendation to significantly increase the breadth and scope of e-mail direct response campaigns in support of air handling duct insulation, before any meaningful sales data are available from the pilot program.



Building the Business Case: Johns Manville

Campaign Cost: \$ 20,000 **Internal Hurdle Rate:** 15%
Net Sales Value: \$500/roll DCFROR
Average Annual Sale: \$5,000 **Contribution Margin:** 40%
Planning Horizon: 12 months **Cost of Capital:** 4.5%

Pilot Campaign Results: 109 registrants (top tier leads) 10 plus employees = 82% or 89



Building the Business Case: Johns Manville

Penetration of the universe required to achieve
financial return on marketing investment

$\$20,000 \times 1.15 = \$23,000$
$\$23,000 / .40 = \$57,500$
$\$57,500 / .957 = 60,084$
$\$60,084 / \$5,000 = 12$
$12 / 89 = 13.5\%$

Penetration of the universe @ \$5,000 annual
purchase = 13.5% or 12 contractors





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