Many companies waste large sums of money and time on marketing, sales, service and innovation—all aiming to drive-up revenues without in-depth consideration of the cost revenue benefit trade-off. For example, most companies think customer expansion is useful, without thinking about the optimal number of customers for the organization, and the revenue that needs to be gained from each customer. Although marketing management is essentially demand management, marketers have largely ceded control of demand to people with less knowledge of customers or markets. They prefer instead a scorecard of metrics, such as customer satisfaction, loyalty, quality and brand health—with an unclear link to the boardroom language of revenue and profit. In these difficult economic times, not understanding this link means that marketing has almost no defense against companies cutting costs and slashing the marketing budget.
To examine this missing link, we interviewed more than a hundred marketing executives on topics relating to revenue measurement and analysis to understand their current best practice norms. In addition, focus groups and workshops have been conducted with more than 1,000 executives, and this article presents the findings on the causes, cures and benefits of revenue analysis.

**POOR REVENUE ANALYSIS CAUSES**
There are six likely causes for poor revenue analysis that we determined from our research.

**Uncoordinated division of labor.** Revenue derives from the coincidence of three factors: the desire to own things, the ability to pay for them and the opportunity to buy them. Traditionally, marketers were responsible for all three factors in an integrated way and could therefore better understand and manage revenue. However, this integrated role has split in many organizations over time. The opportunity to buy things is now more the job of operations and distribution; finance is mainly responsible for pricing and ability to pay; while marketing’s job focuses on “desire.”

Mirroring this, the breakup of revenue responsibility is an issue that manifests itself in many areas: revenue forecasting, marketing budget setting, pricing and promotions. Revenue forecasting tends to be dominated by the supply chain function in modern firms. And although it sometimes receives forecasts from marketing, it often considers marketing an unreliable forecaster. Marketing budgets in most firms are set by finance as a percentage of past revenues; budgets are rarely based on unbanked future revenues. Pricing tends to be decided ultimately by finance, with inputs from sales, while promotions tend to be orchestrated by sales with inputs from finance. Marketing once again is more of a source of opinion, rather than the final decision maker.

**Misguided focus between demand and revenue.** Three principal things are wrong with trying to manage demand. Unlike revenue, demand is difficult to measure, difficult to control and is therefore not as bankable. Since demand is “the desire to own anything, the ability to pay for it and willingness to pay,” it is not measurable in the same way as sales or revenue. Often what is measured instead by marketers is “desire,” while ability and willingness to pay are ignored or forgotten. Demand is less controllable and can only be influenced. But even the ability to influence is divided between departments—with marketing taking “desire,” leaving non-marketers to influence other aspects of demand. Finance deals with “ability and willingness to pay.” Engineers and technicians create new products and services in the hope that they will be desired. Information technology people often run customer service. The final problem with focusing on demand and not revenue is that demand is not bankable. There is unmet demand, latent demand, falling demand and irregular demand. CEOs, chairmen, boards and shareholders all care about what’s bankable—and that’s revenue and not demand.

**Not understanding how revenue and costs behave differently.** On the surface, revenue, like costs, is just money, so why should it need special treatment? The answer is that costs are active things, they drive activity and cause effects—“cost and effect” as accounting scholar Robert Kaplan dubs them—and for most situations linear equations are adequate. Revenues are reactive and are the effects of past activity, so understanding them involves looking back in time at the many events that influenced current
sales, and the Pareto principle (a principle that specifies an unequal relationship between inputs and outputs) that governs them. This means you can have an optimal return on your advertising, direct marketing and innovation. The key is not being deluded into thinking that big revenue or big market share is necessarily beautiful; being the right size is better than always growing bigger.

**Generally accepted accounting principles obscure revenue drivers.** Unfortunately, revenues occupy about 1 percent of accounting reports and there is usually only one revenue line and hundreds of cost lines in a typical weekly or monthly report.

There are three kinds of numbers that don’t always appear in accounting reports. These are mix, response and limit. Revenue streams are not smooth and homogeneous, but a mix of elements: a mix of products, a mix of big and little orders, a mix of on- and off-promotion items. Drilling down into the details of this mix provides essential information about the economic value of the revenue stream—information that is seldom apparent from the accounting reports. Response data tells you how a variable, such as cost or revenue, changes in response to something. Since most companies cannot tell you where the money came from in the first place, they can’t determine how much effect changes in prices, product features, displays or advertising has had on sales revenues.

For example, consumer products firms, like Kraft Foods Inc., research the response of their revenue streams to factors such as advertising spend, promotions and price changes—using econometric analysis techniques. Limit data is also important, since it gives the quantitative limits when appetites become satiated and fashions change, boredom sets in or spending power is exhausted. Limiting factors include total population, total market volume and value, the number of competitors and even the sequence with which they have entered the market. For example, the natural distribution of market shares that results from the order of market entry can be an extremely powerful limit to growth.

**A lack of integration between marketing plans and controls.** Marketers can often encounter a lack of integration problems between marketing plans and control and we focus on plans and reward systems to illustrate this. Reward systems are often designed separately from the other systems, resulting in incentives for sales and marketing staff often being based on revenue or volume targets, and managers are motivated to play the system to maximize their bonuses, even when this is at the expense of profits. For example, drinks company IDV (now part of Diageo) rewarded its sales staff on the basis of volume sales; this had the effect of encouraging sales people to give extremely generous discounts and promotions to customers in order to maximize volumes, even when customer profitability was poor or negative. Tim Ambler, chief executive at the time, took the bold decision to change the basis of the sales bonus to reflect customer profitability rather than volume. Despite initial unease from the sales people, the majority of customers accepted the new terms and customer profitability grew substantially as a consequence (even though volumes were slightly lower than before).

**No one owns and uses revenue figures within the company.** Unlike with costs, where it is very clear where the line of responsibility lies since someone in the company has to authorize the expenditure, many departments have responsibility for revenue—which means in effect that no
one owns it. An associated problem is: Who uses revenue figures? Much to the frustration of some board members and company analysts, the narrative explaining revenue forecasts produced by the marketing or sales department contains few numbers. Finally, there is the question of what revenue figures are used for. Unfortunately, one answer is to impress people such as the marketing director, the chairman and company financial analysts who value companies—all of whom have vested interests in seeing revenues increase. The need to feed the hopeful upward trend of revenues sometimes results in little appetite to deal in detail with appropriate analytical techniques, which are purely factual, numbers driven and are more difficult to upwardly bias.

Poor Revenue Analysis Cure

So what is the alternative? We believe that “revenue management” offers a far more strategic role definition that resolves the problems we’ve discussed. But what does this change mean in practice? Marketers need to review their systems and processes to decide how much they need to change. Here are a few suggestions on what they might do cure the poor state of their revenue analysis.

Establish revenue insight teams. The first job a marketing director needs to do is to employ skilled modelling specialists who can predict how revenue will respond to your marketing strategies, and who can refine and enhance their forecasting accuracy by learning the lessons of experience. Second is to develop an in-house revenue competency. To do this, marketers need to deliver some revenue metrics training in house for middle and senior marketing managers and board members. Internal education is important to develop the in-house capabilities and finance, marketing skills and mathematics are needed.

Get the right data and bridge the CRM/ERP technology divide. A few companies today are using computers effectively in developing revenue analysis, and it is taking them beyond the familiar worlds of customer relationship management (CRM) and enterprise resource planning (ERP) as they collect price, promotions and product-mix data alongside revenue figures. It is especially important to keep data on products that did not do well—in addition to those that did. Sometimes it’s just a question of reorganizing and leveraging data that already exists. For example, brewer Scottish Courage (now part of Heineken) kept computerized records of its sales promotions for financial control purposes on its main SAP (systems, applications and products) system, coded by brand manager, but not by promotional type. It developed a workflow system to plan, authorize and archive its promotions, which proved itself to be a powerful information source and was instrumental in improving the financial effectiveness of promotions as drivers of profitable revenue growth.

Employ RAPO studies and DRAPO technology.

Once the data collection systems are in place, marketers need to get used to the mathematical studies covering revenue analysis and profit optimization (RAPO)—as they can yield substantial benefits. Revenue data-feeds are merged with data about the driving forces behind the revenue patterns and passed through analysis engines to provide insights to marketers. Then optimization algorithms recommend changes to marketing resource allocation and targeting in order to maximize profitability or shareholder value. Such systems can operate in real-time and are hence called dynamic revenue analysis and profit optimization (DRAPO). DRAPO systems need calibrating every 12 months, using either econometrics or judgmental forecasting to populate their assumption banks. Universal Music uses such a system to analyze and optimize its advertising. CD music sales revenues are very responsive to advertising. And by analyzing the effect of daily regional advertising on sales revenues, it can spot where it is over- and under-spending, identify wear-out and recognize weak and strong media channels. The cost of developing the system was less than one percent of its advertising expenditure, and it more than recouped the cost within the first month.

These systems work well for any company with a steady revenue stream, particularly retail, banking, most fast-moving consumer goods, utilities and pharmaceuticals. It is more appropriate for larger organizations that can afford the cost of the infrastructure to collect and analyze the data, publicly quoted companies or those wishing to float on the stock exchange and companies with existing informational infrastructure for collecting data that affects revenue.

Appoint marketing directors with financial skills.

Future marketers will need to have financial skills, as well as an understanding of customers, marketing, sales and service. The new finance marketers must also feel confident in their managers’ decisions about revenues and profits—especially
when they decide to skip revenues for profits. To do this, they must live and breathe the revenue audits and the Pareto models, and not merely spectate from the sidelines.

Teach the discipline in business schools. Finally, if the next generation of marketers is to understand revenue better, this information needs to become part of the mainstream knowledge base that is available to MBA students and businessmen alike. At present, the business schools have not developed any significant offerings in this area.

GOOD REVENUE ANALYSIS BENEFITS
Increasing marketing’s credibility. Every marketing director knows the uncomfortable questioning from shareholders and aggressive finance colleagues designed to make them explain where their revenue forecasts come from. What’s at stake here is the increased personal reputation of the marketing director and the marketing discipline to understand and manage these figures to return consistent shareholder value.

Right-sizing to increase profits. When organizations have taken the trouble to implement proper revenue analysis, they have reported substantial profit improvements equal to 1 percent to 3 percent of the top line and 10 percent to 30 percent of profits. Revenue analysis is therefore important for the efficient and appropriate allocation of resources within an organization, commonly known as right-sizing.

Improved marketing and sales staff morale. Unrealistic revenue projections based upon a lack of understanding can have detrimental effects on staff performance and morale, particularly sales and marketing staff. Revenue projections that are set too high are not realistic and therefore cannot be achieved, undermining the confidence of middle managers and the credibility of the board—while setting everyone in the organization up for failure, which has a negative impact on morale. Revenue analysis makes this less likely.

Increased financial stability and improved investor confidence. With a fuller understanding of what drives revenues, forecasts are more robust and returns to shareholders less prone to volatility, making investors and the company analysts more confident. Investor confidence is further enhanced by open disclosure and sound thinking about factors that drive revenues, since investors place a great value on intangible assets.

Better corporate governance. Transparency is a key issue in business practices today, particularly when it comes to finances. Being more transparent about revenues is part of this progression. When there is no widespread transparency about revenue, people can say what they want and no one knows any better to contradict or correct them. Understanding revenues is also a part of corporate governance. Directors should understand where revenue is coming from and the assumptions underlying any past and future changes.

Due diligence benefits. In mergers and acquisitions (M&A), revenues are usually guaranteed in the purchase. But how confident should a buyer be when taking existing revenue figures at face value? Investigating revenue figures and what they mean should be an automatic part of due diligence in M&A.

IN CONCLUSION
Historically, revenue has been a Cinderella among business metrics, largely ignored by the financial and marketing communities alike. As a result, we believe that revenue is one of the most mismanaged metrics in business. If marketers want to become the Prince Charmings of the business world again, they must understand and manage this key metric. It is, by rights, marketing’s metric, and they should reclaim that right. Knowing and understanding revenue has many benefits that marketers can bring to a company, including: the accuracy and credibility of revenue forecasts, leading to fewer fluctuations in share prices and investor confidence; transparency and corporate governance within the organization; and marketers budgeting and resource allocation to genuine drivers of revenue within the organization. All of the benefits lead to a marketing director’s own understanding of why his company is successful, increasing his credibility within the organization and marketing’s credibility as a business discipline. MM

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